Tax policy and budget proposals

2023-24

Reconnect & Renew

CPA
Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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a) General measures

- Improve Hong Kong's competitiveness:
  - Consider offering a 50% profits tax concession for relevant profits derived by qualifying regional headquarters.
  - Introduce a simple form of group loss relief.
- Open up businesses opportunities and improve market access in the Greater Bay Area ("GBA"):
  - Set up a dedicated and flexible fund to support business promotion and development in the GBA for professional services, also able to be used for internships and to provide opportunities for young GBA professionals in Hong Kong, in sectors suffering from acute manpower shortages.
  - Lend support to Hong Kong professionals' efforts to obtain more practising rights in GBA cities, especially in Qianhai and Nansha.
- Reconnect regionally and internationally, and review tourism strategies to give more attention to higher-end and eco-tourism:
  - Encourage more higher-end tourism and managed eco-tourism, including making efforts to attract more regional and long-haul tourists.
  - Encourage and support the hosting of different international events, conventions and exhibitions in Hong Kong, in the areas of sports, arts and culture, etc. to attract visitors.
- Create an overall business-friendly environment:
  - Allow tax concessions for company formation/ setting-up expenses, including capital expenditure, capped at HK$10,000, for standalone startups.
  - Introduce tax loss carry-back provisions.
  - Review Hong Kong's investment promotion strategies and policies and consider possible non-tax incentives and advantages to attract investment.
  - Continue to expand Hong Kong's network of comprehensive double taxation agreements, particularly with major trading partners.
  - Introduce a corporate rescue procedure into the insolvency law in Hong Kong.
- Improve Hong Kong's language skills:
  - Take steps to maintain and strengthen standards of English and Mandarin.

b) Attract and retain talent

- Examine the causes of the "brain drain", and explore effective ways to encourage people to stay or to return.
- Consider providing subsidies or tax concessions, such as double deductions, to targeted industries facing labour shortages, to enable employers to offer more competitive salaries to attract talent.
- Provide some non-tax incentives to encourage and support talent mobility between Hong Kong and the GBA, including:
  - Consider providing incentives to developers to build hostels for young GBA and overseas professionals coming to Hong Kong
  - Provide subsidies for employers to provide housing allowances
- Encourage child birth and attract overseas talent to raise their families in Hong Kong:
  - Provide an allowance for the private education of the children of overseas talent, up to a certain amount annually, where the local school system cannot adequately serve them.
  - Incentivize businesses to allow work from home ("WFH") arrangements for employees in the first one or two years after the birth of their children.
  - Where WFH is not possible, provide an allowance to engage a helper for the first one or two years of a child's life where the parents are working full time, for up to three children per family; or an equivalent amount for child care/ crèche services.

c) Promote innovation & technology, research & development ("R&D") and intellectual property ("IP") development in Hong Kong

- Review and revise tax rules to promote Hong Kong as an IP hub, given also the impact of the revised foreign-source income exemption ("FSIE") regime:
  - Introduce preferential tax regimes for IP businesses (e.g. IP box regime and refundable R&D credits) and consider providing a concessionary profits tax rate of, say, 8.25% for onshore IP income.
  - Modify the enhanced R&D tax deduction rules, taking into account the real commercial constraints of businesses engaged in R&D activities, which are unable to enjoy the existing normal or enhanced deductions.
  - Consider the possibility of R&D tax credits for start-up businesses or "Qualified Refundable Tax Credits", where appropriate.
  - Relax the anti-avoidance provisions under the IP deduction rules to allow genuine commercial transactions, e.g., deduction for the costs of acquiring IP from associates, IP licensed to another person for use wholly or principally outside Hong Kong, and the costs of outsourced R&D activities.
  - Provide non-tax support to encourage more local R&D activities, including financial subsidies.
  - Extend the coverage of tax and non-tax incentives to R&D activities undertaken in the GBA.
- Introduce tax incentives for businesses in key industries, such as IT and "green" industries:
  - Provide tax credits for start-up companies engaged in relevant IT businesses and green industries.
  - Introduce lower profits tax rates for qualifying IT and green industries for the first 5 years of profits (i.e. beyond the existing general concession on the first HK$2 million of assessable profits).
  - Grant tax concessions/ subsidies to airlines operating out of Hong Kong that use a certain percentage of sustainable aviation fuel.

*Issue 2 – **Help the workforce to upgrade their skill sets***

- Expand the deduction for self-education expenditure to cover expenditure incurred by a taxpayer's dependants.
- Subsidize employers to send employees on qualifying courses to upgrade their skills.
- Extend the "Love Upgrading Special Scheme" for those in between jobs and provide for self-enablement through the provision of free online training programmes for selected industries.

*Issue 3 – **Continue to promote digital transformation***

- Supporting small and medium-size enterprises ("SMEs") in their digital transformation:
  - Subsidize SMEs to obtain time-limited IT support (e.g. up to 36 months), which may include engaging an accounting professional to help them upgrade their accounting systems in readiness for the electronic filing ("e-filing") system for profits tax returns.
  - Support SMEs to (i) upgrade systems and equipment, and (ii) provide technical and infrastructure support, to allow for remote working employees.
  - Establish a dedicated fund, or expand the Continuing Education Fund, to cover practical training in IT and digitalization
  - Extend schemes under the Innovation and Technology Fund to cover artificial intelligence and data analytics projects.
- Make good use of the e-filing system for taxation:
  - Continue to conduct detailed consultations with the market and the profession on the design and operation of the system.
  - Provide early adopters with appropriate incentives, such as a two-month extension of the tax filing deadline, early tax refunds, etc.
  - Leverage on the data provided by e-filing to improve services and streamline the system, including, for example:
    - Reducing the statutory time-bar period for finalization of tax affairs to three or four years, and according a statement of loss the same status as a notice of assessment.
    - Strengthening tax audit capabilities and shortening timeframes for audits.

*Issue 4 – **Provide greater tax certainty and review Hong Kong's tax system***

- Increase tax certainty:
  - Engage stakeholders to provide practical feedback on proposed tax law changes as early as possible in the process.
  - Promote clear understanding of how new tax laws, such as the refined FSIE regime, will interact with the existing Inland Revenue Ordinance and allow sufficient transition time for taxpayers to get prepared.
  - Provide clear guidance and support to those affected by significant changes in tax rules.
  - Accord a statement of loss the same status as a notice of assessment.
- Conduct a more extensive review of Hong Kong's tax system to, among other things:
  - Look at options for broader-based taxation.
  - Lend support to policy objectives and enhance Hong Kong's overall competitiveness.
  - Enhance certainty of tax treatment.
  - Review the effectiveness of existing preferential regimes.

II. Making Hong Kong a more livable city and community measures

*Issue 5 – **Encourage people to adopt a healthy lifestyle and reduce the burden on the public healthcare system***

- Provide a tax deduction for expenses on approved sports courses and activities for taxpayers and dependants, of up to HK$12,000 per person.
- Increase the maximum tax deduction allowable for qualifying premiums paid under the Voluntary Health Insurance Scheme ("VHIS") to HK$12,000 per each insured person.
- Consider extending the scope of VHIS to other programmes (e.g., outpatient services).
- Review and adjust the amount and accumulation limit of vouchers under the Elderly Health Care Voucher Scheme more regularly, e.g., annually.

*Issue 6 – **Arts, culture and sports development, and improve the local environment***

- Encourage and support the holding of more international arts, cultural, and sports events and exchanges in Hong Kong, as well as fostering the development of a vibrant local arts scene.
- Grant concessions for some good-quality refreshment stalls, with some outdoor seating, along the expanding harbour front promenades, to maximize the use and enjoyment of the promenades.

*Issue 7 - **Community relief measures***

- Continue to waive surcharges for payment of tax by instalments for 2022-23.
- Give a tax reduction of 100%., subject to a ceiling of HK$10,000, on salaries tax, tax under personal assessment and profits tax for 2022-23.
- Provide a rates concession for properties, subject to a ceiling of HK$1,500 per quarter.
- Provide an electricity charge subsidy of HK$1,000 to each residential electricity account, in conjunction with promoting energy conservation measures.

*Issue 8 – **Review and rationalize the personal allowances and encourage saving for retirement***

- The basic personal allowances should be increased at least in line with inflation.
- A review of the allowances for dependants should be carried out and any future adjustments should be made on a more transparent and consistent basis.
- Increase the maximum tax deductible amount of voluntary contributions made to individual mandatory provident fund schemes to HK$100,000 per year.

III. Measures to help achieve carbon neutrality and sustainability goals

*Issue 9 – **General policies to promote sustainability in Hong Kong***

- Establish policies to support renewable energy targets and technologies, including supporting businesses to adopt more sustainable practices and ESG standards, and expanding the feed-in tariff arrangements, etc.
- Explore the development and use of alternative energy in Hong Kong, such as green hydrogen and, where feasible, facilities and plants for testing.
- Develop a more coordinated set of policies on recycling. Consider incentives for downstream recycling, waste-to-resources/ energy infrastructure (e.g., subsidies on land costs and facilities); and explore and encourage activities such as the use of recycled building materials, and second-life applications of EV batteries.
- Increase climate literacy among companies and the community.
- Promote training programmes and widely accepted certification schemes for ESG and/ or sustainable finance professionals.
- Support the efforts of the Hong Kong accounting profession to participate actively in the development of international sustainability reporting standards.
- Explore options for "green" taxation and incentives for good practices, as well as non-tax options.
- Consider setting up a tax governance framework to help taxpayers manage their tax risks.

*Issue 10 - **Measures in specific areas***

a) Green buildings

- Adopt best practice standards for energy-efficient buildings in Hong Kong, and mandate some requirements.
- Introduce enhanced industrial ("IBA") and commercial building allowances ("CBA") for buildings that adopt these standards (e.g., an initial allowance of 25% and an annual allowance of 5% for industrial buildings and, say, an annual allowance of 6.5% for commercial buildings).
- Extend CBAs and IBAs beyond the existing 25-year limit, for refurbished buildings that retrofit more sustainable, e.g. energy reducing, features.

b) Electric vehicles ("EVs")

- Expand EV charging facilities to all Housing Authority carparks.
- Continue with and expand the EV-charging at Home Subsidy Scheme, and streamline and expedite the approval process.
- Continue to encourage and support public transport operators to explore and test the application of green innovative transport technologies, e.g., hydrogen fuel cell EVs.
- Meanwhile, adopt, as a minimum, the Euro VI emission standard for all commercial vehicles and consider further incentives to expedite the complete replacement of Euro IV and V polluting commercial vehicles.

c) Green finance

- Develop, or encourage the development of, a more extensive regulatory framework/ set of coordinated, rigorous and transparent benchmarks for the certification of green financial products.
- Support and further develop Core Climate, Hong Kong's international voluntary carbon trading platform.
- Allow a deduction of the costs incurred on purchasing appropriately certified renewable energy and carbon credits.

Introduction

The outbreak of Covid-19 pandemic, starting around early 2020 posed extraordinary challenges in almost every part of the world. To meet these challenges, governments and businesses took decisive action to protect public health and support different sectors of their economies. Ultimately, the pandemic restricted both social and business activities and resulted in significant adverse impacts on economies and public health worldwide.

After around three years in which the pandemic took centre stage, many governments have now moved towards a policy of "living with Covid", on the basis that it cannot be completely eliminated, and given more widely available vaccines and quite extensive immunity within communities where the pandemic was widespread, its impact has reduced substantially. While governments are trying to take steps to capture opportunities in the post-Covid recovery period, the world is also facing other major challenges of inflation, due to supply chain disruption and increased energy prices resulting from the conflict in Ukraine, among other factors, rising interest rates, and also increased government debt, given the large-scale subsidies handed out during the worst period of Covid, when full and partial lockdowns were prevalent. The World Bank is forecasting worldwide growth of just 1.7% in 2023[1].

Hong Kong has maintained certain limited pandemic-related restrictions, after suffering its most severe wave in early 2022, having been relatively unscathed before that, and Mainland China and Macau maintained more restrictive policies until late December 2022, which had made travel between Hong Kong, the Mainland and Macau difficult. We welcome the Government's move to lift most Covid measures on 28 December[2] and the gradual reopening of the boundary with Mainland China in January 2023. While Hong Kong has relaxed most restrictions for arriving visitors[3] and has begun to open up for major international events, the rising tide of uncertainties in the global economy, the US-China tensions and geopolitical conflicts, and internal constraints, such as the "brain drain", low birth rate, poorly performing markets and the housing shortage, continue to affect Hong Kong's economy and delay the return of a "feel good factor". Hong Kong's growth in the third quarter fell 4.5%, following declines of 3.9% and 1.6% in the first and second quarters, respectively. The official estimate for gross domestic product ("GDP") growth for the whole of 2022 was lowered to negative 3.2%, from the previous projection of between negative 0.5% - plus 0.5%. If so, 2022 will be the third year of negative growth in the previous four years.

