Broadening the Tax Base, Ensuring our Future Prosperity:
What's the Best Option for Hong Kong?

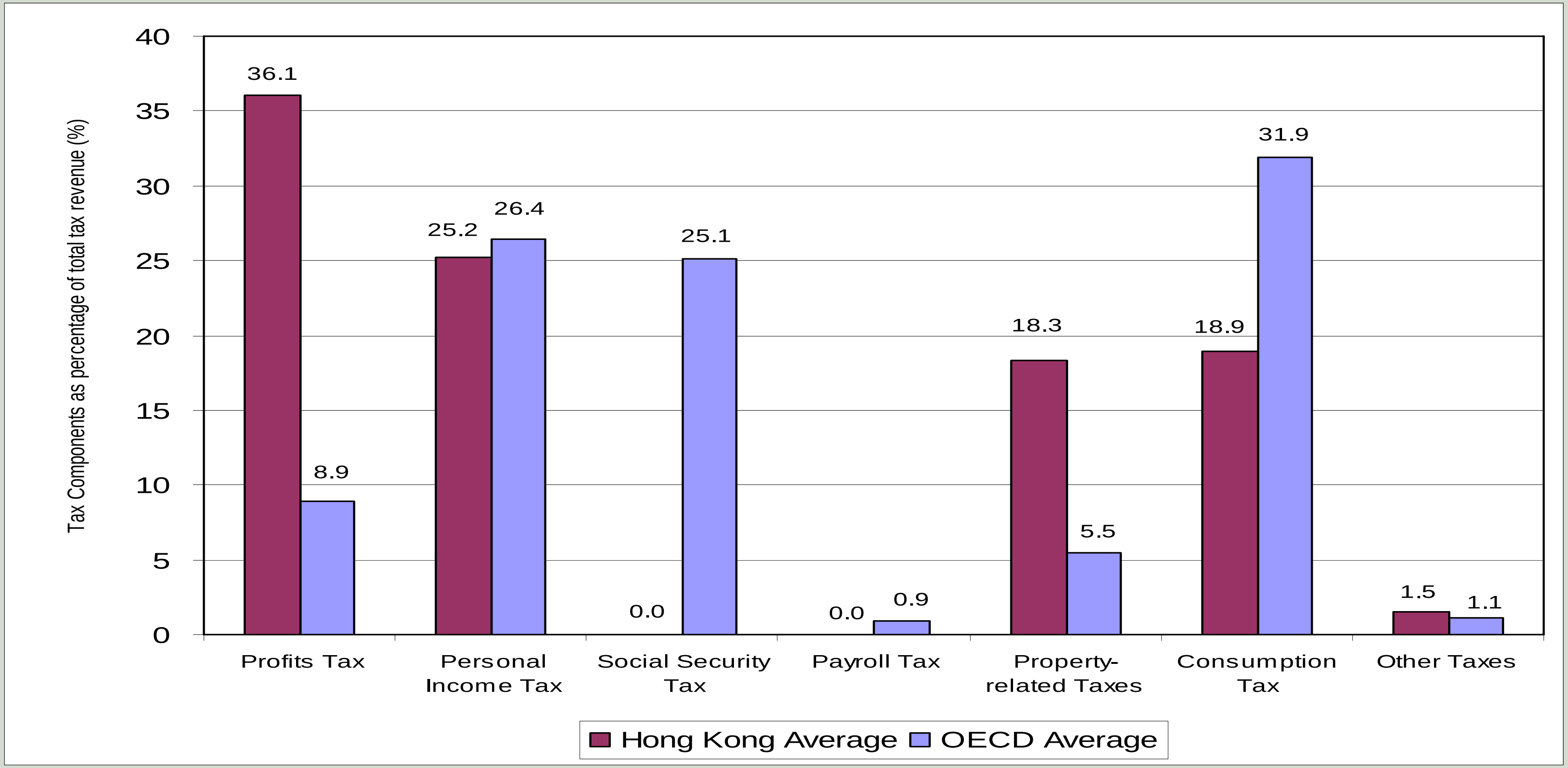
Reforming Hong Kong's Tax System Public Consultation

