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19 January 2024

The Honourable Paul Chan Mo-po, GBM, GBS, MH, JP
Financial Secretary
Hong Kong Special Administrative Region
25/F, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Dear Financial Secretary,

I am pleased to submit for your consideration the Hong Kong General Chamber of Commerce's proposals for the Government's forthcoming Budget.

In the midst of Hong Kong's ongoing recovery, the economy continues to face significant challenges and uncertainties. However, as Hong Kong has proven repeatedly, we possess many unique advantages, not least our unmatched access to the world's second largest economy, and our role as a hub in the heart of the dynamic Asia-Pacific economy.

No doubt we will need to face more obstacles going forward, but with Hong Kong's collective wisdom and expertise, we believe they are not unsurmountable. As 2024 unfolds, we are mindful that the pandemic has depleted our fiscal war chest, so prudent management of public finances may present some constraints over the short term.

However, it is equally important to address the economic pressures faced by Hong Kong businesses and society as a whole. Our attached submission sets out our recommendations on strategies that the Government can consider in order to chart a course forward during these challenging times.

We hope you will find our suggestions useful in formulating the forthcoming Budget.

Yours sincerely,

Betty Yuen
Chairman

Encl.

HKGCC Submission to the 2024-25 Budget
Executive Summary

1 Short-Term Relief

External factors such as high interest rates continue to buffet Hong Kong's economy. Given the challenging economic environment, we call on the Government to provide one-off rebate on profits tax, salaries tax and tax under personal assessment by 100%, subject to a ceiling of HK$6,000 for each case.

We call on the Government to extend the time-limited special concessionary measures of the SME Financing Guarantee Scheme for a further 24 months.

We strongly recommend the immediate and complete removal of the existing property cooling measures, which include the Special and Double Stamp Duties.

2 Retaining and Attracting Talent and Business

- ***Results-Oriented Bureaucracy***

To enhance Hong Kong's overall operating environment, there is a pressing need for a systemic and predictable approach to address policy and administrative inefficiencies. We call on the Government to implement a regulatory impact assessment framework to assess new policies and review existing regulations, ensuring their relevance and effectiveness.

- ***Talent***

Businesses in Hong Kong are grappling with acute manpower shortages, due to such factors as an outflow of local talent and an ageing population. To ensure a sustainable supply of skilled labour in Hong Kong, our recommendations range from introducing a tax deduction for expenses incurred in hiring domestic helpers and caretakers, providing adequate and affordable childcare services for young families, to supporting employers for upskilling their workforce.

- ***Regional Headquarters ("RHQs")***

To attract enterprises from outside of Hong Kong to set up headquarters and/or corporate divisions in Hong Kong, we call on the Government to provide finite concessions such as a 3-year tax holiday and preferential tax rates to RHQs.

We recommend that the Government to engage with its Mainland counterparts on eliminating withholding tax on dividends paid by Mainland businesses to Hong Kong investors by way of an administrative concession. As a starting point, we recommend launching a pilot scheme in the Greater Bay Area ("GBA").

- ***Creating the Ecosystem for Ultra-High-Net-Worth Families and Single Family Office ("SFO")***

To enhance Hong Kong's competitiveness in the global private wealth market, we call on the Government to grant a waiver regarding the 5% cap on incidental transactions and expand the scope of qualifying assets for SFOs to enjoy profits tax concession. We also urge the Government to provide further clarity on the process for the Capital Investment Entrant Scheme.

- ***Company Re-domiciliation***

To elevate Hong Kong as the preferred base for multinational corporations facilitate companies based overseas for re-domiciliation to Hong Kong, we call on the Government to provide greater flexibility and tax certainty for companies seeking to change their domicile to Hong Kong. We recommend that the IRD issues comprehensive guidance to specifically address transitional tax matters.

- ***R&D and Innovation***

The requirement to conduct R&D activities locally in Hong Kong in order to qualify for an enhanced tax deduction poses considerable challenges due to the chronic lack of talent and facilities locally compared to other GBA cities such as Shenzhen. We call on the Government to relax the policy on granting super deduction to also include R&D activities carried out in the GBA.

3 Financial Markets

- ***Green and Sustainable Finance***

Considering the current higher interest rates and the consequent increase in financing costs, we call on the Government to issue bonds in different tranches periodically to mitigate interest rate risks. Consideration should be given to the issuance of green bonds, to support environmentally friendly projects that align with the Government's commitment to sustainable development and addressing climate change.

To promote the development of green and sustainable finance in Hong Kong, private sector participation, especially from SMEs, in sustainable investments is important. We call on the Government to incentivize banks and other financial institutions to develop green finance products and services, to support sustainable projects across various industries, as well as provide related financial and administrative assistance to SMEs in green financing.

- ***RMB Internationalization***

Existing Connect Schemes could be further harnessed to further enhance the internationalization of the RMB across global markets. We also call on the Government to engage with the Mainland authorities to broaden the range of eligible listed stocks under the HKD-RMB Dual Counter Model, thereby facilitating the trading of Hong Kong stocks denominated in RMB.

- ***Virtual Asset***

To further enhance the usage of RMB for international trade finance, we suggest that consideration be given to allowing the issuance of RMB stablecoins or stablecoins backed by a basket of different currencies, including RMB, in addition to HKD or USD stablecoins. We also call on the Government to explore the establishment of a Virtual Asset Connect Scheme, with a daily limit of approximately HK$20 billion initially.

- ***Attracting Financial Investors***

To enhance the diversity of institutional investors in Hong Kong, ranging from hedge funds and pension funds to sovereign wealth funds, it is recommended that the tangible benefits of establishing a presence in Hong Kong be clearly articulated. Additionally, the Government can play a valuable role by facilitating dialogue with Middle East sovereign wealth funds that express interest in investing in the Mainland.

4 Taxing Non-Hong Kong Resident Digital Service Suppliers

To swiftly alleviate Hong Kong's serious financial pressures, the Government could impose a digital services tax ranging from 3% to 5% on digital services provided by foreign service providers, effective from the second half of 2024. This tax would apply to services such as online advertising, e-marketplaces, social media platforms, streaming and sharing of content, search engines, and user data intermediation.