In addition, business leaders have concerns that Hong Kong has been losing its competitiveness due to the lack of international connectivity over the past three years and some of the business lost may not return in the foreseeable future. The situation is exacerbated by the brain drain.

Against this background, Hong Kong badly needs a "shot in the arm" to regain its vibrancy and attractiveness to overseas investors. A major international financial and investment summit was held successfully in November 2022 and, following that, the international Rugby Sevens tournament took place for first time since 2019. These are certainly positive signs but more needs to be done. The time is right for the Government of the Hong Kong Special Administrative Region ("the Government") to review Hong Kong's investment promotion strategies, tax policies and overall competitiveness to boost Hong Kong's connectivity with the other parts of the world, as well as to reinvigorate its status as a leading international financial centre.

Reinforcing Hong Kong's international status and competitiveness

With the keen global competition in the post-Covid-19 era, Hong Kong should redouble efforts to reinforce its traditional competitive advantages, including a favourable business

[1] https://www.worldbank.org/en/news/video/2023/01/10/global-economic-prospects-slowdown-growth-risks-economy-expert-answers#:~:text=Global%20growth%20is%20slowing%20sharply,the%20global%20economy%20into%20recession.
[2] https://www.info.gov.hk/gia/general/202212/29/P2022122900035.htm?fontSize=1
[3] https://www.info.gov.hk/gia/general/202212/28/P2022122800773.htm

environment, sound legal system, free flow of capital, advantageous geographical location, wealth of experience as a “connector” between the Mainland and overseas jurisdictions, and its long-standing reputation as an international financial centre.

In the meantime, Hong Kong is facing fierce competition in the global scramble for talent. The need for talent is acutely felt across all fields – from finance, technology to the creative industries. The pandemic, the emigration wave, the ageing population and other factors have caused talent shortages in many traditional and emerging industries. In order for Hong Kong to attract overseas talent, fully reopening the city's borders and restoring normality is only a precondition. The Government needs to understand the underlying causes of the brain drain and to formulate a comprehensive policy for attracting and retaining talent. In addition to monetary incentives, promoting a better living and working environment and providing greater tax certainty should also be on the agenda.

Given the labour shortages in Hong Kong, the unemployment rate is expected to remain low, but there is also a degree of mismatch between the skills required in future and those available in the labour force, so providing opportunities for upskilling and retraining will remain important.

Making Hong Kong a more livable city and community measures

Hong Kong’s healthcare system has a good reputation and is known for its quality, efficiency and coverage of the community. However, the very long waiting time for booking for stable new cases[4], as well as the overwhelmed capacity of public hospitals during Covid-19, have revealed the acute manpower shortage in Hong Kong’s public hospitals. Coupled with the loss of experienced personnel and the ageing population[5], it is expected that the public healthcare sector will be overstretched and overcrowded in the foreseeable future. To reduce the burden on the system, we recommend that the Government should encourage people to adopt a more active and healthier lifestyle, and promote a more efficient utilization of both public and private health care services, by making use of appropriate tax incentives.

As long as the local Covid situation remains basically under control, with the Government’s support, domestic economic activities are expected to revive further. To overcome challenges until the recovery is in full swing, the Government may need to continue to provide some targeted support to businesses and taxpayers. At the same time, given the negative GDP growth and the projected deficit in 2022-23 of over HK$100 billion, it is also necessary to look at the long-term stability of public finances and the tax system. With very substantial electricity price increases announced in November 2022, resulting from a number of factors, including the conflict in Ukraine, one area of support that may need to be offered is electricity subsidies, at least for low income consumers; but along with that, energy conservation ought to be promoted.

Measures to achieve carbon neutrality and sustainability goals

The Government has committed to striving to achieve carbon neutrality by 2050. In October 2021, the Environment Bureau released Hong Kong's Climate Action Plan 2050 (“CAP”)[6], setting out the vision of "Zero-carbon Emissions-Liveable City-Sustainable Development", and outlining the strategies and targets for combating climate change and achieving carbon neutrality, together with certain quantitative targets. The Hong Kong Institute of Certified Public Accountants (“the Institute”) supports Hong Kong’s efforts to achieve carbon neutrality by 2050 and we are committed to helping the business community here to adopt international sustainability reporting standards, as and when they are promulgated. The Government, regulators, as well as relevant industry organizations, should continue to promote sustainable development to the public and businesses,

[4] https://www.ha.org.hk/haho/ho/sopc/dw_wait_ls_eng.pdf

[5] According to the Chinese University of Hong Kong roughly 30% of the population will be over 65 in 2033. https://www.cuhk.edu.hk/med/shhcgg/healthyageing/ageing_in_hk_demography.html

[6] https://www.info.gov.hk/gia/general/202110/08/P2021100800588.htm

and drive and enforce the related regulations to enhance corporate sustainability performance and disclosure.

The Institute is expected to become the standard setter for sustainability reporting standards in Hong Kong, building on our experience and well-developed infrastructure as the local standard setter for financial reporting, auditing and ethical standards. If this proceeds, we will be committed to ensuring that our members are up to speed with corporate sustainability disclosure and reporting standards, both from the preparers' and the assurers' perspective. As regards assurance, in December 2020, the Institute issued guidance to members on the assurance of environmental, social and governance ("ESG") reporting, which has since been further updated.

The Institute is also a leading advocate of high standards of corporate governance and sustainability in Hong Kong, through our Best Corporate Governance and ESG Awards and related studies[7].

Meanwhile, we also look at ways to make Hong Kong a more livable city and to help achieve long-term and interim decarbonization targets by proposing different green taxes measures and incentives.

To help Hong Kong write a new chapter and re-establish itself in the post-Covid-19 era as one of the best places in the world to live, work and visit, the Hong the Institute is pleased to put forward its 2023-24 budget proposals, under the title of "Reconnect & Renew". The proposals encompass 10 groups of recommendations under the three main headings indicated above.

[7] https://www.hkicpa.org.hk/en/Thought-leadership/Corporate-governance-and-sustainability/Best-Corporate-Governance-and-ESG-Awards

I. Reinforcing Hong Kong's international status and competitiveness

Issue 1: Enhancing Hong Kong's competitiveness and attracting overseas investment

In the latest World Competitiveness Yearbook 2022[8] published in June 2022 by the International Institute for Management Development, Hong Kong was ranked fifth globally (behind Denmark, Switzerland, Singapore and Sweden), up from seventh last year. Among the four competitiveness factors, Hong Kong continued to rank favourably in terms of government efficiency and business efficiency, while its rankings in economic performance and infrastructure also improved. On sub-factors, the city continued to rank top in business legislation and was in the top three positions in public finance, tax policy as well as international investment.

Meanwhile, according to the Global Financial Centres Index report[9] released in September 2022, Hong Kong fell from third place to fourth. However, Hong Kong was ranked only eighth in terms of business environment and human capital and even as low as ninth in terms of reputation. It would seem that the Government may need expedite the implementation of policies to improve the business and living environment in order to consolidate and enhance Hong Kong's status as an international financial centre.

At the same time, Hong Kong moved up to fourth place from fifth in 2022 among the cities with the highest living costs this year, according to the report by the Economist Intelligence Unit. The survey - conducted between August 16 and September 16, 2022 - tracks the prices of more than 200 goods and services in 172 cities worldwide. Given the negative headwinds and data referred to above, this cannot be seen in a positive light.

We support the Government's commitment to further enhancing Hong Kong's position amid keen global competition. Aside from upholding Hong Kong's institutional strengths and competitive advantages, the Government plans to step up investment in infrastructure, innovation and technology ("I&T"), nurturing talent and increasing land supply, among other areas, in order to provide a favourable environment for Hong Kong's long-term economic development. We are also pleased to note that the Government has been holding various meetings and forums to tap into the views of stakeholders from different sectors on maintaining Hong Kong's competitiveness.

Against this background, we propose a range of measures below, with the aim of enhancing Hong Kong's competitiveness.

a) General measures

- **Improve Hong Kong's competitiveness**

  Regional headquarters ("RHQs") tax incentives

  While Hong Kong is a leading international financial centre and regional business hub, Singapore has historically been a preferred location for multinational companies' regional headquarters ("RHQs") in Asia for, especially those in the technology sector[10]. This might partly be attributable to the favourable tax incentives it offers to approved headquarters, which can enjoy a lower corporate income tax rate of 5% to 15% on

[8] https://www.imd.org/centers/world-competitiveness-center/rankings/world-competitiveness/

[9] https://www.longfinance.net/programmes/financial-centre-futures/global-financial-centres-index/

[10] https://www.legco.gov.hk/research-publications/english/1920issh27-foreign-mainland-companies-setting-up-offices-in-hong-kong-20200605-e.pdf

qualifying activities, and 8% for corporate treasury centres ("CTCs"), for intra-group financing activities. In contrast, Hong Kong does not offer a concessionary tax rate for RHQs, and CTCs are taxed at 8.25% under the preferential regime introduced in 2016. In the 2020/21 Budget, the financial secretary ("FS") stated that enterprises could set up their RHQs in Hong Kong to leverage the city's role as a platform for Belt and Road projects and for opening up new markets. However, so far, no specific incentives have been put forward. To encourage multinational enterprises ("MNEs") to establish RHQs in Hong Kong, we recommend introducing specific incentives for RHQs.

Any preferential treatment of this kind would need to be consistent with the future rules under Pillar 2 of the Organisation for Economic Cooperation and Development ("OECD")'s Base Erosion and Profit Shifting ("BEPS") 2.0 initiative, and the imposition of a global minimum effective tax rate of 15% on MNEs above a certain income threshold. Therefore, the Government should also consider providing some non-tax incentives, for example, providing subsidies to qualifying RHQs to hire high-quality talent, and/or for the rental costs incurred by expatriate staff**.**

<u>Group relief</u>

Furthermore, we suggest once again that group tax loss relief be introduced, which is available in other international financial centres, including the United Kingdom ("UK"), the United States ("US") and Australia, together with appropriate anti-avoidance provisions to avoid any abuse. This could encourage the setting up of more RHQs in Hong Kong. A report published by the Financial Services Development Council ("FSDC")[11], in 2017, suggests that the most appropriate form for Hong Kong would be a group tax loss transfer amongst wholly-owned group companies, which should require the fewest amendments to the Inland Revenue Ordinance ("IRO") and should be relatively straightforward to administer. In essence, the transfer of losses could be restricted to current year unrelieved losses transferred from one wholly-owned group company to another. Furthermore, where the company transferring tax losses is subject to tax at a lower rate (e.g., eligible for certain preferential tax regime) than the company receiving the tax losses, the tax losses will need to be adjusted to reflect the tax benefit of those tax losses to the loss-making company.

<u>**Proposals**</u>

- ***Consider offering a 50% profits tax concession (i.e., a rate of 8.25%) for relevant profits derived by qualifying RHQs.***
- ***Introduce a simple form of group loss relief.***

- **Open up business opportunities and improve market access in the Greater Bay Area ("GBA")**

<u>Support business promotion in the GBA and more exchanges between Hong Kong and the GBA</u>

Hong Kong should expand economic integration and collaboration with other GBA cities and continue to attract international capital to invest in the Mainland via Hong Kong. We would urge the Government to help open up the opportunities that the GBA can offer to the fullest extent. Firstly, we need to increase awareness of the different contexts, markets and business environments in the nine Mainland GBA cities. We have also previously suggested that the Government set up a dedicated and flexible fund to support business promotion and development in the GBA to which eligible Hong Kong professionals could apply. It should be open to a broad range of uses,

[11] https://www.fsdc.org.hk/media/uixnycgg/a-proposal-for-the-introduction-of-group-tax-loss-relief-in-hk-english_0.pdf

including internships that may not be covered by existing GBA youth employment and internship funding programmes and to provide employment opportunities in Hong Kong for young professionals from other GBA cities in sectors suffering from acute manpower shortages in Hong Kong, including accounting.