Key messages

- The purposes of implementing a GST in Hong Kong are :
  - To stabilise our public finances
  - To sustain our economic growth and ensure our future prosperity
- It is not driven by the need to generate additional tax revenue
- Revenue neutral for the first five years
- Our proposals are preliminary thoughts and are intended to stimulate discussion
- The consultation will last about nine months

A Narrow Tax Base

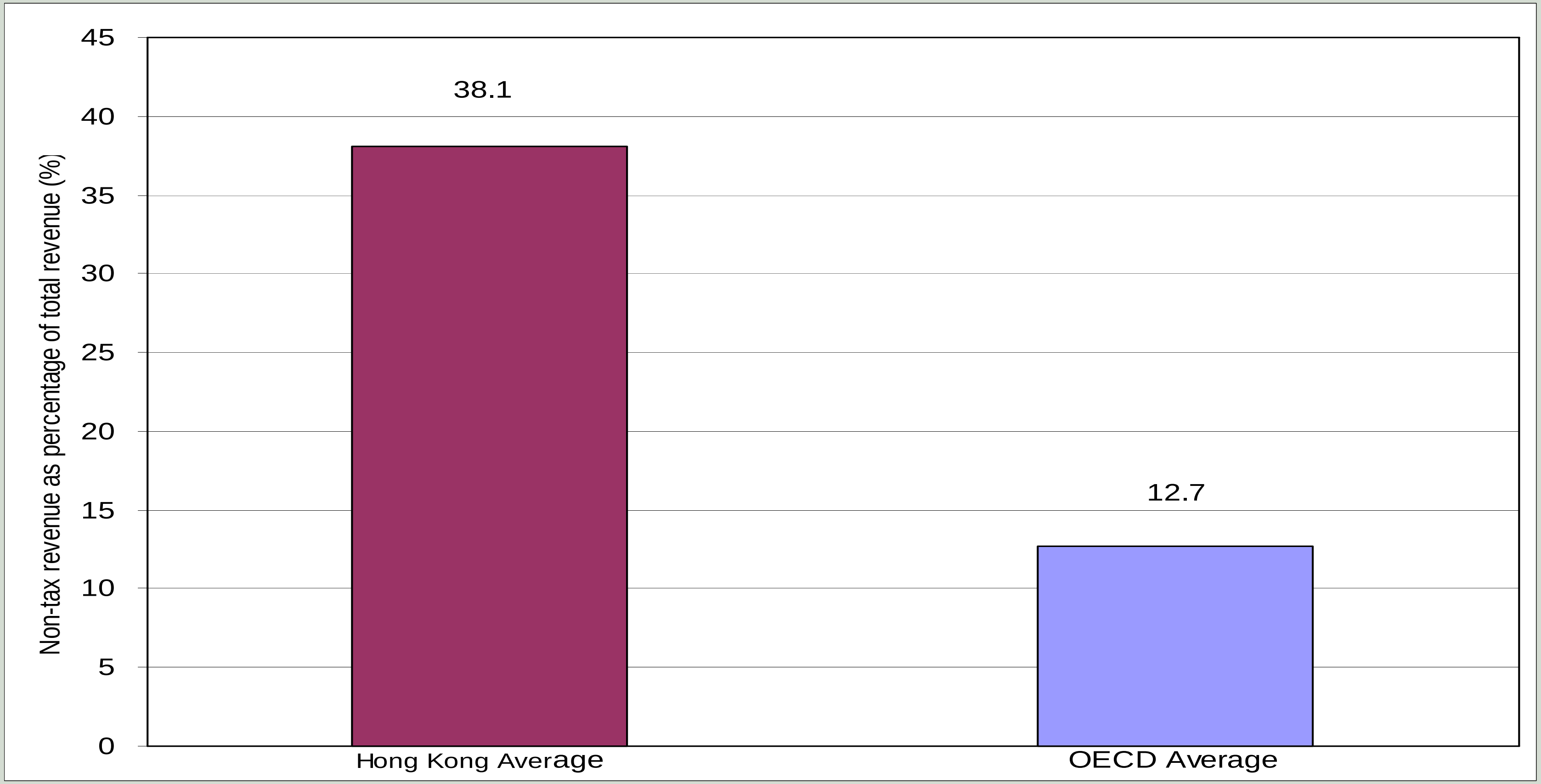
High reliance on Profits Tax and property-related taxes