5 Global Minimum Tax

We recommend that the Government design the domestic minimum top-up tax in a way that satisfies the requirements of functional equivalence to the OECD's Global Anti-Base Erosion Model Rules while satisfying the Consistency Standard set out therein to qualify for Qualified Domestic Minimum Top-Up Tax Safe Harbour. Given the global trend of delayed implementation of the Undertaxed Payments Rule, we suggest that the Government adopt a "wait-and-see" approach, to better determine an appropriate timeline for implementing UTPR in Hong Kong.

6 <u>Tax System</u>

The global tax landscape has been evolving at an unprecedented pace. We call on the Government to (1) rapidly undertake the requisite digital transformation of the tax administration process, (2) set a specific goal on the number of additional treaties to be negotiated over a defined period, and (3) enhance clarity and promote efficiency for the oversight of non-tax grants and incentives.

7 Regional Intellectual Property ("IP") Trading Centre

To enhance Hong Kong's role as a regional IP trading centre, we suggest that the Government widen the scope of eligible IP assets, and permit claims by affiliates of IP owners to qualify for profits tax deductions, as this would encourage IP owners with overseas IP rights to register in Hong Kong.

8 International Trade Centre

To enhance the appeal of establishing a trading base in Hong Kong, we suggest that international traders be incentivized with a reduced tax rate of either 5% or 10%, depending on the nature of the qualifying trading income. Such a measure would be highly attractive for international traders that are seeking to establish a trading base in Hong Kong.

9 Retirement Protection

In the face of an ageing population, we call on the Government to provide tax incentives to boost retirement savings. Consideration should be given to setting the individual tax deduction caps at HK$60,000 for tax deductible MPF voluntary contributions and qualifying deferred annuity policies premiums.

We also call on the Government to broaden the range of investment vehicles currently on offer. Consideration should be given to allowing partial withdrawal of MPF contributions for major life events, such as making a property purchase deposit by first time homeowners.

HKGCC Submission to the 2024-25 Budget

1 Short-Term Relief

1.1 External factors such as high interest rates continue to buffet Hong Kong's economy, and there are concerns that the Government may face a structural fiscal deficit as a result of shrinking revenue from stamp duties and land sales. Citing the weak external economic environment and slow post-pandemic recovery, the Financial Secretary predicted that Hong Kong's full-year deficit for 2023-24 may exceed HK$100 billion, and that there would be a budget deficit in the next financial year.

1.2 Given the challenging economic environment, it is crucial for the Government to exercise prudent management of public finances by keeping expenditures within the limits of revenues. However, to alleviate the economic pressure on the public, we suggest that the Government provide one-off rebate on profits tax, salaries tax and tax under personal assessment by 100%, subject to a ceiling of HK$6,000 for each case.

1.3 The time-limited special concessionary measures, which provide the 80% Guarantee Product, the 90% Guarantee Product and the Special 100% Loan Guarantee, of the SME Financing Guarantee Scheme will end in March 2024. However, despite the Hong Kong economy showing signs of recovery, many SMEs have not fully regained their pre-pandemic levels of business. Given the challenges the Hong Kong economy is currently facing, we strongly suggest that the scheme be extended for a further 24 months to provide assistance to businesses experiencing cashflow issues.

1.4 Given the likelihood of ongoing economic weakness and a high interest rate environment, housing prices in Hong Kong are expected to continue their decline. Given this challenging outlook, we strongly recommend the immediate and complete removal of the existing property cooling measures, which include the Special and Double Stamp Duties, as they no longer effectively serve their intended purpose as countercyclical instruments.

2 Retaining and Attracting Talent and Business

- ***Results-Oriented Bureaucracy***

2.1 In order to enhance Hong Kong's overall operating environment, there is a pressing need for a systemic and predictable approach to address policy and administrative inefficiencies. We suggest that the Government adopt a rigorous cost-benefit analysis approach to assess new policies and review existing regulations, ensuring their relevance and effectiveness. The advantages offered by a regulatory impact assessment ("RIA") are that these are fact-based, transparent, regular, and facilitates public engagement. While efforts are being made to retain and attract talent and

business, the implementation of an RIA framework would significantly improve Hong Kong's overall business environment, ensuring that both existing and new policies are attractive and beneficial.

- ***Talent***

2.2 Businesses in Hong Kong are grappling with acute manpower shortages, due to such factors as an outflow of local talent, particularly middle managers, and an ageing population. We therefore welcome the policy initiatives as outlined in the 2023 Policy Address to seek and retain talents. However, to stem and reverse the trend of a shrinking local talent pool over the immediate term, we suggest adopting a targeted approach that is focused on addressing the needs of local workers.

2.3 COVID-19 has resulted in changes in the propensity for people to participate in the labour force, leading to the decline in the labour force participation rate ("LFPR") in recent years. The overall LFPR, excluding foreign domestic helpers, exhibited a gradual decline from 58.6% in 2019 prior to the pandemic to the most recent figure of 55.6% in the third quarter of 2023. In this context, it is crucial to address the pressing need to expand the local workforce.

2.4 Given that Hong Kong's birth rate remains at its lowest level, with the average parity of local couples dropping to a record low of 0.9 in 2022, we welcome the Government's efforts to provide a wide range of financial incentives aimed at promoting childbirth. However, caring for young children is often a key reason why parents, choose to leave the workforce.

2.5 To tap into such a latent labour pool, we suggest granting tax allowances and subsidies for stay-at-home parents, to encourage their re-entry into the workforce. Specifically, consideration should be given to introducing a tax deduction for expenses incurred in hiring domestic helpers and caretakers. This measure would provide support to working parents who require assistance in caring for their young children while they are at work. Additionally, alongside financial support, we recommend that the Government provide adequate and affordable childcare services for young families.

2.6 It is also crucial to invest over the long-term to ensure that the workforce is equipped with the necessary skills to support and sustain Hong Kong's economic development. In this regard, we suggest that the Government provide incentives, such as tax deductions, to employers to encourage them to invest in upskilling their workforce.