Support an extension of professional practising rights in the GBA

We would also ask the Government to lend its support to Hong Kong professionals, where appropriate, to be able to practise and serve their clients who set up offices in the GBA. In this connection, registered auditors and accountants from the Union of Associations of Professional Accountants of Macau have been granted certain rights to practise tax in the Shekou and Qianhai areas of Shenzhen, as have holders of one particular Hong Kong "tax adviser" designation. We propose that Institute members who are tax practitioners, especially those members who have successfully completed the Institute's intensive, exam-based, Professional Diploma in China Tax programme, should be granted similar practising rights to perform tax work in relevant areas of the GBA. This would help to establish a more level playing field. Meanwhile, other members with tax knowledge should be able to be partners in firms offering Hong Kong and cross-border tax advice.

In addition, we would ask that practising members of the Institute who do not hold the Chinese Institute of CPAs qualification should be eligible to be non-audit service partners in CPA firms in the GBA, or at least, as first step, in specific development areas such as Qianhai and Nansha.

We would urge the Government to support these measures to assist Hong Kong professionals to take advantage of the opportunities in the GBA, improve market access and ensure that the GBA can fulfil the ambitious targets set for it in the national development plans.

Proposals

- ***The Government should:***
  - ***(a) Set up a dedicated and flexible fund to support business promotion and development in the GBA for professional services, which could also be used for internship programmes and to provide employment opportunities in Hong Kong for young GBA professionals in sectors suffering from acute manpower shortages, such as accounting.***
  - ***(b) Lend its support to Hong Kong professionals' efforts to obtain more practising rights in GBA cities, especially Qianhai and Nansha.***

- **Reconnect regionally and internationally, and review tourism strategies to give more attention to higher-end and eco-tourism**

It has been widely reported that the non-domestic tourism industry, particularly in-bound tourism, is virtually non-existent and may find it difficult to recover to pre-pandemic levels in the short to medium term. It was disappointing to note, for example, the closure of Morning Star Travel and Hong Thai Travel, two of Hong Kong's best known group tour agencies, in 2022. While the tourism sector has suffered considerable hardship during the pandemic, we would nevertheless suggest that the Government take the opportunity to review Hong Kong's longer-term tourism policies and strategies. Careful consideration should be given as to whether Hong Kong should be aiming for the return of the kind of low-cost tours and mass market tourism, which in the past has supported primarily low-paid jobs and even led to some friction with the local population; or whether, instead, we should be doing more to promote higher-end tourism and managed eco-tourism, including making efforts to attract more regional and long-haul tourists, who could help boost Hong Kong's image and reputation as a modern and livable international city that offers much more than just shopping. In the long run, this can also help in the drive to attract talent.

This is line with the 2018 Policy Address[12], in which the then chief executive of the Hong Kong SAR remarked that the Government would promote the development of sustainable green tourism by enhancing the supporting facilities of key hiking trails and piers with a view to strengthening the development of Hong Kong's green and eco-tourism. International bodies such as the International Union for Conservation of Nature[13] recognize that sustainable green tourism helps generate revenue, provides economic opportunities, and raises awareness of the conservation of protected areas. In recent years, many places overseas have focused on developing green tourism in light of its economic and environmental benefits. Australia is one example. With the reopening of Hong Kong's border, it's a good timing to review Hong Kong's tourism policies and enhance the promotion of sustainable eco-tourism.

While the border control measures and quarantine requirements were still mostly in place, not only the tourism sector remained at a standstill, but the organization of international events and forums, such as the Hong Kong Rugby Sevens and the proposed International Financial Leaders' Investment Summit, looked to be in jeopardy. We were, therefore, pleased to see the Government's decision in September to relax some of the social distancing measures and remove the hotel quarantine requirement, among other things[14].

Further relaxations took place in December 2022, such that the pre-departure testing arrangements for all inbound persons were standardized and nucleic acid testing requirements after their arrival at Hong Kong were lifted[15]. We appreciate the Government's efforts in adjusting the anti-epidemic measures from time to time based on analyses of scientific data. In the meantime, we urge the Government to set out a plan and timeline for relaxing all the residual restrictions, so as to enable Hong Kong to minimize the disruption to normal social activities and reconnect with the international community.

As well as fostering complementary and coordinated development with the Mainland, Hong Kong should maintain and enhance regional and international connections, in order to serve as the bridge between the Mainland and the rest of the world. Therefore, in parallel with the collaboration with the GBA cities, the Government should continue to enhance economic cooperation and interaction with overseas economies, including members of the Association of Southeast Nations and other Asian countries, in order to help maintain Hong Kong's long-established competitive advantages.

In addition to outbound visits and participation in international conferences, we suggest that Hong Kong should provide more support for holding different international events, conventions and exhibitions, covering the areas of sports, arts and culture, etc. Different types of promotion campaign and programmes should also be carried out to bring in tourists from the region (see *Issue 6* below). These activities can attract

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[12] https://www.policyaddress.gov.hk/2018/eng/policy_ch04.html

[13] https://www.iucn.org/

[14] https://www.info.gov.hk/gia/general/202209/24/P2022092400048.htm

[15] All inbound persons, regardless of being from the Mainland, Macao, Taiwan or overseas places, are required to conduct an RAT within 24 hours, or undergo a polymerase chain reaction-based nucleic acid test within 48 hours, prior to the scheduled time of flight departure (for those entering Hong Kong via the airport) or the scheduled time of arrival at Hong Kong (for those entering Hong Kong via other boundary control points), and obtain a negative result for entering Hong Kong. Upon receiving the test results, relevant persons should keep the photos showing the test results or the test report for 90 days for presentation for checking on request by Government personnel. They may also voluntarily declare the test result via the Department of Health's electronic health declaration form. For more details, please see: https://www.info.gov.hk/gia/general/202212/28/P2022122800773.htm?fontSize=1

overseas visitors and bring about significant direct and indirect economic benefits to the local economy, encompassing a wide range of sectors from traditional tourism sectors, such as aviation, hotels, food and beverage, and retail, to event management, booth design and construction, logistics, and professional services, etc.

Proposals

- ***In re-opening fully to tourism in Hong Kong, do more to promote and encourage higher-end tourism and managed eco-tourism, including making efforts to attract more regional and long-haul tourists.***
- ***Encourage and support the hosting of different international events, conventions and exhibitions in Hong Kong, in the areas of sports, arts and culture, etc. to attract visitors.***

- **Create an overall business-friendly environment**

In view of the keen competition among global economies, Hong Kong should consolidate and enhance its existing advantages, develop new edges and provide an all-round favourable business environment to attract overseas investment.

Support for entrepreneurship

We suggest that additional support be shown for entrepreneurship in Hong Kong, by offering a tax concession for setting-up expenses for standalone startups. This can help send a signal to young people that the community welcomes their efforts to develop their business and leadership skills by setting up their own companies.

During these challenging economic times, we reiterate that a limited form of loss carryback can make Hong Kong more competitive and help businesses facing temporary cash flow problems.

Review investment promotion strategies

Given the evolving international tax environment, which will make it more difficult to rely extensively on tax incentives and a low tax regime to attract investment from MNEs in future, there is a clear need to review Hong Kong's investment promotion strategies and policies. Consideration needs to be given to Hong Kong's positioning and to potential non-tax incentives and advantages that could be offered to boost Hong Kong's standing and reputation as a top-tier location for investment and place to live and work.

To this end, the Government should make use of a variety of channels and events to generate fresh, new and innovative ideas to attract business and investment in the post-Covid-19 era. We were pleased to see the recent Financial Leaders' Investment Summit held in Hong Kong, as an example of this approach for the financial services sector, and would suggest that the views of key stakeholders in other industry sectors be canvassed through appropriate channels.

Expand double taxation treaty network

We understand that the Government has been making concerted efforts to expand Hong Kong's tax treaty network, even during the pandemic. However, the number of comprehensive double taxation agreements ("CDTAs") in place is still well below that in other major jurisdictions (e.g., the Mainland, the UK, Japan and Singapore have each signed over 90 CDTAs, compared with 46 in Hong Kong).

Introduce a corporate rescue procedure

We would also urge the Government to proceed with the proposed statutory corporate rescue procedure ("CRP"), which was held up in 2021. Proposals for a statutory CRP were first put forward by the Law Reform Commission in 1996 and, despite several attempts to introduce legislation, we are no further forward today. A CRP could help companies with a sound business model that may be facing short-term cash flow issues. There can be few, if any, other major business and financial centres that do not have a formal CRP arrangement.

In summary, we propose the following measures which would help create a more business-friendly environment in Hong Kong:

Proposals

- ***Allow tax concessions for company formation/ setting-up expenses, including capital expenditure, capped at HK$10,000, for standalone startups, (i.e., those not part of an existing group).***
- ***Introduce tax loss carry-back provisions, which are a common feature of the corporate tax systems in many advanced economies.***
- ***Review Hong Kong's investment promotion strategies and policies and consider possible non-tax incentives and advantages to attract investment.***
- ***Continue to expand Hong Kong's network of CDTAs, particularly with major trading partners.***
- ***Introduce a statutory CRP into insolvency law in Hong Kong.***

- **Improve Hong Kong's language skills**

According to a report issued by Education First on English Proficiency Index 2021[16], Hong Kong has "moderate proficiency" and is ranked 33th globally and only 5th in Asia. Despite Hong Kong's image as a metropolis that combines different cultures and languages, English proficiency here is lagging behind that of Malaysia, the Philippines, Singapore and South Korea.

To maintain Hong Kong's competitive edge as an international business, financial and trading centre, action needs to be taken to address perceptions of declining standards of, and interest in, English in the community. Meanwhile, in order to take full advantage of the opportunities generated by the Mainland's development, particularly in the GBA, attention also needs to be given to enhancing the general standard of Mandarin. The Government needs to support the objective of making Hong Kong truly a bi-literate (Chinese and English) and trilingual (Cantonese, Mandarin and English) society by setting out its strategy and policies for achieving this, both within the formal education system and through support for good-quality language courses offered by other training institutes and adult education centres.

Proposal

- ***Take steps to maintain and strengthen standards of English and Mandarin***

[16] https://www.ef.com/wwen/epi/

b) Attracting and retaining talent

- **Addressing the brain drain and the talent gap**

  Examine the causes of the "brain drain" and take action to address it

  According to the 2022 mid-year population statistics[17] released by the Census and Statistics Department in August 2022, Hong Kong recorded a 121,500 (1.6%) drop in its population during the first half of 2022. Meanwhile, the Hong Kong Investment Funds Association conducted a survey of 36 companies in July 2022 and the results revealed that nearly 70% of fund management companies with operations in Hong Kong said it was "extremely difficult" or "difficult" to attract and retain talent for global roles based in Hong Kong[18]. The situation was even worse when hiring staff non-native to Hong Kong or the Mainland. More than 40% said it was extremely difficult to hire expatriates, even though as many as 20% of firms offer hardship allowances to prospective employees from overseas[19].

  In relation to the population drop, the Government has acknowledged that the pandemic and the related quarantine requirements impacted talent inflow, especially those on short-term employment visas/ entry permits. In terms of pooling talents, the Government will continue efforts to attract talent from home and abroad to settle in Hong Kong and to promote the flow of talent within the GBA[20].

  While we welcome the focus on policies and measures to attract talent in the 2022 Policy Address, including the proposed establishment of a Talents Service Unit, we also need to try to tackle other issues adversely affecting Hong Kong, including the low birth rate and the brain drain. We urge the Government to study and investigate the underlying issues, analyse the potential impact on different industries and explore effective ways to encourage people to stay or return, as well as to bring up families here. In addition, we propose consideration of various other measures below.

- **Supporting enterprises to hire high-quality talent in targeted industries**

  The brain drain has affected a number of different professional sectors in Hong Kong, including health, education, information technology ("IT") and professional services, such as accounting. We suggest that the Government consider providing additional support to targeted industries, so that employers can offer more competitive salaries to attract talent, where labour is in particularly short supply. The IT industry, for example, is one of key industries due to the higher demand in facilitating digital transformation in the next few years (see *Issue 3* below).

- **Promoting talent development and mobility between GBA and Hong Kong**

  To promote talent development in the GBA, the Government needs to ensure those interested in working in other GBA cities are equipped with the essential skills needed to capture the opportunities and cope with the challenges ahead. For example, the Government may consider building an online learning platform to provide training on the core skill sets (including language, soft skills, etc.) to interested talent. Encouraging and facilitating the formation of exchange groups to share information on life

[17] https://www.censtatd.gov.hk/en/web_table.html?id=2
[18] https://www.thestandard.com.hk/breaking-news/section/4/193523/Hong-Kong%E2%80%99s-brain-drain-challenge-rises-as-funds-relocate-roles
[19] https://www.fundsglobalasia.com/news/hk-fund-managers-brain-drain-challenge
[20] https://www.info.gov.hk/gia/general/202208/11/P2022081100393.htm

experience, job opportunities and career guidance among Hong Kong young people and new arrivals should also be considered.