* The most up-to-date actual OECD tax revenue data available are for 2003, In order to avoid the impact of annual fluctuations, the comparison is based on a ten-year average of OCED (1994-2003 calendar years) and Hong Kong (1993-94 to 2002-03 fiscal years) tax revenue data.

** The OECD average does not add up to 100% due to rounding.

High reliance on non-tax revenue



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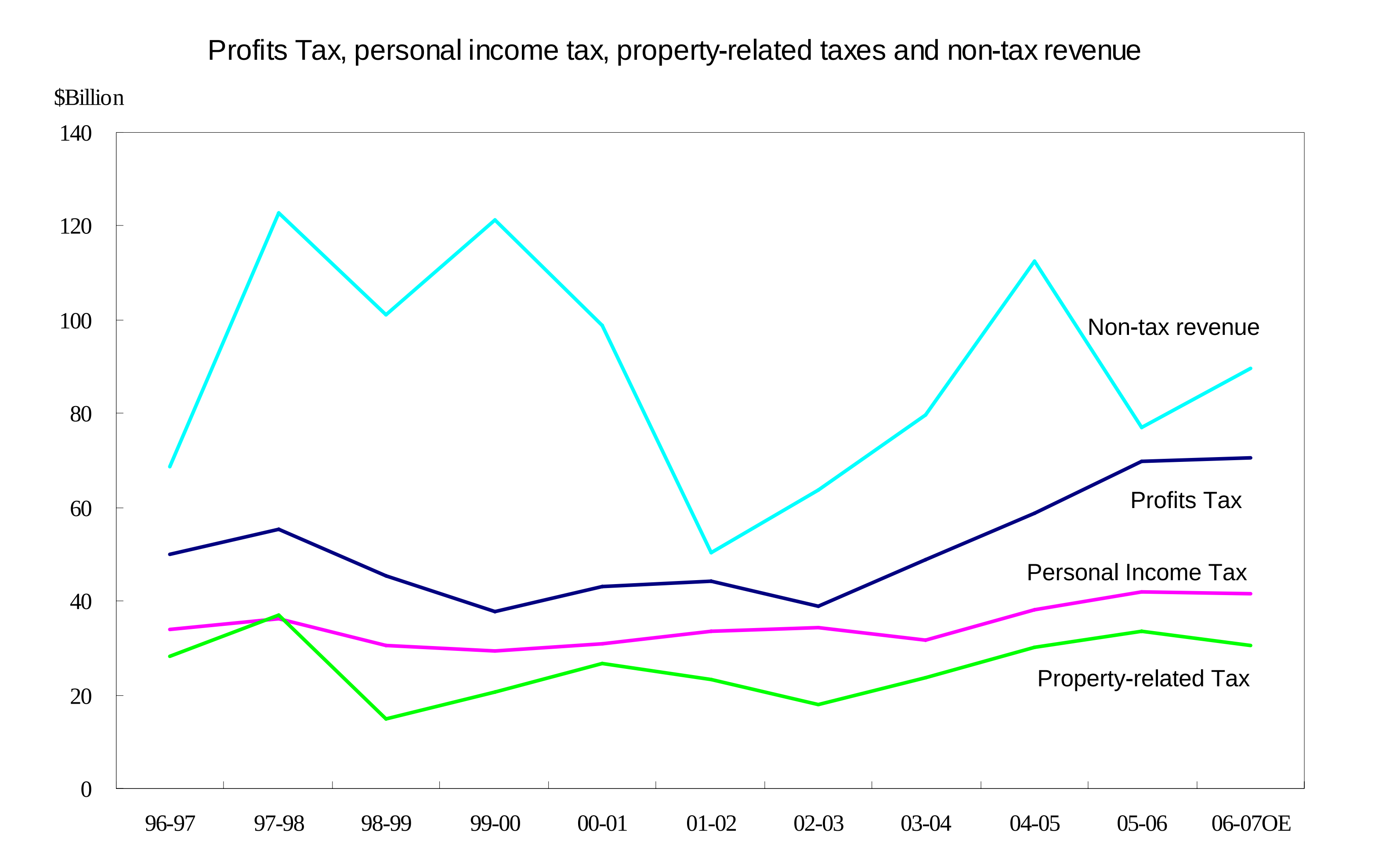
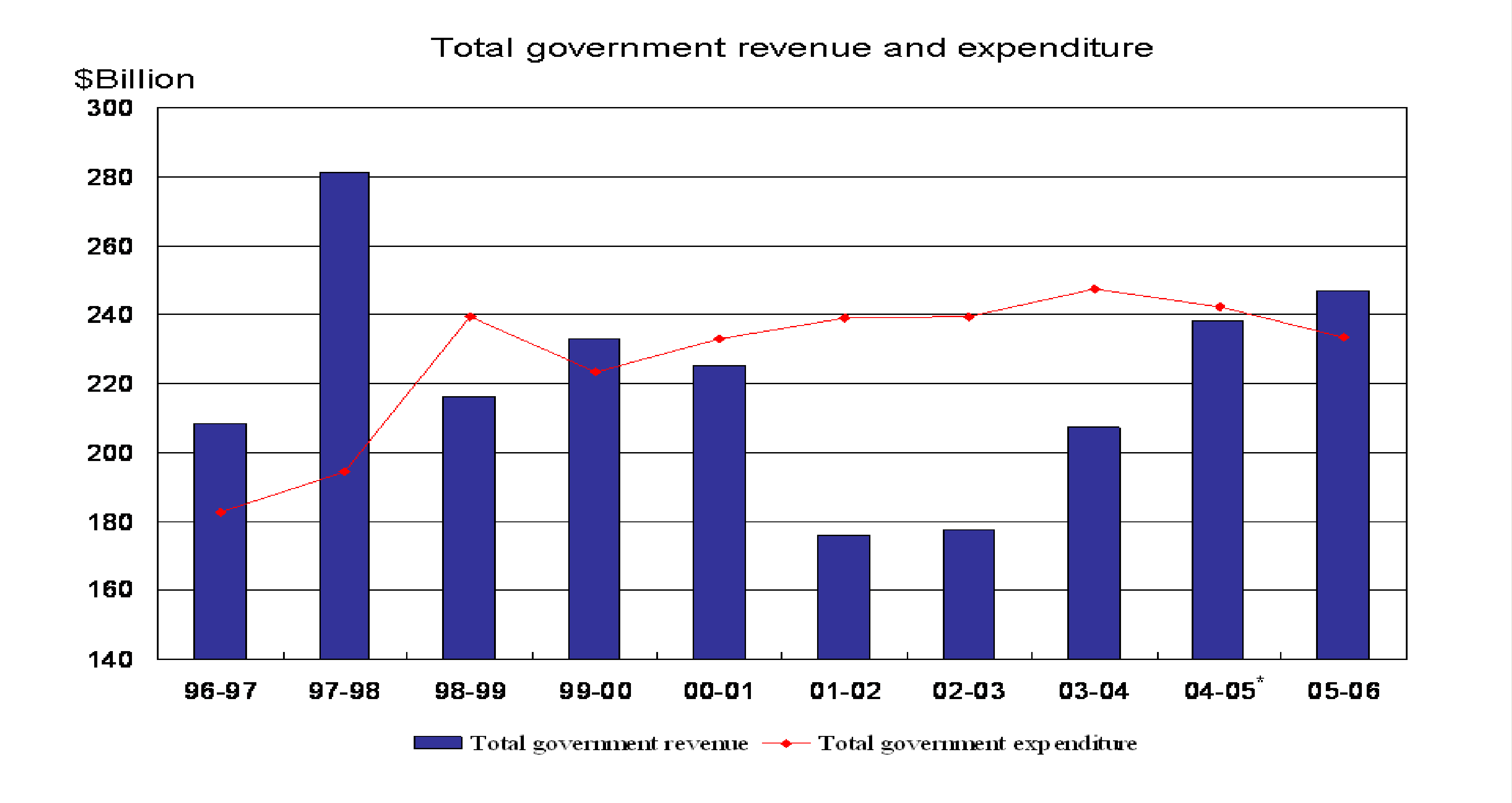
Volatile Income from Profits Tax, personal income tax, property-related taxes and non-tax revenue