2.7 Ensuring a steady supply of skilled labor in key sectors, particularly in the medical sector and construction industry, is crucial to meet the demands and drive ongoing progress in Hong Kong:

2.7.1 Medical sector: Hong Kong's ageing population, along with increased health consciousness and higher life expectancy, will drive strong demand for healthcare and medical services. The Government has allowed non-locally

trained doctors to practice in Hong Kong since October 2021 and has offered 100 non-local doctors to work in public hospitals. We recommend that the Government expedite the recruitment of various healthcare practitioners, such as doctors and nurses, to alleviate manpower shortages and significantly reduce the lengthy waiting times experienced in public hospitals.

2.7.2 Construction industry: The current Labour Importation Scheme for the Construction Sector, which began accepting applications in July 2023, primarily targets public sector projects. In the first two rounds of applications, a total of 35 public sector works (including the Three-runway System, hospital development, public housing, etc.) were approved, involving 6,349 quotas. While we understand that the Scheme mainly applies to public sector construction works with a contract value of no less than HK$1 billion, we recommend that the Government expand its coverage to include private sector construction projects, addressing the significant blue-collar manpower shortage faced by the private sector and alleviating industry-wide manpower challenges.

2.8 Furthermore, efforts should be made to improve working conditions and make Hong Kong an appealing work location for talent. We suggest that the Government take steps to motivate and support southbound cross-border talent mobility by fostering connections between relevant employers and educational institutions as well as offering funding for travel and accommodation. Consideration should also be given to providing affordable and easily accessible recreation and fitness facilities to align with the priorities of future generations.

- ***Regional Headquarters ("RHQs")***

2.9 We welcome the Government's initiative to develop a "headquarters economy", by attracting enterprises from outside of Hong Kong to set up headquarters and/or corporate divisions in Hong Kong. In order to facilitate this outcome, we reiterate the call we made last year for providing finite concessions such as a 3-year tax holiday to RHQs that were previously based in Hong Kong.

2.10 Alternatively, consideration could be given to replicating Singapore's approach of providing preferential tax rates to RHQs, subject to the fulfilment of certain criteria, including the number of local employees they employ and/or the attainment of a pre-defined expenditure threshold. In this connection, we recommend that more attention be given to addressing pressing issues such as boosting human capital. To promote local employment opportunities, we suggest that the Government further reduce the corporate tax rate for RHQs that employ local workers or workers from the Greater Bay Area ("GBA").

2.11 The Government has made it a key objective to facilitate foreign enterprises' access to the Mainland market, and also to assist Mainland enterprises to expand abroad. However, under the existing provisions of the Mainland-Hong Kong Comprehensive Avoidance of Double Taxation Agreement, dividends paid by a Mainland entity to a

Hong Kong corporate shareholder are subject to a 5% withholding tax rate if the relevant substance requirements are met. For Hong Kong-based individual shareholders receiving similar dividends, the withholding tax rate is 10%. To further promote Hong Kong as the preferred gateway for investments into and out of the Mainland, we reiterate the call we made last year for the Government to engage with its Mainland counterparts on eliminating withholding tax on dividends paid by Mainland businesses to Hong Kong investors (whether corporates or individuals) by way of an administrative concession. As a starting point, we recommend launching a pilot scheme in the GBA.

2.12 In addition to tax incentives, a holistic approach that incorporates non-tax arrangements is also of critical importance to further enhance the appeal of the headquarters economy initiative. These could encompass measures such as assistance with applying for visas, housing, education, and healthcare services. By providing such comprehensive support, businesses and their international executives would find Hong Kong more attractive and desirable as a place to live and work.

2.13 The recent success of the Office for Attracting Strategic Enterprises ("OASES") in bringing 30 strategic enterprises to Hong Kong has provided the city with substantial opportunities to develop into an international innovation and technology centre. We recommend that the Government strengthen and broaden OASES' mandate. This expansion of responsibilities could include attracting leading enterprises from sectors other than those traditionally targeted, especially if these enterprises are committed to establishing a significant presence and conducting core income-generating activities in Hong Kong.

- ***Creating the Ecosystem for Ultra-High-Net-Worth ("UHNW") Families and Single Family Office ("SFO")***

2.14 We overall welcome the approach that Hong Kong has in creating an ecosystem for UHNW families and SFOs. Fundamental to this, is the recognition that UHNW families and their family offices need more than a tax regime to be attracted to a jurisdiction. The new eight-pronged incentive to grow family offices in Hong Kong announced in March 2023 was thus a step in the right direction.

2.15 In 2023, we welcome and support the implementation of several initiatives. These include the introduction of the tax concession regime for family offices in May 2023, the launch of the Hong Kong Academy for Wealth Legacy in November 2023, and the release of additional details of the Capital Investment Entrant Scheme ("CIES") in December 2023. InvestHK has also proven to be a valuable counterpart, with their willingness to meet and engage families through events and one-on-one meetings alongside the bank, and fielding queries for non-standard situations promptly. The Government's strong presence and commitment to promoting the growth of family offices in Hong Kong are widely welcomed.

2.16 For UHNW families, a significant portion of their portfolio is typically allocated to income-generating assets. However, the current 5% cap on incidental transactions poses practical challenges for SFOs to effectively manage their investments. It requires constant monitoring of the asset classes held by the family-owned investment holding vehicles ("FIHVs") to ensure compliance with the scope of qualifying assets. SFOs must ensure that profits from incidental transactions, such as interest and dividends, do not exceed 5% of the overall trading profits within a specific period.

2.17 While professional fund managers may have the necessary resources to meet the 5% threshold requirement, SFOs may face difficulties in doing so. Yet, in reality, many family offices have portfolios with a significant weighting towards fixed income assets. The current limit fails to align with the asset allocation needs of UHNW families and imposes operational challenges for SFOs to meet the requirement. As such, consideration should be given to granting a waiver for SFOs regarding the 5% cap on incidental transactions.

2.18 The Government's commitment to developing Hong Kong into a family office hub is evident from the implementation in May 2023 of the tax concession regime for FIHVs, which represents a significant leap forward in enhancing Hong Kong's competitiveness in the global private wealth market. However, considering the success of family office regimes in other jurisdictions, and their appeal to investors, we believe it is essential that continuous efforts be made to review and enhance our tax regime to maintain its competitiveness. We suggest that consideration should be given to referencing on Singapore's approach of granting a concessionary tax rate of 10% to eligible SFOs on qualifying income, subject to the fulfilment of certain criteria.

