For discussion
on 14 March 2022

Legislative Council Panel on Financial Affairs

Review of Rating System

PURPOSE

In his 2022-23 Budget speech, the Financial Secretary ("FS") announced the Government's proposals to introduce a progressive element to the rating system and implement a new rates concession mechanism. This paper sets out the Government's proposed framework and parameters for implementing these proposals, and invites Members' views on the proposals.

BACKGROUND

2. Since 2000, rates have been charged to properties at a flat rate of 5% of the annual rateable value. Under the Rating Ordinance (Cap. 116), both the owner and occupier are liable for rates but, in the absence of any agreement to the contrary, liability for rates rests with the occupier. The revenue collected from rates forms part of the Government's general revenue. In 2020-21, the total rates revenue was $19.0 billion (after netting off the one-off concession of $17.5 billion[1]), contributing to about 3.4% of the total government revenue. As at 1 April 2021, there were some 2.6 million rateable tenements in Hong Kong, of which 2.18 million were domestic tenements and 0.42 million were non-domestic tenements.

3. The rating system in Hong Kong has a history of over 170 years and has not undergone any major changes in the last two decades. Public concerns were raised in recent years about the current rating system. Firstly,

[1] Rates revenue after rates concession and the revenue forgone arising from rates concession for 2020-21 are as follows:

	Rates revenue after one-off rates concession ($billion)	Revenue forgone arising from one-off rates concession ($billion)
Domestic	6.2	13.1
Non-domestic	12.8	4.4

there have been calls for adjusting the rating system to better reflect the "affordable users pay" principle. Secondly, since one-off rates concession is available to all ratepayers, this has led to concerns that such relief measure is more advantageous to property developers and owners who hold multiple properties.

4. In his 2021-22 Budget speech, FS announced that a review of the rating system would be conducted. The review covers the cases for –

(a) introducing a progressive element to the rating system;

(b) providing rates concession to owner-occupied properties on a regular basis; and

(c) shifting the primary liability for rates payment from the occupier to the owner of the property.

REVIEW OF RATING SYSTEM

5. The guiding principles of the review are to –

(i) improve the rating system in line with the "affordable users pay" principle;

(ii) ensure fairness when providing rates concession; and

(iii) generate additional revenue while maintaining a simple rating system that is easy to administer.

Having regard to the above principles, our recommendations are set out as follows.

Introducing Progressive Element to the Rating System

New progressive scale

6. The existing rates regime involves the application of a flat rate of 5% to a property's rateable value. As a property's rateable value reflects the

value of the property concerned, the existing regime to a certain extent already aligns with the "affordable users pay" principle by collecting more rates revenue in absolute amount from more valuable properties.

7. To further uphold the "affordable users pay" principle and to generate additional revenue, we **recommend** introducing a **progressive element** to the existing rating system by applying higher rates percentage charge(s) to high rateable value **domestic properties**. Specifically, we **recommend –**

(a) **applying higher rates percentage charge(s) to domestic properties beyond specified threshold(s) in terms of rateable values** – This will enable higher rates percentage charge(s) to be applied to properties with high rateable values, which is consistent with the "affordable users pay" principle; and

(b) **adopting a marginal approach by applying higher rates percentage charge(s) to the portion of rateable value that exceeds specified threshold(s) –** While applying higher rates percentage charge(s) to the entire rateable value of properties meeting specified threshold(s) will bring in more revenue, it will result in a drastic increase in rates liability for the ratepayers concerned. Adopting a marginal approach by applying higher rates percentage charge(s) to only the portion of rateable value that exceeds specified threshold(s) will result in more moderate increases in rates for affected properties without undermining the "affordable users pay" principle.