In addition to tax incentives, the Government should provide some non-tax incentives to encourage and support talent mobility between Hong Kong and the GBA. For example, given the high cost of housing in Hong Kong, incentives could be offered to developers to build hostel accommodation for young GBA and overseas professionals and/or subsidies could be given to employers to provide housing allowances.

- **Measures to encourage child birth and to attract overseas talent to raise their families in Hong Kong**

According to the 2022 mid-year population statistics[21], the number of births in Hong Kong has declined continually over the past five years, from 59,500 in 2016/17 to 35,100 in 2021/22. Hong Kong's fertility rate is consistently among the lowest in Asian economies. The downward trend has been effecting enrolments in schools and will eventually have an impact on the workforce, as well as exacerbating the ageing population situation.

Amid the sweeping changes to daily life and working environments triggered by the pandemic, many companies have provided more flexible work models and utilized technology to adapt to the "new normal" in the workplace. In the post-Covid-19 environment around the world, many businesses have continued to adopt a hybrid work from home ("WFH")/ in office model, as a way to help employees maintain a better work-life balance and improve their physical and mental wellbeing. This is particularly important for working parents. With this in mind, to encourage child birth, we suggest that businesses be incentivized to allow employees to work partly from home for the first one or two years after the birth of their children, through e.g., subsidies for upgrading IT infrastructure support for remote working and carrying out cybersecurity audits (See *Issue 3* below). Where their jobs do not allow for working from home, an allowance for employees to hire a helper or for child care/ crèche services could be provided for the same period.

To encourage overseas talent to come to Hong Kong, bring/ raise their families here and stay for the longer term, which is clearly the aim of the extra stamp duty refund measure announced in the 2022 Policy Address, support should be provided for their children's education, where the local school system cannot accommodate their needs.

Against the above background, we propose that the following measures be considered:

Proposals

- ***Examine the causes of the brain drain, and explore effective ways to encourage people to stay or to return.***
- ***Consider providing subsidies or tax concessions, such as double deductions, to targeted industries facing labour shortages so that employers can offer more competitive salaries to attract talent.***
- ***Provide some non-tax incentives to encourage and support talent mobility between Hong Kong and the GBA. For example, given the high cost of housing, consider providing incentives to developers to build hostels for young GBA and overseas professionals coming to Hong***

[21] https://www.censtatd.gov.hk/en/web_table.html?id=2

Kong and/or offering subsidies for employers to provide housing allowances.

- ***Provide an allowance for the private education of the children of overseas talent, up to a certain amount annually, where the local school system cannot adequately serve them.***
- ***Incentivize businesses to allow WFH for employees in the first one or two years after the birth of their children.***
- ***Where WFH is not practicable, provide an allowance for new parents to engage a helper for the first one or two years of a child's life, where both parents (or the single parent in a one-parent family), are working full time, for up to three children per family; or an equivalent amount for child care/ crèche services.***

c) Promote I&T, research and development ("R&D") and intellectual property ("IP") development in Hong Kong

- **Review and revise tax rules to promote Hong Kong as an IP hub**

One of the roles envisaged for Hong Kong under the 14th National Five-Year Plan ("14th FYP"), which was echoed in the 2022 Policy Address, is an IP trading hub. However, responding to the concerns of the European Union ("EU") over possible double non-taxation arising from tax exemptions for offshore passive income in Hong Kong, the Government made a commitment to refine Hong Kong's foreign-source income exemption ("FSIE") regime for passive income. Under the refined FSIE regime, four types of offshore income, including income from IP, are deemed to be sourced from Hong Kong and will be subject to profits tax. This applies if the income is "received in Hong Kong" by a taxpayer that is a constituent entity of a MNE group, and where it does not meet the relevant test of having sufficient economic activity in, or "nexus to", Hong Kong, depending on the type of income. The refined FSIE regime came into force on 1 January 2023.

For foreign-source IP income that is received in Hong Kong, the "nexus" approach adopted by the OECD is used to determine the granting of tax exemption in future. While income from certain IP (i.e. patents and patent-like IP) may continue to be non-taxable, based on the qualifying expenditure of the Hong Kong constituent entity as a proportion of the overall expenditure incurred by the taxpayer to develop the IP, this has resulted in a very limited scope of non-taxable offshore IP income[22]. This is likely to discourage companies from establishing IP-related business in Hong Kong.

We understand that the Government will explore devising a preferential tax regime for Hong Kong-sourced IP income to encourage more R&D activities in Hong Kong. This is to be welcomed. Meanwhile, we would urge the Government to consider other initiatives (both tax and non-tax) to foster the development of Hong Kong's I&T sector, and strengthen Hong Kong competitiveness in terms of offering a favourable onshore IP regime. The measures that should be considered to further enhance the IP tax regime include the following:

[22] Essentially this is likely to be only where R&D activities directly connected to patents or equivalents are undertaken by the taxpayer outside Hong Kong, or are outsourced to an unrelated party outside of Hong Kong, because carrying out R&D activities in Hong Kong could result in the IP income being regarded as onshore sourced and, as such, taxable.

Proposals

- ***Introduce preferential tax regimes for IP businesses (e.g., IP box regime and refundable R&D credits), and consider providing a concessionary profits tax rate of say, 8.25%, for onshore IP income.***
- ***Modify the enhanced R&D tax deduction rules (i.e., the so-called "super-deductions"), taking into account the real commercial constraints of businesses engaged in R&D activities, which are unable to enjoy the existing deduction (normal or enhanced).***
- ***Consider the possibility of R&D tax credits for start-up businesses. Alternatively, consider converting the super-deductions into "Qualified Refundable Tax Credits" ("QRTCs"), where appropriate[23], as QRTCs will be more beneficial for businesses, once the Global Anti-Base Erosion or GloBE rules under BEPS 2.0 are implemented.***
- ***Relax the anti-avoidance provisions under the IP deduction rules to allow genuine commercial transactions to enjoy the benefits, e.g., deductions for costs of acquiring IP from associates, IP licensed to another person for use wholly or principally outside Hong Kong, and fir the costs of outsourced R&D activities.***
- ***Provide non-tax support for local R&D activities, including financial subsidies to encourage more local R&D activities.***
- ***Extend the coverage of tax and non-tax incentives to R&D activities undertaken in the GBA.***

- **Introduce tax incentives for businesses in key industries, such as IT and "green" industries**

Hong Kong should develop its role as a hub for I&T in the context of the 14th FYP. In addition to developing the necessary infrastructure, which the Government is already doing, tax incentives can also play a part in facilitating this process. Given the increased focus on sustainable development, this is one of the areas in which R&D should be encouraged. "Sustainable investing takes off in Asia Pacific"[24], published by PwC in August 2021, which explores the sustainable investment landscape in eleven Asia Pacific jurisdictions, including Hong Kong, found that only one out of the eleven jurisdictions (i.e., Indonesia) does not have green and sustainable tax incentives in place. There are some innovative green and sustainable tax incentives or practices, for example, Japan provides tax credits or a special tax depreciation for certain assets that contribute significantly to the reduction of greenhouse gases and Australia provides green tax incentives for the asset and wealth management sector.

The existing, but fairly limited, green tax incentives in Hong Kong include an accelerated tax deduction on capital expenditure incurred by enterprises in procuring eligible energy-efficient building installations and renewable energy devices, 100% tax deduction on environmental protection machinery, environmental protection installations and environmentally-friendly vehicles.

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[23] Under the GloBE rules, refundable tax credits that are recognized as QRTCs will be treated as an addition to income rather than a reduction to Covered Taxes in the computation of a MNE group's jurisdictional ETR, in line with the financial accounting treatment for refundable tax credits. This means QRTCs will be taken in account in the denominator of the Pillar Two effective tax rate ("ETR") formula rather than the numerator and, accordingly, will tend to have a less significant downward impact on jurisdictional ETR compared with other tax incentives.

Hong Kong currently does not offer any tax credit that would qualify as a QRTC. The enhanced deductions on R&D expenditure under the IRO will give rise to permanent differences for the purposes of the GloBE rules, they will result in a reduction to Covered Taxes as opposed to an addition to income and will have a more significant downward pressure on ETR. Therefore, the Government should consider modifying the rules or converting the enhanced deductions to QRTCs.

[24] https://www.pwccn.com/en/asset-management/sustainable-investing-ap-2021.pdf

It is also important to encourage the development of industries that can contribute to the green economy and improve Hong Kong's sustainability credentials, as well as R&D in areas such as new energy sources and applications, energy conservation, and use of IT to create a more energy efficient and less wasteful society. There are opportunities for Hong Kong as a densely-populated, highly-developed territory, surrounded by sea and hills, and receiving quite high levels of sunlight annually, to conduct more research into the generation and application of renewable energy, from sources such as wind and solar power.

As noted above, preferential tax treatment will need to ensure consistency with the future rules under Pillar 2 of BEPS 2.0, but for start-up or other companies not linked to in-scope MNEs, this should not be an issue.

Another role envisaged for Hong Kong in the 14th FYP is an aviation hub. In order to attract more airlines to fly into and out of Hong Kong and base themselves here, and to bring in more airline-related business, without substantially increasing our carbon footprint, another measure that should be considered is incentivizing the use of sustainable aviation fuel.

Against the above background, we propose the following measures:

Proposals

- ***Provide tax credits for start-up companies engaged in relevant IT businesses and green industries.***
- ***Introduce lower profits tax rates for qualifying IT and green industries for the first 5 years of profits (i.e., beyond the existing general concession on the first HK$2 million of assessable profits).***
- ***Grant tax concessions/ subsidies to airlines operating out of Hong Kong that use a certain percentage of sustainable aviation fuel***[25]**.**

Issue 2: Helping the workforce to upgrade their skill sets

- **Developing the skill of the workforce generally**

To support members of the workforce who want to upgrade their skills and thus improve their opportunities and competitiveness, we suggest allowing more flexible use of the deduction for self-education expenses, currently capped at HK$100,000. We suggest expanding the scope of the deduction to cover expenditure incurred by a taxpayer's dependants, if they are not eligible for a deduction in their own right.

Upgrade employees' skills

The Government should consider subsidizing employers to send employees on qualifying courses to upgrade their skills in areas that are most in demand, such as the I&T field. In addition, such training should not be treated as a taxable perquisite in the hands of employees.

Extend the "Love Upgrading Special Scheme"

The Government should provide online training programmes for selected industries to help the unemployed and underemployed to develop their skill sets and ensure that their skills are up-to-date and relevant to the demands of the market.

[25] https://www.cathaypacific.com/cx/en_HK/about-us/sustainability/climate-action/corporate-sustainable-aviation-fuel-programme.html

The Employees Retraining Board has launched six rounds of the "Love Upgrading Special Scheme" (LU Special Scheme)[26] since Q4 2019. The scheme provides free training courses and special monthly allowances to those between jobs, with the aim of helping them get back into the job market. The Government should extend the training period beyond the March 2023 end date.

In addition, as businesses are becoming more reliant on technology, it is important for workers to be well-trained in using new technology. The provision of free online training programmes on the usage of popular system software and application software can help them to upgrade their skills effectively for self-enhancement and employment.

Proposals

- ***Expand the deduction for self-education expenditure to cover expenditure incurred by a taxpayer's dependants, if they are not eligible for a deduction in their own right.***
- ***Subsidize employers to send employees on qualifying courses to upgrade their skills.***
- ***Extend the period of the "Love Upgrading Special Scheme" for training for those in between jobs and provide for self-enablement through the provision of free online training programmes for selected industries.***

Issue 3: Continuing to promote digital transformation

- **Supporting small and medium-size enterprises ("SMEs") in their digital transformation**

  Supporting SMEs' digital transformation and encouraging the deployment of secured cloud services, big data and artificial intelligence ("AI")

  There are over 340,000 SMEs in Hong Kong, constituting more than 98% of our businesses and employing about 45% of the workforce in the private sector. It is expected that more SMEs will need to undergo digitalization in the coming years to ensure the sustainability of their business. They will also be asked to play their part in Hong Kong's transformation to a carbon neutral economy in the longer term and, in this regard, digitalization can help them move away from paper-based processes and operate more sustainably. Following the Government's Smart City initiative, set out in the second edition of Hong Kong's Smart City Blueprint[27], the deployment of secured cloud services, big data and AI should also be encouraged. Although there are various IT support schemes to help SMEs with digital transformation, they tend to provide one-off project-based subsidies, while SMEs may also require continuing digitalization support.