2.19 We note that qualifying assets under the regime are limited to those listed under Schedule 16C of the Inland Revenue Ordinance. To ensure that Hong Kong's family office tax concession regime is comparable to, if not better than, those offered in other jurisdictions, consideration should be given to expanding the scope of qualifying assets to meet the evolving demands of investors. For instance, virtual assets and collectible assets such as art pieces, antiques, classic cars, and wine, have gained significant popularity as investment choices. By broadening the scope to include these asset classes, Hong Kong could further enhance its appeal as a destination for family offices.

2.20 In a rapidly changing global financial landscape, wealthy families are increasingly seeking certainty and clarification when it comes to tax and wealth management. Given the complexity of the tax concession regime, it is essential that the Inland Revenue Department ("IRD") provide detailed guidance and clear directives. In particular, priority should be given to the issuance of the Departmental Interpretation and Practice Notes ("DIPNs") to facilitate better understanding of and clarity on the IRD's interpretation of relevant tax laws. This guidance would facilitate the smooth setup and day-to-day management of SFOs.

2.21 We also recommend the Government to provide further clarity regarding the information and statutory ownership declarations necessary to demonstrate the 95% family ownership. This clarification is particularly crucial when dealing with complex trust structures. It is important to recognize that some families may opt not to disclose detailed trust information, and in multi-generational families, certain patriarchs or matriarchs may prefer not to share the backend trust structures with the next generation involved in the family offices.

2.22 Currently, the grant of income tax incentives is subject to review and approval by the IRD. Under prevailing practice, it can take years before taxpayers are notified on whether they are entitled to such incentives, a process similar to that of the Corporate Treasury Centre tax incentive. We reiterate the call we made last year for the IRD to commit to completing its review process within two years after the year of assessment in which the SFOs and related FIHVs have filed their returns to claim the tax concession. Such a timeline would provide the necessary clarity and assurance to these entities, making Hong Kong a more attractive destination for SFOs.

2.23 We welcome and support the relaunch of the CIES as it offers a valuable opportunity for wealthy individuals to apply for residency in Hong Kong while setting up family offices here to manage their assets. However, we suggest that the Government provide further clarity on the process for the CIES, offering specific details regarding the required centralized bank account information and the portfolio requirements. Consideration should be given to providing guidance on various scenarios, such as when assets are held within a trust and the applicant is a beneficiary of a family trust – whether such scenarios fall within the scope of the CIES and how the assessment would be conducted.

- ***Company Re-domiciliation***

2.24 We welcome the Government's plans to establish a mechanism for facilitating companies based overseas to re-domicile to Hong Kong as outlined in the 2023 Policy Address. This initiative represents a significant step forward in sustaining Hong Kong's position as a premier international business hub and will elevate the city as the preferred base for multinational corporations.

2.25 However, we note that under the proposed company re-domiciliation regime there is a requirement to provide audited financial statements dating no more than three months prior to the application. We believe that such a requirement would be overly stringent. Given that post-redomiciled companies are still required to provide audited financial statements for Hong Kong tax filings and other purposes on an annual basis, we suggest that consideration be given to relaxing the requirement to statements prepared at the last twelve months prior to the application to encourage applications for company re-domiciliation.

2.26 To provide greater flexibility for companies seeking to change their domicile to Hong Kong, we suggest that the Government adopt some flexibility when evaluating requests for extension of the 60-day period to complete the deregistration process in the original domicile jurisdiction. We note that, since June 2023, the IRD has implemented a streamlined process for issuing Certificates of Residence ("COR") to entities incorporated or constituted under the laws of Hong Kong. We hope that consideration will be given to extending this simplified COR application process to encompass companies that have re-domiciled to Hong Kong.

2.27 In addition, we note that, under the prevailing tax law, the IRD is empowered to issue an assessment to taxpayers who have not been assessed or under-assessed within six years after the end of the relevant year of assessment (or up to ten years in cases of fraud or wilful evasion). Although companies have the option to file an objection or appeal against their tax assessment results, and provide justification for income generated in prior years not being subject to tax in Hong Kong, we believe that this could, to some extent, discourage companies from choosing to re-domicile in Hong Kong.

2.28 We therefore suggest that the relevant tax law should be amended to provide tax certainty for domiciliation applicants. An example would be to treat an entity as newly- incorporated on the date of re-domiciliation. We further recommend that the IRD issues comprehensive guidance, through a DIPN, to specifically address transitional tax matters, that would include issues such as the valuation of trading stocks, bad debts, financial assets, tax depreciation, and (more importantly) confirmation of no trace back of records for periods before the effective date of re-domiciliation.

- ***R&D and Innovation***

2.29 Currently, businesses in Hong Kong can claim 300% in tax deduction for the first $2 million of eligible R&D expenses and 200% for the remaining amount, without any limit on the amount eligible for the 200% deduction, subject to such qualifying R&D activities being carried out in Hong Kong. It is well- recognized that the objective of such an enhanced tax deduction is to encourage businesses in Hong Kong to engage in more R&D activities.

2.30 However, the requirement to conduct R&D activities locally in Hong Kong poses considerable challenges, due to the chronic lack of talent and facilities locally compared to other GBA cities such as Shenzhen. To leverage Hong Kong's unique advantages such as our close connection with the Mainland, and better contribute to the nation's objective of becoming an IT superpower, we reiterate the call we made last year for the relaxation of the policy on granting super-deduction to also include R&D activities carried out in the GBA.

3 Financial Markets

- ***Green and Sustainable Finance***

3.1 We commend the policy initiatives outlined in the 2023 Policy Address which aim to strengthen Hong Kong's fiscal position and support major infrastructure projects like the Northern Metropolis. As the development of the Northern Metropolis is expected to create a funding gap for the Government, addressing the cash flow issue is crucial, and bond financing emerges as one of the most effective solutions. Considering the current higher interest rates and the consequent increase in financing costs, we suggest that the Government issue bonds in different tranches periodically to mitigate interest rate risks. In terms of the allocation of bond issuance, efforts should be made to accommodate the investment needs of both institutional and individual investors to the greatest extent possible.