8. Having regard to the proposed features as outlined in paragraph 7 and taking into account the affordability of ratepayers, the additional revenue that could be generated and the need to maintain a simple rating system that is easy to administer, we **recommend adopting a progressive rating scale with three rates bands and the rates percentage charge(s) for the three rates bands be set at 5%, 8% and 12%**, as follows –

Annual rateable value ("RV") of domestic tenements *(Monthly RV)*	**Proposed new rates percentage charges**	**Percentage out of all private domestic tenements[2] *(Number of such tenements)***
$550,000 or below *($45,833 or below)*	5% (Remains unchanged)	97.8% *(around 1 866 400)*
$550,001 to $800,000 *(around $45,833 to $66,667)*	First $550,000: 5% Next $250,000: 8%	1.3% *(around 24 800)*
Above $800,000 *(above $66,667)*	First $550,000: 5% Next $250,000: 8% Above $800,000: 12%	0.9% *(around 17 200)*

In gist, under the proposed new progressive rates regime –

(a) domestic properties with rateable value of $550,000 (equivalent to monthly rental of around $46,000) or below would not be affected and would continue to be subject to rates levied at 5% of their rateable values. These represent 97.8**%** of all private domestic tenements on the 2021-22 Valuation List;

(b) only 2.2% of private domestic tenements (i.e. around 42 000 tenements) with a rateable value above $550,000 would have part of their rateable values being subject to rates levied at higher than 5%; and

(c) only around 17 200 (representing 0.9% of private domestic tenements) with rateable values above $800,000 (equivalent to monthly rental of around $67,000) would have part of their rateable values subject to rates being levied at the highest rates percentage charge of 12%.

9. The estimated additional revenue generated from the proposal is $0.76 billion per year. Illustrations of the impact of the proposed new progressive rates regime on domestic properties of different rateable values are detailed at **<u>Annex A</u>.**

[2] Separately assessed car parking spaces are excluded to better illustrate the implications of the proposal on premises for dwelling use. These car parking spaces will be subject to the progressive rating regime.

Carve-outs from the new progressive scale

10. At present, rates for many public rental housing ("PRH") flats provided by the Housing Authority ("HA") and the Housing Society are assessed on a block-basis and therefore whole blocks of PRH flats have high rateable values. To avoid PRH flats being subject to higher rates liability under the proposed progressive rates regime, we **recommend that such flats be carved out from the progressive rating scale**. This is consistent with the public policy objective to provide low-income families or target groups with affordable accommodation.

11. We **do not recommend applying the proposed progressive rates regime to non-domestic properties** due to the following reasons –

(a) given the varied nature of businesses and different requirements for business operation, applying progressive rates to non-domestic properties would create anomalous situations. For example, some sectors (e.g. manufacturing sector or hotel) by their nature require larger floor space for operation and would naturally need to base their operations in properties with higher rateable values. On the other hand, some asset-light businesses with a high profit margin (e.g. financial services and digital businesses) may only require limited operating space. Sectors with operational requirement for being located in properties with higher rateable values are already paying a higher amount of rates in absolute terms under the present rates regime, and imposing a progressive rates percentage on them will incur a higher financial burden on their operation as compared with other sectors. This will not be conducive to maintaining a fair and competitive business environment and providing a level playing field for all types of businesses;

(b) owners of some non-domestic properties (e.g. office blocks and shopping malls) may readily circumvent a progressive rates regime by subdividing their properties into several tenements so as to avoid their properties falling into the higher rates band; and

(c) rates payment is in effect reflected in the rent agreed between the owner and occupier regardless of the identity of the ratepayer. We note that rental expenditure on land and buildings attributes to around 12% of the total operating expenses of businesses in Hong Kong[3], and the proportion is much higher for certain economic sectors, such as retail trade as well as food and beverage services. Introducing a progressive element to the rates regime for non-domestic properties may inadvertently increase the burden of many small and medium-sized enterprises.

Rates concession mechanism for domestic tenements

Proposed new rates concession mechanism

12. Presently, one-off rates concession is available to all ratepayers, and this gives rise to opportunities for property developers and owners who hold multiple properties to enjoy multiple relief. For example, around 19 400 domestic tenements were held by the top 100 ratepayers for 2021-22.

13. In view of calls by society and LegCo members about the need for adopting a more targeted approach in providing any rates concession in future, we **recommend that rates concession in respect of a domestic tenement** would in future only be granted –

(i) on election by a **natural person holding a valid Hong Kong Identity Card** ("HKIC") (i.e. legal persons will not be eligible for election);

(ii) if the person referred to in (i) is **registered in the Land Register as the owner** of the subject tenement as at a designated reference date; and

(iii) the subject tenement is **the only tenement elected by the person** referred to in (i) for claiming rates relief[4]**.**

14. The proposed approach is consistent with the "affordable users pay" principle given that multiple domestic property owners should not be

[3] It is derived from the 2019 Annual Survey of Economic Activities conducted by the Census and Statistics Department.