  To enhance the overall digital transformation in the business community and help make Hong Kong a centre for I&T, the Government should consider various measures, as suggested below.

[26] https://www.erb.org/scheme/en/Main/

[27] https://www.smartcity.gov.hk/
Second edition: https://www.smartcity.gov.hk/modules/custom/custom_global_js_css/assets/files/HKSmartCityBlueprint(ENG)v2.pdf

Funding for IT support and/ or training

Representatives of the I&T sector have urged the Government to take steps immediately to keep talent in Hong Kong and attract more to the city, saying an ongoing brain drain could be hard to reverse[28]. With limited resources and funds, it has become more difficult for SMEs to recruit suitable IT personnel in recent years. Therefore, we suggest that consideration be given to providing SMEs with time-limited (i.e. up to 36 months) support to hire an IT specialist to facilitate their general digital transformation. This should extend to engaging an accounting professional to help them upgrade their accounting systems in readiness for the implementation of an electronic tax filing ("e-filing") system, which is currently under development. The proposed funding should also be able to be used by SME proprietors to up-skill their employees', or their own, skill sets to improve their IT capabilities.

An arrangement could be put in place along the lines of the Research Talent Hub for Innovation and Technology Fund projects ("RTH-ITF")[29] under the Innovation and Technology Commission, with an emphasis on engaging more experienced IT (post) graduates and specialists.

As noted above, more flexible working arrangements to allow employees to work remotely have become increasingly commonplace since the outbreak of Covid-19. In practice, this could also help companies hire overseas talent without necessarily requiring them to work in Hong Kong. Given the current shortage of IT professionals in Hong Kong, this could also offer a partial solution for companies and may even allow departing Hong Kong professionals to continue to do work for their existing employers in some cases. However, smaller organizations may not be able to afford the costs of new hardware, networks and technologies to support employees working remotely. The Government should consider providing support to SMEs to (i) upgrade systems and equipment, (ii) provide technical and infrastructure support (including computers, software, Wi-Fi networks, etc.) to remote working employees, including WFH parents (see also *Issue 1(b)* above).

Set up a dedicated fund, or expand the Continuing Education Fund to cover practical training in IT and digitalization

We would also suggest establishing a more focused version of the Continuing Education Fund ("CEF"), or expanding the CEF, to cover practical training for company staff and proprietors in IT and digitalization. In addition to increasing digital awareness, SMEs' awareness of other related areas, including cyber security and data protection also needs to be strengthened.

Provide funding to promote adoption of AI and data analytics projects

Hong Kong's I&T sector, together with that of Shenzhen and Guangzhou (i.e. the Shenzhen-Hong Kong-Guangzhou science and technology cluster), ranks as the world's second-performing cluster according to the Global Innovation Index 2021[30]. Biotechnology, AI, smart city and financial technologies were identified as the four key areas for Hong Kong's I&T industry. We have suggested above that green technology and sustainability should also be an important area in the future. In terms of

[28] https://news.rthk.hk/rthk/en/component/k2/1640309-20220322.htm
[29] https://www.itf.gov.hk/en/funding-programmes/nurturing-talent/research-talent-hub/research-talent-hub-for-itf-projects-rth-itf-/index.html
[30] https://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2021.pdf

applications, financial technology or "fintech", smart city and smart home, health care and big data applications are among the most popular sectors[31].

Currently, there are 17 funding schemes under the Innovation and Technology Fund, supporting R&D, facilitating technology adoption, nurturing technology talent, supporting technology start-ups and fostering an I&T culture, etc. To nurture the ecosystem and encourage a wider digital adoption in Hong Kong, we suggest to extending the funding schemes to AI and data analytics projects, which are two major development areas in Hong Kong. The Government may draw reference from Singapore's Artificial Intelligence and Data Analytics Grant[32], which is open to financial institutions, and expand it further to selected industries.

Feedback suggests that the applications for the various funding schemes involve onerous procedures and that the process can take over one year. We suggest consolidating these different funding schemes where possible, and simplifying and expediting the approval procedure. Consideration should be given to establishing a central contact point or "one-stop shop" to assess potential applicants, and advise them on the most efficient route to apply for the most relevant support programmes.

<u>Proposals</u>

- ***Subsidize SMEs to obtain time-limited IT support (e.g., up to 36 months), which could include engaging an accounting professional to help them upgrade their accounting systems in readiness for the tax e-filing regime.***
- ***The above funding should also be usable by SME proprietors to up-skill their employees', or their own, skill sets to improve their IT capabilities.***
- ***Support SMEs to (i) upgrade systems and equipment, and (ii) provide technical and infrastructure support (including computers, software, Wi-Fi networks, etc.) to remote working employees, including, where applicable, WFH parents (see also Issue 1(b) above). This could also enable IT support to be delivered remotely, if need be.***
- ***Establish a dedicated fund, or expand the CEF, to cover practical training for company staff and proprietors in IT and digitalization.***
- ***Extend funding schemes under the Innovation and Technology Fund to cover AI and data analytics projects. Consolidate the many different funding schemes, where possible, and simplify and expedite the approval procedure. Consider establishing a "one-stop shop" to assess and advise potential applicants on the most suitable funding schemes for them.***

- **Make good use of the electronic filing system for taxation**

<u>Ensure a smooth implementation of e-filing of profits tax returns</u>

Since early 2021, the Inland Revenue Department ("IRD") has been undertaking a two-phase project on the e-filing of profits tax returns. In the first phase, the existing eTAX Portal will be enhanced by 2023 to enable more businesses to voluntarily file profits tax returns electronically, together with their financial statements and tax computations. In the second phase, a new Business Tax Portal will be developed by 2025 for the e-filing of profits tax returns, with the ultimate goal of achieving full-scale implementation of mandatory e-filing by 2030.

[31] https://research.hktdc.com/en/article/MzEzOTIwMDIy
[32] https://www.mas.gov.sg/schemes-and-initiatives/Artificial-Intelligence-and-Data-Analytics-AIDA-Grant

The Institute made submissions on consultations on the proposed Taxonomy Package, aimed at facilitating the electronic submission of financial statements and tax computations in inline eXtensible Business Reporting Language ("iXBRL") format, and on further proposals for taking forward the e-filing project, as well as on the legislation providing the platform for e-filing. We have all along encouraged digitalizing the tax return filing process. Any e-filing system needs to be user-friendly and compatible with the way business is conducted and how businesses and their professional advisers interact. We expect that the system should help to improve efficiencies and align Hong Kong with international best practices. To ensure the most effective outcome, the IRD should continue to conduct detailed discussions and consultations with the market and the profession on the design and operation of the system, with the help of the testing data from trial runs. They should also continue to gather views from the public to improve and fine-tune the system from time to time after the official launch. The IRD should also explore the best way to use the data so gathered, so as to streamline tax administration and enhance their services, and they should be transparent as to the usage of the data.

Encourage early adopters by providing appropriate incentives

The voluntary e-filing of profits tax returns, together with financial statements and tax computations in iXBRL format, will be launched in April 2023. This means that taxpayers and practitioners will be able to familiarize themselves with the e-filing system, as well as the IRD Taxonomy Package and the iXBRL Preparation Tools, during the two-year transition period before the implementation of mandatory e-filing for some taxpayers, in 2025. This will allow users to solve any technical issues at an early stage and reflect their concerns/ comments on the system to the IRD as early as possible. Therefore, to pave way for implementation of mandatory e-filing, the Government should incentivize taxpayers to use the e-filing system.

Analyse the e-filing data collected

The data received from e-filing should be leveraged to improve services and streamline the system for taxpayers and their representatives.

Under the current Hong Kong tax legislation and regulatory framework, it can take considerably more than six years for taxpayers to settle field audit and tax investigation cases with the IRD. Taxpayers, therefore, need to retain documents for many years to corroborate their cases. Changes in employees or business owners may make it more difficult to provide supporting evidence, thereby disadvantaging taxpayers.

Upon the full adoption of e-filing of profits tax returns for businesses, all companies, including inactive and loss-making companies, will be required to perform annual tax filing. With all the financial and accounting data collected in a system, less manual effort will be needed and the IRD should be able to analyse tax data more efficiently. As the IRD's review process can be accelerated, we propose that the Government consider reducing the statutory limitation period to three or four years (from the current six years) after the end of a particular year of assessment, and revise the tax law to give statements of loss the same status as notices of assessment. This will increase certainty for taxpayers and investors and reduce their compliance costs. Shortening the limitation period would also help speed up the collection of tax underpaid in field audit and tax investigation cases. To cope with the more extensive work, the IRD should also strengthen its audit resources and capabilities.

Proposals

- ***IRD should continue to conduct detailed consultations with the market and the profession on the design and operation of the e-filing system, currently under development, with the help of the testing data from trial runs.***
- ***Provide early adopters with appropriate incentives, such as a two-month extension of the tax filing deadline, early tax refunds, etc.***
- ***Leverage the data provided by e-filing to improve services and streamline the system, by, for example:***
  - ***reducing the statutory time-bar period for finalization of tax affairs to three or four years, and according a statement of loss the same status as a notice of assessment;***
  - ***strengthening the IRD's tax audit capabilities and shortening timeframes for audits.***

<u>Issue 4: Providing greater tax certainty and reviewing Hong Kong's tax system</u>

- **Increase tax certainty**

In addition to a low-rate and relatively simple tax regime, certainty of tax treatment has been another important factor of the tax system affecting the overall attractiveness of Hong Kong as a place of investment for MNEs. However, there have been numerous changes in Hong Kong's tax regime in recent years, often brought about by international developments, such as the BEPS initiative, which has global implications, and, recently and more specifically for Hong Kong, the call by the EU for a review of Hong Kong's FSIE regime for passive income, aimed at addressing aspects of it that could be considered to be harmful tax practices. These developments have created uncertainties, particularly for MNEs and, where there have been consultations on the implementation of such proposals in Hong Kong, they have tended to come at a later stage in the discussion when there is little room left for change, and sometimes certain important questions can remain unresolved.

The refined FSIE regime is a case in point. The arrangements negotiated and agreed with the EU have resulted in a number of new tax-related concepts being introduced in Hong Kong, representing significant new developments, and, as a result, Hong Kong's territorial source principle of taxation will no longer be as straightforward as it was previously. The way in which the refined FSIE regime will interact with the existing preferential regimes also needs to be explained clearly. MNEs need sufficient time to understand the details, and to review their existing investment holding structures and operating models, in order to assess whether they can preserve their existing tax exemptions. Therefore, we recommend that the Government should continue to keep MNEs well informed about how the refined FSIE regime will be administered.

Representatives of the Taxation Faculty have met the Financial Services and the Treasury Bureau ("FSTB") and the IRD and appreciate the efforts made by the Government to gather views from stakeholders. Nevertheless, we would urge that the taxpaying community be involved as early as possible during the discussion phase of future legislative proposals, such as those relating to the BEPS 2.0 initiatives, so that taxpayers and tax practitioners can provide feedback on the real practical impact of the proposed changes, which can, in turn, inform the discussions and negotiations at the international level. This will also enable stakeholders to better prepare themselves for the changes to be made, which may require a reasonable lead time to facilitate restructuring or re-organization.

We have previously suggested that the Government should consider engaging more outside expertise from the tax and commercial fields, either within the more formal government structure, such as the Tax Policy Unit, or in an informal advisory/ consultation groups. We reiterate this suggestion here.

In relation to more specific issues, as mentioned above, the Government should consider revising the tax law is to give statements of loss the same status as notices of assessment. Currently, if warranted, the IRD has the right to deny the tax losses stated in the statements of loss when they issue notices of assessment in future years, which, as also indicated above, could be many years later. The uncertainty about the availability of tax losses is detrimental to business planning.

Proposals

- ***Engage stakeholders to provide practical feedback on proposed tax law changes as early as possible in the process***.
- ***Promote clear understanding of how new tax laws, such as the refined FSIE regime, will interact with the existing IRO and allow sufficient transition time for taxpayers to get prepared.***
- ***Provide clear guidance and support to those affected by significant incoming changes in tax rules.***
- ***Accord a statement of loss the same status as a notice of assessment.***

- **Review of the tax system**

We continue to urge that a more extensive review of the tax system be conducted. International developments, such as those referred to above, the importance of safeguarding Hong Kong's competitive position, retaining a simple, relatively low-rate tax regime, as far as possible, while also being able to fund vital public services, against the backdrop of Hong Kong's ageing population, all points to the need for a tax system that is responsive, up to date and fit for purpose. It has been over 45 years since the previous review of the IRO and, although numerous changes have been made since that time, for specific purposes, the framework has not been re-examined from a holistic perspective. It is time to conduct a review of the IRO once again.