3.2 By expanding bond issues, the Government can secure additional cash inflows to be allocated towards infrastructure enhancements. Moreover, consideration should be given to the issuance of green bonds, to support environmentally friendly projects that align with the Government's commitment to sustainable development and addressing climate change. Additionally, the Government may explore the option of issuing "land development bonds". This approach involves acquiring land from landowners and compensating them with bonds instead of solely relying on cash payments. This method addresses the limitations of cash-only land acquisitions and helps alleviate the Government's financial burden when compensating private landowners.

3.3 Currently, the Government is the leading issuer of green bonds in Hong Kong. To promote the development of green and sustainable finance in Hong Kong, private sector participation, especially from SMEs, in sustainable investments is equally important. We suggest that the Government incentivize banks and other financial institutions to develop green finance products and services, including green bonds and loans, to support sustainable projects across a broad spectrum of industries.

3.4 Although the Green and Sustainable Finance Grant Scheme under the Hong Kong Monetary Authority offers financial support to eligible bond issuers and loan borrowers for expenses incurred for bond issuance and external review services, we believe that the grant ceiling is too conservative to be useful, as the cost of issuing green bonds can be high. We therefore reiterate the call we made last year to raise the subsidy cap to provide substantive and meaningful support to SMEs.

3.5 In addition, given that SMEs may face difficulties in green financing due to limited resources and capacities, we suggest that the Government provide more financial and administrative assistance to them. In particular, SMEs may lack practical skills in implementing green and sustainable practices. Consideration should be given to providing enhanced education and training programs across all sectors, and allocating resources to directly coach and support SMEs in their green and sustainable efforts.

3.6 Furthermore, as the Government is committed to capitalizing on the abundant green finance opportunities offered in the GBA and Belt and Road Initiative ("BRI"), we believe it would be useful to consider the approach in Singapore, where investments in green infrastructure projects, as well as blended finance structures and local equities, are recognized at twice their actual value for meeting the assets under management requirement, subject to the fulfillment of certain criteria. Such an approach would help incentivize and support sustainable investments in Hong Kong.

- ***RMB Internationalization***

3.7 To further enhance the internationalization of the RMB across global markets, we recommend strengthening the respective Connect Schemes through the following measures:

3.7.1 Stock Connect: Allow block trade, trading of non-Hang Seng Index shares, non-Hong Kong underlying ETFs, and more importantly, IPOs. Lower Southbound eligible investor threshold. Expand the range of eligible stocks for Northbound trading. Expedite HKEX's development of the HKD-RMB Dual Counter Program to include more securities and incentivize RMB counter trading;

3.7.2 Bond Connect: Allow repurchase agreement (repo) trading, which is a key funding tool. Alternatively, consideration should be given to the establishment of a Repo Connect Scheme. Expand the scope of eligible securities for Southbound Bond Connect and simplify the registration process with onshore regulators. Set up an eligibility and onboarding protocol for preliminary securities and allow investors to participate in CNH/CNY new issues; and

3.7.3 Swap Connect: Enhance Northbound trading clearing and documentation arrangements to enable more participation by foreign investors and, in the process, contribute to higher liquidity. Expand the range of eligible underlying for Northbound trading to include credit default swaps.

3.8 Apart from enhancement to Connect Schemes, we recommend that the Government engage with the Mainland authorities to broaden the range of eligible listed stocks under the HKD-RMB Dual Counter Model, thereby facilitating the trading of Hong Kong stocks denominated in RMB. Also, to consistently issue offshore RMB bonds with varying maturities, this would expedite the establishment of yield curves and enhance Hong Kong's position as the leading offshore RMB business centre.

3.9 We welcome and support the recent announcement of the facilitation measure for the cross-boundary data flow within the GBA, which can deepen cooperation and facilitate the provision of relevant cross-boundary services in the GBA. To expedite mutual access between the insurance markets of Hong Kong and the Mainland, consideration should be given to advancing the progress of allowing Hong Kong-based insurance companies to establish insurance after-sales service centres in locations like Qianhai, to cater to Mainland residents in the GBA who hold insurance policies purchased in Hong Kong.

- ***Virtual Asset***

3.10 The rapidly evolving virtual asset sector is presenting new opportunities for financial innovation and inclusion. To further enhance the usage of RMB for international trade finance, we suggest that consideration be given to allowing the issuance of RMB stablecoins or stablecoins backed by a basket of different currencies, including RMB, in addition to HKD or USD stablecoins. This move would promote the broader adoption of RMB and facilitate international trade transactions.

3.11 To further facilitate to conduct virtual asset businesses and trading for Mainland companies and individuals in Hong Kong, we suggest that the Government to explore the establishment of a Virtual Asset Connect Scheme, with a daily limit of approximately HK$20 billion initially. This scheme would enable Mainland companies to leverage Hong Kong as a platform for conducting virtual asset trading with global counterparts. Such an incentive would foster the growth of the virtual asset industry and reinforce Hong Kong's position as an international financial hub.

- ***Attracting Financial Investors***

3.12 To enhance the diversity of institutional investors in Hong Kong, ranging from hedge funds and pension funds to sovereign wealth funds, it is recommended that the tangible benefits of establishing a presence in Hong Kong be clearly articulated. The open-ended fund company regime, launched during the COVID-19, did not receive the attention it deserved, and its advantages should be effectively communicated. Additionally, the Government can play a valuable role by facilitating dialogue with Middle East sovereign wealth funds that express interest in investing in the Mainland. Such practical marketing support is crucial for elevating the city's international profile as a whole and fostering the growth of the financial industry.

4 Taxing Non-Hong Kong Resident Digital Service Suppliers

4.1 To address the imminent fiscal challenges, it is imperative to adopt a multi-pronged approach that ensures economic stability and upholds the integrity of Hong Kong's public finances. To prevent further strain on businesses amidst prevailing economic headwinds, the Government should refrain from raising profits and salaries taxes. Preserving a low and simple local tax regime is crucial for maintaining Hong Kong's competitive tax position. In this connection, we recommend that the Government conduct a thorough review regarding the introduction of new broad-based taxes, such as a digital services tax ("DST")[1].

[1] DSTs are emerging forms of taxation designed to address the perceived unfairness that arises when digital businesses based outside a country can make cross-border sales without paying local corporate income tax. These taxes are typically calculated as a percentage of the revenue from designated digital activities and are applied when sales exceed certain thresholds.