[4] One domestic tenement is entitled to relief by one owner only even if it is formed by two or more domestic properties that are held by different owners. If the ratepayer, being one of the owners, satisfies the criteria for the relief, the relief will be granted to the whole of the tenement.

able to enjoy multiple rates relief. Restricting entitlement to rates relief to natural person owners only would avoid ratepayers circumventing the new mechanism by claiming relief for multiple properties owned via different companies or vehicles.

15. By limiting the provision of rates concession to one tenement to be elected by an eligible owner, the proposed new rates concession mechanism would fully address concerns about multiple property owners being "overly" relieved, and we see no need to further limit rates concession to owner-occupied domestic properties. Tying the rates concession to the occupation status of domestic properties will also complicate the rates concession mechanism, necessitate owners to update Rating and Valuation Department ("RVD") on their resident status and add to the administrative burden on RVD arising from declaration and verification of owner-occupier status, compliance checks, and enforcement actions, etc.

16. From the fiscal perspective, we consider it more prudent and appropriate to consider whether to provide rates concession in the context of each Budget exercise, rather than in the form of a statutory relief to be provided on a regular basis. We therefore **recommend that rates concession should continue to be provided on a one-off basis** so as to preserve the flexibility of providing relief having regard to the prevailing economic and fiscal conditions. It should be noted that one-off rates concessions had been offered on 21 occasions since 1997, including in the 2022-23 Budget where one-off rates concession for four quarters of 2022-23 would be offered subject to a ceiling of $1,500 per quarter in the first two quarters and a ceiling of $1,000 per quarter in the remaining two quarters for each domestic tenement, and a ceiling of $5,000 per quarter in the first two quarters and a ceiling of $2,000 per quarter in the remaining two quarters for each non-domestic tenement. If the new rates concession mechanism is applied to the one-off rates concession level offered in the 2022-23 Budget (i.e. capped at $5,000 per year), the revenue forgone would be reduced from $11.7 billion to $8.6 billion per year.

Non-applicability of new rates concession mechanism

17. We **recommend that the proposed new concession mechanism will not apply to PRH flats**, and rates concession should continue to be granted to PRH tenants as a special arrangement in line with the prevailing practice. Under a special arrangement currently in place, HA passes on the

rates concession calculated on an individual flat basis to domestic tenants/licensees on a monthly basis by offsetting an equivalent amount of the monthly rent/licence fee payable by them.

18. We **recommend** that **should one-off rates concession be granted to non-domestic properties**[5]**, such concession would continue to be granted to all such properties under the current mechanism** owing to fundamental differences in the ownership/tenancy and rate-paying pattern of domestic and non-domestic properties. Ownership of multiple non-domestic properties (e.g. shopping malls) is much more prevalent as compared with domestic properties, as does ownership by legal persons in respect of non-domestic properties. Therefore, if the proposed rates concession mechanism is extended to non-domestic properties, only a limited number of non-domestic properties can be elected by the owners to enjoy rates concession.

Implementation of new rates concession mechanism

19. When implementing the new rates concession mechanism, RVD will design the new system in such a way which provides maximum facilitation to ratepayers in making election on the tenement for applying the rates concession. Once eligibility has been established for a tenement for rates concession, rates concession would be tied to the tenement and reflected in all subsequent quarterly demands during the period when the rates concession is offered, until it comes to the knowledge of RVD that the tenement is no longer eligible for rates relief or the owner elects not to claim the concession for the tenement. An implementation framework for the new rates concession mechanism is set out at **Annex B**.

<u>Maintaining status quo for parties liable to rates</u>

20. There have been suggestions that the present tenement/payer-based rates system should be reformed by switching to a system which mandates the owners to be the ratepayer on the ground that this would better reflect the

[5] At present, some separately assessed parking spaces in domestic developments are categorised as domestic tenements and the new rates concession mechanism will also apply to such parking spaces. Therefore, an owner who owns a residential property and a separately assessed parking space has to elect for receiving concession in respect of either the residential property or the parking space under the new mechanism.

nature of rates as an indirect tax on properties. We recommend **maintaining the status quo**, i.e. both owners and occupiers are liable to rates, for reasons as set out in the ensuing paragraphs.