We propose, therefore, a more extensive review of Hong Kong's tax system to examine various pressing issues, including those set out below.

<u>Options for broader-based taxation</u>

The FS, Mr Paul Chan, revealed that the epidemic was still impacting Hong Kong's economy in the third quarter of 2022 and that prospects for the next few quarters remained highly challenging. Furthermore, the Government is expecting a substantial deficit to be recorded this year, which will result in a fall in the fiscal reserves[33]. The GDP growth estimate for 2022 has recently been revised downwards to minus 3.2%.

In view of the above, there is an increasing need to explore broader-based taxes to ensure stability of revenues in the future, to help address the longer-term public finance needs and avoid structural deficits. This remains important given Hong Kong's ageing population; the lack of indirect, consumption-based taxes; and over-reliance on a few sources of revenue, primarily profits tax, salaries tax, land

[33] https://www.fso.gov.hk/eng/blog/blog20220918.htm

premiums, stamp duty (a large proportion of which is also property-related), and investment income - all of which are quite volatile.

The overall competitiveness of the system needs to be considered, what may still be possible and what will not be, in the light of international tax developments, such as those outlined above, and what Hong Kong's positioning should be from a tax perspective in the future. Existing policies and tax incentives also need be monitored and reviewed regularly for their effectiveness in achieving their stated objectives.

The Government should research into how the tax system could be used better to support policy objectives, such as developing Hong Kong's role as an IP hub, and providing more assistance to start-up businesses that cannot make use of the existing incentives. Given the increasing focus on, and importance of, sustainable development, the Government should consider green taxes and incentives (e.g., emission taxes, additional carbon taxes, incentives for energy conservation, etc.). Push and pull measures can be used to increase the take up of electric vehicles ("EVs") and encourage the development of new energy vehicles, including commercial vehicles and public transport, in order to help achieve a carbon neutral Hong Kong by 2050 (see *Section III* below). New business models also need to be understood and accommodated.

<u>Providing greater clarity and certainty of tax treatment</u>

In general, there is a need to provide greater clarity and certainty of tax treatment, which has come to rely too heavily on debatable interpretations of court judgments, and non-statutory interpretations through IRD departmental interpretation and practice notes ("DIPN"), and, in some cases, informal, and perhaps conflicting administrative arrangements.

Accelerating the tax audit process or committing to a performance pledge on the timeframe for concluding field audit and investigation cases, would help taxpayers manage their tax risks and exposures. We would also welcome a reform of the penalty system, the calculation of judgement debt interest and the interest rate on tax reserve certificates, to achieve a more equitable system.

<u>Proposals</u>

- ***Conduct a more extensive review of the tax system to, among other things:***
    - ***look at options for broader based taxation***
    - ***lend support to policy objectives and enhance Hong Kong's overall competitiveness***
    - ***enhance certainty of tax treatment***
    - ***review the effectiveness of existing preferential regimes***

II. Making Hong Kong a more livable city and community measures

Issue 5: Encouraging people to adopt a more active and healthy lifestyle and reducing the burden on the public healthcare system

- **Support for health and the public health system**

Encourage more participation in physical activity

According to the Centre of Health Protection ("CHP")[34], about one in six adults (17%) aged 18 or above in Hong Kong had insufficient physical activity based on World Health Organization's recommendation in 2018-19, up from 13% in 2014-15. In addition, about one-fifth of the Hong Kong population aged 15 or above reported sitting or reclining for 10 hours or longer every day in 2020. The outbreak of Covid-19 has reportedly exacerbated the problem, owing to closure of some sports facilities and cancellation of sports events. While Covid-19 has affected exercise routines, some jurisdictions have explored new approaches, such as supporting virtual events (e.g., virtual London Marathon[35]) and issuing sports vouchers (e.g. Taiwan sports vouchers[36]), to revive public interest in physical activities. These overseas examples may provide good references for the Government to encourage Hong Kong citizens to adopt a healthier lifestyle.

Enhance Voluntary Health Insurance Scheme ("VHIS")

Education, health services and social welfare account for a large part of government expenditure. An ageing population and increasing dependency ratio are among the challenges that Hong Kong faces, which will inevitably lead to increases in health and social welfare costs. While we welcome the Government's recent announcement of a Primary Healthcare Blueprint, this is likely to take some years to come to full fruition. In the meanwhile, the public health services will remain under strain.

To help relieve the pressure on the public healthcare system in and provide the public with an additional choice of using private healthcare services through hospital insurance, the VHIS was launched in 2019. Taxpayers who, or whose spouse, is the policyholder of a policy issued under a Certified VHIS Plan may claim tax deductions up to HK$8,000 per insured person for the premiums paid. Since premiums generally vary by age and gender, we recommend increasing the annual cap to HK$12,000 per insured person to encourage more people, especially those aged 60 or above to participate in VHIS policies. Since the VHIS covers only insurance products that provide hospital insurance protection of an indemnity nature, bought by individuals for themselves and their families, the Government should consider extending the scope to other programmes, such as outpatient services.

The Government launched the Elderly Health Care Voucher Scheme[37] in 2009 to provide subsidies for eligible elderly persons to access private primary healthcare services that best suit their health needs. Currently, vouchers can be spent on healthcare services provided by medical practitioners, Chinese medicine practitioners, dentists, nurses, physiotherapists, optometrists, etc. Since 2014, the annual voucher amount has been HK$2,000 and the Government provided an additional one-off HK$1,000 voucher amount to each eligible elderly person in 2018 and 2019 as a budget measure during the pandemic. There is no restriction on the number of years

[34] https://www.chp.gov.hk/en/static/104075.html?f=466
[35] https://www.tcslondonmarathon.com/the-event/virtual-marathon
[36] https://english.moe.gov.tw/cp-117-29832-b921f-1.html
[37] https://www.hcv.gov.hk/en/hcvs/service_area.html

that an elderly person may carry forward unspent vouchers, but the unspent amount cannot exceed the accumulation limit of HK$8,000. As stated in the 2022 Policy Address, the Government will allow the shared use of vouchers between spouses and extend the coverage and roll out of a pilot scheme to encourage use of primary healthcare services through increasing the annual voucher amount from existing HK$2,000 to HK$2,500, with conditions.

To allow elderly persons to obtain better quality healthcare services after the epidemic and facilitate them to plan for the use of the voucher, we recommend that the Government review the annual amount and cumulative limit under the scheme more regularly.

<u>**Proposals**</u>

- ***Provide tax deduction for expenses on approved sports courses and activities for taxpayers and their dependants, of up to HK$12,000 per person.***
- ***Increase the maximum tax deduction allowable for qualifying premiums paid under the VHIS Policy to HK$12,000 per each insured person.***
- ***Consider extending the scope of VHIS to additional programmes (e.g., outpatient services).***
- ***Review and adjust the amount and accumulation limit of vouchers under the Elderly Health Care Voucher Scheme annually, or at least more regularly.***

<u>***Issue 6: Arts, culture and sports development and improving the local environment***</u>

- **Arts and culture, and sports**

The Culture, Sports and Tourism Bureau[38] ("CSTB") was established on 1 July 2022 to integrate subjects relating to Hong Kong's culture, sports and tourism sectors. The mission of the CSTB is to enhance Hong Kong's position as an East-meets-West centre for international cultural exchanges, as envisaged in the 14th FYP, reinforcing Hong Kong's leading position in the international arts market and facilitating the development of arts, cultural and creative industries. Bringing these subjects together could generate synergies to promote Hong Kong as an international cultural and sports hub more effectively. In the post-Covid-19 environment, we suggest the Government should strengthen its support for holding more international arts, cultural and sports events to promote international exchanges, by providing additional subsidies to international exhibitors and performers. In order to enhance the chemistry of culture and tourism, the Government should also promote local events such as the Hong Kong Arts Festival, Hong Kong Food Festival, etc. more actively to overseas visitors. For example, the Government may distribute free/ discounted admission tickets to visitors in the initial period after the Covid-related restrictions are lifted.

In the respect, we welcome the setting up of Mega Arts and Cultural Events Fund, as announced in the 2022 Policy Address and acknowledge the funding already in place for major sports events. However, we believe there is still scope for supporting other international events that may not be sufficiently large scale to benefit from this funding.

To enhance cultural life and the creative arts, Hong Kong also needs to continue to actively foster a vibrant and creative local arts scene, and not only promote international events and the international arts market. There must be scope for local artists to express themselves and, where appropriate, to ask questions about our society. This requires an environment that is genuinely open to a diversity of

[38] https://www.cstb.gov.hk/en/about-us/our-portfolio.html

perspectives and channels of expression. In this regard, there is room for boundaries to be made clearer.

- **Harbour front enhancement**

In recent years, harbour side development[39] in Hong Kong has taken some significant strides forward. At present, the harbour front along both sides of the Victoria Harbour has a total length of about 73 kilometres. Of this length, some 35 kilometres are unconnected at the moment because of natural coastline, private land and container terminals. Out of the remaining 38 kilometres that have been planned to be developed into harbour front promenades, about 25 kilometres have been opened for public enjoyment. It is expected that the harbour front promenades will be further extended to 34 kilometres in 2028, crossing Sheung Wan, Wan Chai and North Point. Upon the full completion of the boardwalk underneath the Island Eastern Corridor in 2025, the promenade along the northern shore of Hong Kong Island will be connected from Kennedy Town to Shau Kei Wan. The Government's efforts in taking forward this harbour front development in recent years, including the Central harbour front park, are to be commended.

To enhance the attractiveness of the promenades and maximize the usage and enjoyment of them, we suggest that the Government should consider granting some concessions for good-quality refreshment stalls with some outdoor seating along these promenades.

We propose, therefore, the following specific measures in relation to arts, culture and sports development, and tourism:

Proposals

- ***Encourage and support the holding of more international arts, cultural, and sports events and exchanges in Hong Kong, which may not be eligible for existing funding schemes aimed at large-scale events, including by offering subsidies to international exhibitors/ performers, especially in the immediate post-Covid period.***
- ***Continue to actively foster the development of a vibrant local arts and culture scene*.**
- ***Hong Kong harbour front promenades are increasingly extensive and attractive. Concessions should be granted for some good-quality refreshment stalls some limited outdoor seating along these promenades to maximize the use and enjoyment of them.***

Issue 7: Community relief measures

Covid-19 has brought exceptional challenges to Hong Kong. As the local pandemic situation has improved and the social distancing measures have been relaxed in tandem, and aided by the Government's various support measures (including the two rounds of consumption vouchers), there has been some revival in domestic activities. Nevertheless, both businesses and individual taxpayers are still facing continued pressure, given, among other things, the increasing cost of living. Some businesses are struggling to stay afloat amidst the uncertain economic outlook. Individuals in some industries have been unemployed or underemployed for lengthy periods, while others have been required to take unpaid leave.

[39] https://www.devb.gov.hk/en/home/my_blog/index_id_1510.html

Moreover, CLP Power and the Hongkong Electric Company recently announced an increase in the price of electricity by 6.4%[40] and 5.5%[41] respectively in 2023, based on November 2022 tariffs (representing a year-on-year rise of 19.8% and 45.6% respectively) as they face increasing costs due to the uncertain outlook of the international energy market. The community will continue to need some help to absorb this in the present general economic climate.

Therefore, to help alleviate the ongoing burden on taxpayers and other members of the community, we propose the measures below.

Proposals

- ***Continue to waive surcharges for payment of tax by instalments for 2022-23.***
- ***Provide a tax reduction of 100%, subject to a ceiling of HK$10,000 on salaries tax, tax under personal assessment and profits tax for 2022-23.***
- ***Provide rates concession for properties, subject to a ceiling of HK$1,500 per quarter.***
- ***Grant an electricity charge subsidy of HK$1,000 to each residential electricity account. This should be done in conjunction with promoting energy conservation measures.***

Issue 8: Review and rationalize the personal allowances and encourage saving for retirement

- **Review and rationaize personal allowances**

  The amount of personal allowances under salaries tax and personal assessment have not been revised since 2018/19. The basic personal allowances should be increased in line with inflation.