4.2 While the Government has adopted a pragmatic approach in attracting investors to build substance in Hong Kong, thereby generating more public revenue, we recommend that it also explores the viability of introducing a tax on digital activities carried out by non-Hong Kong residents to help reduce its fiscal deficit. The Government previously pledged to implement digital business taxation in accordance with the BEPS 2.0 guidelines. However, recent developments suggest that the implementation of Pillar One globally, a key BEPS 2.0 component, is unlikely to happen anytime soon.

4.3 Numerous EU and ASEAN and other jurisdictions have already fully implemented a DST and/or Goods and Services Tax on cross-border digital transactions, Hong Kong has yet to do so. Please refer to Appendix 1 for the latest implementation of DST in Europe, Asia Pacific, Americas, Africa and Middle East for reference. The lack of DST in Hong Kong allows non-resident entities to generate substantial revenue without contributing to the local economic development. Conversely, Hong Kong-based businesses are taxed on digital services and products supplied to many overseas markets.

4.4 In addition, a portion of the government's tax revenue, traditionally collected from activities such as cinema ticket sales, has been lost due to the consumers switching towards digital streaming or downloading of content through digital devices. These digital modes of content acquisition are entirely outside the current taxation net of Hong Kong. There is a need to capture the various sources of revenue from Hong Kong consumers paid to foreign service providers. We propose that the Government introduce taxes targeting digital sales solely by non-Hong Kong suppliers, to level the playing field for traditional mode of service delivery as well local digital businesses, while also safeguarding the Government's revenue base.

4.5 The Advisory Panel on BEPS 2.0 had previously recommended that Hong Kong adopts the BEPS 2.0 framework, including Pillar One, to align with anticipated international consensus. However, to swiftly alleviate Hong Kong's serious financial pressures, the Government could impose a DST ranging from 3% to 5% on digital services provided by foreign service providers, effective from the second half of 2024. This tax would apply to services such as online advertising, e-marketplaces, social media platforms, streaming and sharing of content, search engines, and user data intermediation. Please refer to Appendix 1 for the DST rate and the scope of taxation by other worldwide jurisdictions.

4.6 With strategic policy design and execution, a DST on cross-border digital services can become a tool to encourage foreign technology companies to invest or re-invest in Hong Kong.

5 Global Minimum Tax

5.1 The Government announced in February 2023 plans to introduce a global minimum effective tax rate of 15% on large multinational enterprise ("MNE") groups with global turnover of at least EUR750 million, and to implement a domestic minimum top-up tax ("DMTT") starting from 2025. It is noteworthy that several jurisdictions intend to implement the Income Inclusion Rule and Qualified Domestic Minimum Top-Up Tax ("QDMTT") either on December 31, 2023, or January 1, 2024. Given the deep ties that MNE groups based in Hong Kong have with the local economy, it is essential for the Government to strike a balance between safeguarding Hong Kong's taxing rights over in-scope MNE groups, and preserving the competitiveness of Hong Kong's simple low-tax regime.

5.2 We recommend that the Government design the DMTT in a way that satisfies the requirements of functional equivalence to the OECD's Global Anti-Base Erosion Model Rules, while satisfying the Consistency Standard set out therein to qualify for QDMTT Safe Harbour. The application of QDMTT provides the benefit of greater certainty to all in-scope MNE groups, whereby no additional top-up tax liability would be incurred and payable to other jurisdictions. In addition, given the global trend of delayed implementation of the Undertaxed Payments Rule ("UTPR"), we suggest that the Government adopt a "wait-and-see" approach, to better determine an appropriate timeline for implementing UTPR in Hong Kong.

5.3 Given that outcomes with R&D projects are inherently uncertain as they involve exploring novel ideas and technologies which may not always be successful, government support – both as a performer and funder of R&D activities – is crucial in helping businesses overcome such challenges and uncertainties. We suggest that consideration be given to replicating the UK's R&D tax relief regime, whereby companies that work on innovation projects are eligible to make an R&D tax credit claim to receive a cash payment and/or corporate tax reduction. For in-scope MNE groups undertaking qualifying R&D activities that may be subject to the global minimum tax of 15%, consideration should be given to offering them a reasonable tax incentive in the form of a Qualified Refundable Tax Credit. These qualified tax credits could benefit taxpayers by minimizing the downward pressure on the effective tax rate calculation.

6 Tax System

- ***Tax Administration***

6.1 The global tax landscape has been evolving at an unprecedented pace. In light of the push for global tax transparency, there is a growing need for tax authorities to implement real-time reporting and analysis to enhance the tax collection process. Moreover, the COVID-19 pandemic has led to a significant increase in the adoption and utilization of digital technology.

6.2 Although the Government has made progress in promoting e-tax filing in Hong Kong, many other tax operations, including inquiries and the applications for COR, still rely on manual and paper-based methods. In contrast, numerous developed jurisdictions have fully embraced digitalization in these areas. We urge the Government to rapidly undertake the requisite digital transformation of the tax administration process. A transition to digitalization would enable the IRD to retrieve real-time data and facilitate better forecasting during the formulation of economic policies. Streamlining the workload would also allow the IRD to allocate its resources more efficiently, expediting the review and assessment process for long-standing tax disputes.

- ***Tax Treaties***

6.3 While we appreciate the Government's efforts in negotiating new treaties, including those with Mauritius and Bangladesh, Hong Kong's treaty network is less extensive compared to other key markets in the Asia-Pacific region. For instance, Mainland China and Singapore already have tax treaty networks with more than 100 jurisdictions. Although the Government intends to expand Hong Kong's tax treaty network with a focus on jurisdictions that fall under the BRI and those in emerging markets, such as ASEAN, the Middle East, Central Asia and Africa, we believe that there is a compelling need for Hong Kong to further upscale its treaty network as a matter of urgency. This would have a direct and considerable positive impact on the city's attractiveness as a location for international businesses to conduct their operations.

6.4 We reiterate our call over the last few years for setting a specific goal on the number of additional treaties to be negotiated over a defined period, and to invest necessary resources, including increasing headcount (through such means as recruiting professionals from the private sector) in the respective agencies, to achieve such an objective. Reference could be drawn from Australia's commitment to expand its tax treaty network by allocating AU$11.6 million (HK$57 million) to enter 10 new and updated tax treaties by 2023.