21. Firstly, mandating that owners should be the primary ratepayers will bring unnecessary inconvenience to an estimated number of around 400 000 tenements, of which rates are currently paid by parties other than owners (e.g. occupiers, agents). This is particularly the case for non-domestic properties whereby rates of at least 50% of such properties are paid by non-owners. Given the diverse nature, uses and types of non-domestic properties, landlords and tenants presently make their own arrangements for rates payment pursuant to their tenancy agreements/licences. If owners are mandated to be the ratepayer, landlords and tenants may have to re-negotiate the relevant terms of their tenancy agreements, and this may cause unnecessary interference to the commercial arrangement between the landlord and tenant in the free market.

22. Secondly, the current rates regime provides flexibility for rates to be settled by the occupiers to cater for the situation that the owners may not be able to assume the role of ratepayers (e.g. they are located overseas). If the liability is mandatorily shifted entirely to the owners, it is envisaged that RVD will encounter difficulties in locating some owners who are currently not ratepayers. This may in turn lead to a higher default rate and potential bad debts, resulting in revenue loss to the Government.

23. Thirdly, the impact of shifting the primary rates liability to owners is limited in practice as rates payment is in effect reflected in the rental level agreed between the owner and occupier regardless of the identity of the ratepayer. This is particularly the case for domestic properties whereby rates of more than 90% of such properties are already being paid by owners.

IMPLEMENTATION PLAN

24. Implementation of the proposed new rates concession mechanism and the proposed progressive rates regime would both entail fundamental changes to RVD's core computer systems. It is proposed to implement the above proposals **by phases**, with Phase 1 implementing the proposed new rates concession mechanism and Phase 2 implementing the proposed progressive rates regime.

25. Implementation of the proposed new rates concession mechanism entails (i) the development of a new system by RVD as well as enhancement to its core computer systems to process rates relief applications and to conduct data matching for verification of applicants' eligibility; (ii) liaison with the Land Registry ("LR") and the Immigration Department for conducting data matching on the land records of the LR as well as the validity of applicants' HKIC; and (iii) necessary preparation work. It is expected that RVD could **launch the new rates concession mechanism in Phase 1 in March 2023** at the earliest by inviting applications for electing a property to enjoy new rates concession. If a decision is made to offer rates concession for domestic properties in 2023-24, rates demands for the third quarter of 2023-24 (i.e. October – December 2023) reflecting the new rates concession mechanism are scheduled to be issued in September 2023[6].

26. Implementation of the proposed progressive rates regime involves enhancement by RVD to its core computer systems for revised accounting and billing as well as rating assessment functions to reflect the progressive element in assessing the rates payable. Such enhancement will be developed in parallel with the necessary enhancement for the new rates concession mechanism as far as practicable. We expect that the first rates demands reflecting the new progressive rates regime could be issued by **December 2024** at the earliest for the fourth quarter of 2024-25 (i.e. January – March 2025).

FINANCIAL IMPLICATIONS

27. It is estimated that about 69% of all private domestic tenements (separately assessed parking spaces excluded) (i.e. around 1.3 million domestic tenements) will be eligible for rates relief under the proposed rates concession mechanism for domestic properties. Assuming that one-off rates concession will remain at the 2022-23 level of being capped at $5,000, the revenue forgone in providing one-off rates concession for domestic properties will reduce from $11.7 billion to $8.6 billion per year, representing savings of around **$3.1 billion per year**. The additional revenue to be generated by the progressive rating system will be **about $0.76 billion per year**.

[6] Rates concession for the first two quarters of 2023-24 will be granted under the current mechanism.