  The Government should also review and rationalize the allowances for dependants. Allowances for children and other dependants have been revised at various times over the past decade or so, with different levels of increases for each. For example, since 2017-18, while allowances and additional allowances for dependent parents and grandparents have been increased by around 8.7%, allowances for dependent siblings have not been increased at all, while child allowances have been increased by 20%. Pending a review, the allowances for dependants should also be increased in line with inflation.

  In addition, following a review, any future adjustments should be made on a more transparent and consistent basis. Where there are sound policy, or other, reasons for differential adjustments, these should also be made clear.

  Proposals

  - ***The basic personal allowances should be increased, at least in line with inflation, as this can help retain more money in consumers' pockets.***
  - ***A review of the allowances for dependants should be carried out and, following the review, any future adjustments should be made on a more transparent and consistent basis.***

[40] https://www.clp.com.hk/content/dam/clphk/documents/tariff-adjustment-20221/Tariff2023_PressRelease_ENG.pdf
[41] https://www.hkelectric.com/en/media-resources/press-releases/2022/11/22/HK-Electric-2023-Tariff-Adjustments

- **Encourage saving for retirement**

  To help people plan better for their retirement, which will also help reduce the burden on public finances in the long run, the Government should encourage and incentivize employees to save more through the Mandatory Provident Fund Scheme, where they are able to do so.

  <u>Proposal</u>

  - ***Increase the maximum tax deductible amount of voluntary contributions made to individual mandatory provident fund schemes from HK$60,000 to HK$100,000 per year, under salaries tax or tax under personal assessment.***

III. Measures to help achieve carbon neutrality and sustainability goals

Globally, 2022 is likely to be the fifth or sixth warmest year on record, according to the World Meteorological Organization's preliminary assessment. Global mean sea level continued to rise, reaching a record high in 2022. Various extreme weather events continued to batter different parts of the world, including heatwaves, blizzards, severe drought and extreme rainfall-triggered severe flooding[42].

Hong Kong must play its part to combat global warming. The Government has committed to achieving carbon neutrality by 2050. As noted above, the CAP, issued in October 2021, outlines the strategies and targets for combating climate change and achieving carbon neutrality, together with certain quantitative targets. Under the CAP, the Government will pursue more vigorous interim decarbonization targets, to reduce Hong Kong's carbon emissions by 50% before 2035 as compared with the 2005 levels.

We fully support Hong Kong's efforts to achieve carbon neutrality by 2050. Yet, the CAP mainly focuses on the continuation and improvement of existing policies. To strengthen these policies, the Government should formulate a science-based, long-term comprehensive climate policy, such as long-term carbon reduction strategies, which should include researching low-carbon power generation technology, exploring the possibility of applying renewable energy, energy storage and other technologies, etc. Support for recycling in Hong Kong is also patchy. There is a need for a more coordinated set of policies in this area, which can help both to reduce waste and also change mindsets and influence lifestyle choices within the community.

The 14th FYP supports the development of Hong Kong as a green finance centre in the GBA. The 2020 Policy Address also indicated the development of green finance in Hong Kong to boost investments conducive to reducing carbon emissions. We welcome the initiative to develop Hong Kong as a regional green and sustainable finance hub, including encouraging institutions to conduct relevant investment, financing and certification activities and attracting top-notch institutions and talents to Hong Kong to provide the relevant services. By leveraging its advantages as an international financial centre, Hong Kong can facilitate matching between international capital and quality green projects, as well as propelling Hong Kong towards its carbon neutrality target by 2050 and promoting green transformation of the economy.

The Government Green Bond Programme with a borrowing ceiling of HK$100 billion was launched in 2018 to demonstrate the Government's commitment to promote green finance and developing Hong Kong into a more sustainable and livable city. As a consistent step to consolidate and develop Hong Kong's position as a premier green finance hub regionally and internationally, the Legislative Council approved the Government's proposal in July 2021 to expand the scope of the programme and raise the borrowing ceiling to HK$200 billion. As at 31 July 2022, the Government had issued close to US$10 billion worth of green bonds[43]. The Green Bond Framework[44], which was first published in March 2019 and is applicable to the Government green bond issuances, was updated in February 2022 to reflect the Government's latest commitments and strategy, and to align with the latest international standards and practices in the green bond market.

In terms of ESG development, the Institute is currently in communication with FSTB about becoming the standard setter for sustainability reporting standards in Hong Kong, building on our experience and well-developed infrastructure as the local standard setter for

[42] https://www.info.gov.hk/gia/general/202301/09/P2023010900277.htm
[43] https://www.hkgb.gov.hk/en/others/documents/Green_Bond_Report_2022.pdf
[44] https://www.hkgb.gov.hk/en/greenbond/greenbondframework.html

financial reporting, auditing and ethical standards. As noted above, if the Institute becomes the local standard setter, we will be committed to ensuring that our members are up to speed with corporate sustainability disclosure and reporting standards, both from the preparers' and the assurers' perspective. As also noted previously, the Institute already issued, in December 2020 (and recently revised) initial guidance to members on the assurance of ESG reporting.

While education and certifications for professionals in the field of ESG and sustainable finance are relatively new in the market, they are important to train up talents in these fields. There are some choices of training and certificate programmes available in the market, but the information is scattered and not well organized. We believe the Government could promote some designated training programmes and certification schemes for ESG and sustainable finance more actively, so that participants can be assured that the training and certificates are recognized by relevant bodies.

Pressure on businesses (from governments, investors, regulators, the media, etc.), in particular MNEs, to disclose more about the taxes that they pay has been increasing for years. Some people take the view that tax is a crucial part of the ESG development, as tax reporting through an ESG perspective can help businesses build trust and demonstrate their commitment to sustainability and social responsibility. Tax governance, therefore, is becoming as important as tax transparency. Some jurisdictions, such as Australia[45] and Singapore[46], have established tax governance frameworks to encourage taxpayers to implement tax controls to identify, mitigate and monitor key tax risks on an ongoing basis. We suggest the Government consider introducing a tax governance framework for Hong Kong entities and help taxpayers, in particular private companies, to improve their tax governance.

<u>Issue 9: General policies to promote sustainability in Hong Kong</u>

Against the above background, we propose consideration of the following general policies to promote more sustainable development in Hong Kong:

<u>Proposals</u>

- ***Establish policies to support renewable energy targets and technologies, including supporting businesses to adopt more sustainable practices and ESG standards, and expanding the feed-in tariff arrangements, etc.***
- ***Explore the development and use of alternative energy in Hong Kong, such as green hydrogen and, where feasible, facilities and plants for testing.***
- ***Develop a more coordinated set of policies on recycling. Consider incentives for downstream recycling, waste-to-resources/ energy infrastructure (e.g. subsidies on land costs and facilities); and explore and encourage areas such as the use of recycled building materials, and second-life applications of EV batteries.***
- ***Increase climate literacy among companies and the community.***
- ***Promote training programmes and widely accepted certification schemes for ESG and/ or sustainable finance professionals.***
- ***Support the efforts of the Hong Kong accounting profession to participate actively in the development of international sustainability reporting standards.***
- ***Explore further options for "green" taxation and incentives for good practices, as well as non-tax options.***
- ***Consider setting out a tax governance framework to help taxpayers manage tax risks.***

[45] https://www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/Tax-governance/

[46] https://www.iras.gov.sg/taxes/goods-services-tax-(gst)/getting-it-right/tax-governance-and-tax-risk-management/tax-governance-framework-(-tgf-)

Issue 10: Measures in specific areas

To achieve carbon neutrality by 2050, we understand that the Government has been implementing strategies and measures to reduce carbon emissions in accordance with the CAP. Over the past few years, resources have been allocated in the budget to take forward the building of a green city and implement a range of measures on various fronts to combat climate change. In June 2021, the Government announced the Clean Air Plan for Hong Kong 2035, setting out the vision under the slogan "Healthy Living - Low-carbon Transformation - World Class". The Clean Air Plan covers six major areas of action, namely green transport, livable environment, comprehensive emissions reduction, clean energy, scientific management and regional collaboration. Concurrently, the Government committed in the 2022-23 budget that it would continue to promote new energy transportation so as to further enhance air quality.

With a view to improving the environment, conserving resources and helping to achieve a carbon-neutral Hong Kong, we propose the specific measures below.

- **Green buildings**

  In recent years, many countries have introduced green building certification systems to provide indicators for building performance and encourage the adoption of low-carbon construction methods for structures that are newly built, undergoing renovation, or already occupied. Common green building certification systems in Hong Kong include the Leadership in Energy and Environmental Design (LEED[47]) by the US Green Building Council and BEAM Plus[48] New Buildings by the Hong Kong Green Building Council.

  Sections 16H-K of the IRO allow accelerated tax deductions on certain specified capital expenditure incurred by taxpayers for their environment-friendly initiatives. "Specified capital expenditure" means any capital expenditure incurred on the provision of any environmental protection machinery or environmentally-friendly vehicles; or the construction of any environmental protection installations, where "environmental protection installation" includes 11 types of environmentally-friendly installations, e.g., solar water heating, solar photovoltaic, wind turbine, hydroelectric, etc.

  While, in principle, these measures can help develop Hong Kong as a greener city, as Hong Kong is primarily an international financial centre and service-based economy, not many taxpayers will employ local environmental installations. Hence, the effectiveness of these environmental tax measures may be limited. Meanwhile buildings in Hong Kong constitute the largest source of energy usage. The CAP notes: "Buildings account for about 90% of Hong Kong's total electricity consumption, and over 60% of our carbon emissions are attributable to generating electricity for our buildings"[49]. However, new buildings that are not very energy efficient are still being constructed, while green building codes, such as BEAM Plus, in Hong Kong, remain voluntary. Also, it is noted that the energy conservation measures mentioned in the 2022 Policy Address focus only on the government buildings and infrastructure[50]. We believe that the measures should be extended to the private sector and the Government should explore incentives to drive the development of more private green buildings.

[47] https://www.usgbc.org/leed/why-leed
[48] https://www.hkgbc.org.hk/eng/beam-plus/beam-plus-new-buildings/index.jsp
[49] https://www.climateready.gov.hk/files/pdf/CAP2050_booklet_en.pdf
[50] https://www.policyaddress.gov.hk/2022/en/policy.html (see paragraph 110)

In addition to considering mandating key elements of green building codes in new building and incentivizing/ subsidizing retrofitting and/or developing best practice standards for energy-efficient buildings in Hong Kong, where feasible, providing enhanced commercial ("CBA") and industrial building allowances ("IBA") for new commercial and industrial complexes that adopt approved, environmentally-sustainable, designs could be an effective means to encourage developers to build greener, more energy-efficient buildings. For example, we recommend, at least, an initial allowance of 25% and an annual allowance of 5% for industrial buildings and, say, an annual allowance of 6.5% for commercial buildings. This would help in the effort towards achieving carbon neutrality by 2050 and benefit the living and working environment.

In relation to non-tax incentives, a gross floor area ("GFA") concession[51] (capped at 10% of the total GFA of the development) is currently granted to buildings meeting only the minimum standards for BEAM Plus certification, and performance verification post-occupancy is not required. This means that it is not providing motivation to developers to pursue higher-tier ratings or to strive for more energy-efficient designs. Therefore, we suggest that the Government should review the scope of this incentive and modify it to encourage developers to obtain higher green building ratings.

<u>Extend commercial and industrial building allowances beyond 25 years for refurbished buildings that retrofit more sustainable features</u>

In the 2008 Annual Meeting between the Institute and the IRD[52], the IRD advised that, since the combined effect of sections 33A to 36 of the IRO was to grant relief in respect of the capital expenditure incurred on construction within a period of not more than 25 years, there was no provision for granting relief for the capital expenditure incurred by the buyers of industrial or commercial buildings more than 25 years old. This was confirmed in the 2022 Annual Meeting. This means, in case the relevant interest in a commercial building constructed before the year of assessment 1998-99 is sold for a consideration after the year of assessment 2023-24, while the seller would be subject to a balancing charge on the amount of the sale money (restricted to the allowances previously made to the seller), the buyer would not be entitled to any annual allowance on the residue of expenditure immediately after the sale. This asymmetric tax treatment results in an incongruent situation that at least part, if not the whole, of the capital expenditure incurred on construction will not be relieved, even though the building has all along been used for the purpose of producing profits chargeable to tax during the 25-year period.

In light of the advancements in construction technology over the years, it is not uncommon that buildings are still in good condition and in use even after the 25-year period. In particular, given that a significant number of pre-1998-99 commercial buildings are still in use and the year of assessment 2023-24 is fast approaching, we would ask the Government to consider granting relief to buyers in the above situations. This incentive would be in line with the policy on refurbishing old industrial and commercial buildings. In order to support Hong Kong's progress towards higher levels of sustainable development, this concession could be tied to buildings that retrofit more sustainable, e.g., energy-efficient, features.