- ***Government Support Schemes***

6.5 Currently, oversight of non-tax grants and incentives is dispersed across various government agencies, resulting in longer than necessary vetting processes that adversely affect the attractiveness of such measures. For example, the newly established OASES and InvestHK have similar mandates. The former is tasked with attracting representative and high-potential strategic enterprises from around the world to Hong Kong, while the latter is responsible for attracting and retaining foreign direct investment that is of strategic importance to Hong Kong's economic development. It would be more logical and efficient to combine these overlapping responsibilities within a single Government department.

6.6 To enhance clarity and promote efficiency, we therefore reiterate the call we made last year to emulate the model in Singapore, where the Economic Development Board assumes the key responsibilities of connecting investors with respective government agencies and in disbursing investment incentives.

7 Regional Intellectual Property ("IP") Trading Centre

7.1 We welcome the introduction of the "patent box" tax incentive, as outlined in the 2023 Policy Address, to encourage more R&D activities by reducing the tax rate from the existing 16.5% to 5% for qualifying profits derived from patents. However, we note that the scope of eligible IP assets, as currently defined, is quite restrictive. This would render the proposed regime less appealing compared to that offered in other jurisdictions. We suggest that the Government widen the scope of eligible IP assets beyond that of patents, copyrighted software, and plant variety rights registered in Hong Kong to also expand the jurisdictional coverage of qualifying IP activities to the GBA.

7.2 Although profits tax deductions are provided for capital outlays in the acquisition of IP rights, claims are often denied where they are made by affiliates of IP owners, or where the IP is already in use under a licence outside Hong Kong at the time of purchase. Given that transfer pricing rules are already in place, such transactions would, by definition, take place at arm's length and therefore have a lower probability of abuse. As such, we suggest that claims by affiliates should be eligible for deductions, as this would encourage IP owners with overseas IP rights to register in Hong Kong.

8 International Trade Centre

8.1 The Government reiterated in its 2023 Policy Address the importance of reinforcing and enhancing Hong Kong's status as an international trade centre. This is a commendable endeavour, as it will not only attract international traders to establish their trading base in Hong Kong, but also draw talent from various trading industries to work in the city.

8.2 To enhance the appeal of establishing a trading base in Hong Kong, we suggest that international traders be incentivised with a reduced tax rate of either 5% or 10%, depending on the nature of the qualifying trading income. Similar tax concessions are already in place for other businesses, including intra-group financing, shipping, and aviation. Such a measure would be highly attractive for international traders that are seeking to establish a trading base in Hong Kong.

9 <u>Retirement Protection</u>

9.1 Similar to many advanced economies, Hong Kong is grappling with the challenge of an ageing population. As post-war baby boomers enter old age and lift expectancy increases for both genders, Hong Kong is expected to witness a substantial rise in the number of elderly persons aged 65 and above over the next 25 years. Excluding foreign domestic helpers, the number of elderly persons is projected to almost double, growing from 1.45 million in 2021 to 2.74 million in 2046. This demographic shift will result in the corresponding proportion of the population increasing from 20.5% to 36%, indicating that more than one in every three Hong Kong people will be an elderly.

9.2 In the face of an ageing population, the ability to adequately cover the costs of retirement is not only crucial for individuals but also holds significant importance for policy makers and society as a whole. As such, we suggest that the Government provide tax incentives to boost retirement savings. Currently, tax deductions are available for retirement savings by way of qualifying deferred annuity policies ("QDAP") or tax deductible MPF voluntary contributions ("TVC"), with a cap at HK$60,000 per year, which is an aggregate limit for both qualifying deferred annuity premiums and TVC. To further incentivise employees to increase their contributions, consideration should be given to setting the individual caps at HK$60,000 for TVC contributions and QDAP premiums. Additionally, we suggest that the Government offer tax incentives for purchasing HKMC Annuity Plan and lowering the minimum eligible age to 50.

9.3 In order to provide additional incentives for those with the financial wherewithal to increase their contributions, we suggest that consideration be given to broadening the range of investment vehicles currently on offer. Moreover, we believe that the ability to utilize MPF savings for major life events would also have the virtuous effect of encouraging employees to increase their contributions. These include the partial withdrawal of MPF contributions for making a property purchase deposit by first time homeowners, and expenses related to long-term care or payments for medical insurance.

HKGCC Secretariat
January 2024

HKGCC Submission to the 2024-25 Budget
Appendix 1

1. Global Digital Services Tax – at a glance

Jurisdictions	Jurisdictions with enforced DST	Jurisdictions with proposed DST
Europe	10	3
Asia Pacific	12	1
Americas	7	1
Africa and Middle East	9	0

2. Digital Services Tax – country by country summary

- ***Europe***

Jurisdiction	Tax Scope (including but not limited to)	Rate	Global Revenue Threshold	Domestic Revenue Threshold	Enforcement
Austria	• Digital advertisements: banner advertising, search engine advertising, comparable advertising services	5%	€750M (US$821M)	€25M (US$27M)	Jan 2020
Czech	• Targeted advertising on a digital interface • Transmission of data about users • Market places that facilitate the provision of supplies of goods and services among users	3%/5%	€750M (US$821M)	CZK100M (US$4.4M)	Proposed
Denmark	• On-demand audio-visual media supply of films, fictional series, and documentary programs	6%	—	—	Jan 2024