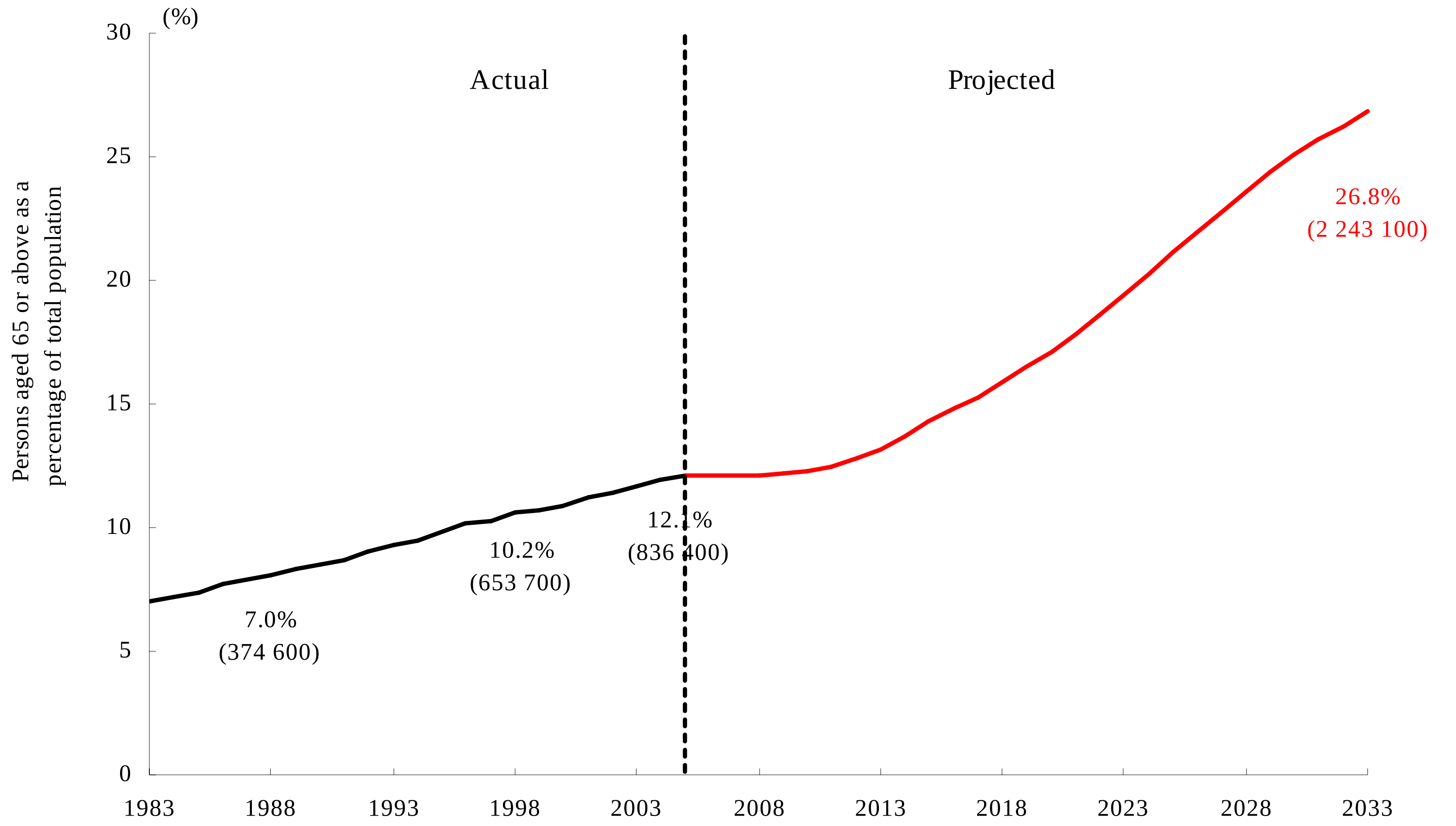


High volatility in revenue and rigid public expenditure pattern



* Revenue income for 2004-05 does not include the issuance of a $6 billion Toll Revenue Bond for the securitisation of tolled tunnels and bridges and $20 billion bonds and notes.

The challenges of an ageing population



Note : Figures in brackets represent number of persons

The challenges of an ageing population

- **Projections on labour force as a % of the total population :**

2004	**52.1%**
2014	**51.0%**
2023	**46.1%**

International trend : Lowering Profits Tax rate

Jurisdiction	2000 Corporate Profits Tax Rate	2005 Corporate Profits Tax Rate	Change in Percentage Points
Singapore *	26%	20%	- 6
Iceland	30%	19%	- 11
Hong Kong	16%	17.5%	+ 1.5
Macau *	15.75%	12%	- 3.75
Hungary	18%	16%	- 2
Lithuania	24%	15%	- 9
Ireland	24%	12.5%	- 11.5
OECD	33.6%	29.8% (2004)	- 3.8
European Union	About 35%	About 25%	About - 10
South Korea *	30.8%	27.5%	- 3.3
Austria	34%	25%	- 9

* These jurisdictions also offer tax incentives or holidays that can reduce the effective tax rate

International Trend : Lowering Salaries Tax rate

Region	2000 Top personal income tax rates	2006 Top personal income tax rates	Change in percentage points
Singapore	28%	21%	-7
Hong Kong	17% (standard rate is 15%)	19% (standard rate is 16%)	+2 (standard rate +1)
Macau	15%	12%	-3
OECD	47%	41.9%	-5.1
European Union	51.1%	44%	-7.1

Problems arising from a narrow tax base

1. Due to the high volatility in revenue and the rigid expenditure patterns, we may have to increase taxes and cut government expenditure on public services, draw down on our reserves or even borrow money from the international markets when there is another economic downturn

2. Ageing population will further narrow the tax base –
   - the proportion of taxpayers ↓
   - the proportion of population using health and welfare services for the elderly ↑
   - long-term fundamental problems

Options for broadening the tax base

Options considered by the Advisory Committee on New Broad-based Taxes (Advisory Committee)

1. Increase Salaries Tax rates
2. Increase Profits Tax rates
3. Increase Stamp Duty on landed property transactions
4. Reduce personal allowances and concessionary deductions under Salaries Tax
5. Increase Rates
6. Introduce Capital Gains Tax
7. Introduce Tax on Interest

Options considered by the Advisory Committee on New Broad-based Taxes (Advisory Committee)(Cont'd)