[51] Hong Kong implemented a policy on green and innovative buildings in 2001 to allow green features such as balconies, communal podium gardens and sky gardens to be exempted from the calculation of the GFA of residential development projects. Later the Buildings Department included BEAM Plus as one of the prerequisites for seeking GFA concession. Besides, a 10% cap was imposed on the amount of concession. For more details, see: https://www.bd.gov.hk/en/resources/codes-and-references/notices-and-reports/GFA.html

[52] https://www.hkicpa.org.hk/-/media/HKICPA-Website/HKICPA/section5_membership/Professional-Representation/tb18.pdf

Based on the provisions in the IRO, the annual allowance for a used building is calculated by dividing the residue of expenditure immediately after the sale by the number of years of assessment comprised in the period which begins with the year of assessment in which the sale takes place, and ends with the 25th year after the year of assessment in which the building was first used (or the 25th year after the year of assessment 1998-99 for a pre-1998-99 commercial building). In these cases, we suggest that the Government consider allowing the buyer to claim the entire amount of the residue of expenditure immediately after the sale as annual allowance in the year of acquisition, by deeming the denominator of the fraction (which is not a positive figure) to be one.

<u>Proposals</u>

- ***Adopt best practice standards for energy-efficient buildings in Hong Kong and mandate some requirements.***
- ***Introduce enhanced IBAs and CBAs for buildings that follow these standards (e.g., an initial allowance of 25% and an annual allowance of 5% for industrial buildings and, say, an annual allowance of 6.5% for commercial buildings).***
- ***Extend CBAs and IBAs beyond 25 years for refurbished buildings that retrofit more sustainable, e.g., energy-reducing, features.***

- **Electric vehicles ("EVs")**

As EVs have no tailpipe emissions and low carbon emissions, the Government has been actively promoting EV adoption and has formulated a series of policies and measures to encourage this. In March 2021, the Government issued the Hong Kong Roadmap on Popularization of Electric Vehicles[53], which has introduced a series of measures, such as stopping the registration of fuel-propelled private cars in 2035 or earlier; promoting trials for electric public transport and commercial vehicles, including buses, public light buses, taxis and goods vehicles, and striving to legislate a producer responsibility scheme for retired EV batteries in the next few years.

To facilitate the popularization of EVs, the Institute has previously highlighted that the infrastructure for EVs needs to be further enhanced, including installing fast charging stations in convenient locations. We are pleased to note that, in the 2022 Policy Address, the chief executive committed to provide 7,000 additional parking spaces with electric vehicle chargers in government premises in the next three years. Currently, a total of 37 Housing Authority carparks are installed with EV charging facilitates at the selected hourly parking spaces therein. Electricity is provided at these facilitates for free[54]. We recommend that, if possible, the Government should expand these EV charging facilities to all carparks under the Housing Authority. Additional incentives for potential purchasers of EVs, such as the waiving of parking fees for EVs for the first hour, should also be considered.

The EV-charging at Home Subsidy Scheme[55], which subsidizes private building owners to install charging stations in car parks of existing private residential buildings, has been well received since its launch in October 2020. In order to meet the public demand, in the 2022-23 budget, the FS announced additional funding of HK$1.5 billion on top of the original HK$2 billion, to extend the scheme for four years to the 2027-28 financial year. It is anticipated that the funding will be able to support

[53] https://www.evhomecharging.gov.hk/downloads/ev_booklet_en.pdf
[54] https://www.housingauthority.gov.hk/en/common/pdf/commercial-properties/leasing-information/parking-spaces/ev_charging_facilities_en.pdf
[55] https://www.evhomecharging.gov.hk/en/

installation of an EV charging-enabling infrastructure for around 140,000 parking spaces in 700 car parks in existing private residential buildings. We support the extension of the scheme, however, there is feedback that the application process can take as long as 2.5 years. Therefore, we suggest that the procedure be reviewed and that the approval process be expedited and streamlined, as far as possible, in view of the huge response.

In terms of commercial vehicles, other new energy vehicles should also be explored with a view to achieving zero emissions by 2050. To encourage the trial and wider use of green innovative transport technologies, the Government injected an additional HK$800 million to the New Energy Transport Fund[56] to extend its scope in 2020. We note that Citybus acquired Hong Kong's first hydrogen-powered double-deck bus specifically designed and built for Hong Kong in June 2022. However, the testing plan of the hydrogen vehicle has stalled as Hong Kong has no law on its production, storage and refuelling[57]. To allow the industry to participate more actively in testing both battery-electric and hydrogen vehicles in parallel on Hong Kong roads, we urge the Government to work closely with the industry to prepare the relevant legislation and guidance and build the supporting infrastructure to facilitate the adoption as early as possible.

Currently, not all internal combustion engine vehicles can be replaced with EVs or a new energy equivalent. In the meanwhile, efforts should continue to be made to have older polluting vehicles removed from Hong Kong's roads.

We propose, therefore, the specific measures below in relation to green transport.

<u>Proposals</u>

- ***Expand the EV charging facilities to all Housing Authority carparks.***
- ***Continue with and expand the EV-charging at Home Subsidy Scheme and streamline and expedite the approval process.***
- ***The Government should continue to encourage and support public transport operators to explore and test the application of green innovative transport technologies, e.g., hydrogen fuel cell EVs.***
- ***Meanwhile, Hong Kong should adopt, as a minimum, the Euro VI emission standard for all commercial vehicles and consider further incentives to expedite the complete replacement of Euro IV and V polluting commercial vehicles.***

- **Green finance**

<u>Regulatory framework/ independent and transparent benchmarks for the certification of green financial products</u>

It is clear from the measures referred to above that active steps are being taken to develop Hong Kong into a regional and international green finance hub. However, in order to give this initiative greater credibility, we would suggest that the Government and regulatory bodies also seek to develop, or encourage the development of, a more extensive regulatory framework/ set of coordinated, rigorous and transparent benchmarks for the certification of green financial products, to ensure that any products issued under the framework will genuinely contribute to decarbonization, or other relevant environmental objectives, and avoid the risk of being labelled as "greenwashing".

[56] https://www.epd.gov.hk/epd/english/environmentinhk/air/prob_solutions/new-energy-transport-fund.html
[57] https://www.scmp.com/news/hong-kong/health-environment/article/3188789/hong-kong-gets-its-first-hydrogen-powered-bus

Core Climate: Voluntary international carbon trading platform

In October 2022, Hong Kong Exchanges and Clearing Limited ("HKEX") announced[58] the launch of a new international voluntary carbon trading platform, namely Core Climate, that seeks to connect capital with climate-related products and opportunities in Hong Kong, the Mainland, Asia and beyond. Core Climate will provide a one-stop solution for trading, custody and settlement of voluntary carbon credits and facilitate effective and transparent trading of carbon credits and instruments to support the global transition to carbon neutrality. Carbon credits on the platform will come from internationally-certified carbon projects from around the world, including carbon avoidance, reduction and removal projects. All projects listed on Core Climate are verified against international standards, such as the Verified Carbon Standard by Verra[59].

We appreciate HKEX's commitment to building an integrated ecosystem and international "first class platform" in Hong Kong, and support the setting up and further development of an integrated carbon marketplace in Hong Kong to address the needs of stakeholders across the climate value chain.

Deduction on the costs incurred on purchasing renewable energy credits ("RECs")

Taxpayers may purchase RECs or carbon credits on a voluntary basis as a means to lower their carbon footprint, or meet their greenhouse gas emission goals. For example, a business group can purchase RECs from the market in a year to match its electricity consumption relating to business operations/ activities in that year with an equivalent amount of energy produced in renewable energy projects. The purchase of RECs will generate a renewable energy certificate, indicating the estimated amount of carbon emissions that has been avoided in that year. To encourage more taxpayers to participate in ESG initiatives, we suggest that the Government should give consideration to the idea of deeming such expenses to be connected to the profit-earning processes of the taxpayer's business, and allowing a deduction on the costs incurred on purchasing appropriately certified RECs or carbon credits by companies chargeable to Hong Kong profits tax. Such deductions should also be extended to the costs shared among group companies in relation to the purchase of RECs or carbon credits.

Proposals

- ***Develop, or encourage the development of a more extensive regulatory framework/ set of coordinated, rigorous and transparent benchmarks for the certification of green financial products.***
- ***Support and further develop Core Climate, Hong Kong's international voluntary carbon trading platform.***
- ***Allow a deduction on the costs incurred on purchasing appropriately certified RECs or carbon credits.***

[58] https://www.hkex.com.hk/News/News-Release/2022/221028news?sc_lang=en
[59] https://verra.org/programs/verified-carbon-standard/

Appendix 1: Proposed changes for salaries tax allowances and deductions[60]

Allowances and deductions	Existing (HK$)	Proposed (HK$)
Allowances[61]:		
- Basic	132,000	134,640
- Married person	264,000	269,280
- Child (annual, each dependant, the 1st to 9th child)	120,000	122,400
- Child (initial, each dependant, the 1st to 9th child)	120,000	122,400
- Dependent brother or sister (each dependant)	37,500	38,250
- Dependent parent/ grandparent (each dependant)		
- aged 60 or above or is eligible to claim an allowance under the Government's disability allowance scheme	50,000	51,000
- aged 55 or above but below 60	25,000	25,500
- Additional dependent parent/ grandparent (each dependant)		
- aged 60 or above or is eligible to claim an allowance under the Government's disability allowance scheme	50,000	51,000
- aged 55 or above but below 60	25,000	25,500
- Single parent	132,000	134,640
- Personal disability	75,000	76,500
- Disabled dependant (each dependant)	75,000	76,500
Deductions, maximum limit:		
- Self-education expenses	100,000 limited to claims by taxpayer	100,000 limited to claims by taxpayer
- Private healthcare insurance premiums	8,000	12,000
- Rental payment for taxpayer's primary residence	100,000	100,000

[60] The forecast rates of underlying and headline consumer price inflation for 2022 are maintained at 2% and 2.1% respectively.

https://www.hkeconomy.gov.hk/en/situation/development/index.htm
https://www.hkeconomy.gov.hk/en/pdf/22q2_pr.pdf

[61] For illustration purposes, the proposed allowances are increased on the assumption that the benchmark is set at current levels and the inflation rate is 2%.

Appendix 2: Proposed changes in salaries tax allowances and deductions - impact on a typical individual

Example: Single person

This example illustrates the impact of[62]:

- an increase of basic allowance to HK$134,640
- an increase of the annual limit on the deduction of qualifying premiums paid under VHIS policy to HK$12,000

	Existing (HK$)		Proposed (HK$)		Savings (HK$)	Savings (%)
Income		300,000		300,000		
Allowances/ deductions:						
Basic allowance	132,000		134,640			
Mandatory MPF contribution	18,000		18,000			
Qualifying premiums paid under VHIS	8,000		12,000			
Rental payment	100,000		100,000			
Total allowances/ deductions		258,000		264,640		
Net chargeable income		42,000		35,360		
Tax payable		840		707	133	16%

[62] Assumptions are as for Appendix 1.

Appendix 3: Proposed changes in salaries tax allowances and deductions - impact on a typical family

Example: Married person with spouse separately assessed, two children who are not newborns, and living with two dependent parents over 60 years of age throughout the whole year

This example illustrates the impact of[63]:

- an increase of basic allowance to HK$134,650
- an increase in child allowance to HK$122,400
- an increase in dependent parent allowance and additional allowance to HK$51,000
- an increase of the annual limit on the deduction of qualifying premiums paid under VHIS policy to HK$12,000

	Existing (HK$)			Proposed (HK$)			Savings (HK$)	Savings (%)
Income			750,000			750,000		
Allowances/ deductions:								
Basic allowance		132,000			134,640			
Child allowance	2 children 120,000 each	240,000		2 children 122,400 each	244,800			
Dependent parent allowance and additional allowance	2 parents 100,000 each	200,000		2 parents 102,000 each	204,000			
Mandatory MPF contribution		18,000			18,000			
Qualifying premiums paid under VHIS	1 taxpayer and 2 children 8,000 each	24,000		1 taxpayer and 2 children 12,000 each	36,000			
Total allowances/ deductions			614,000			637,440		
Net chargeable income			136,000			112,560		
Tax payable			7,600			5,256	2,344	31%

[63] Assumptions are as for Appendix 1.