France	• Provision of a digital interface such as market places and intermediation services • Targeted advertising and transmission of data collected about users for advertising purposes	3%	€750M (US$821M)	€25M (US$27M)	Jan 2019
Hungary	• Internet advertising	0%/7.5%	—	HUF100M (US$0.3M)	0% from 31 Dec 2019 to 31 Dec 2023
Italy	• Online advertising • Digital marketplaces that facilitate the sale of goods or services • The transmission of user data generated from a marketplace	3%	€750M (US$821M)	€5.5M (US$6M)	Jan 2020
Poland	• Streaming services	1.5%	—	—	Jun 2020
	• Digital Advertising	5%	€750M* (US$821M)	€5M (US$5.5M)	Proposed
	• Online payment services, advertising, providing digital content or communication services online. sales of goods and services, etc	7%	€750M (US$821M)	€4M (US$4.4M)	Proposed
Portugal	• Audiovisual commercial communication in streaming platforms	1%	–	–	2020
	• Video-on-demand services	4%	–	–	
Slovakia	• Online advertising,online platforms, sale of user data	Not yet specified	–	–	Proposed
Spain	• Online advertising, online intermediation services , sale of user data generated through a digital interface	3%	€750M (US$821M)	€3M (US$3.3M)	Jan 2021
Turkey	• Digital advertising services, digital services	15%/7.5%	€750M (US$821M)	TRY20M* (US$0.66M)	Mar 2020
UK	• Social media platforms, internet search engine, online marketplace	2%	£500M (US$638M)	£25M (US$32M)	Apr 2020
Ukraine	• Electronic services	20% (VAT)	–	UAH1M (US$26,390)	Jan 2022

- ***Asia Pacific***

Jurisdiction	Tax Scope (including but not limited to)	Rate	Global Revenue Threshold	Domestic Revenue Threshold	Enforcement
Bangladesh	● Sale of digital goods or services to consumers	15% (VAT)	–	–	Jul 2019
India	● Online advertising, any provision for digital advertising space or any other facility or service for the purpose of online advertising	6%	–	INR0.1M (US$1,207)	Jun 2016
	● Online sale of goods owned by the e-commerce operator ● Online provision of services provided by the e-commerce operator ● Any of the above facilitated by the e-commerce operator	2%	–	INR20M (US$0.24M)	Apr 2020
Indonesia	● Sell intangible goods or services to Indonesian customers through electronic system/e-commerce	11% (VAT)	–	Rp. 600M/year (US$0.04M/year) Rp. 50M/month (US$3,214/month)	Jul 2020
Kazakhstan	● E-commerce sale of goods and providing digital services to individuals	12% (VAT)	–	–	Jan 2022
Laos	● E-commerce and digital platform services	7% (VAT)	–	LAK400M (US$19,320)	Feb 2022
Malaysia	● Digital Services	6% (Service Tax) (8% from 1 Mar 2024)	–	RM500,000 (US$107,550)	Jan 2020
	● Digital platform services relating to online booking of accommodation premises in Malaysia	MYR 10.00 per room per night	–	–	Jan 2023
Nepal	● Digital services	2% (Income Tax)	–	NRP2M (US$15,080)	Jul 2022
	● Digital services	13% (VAT)	–		May 2022

New Zealand	● In-scope "taxable digital services" – principally the provision of intermediation platforms, social media and content sharing platforms, and internet search engines.	3%	€750M* (US$821M)	NZD3.5M (US$2.2M)	Jan 2025 (may defer by up to 5 years – Jan 2030)
Pakistan	● Offshore digital services	10% (WHT)	–	–	July 2022
Philippines	● Video and online games, electronic marketplaces, digital advertising platforms, file sharing and cloud storage services, internet-based telecommunication, payment processing services and the like	12% (VAT)	–	PHP3M (US$53,610)	Proposed
Singapore	● Digital services	9% (GST)	S$1M (US$0.75M)	S$100,000 (US$75,060)	Jan 2024
Thailand	● Digital services	7% (VAT)	–	THB1.8M (US$51,552)	Sep 2021
Vietnam	● E-commerce, digital platform-based businesses	Deemed tax rates	–	–	Jan 2022

- ***Americas***

Jurisdiction	Tax Scope (including but not limited to)	Rate	Global Revenue Threshold	Domestic Revenue Threshold	Enforcement
Argentina	● Adaptation or application of the protocols, platforms or technology used by the internet or another network, etc.	3% - 5%	–	–	Jan 2021
Brazil	Not yet specified	Not yet specified	Not yet specified		Proposed
Canada	● Online marketplace/advertising services, social media, user data	3%	€750M* (US$821M)	CAD20M (US$15M)	Jan 2024 with retrospective effects from 1 Jan 2022
Colombia	● Digital advertising, streaming or download media and content, sale of user data, hosting, online e-learning and training, etc.	10% (WHT) or 3% (over gross revenues)	–	US$297,000	Jan 2024
Mexico	● Download/access to images, movies, music, etc. ● Intermediation services	16% (VAT)	–	–	Jun 2020
Peru	● Software maintenance, customer technical support, data warehousing, hosting applications, etc.	30% (WHT)	–	–	2007
US - Maryland	● Advertising on a digital interface	2.5% - 10%	US$100M*	US$1M*	Jan 2022
Uruguay	● Audio-visual services provided via the internet	12% (WHT)	–	–	Jan 2018

- ***Africa & Middle East***

Jurisdiction	Tax Scope (including but not limited to)	Rate	Global Revenue Threshold	Domestic Revenue Threshold	Enforcement
Congo	• Video streaming services	10% (WHT)	–	–	2020
Côte d'Ivoire	• Digital services	18%	–	XOF200M (US$0.33M)	Jan 2022
Kenya	• Digital interface services	1.5%	–	–	Jan 2021
	• Transfer/exchange value of the Digital asset	3%	–	–	Sep 2023
Nigeria	• Most services delivered through digital means	30% (CIT)	–	N25M* (US$26,000)	Jan 2022
Sierra Leone	• Digital transactions / Digital services to a customer	1.5%/10.5% (WHT)	–	–	Jan 2021
Tanzania	• Electronic service or transaction conducted in the digital marketplace	2% (Income Tax) 18% (VAT)	–	–	Jul 2022
Tunisia	• Sales of computer software and services	3%	Not yet specified		Jan 2020
Uganda	• Online advertising services, data services, cloud computing services, etc.	5%	–	–	Jul 2023
Zimbabwe	• Supply of radio and television services, satellite broadcasting services and electronic services by electronic commerce operators	5% (Income tax) 15% (VAT)	–	US$500,000 (Income Tax) US$40,000 (VAT)*	Jan 2019 (Income tax) Jan 2020 (VAT)

Note:
1. " — " indicates that no relevant thresholds have been set
2. For thresholds, the number itself is not inclusive unless otherwise specified
3. "" indicates that the number itself is inclusive*