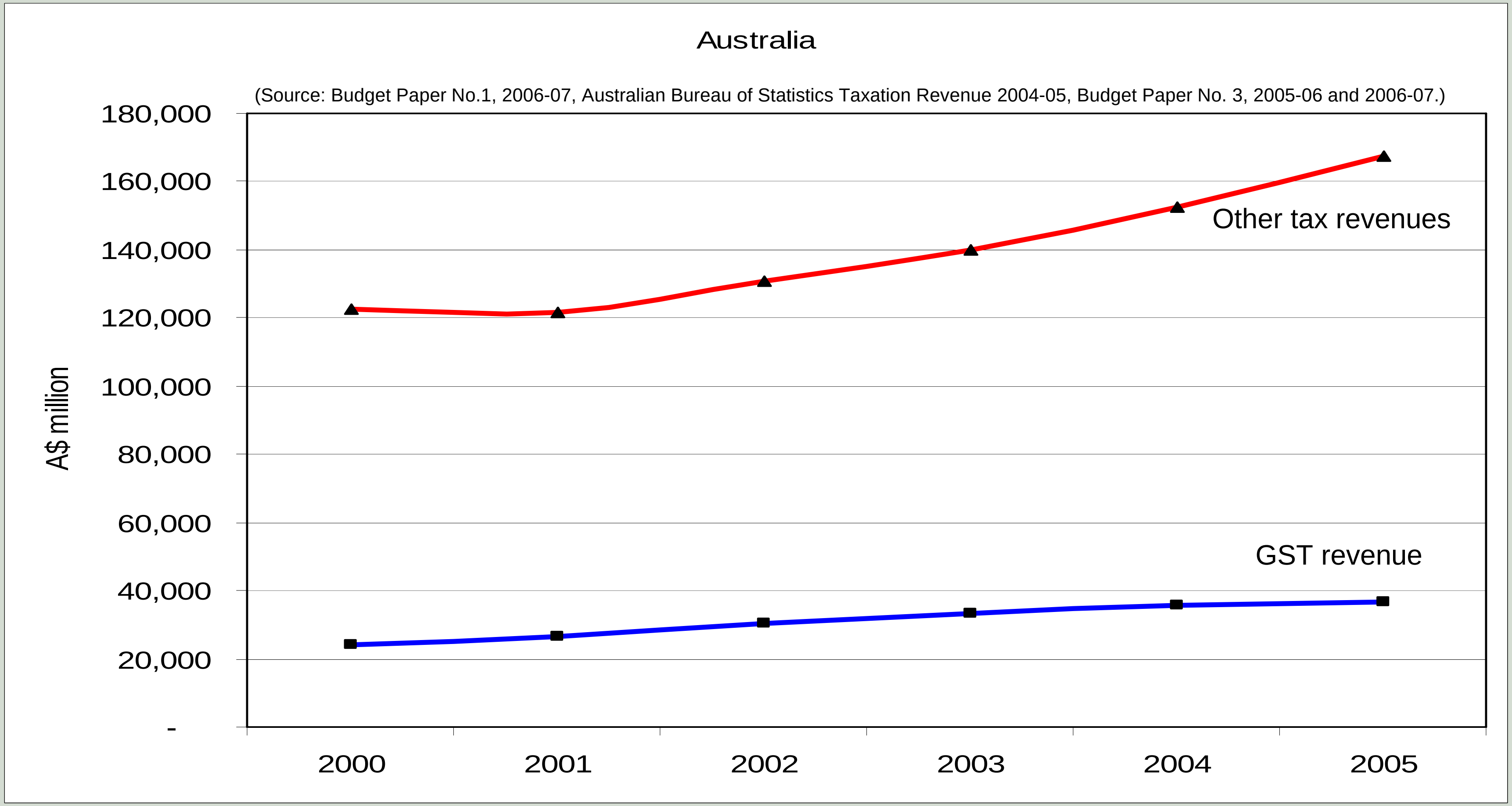
8. Tax on Dividends
9. Tax worldwide income of businesses and individuals
10. Introduce Land and Sea Departure Tax
11. Introduce Payroll Tax and Social Security Tax
12. Introduce Poll Tax
13. Introduce General Consumption Tax
14. Tax on Mobile Telephone Services and Signboards

The most viable option recommended by the Advisory Committee

- **Introduce a GST**
  - Could produce stable and growing revenue
  - Could be levied at a low rate with a broad base to produce significant revenue
  - Difficult to avoid due to its multi-stage taxing and crediting mechanism
  - The tax is capable of growing in line with consumption in the economy, even with an ageing population
  - Would maintain our competitiveness and low-tax environment for attracting foreign investment and talent