ADVICE SOUGHT

28. Members are invited to give views on the proposed way forward as set out above.

Financial Services and the Treasury Bureau
February 2022

Implications of progressive rating system

Annual rateable value ("RV") of domestic tenements (Monthly RV)	Proposed new rates percentage charges	Percentage out of all private domestic tenements (excluding separately assessed car parking spaces)	Examples of additional annual rates corresponding to tenement of different RV
$550,000 or below (Monthly RV $45,833 or below)	5% (Remains unchanged)	97.8%	• The rates payable for tenements for which the annual RV is at $550,000 remains unchanged.
$550,001 to $800,000 (Monthly RV around $45,833 to $66,667)	First $550,000: 5% Next $250,000: 8%	1.3%	• Tenements for which the annual RV is at $600,000 will need to pay additional annual rates of $1,500. • Tenements for which the annual RV is at $800,000 will need to pay additional annual rates of $7,500.
Above $800,000 (Monthly RV above $66,667)	First $550,000: 5% Next $250,000: 8% Above $800,000: 12%	0.9%	• Tenements for which the annual RV is at $1,000,000 will need to pay additional annual rates of $21,500. • Tenements for which the annual RV is at $2,000,000 will need to pay additional annual rates of $91,500.

Annex B

Implementation Framework for Proposed New Rates Concession Mechanism for Domestic Tenements (assuming rates concession is offered in 2023-24)

(a) Eligibility	Rates concession in respect of a domestic tenement would only be granted – (i) on election by a natural person holding a valid Hong Kong Identity Card ("HKIC"); (ii) if the person referred to in (i) is registered in the Land Register as the owner of the subject tenement as at a designated reference date; and (iii) if the subject tenement is the only tenement elected by the person referred to in (i) for claiming rates relief.
(b) Application period and determination of eligibility	(i) For claiming rates concession for the period October-December 2023 (which will be the first quarter when the Proposed New Rates Concession Mechanism is applied), the Rating and Valuation Department ("RVD") will allow an application period from March to June 2023. RVD would designate 1 July 2023 as the reference date for the purpose of determining the eligibility of an owner for rates concession. (ii) In subsequent quarters, RVD would designate a reference date for each quarter for the purpose of determining the eligibility of an owner for rates concession in respect of that quarter. Applications may be submitted by new property owners or owners of multiple properties who choose to re-elect another tenement for rates concession before the reference date –

Reference date	Rates Concession period
2023	
1 December	January–March 2024
2024 onwards#	
1 March	April-June
1 June	July-September
1 September	October-December
1 December	January-March

The reference dates may need to be adjusted if rates concession resumes after an intermittent year/quarter where the Government does not grant any rates concession.

(iii) Once eligibility has been established for a tenement, rates concession would be tied to the tenement and reflected in all subsequent quarterly demands during the period when the rates concession is offered **until**:

(1) it comes to the knowledge of RVD that the tenement is no longer eligible for rates relief (e.g. owner has passed away[1]); or

(2) no eligible owner claims the concession. For example, the owner chooses to re-elect another tenement for rates concession, or there is change in ownership in the tenement and the person claiming the concession is no longer an owner[2].

(c) Application method	Apart from hardcopy submission, RVD will accept electronic applications through a new e-form service on RVD's website.

[1] RVD will confirm the validity of the applicants' HKIC with the Immigration Department.

[2] In case of change in ownership within a quarter, the ex-owner would continue to receive the rates relief for that quarter as rates demands are issued quarterly in advance whilst the new owner could only apply for rates relief starting from the ensuing quarter. It is also current practice that law firms would apportion the quarterly rates paid in advance for sellers and purchasers in property assignments.

(d) Design of the application form	(i) According to the initial design, applicants are only required to provide in the application form the **HKIC number** and its date of issue, **name** of the owner in English and Chinese, **assessment number** and the **address of the tenement elected** to receive rates concession, **correspondence address** (if it differs from the address to receive rates demands of the elected tenement), **local contact number** and **email address**; (ii) applicants will be required to **declare** in the application form that he/she is the owner of the elected tenement and he/she has elected only one tenement to enjoy rates concession; (iii) a statement will be included in the application forms to the effect that should the applicants provide false information, he or she would be liable to prosecution and for refunding the amount (in addition to any penalty arising thereof); and (iv) applicants will undertake to inform RVD on any change in eligibility for rates relief in respect of the property elected, and will be required to provide consent for RVD to conduct matching of data with the Land Registry and the Immigration Department in order to verify their eligibility.
(e) Communication channels	Applicants will receive an acknowledgement of receipt of application, and will be provided with means of communication or enquiry through telephone, email or letter. RVD will enhance manpower of enquiry counter to provide necessary assistance during the first application period.