Experience of other jurisdictions in introducing a GST

GST revenue is relatively stable in comparison with other sources of tax revenue



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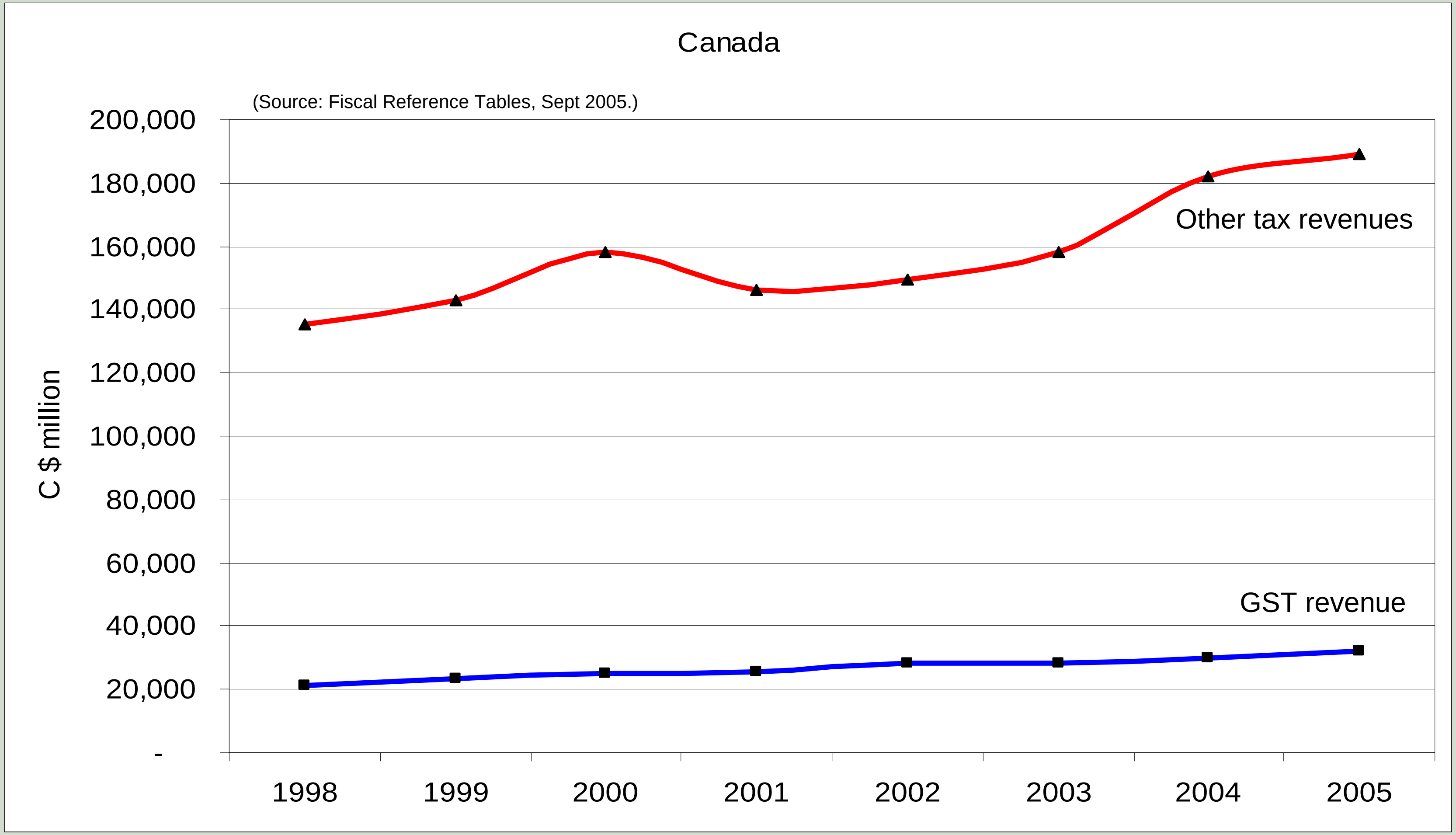

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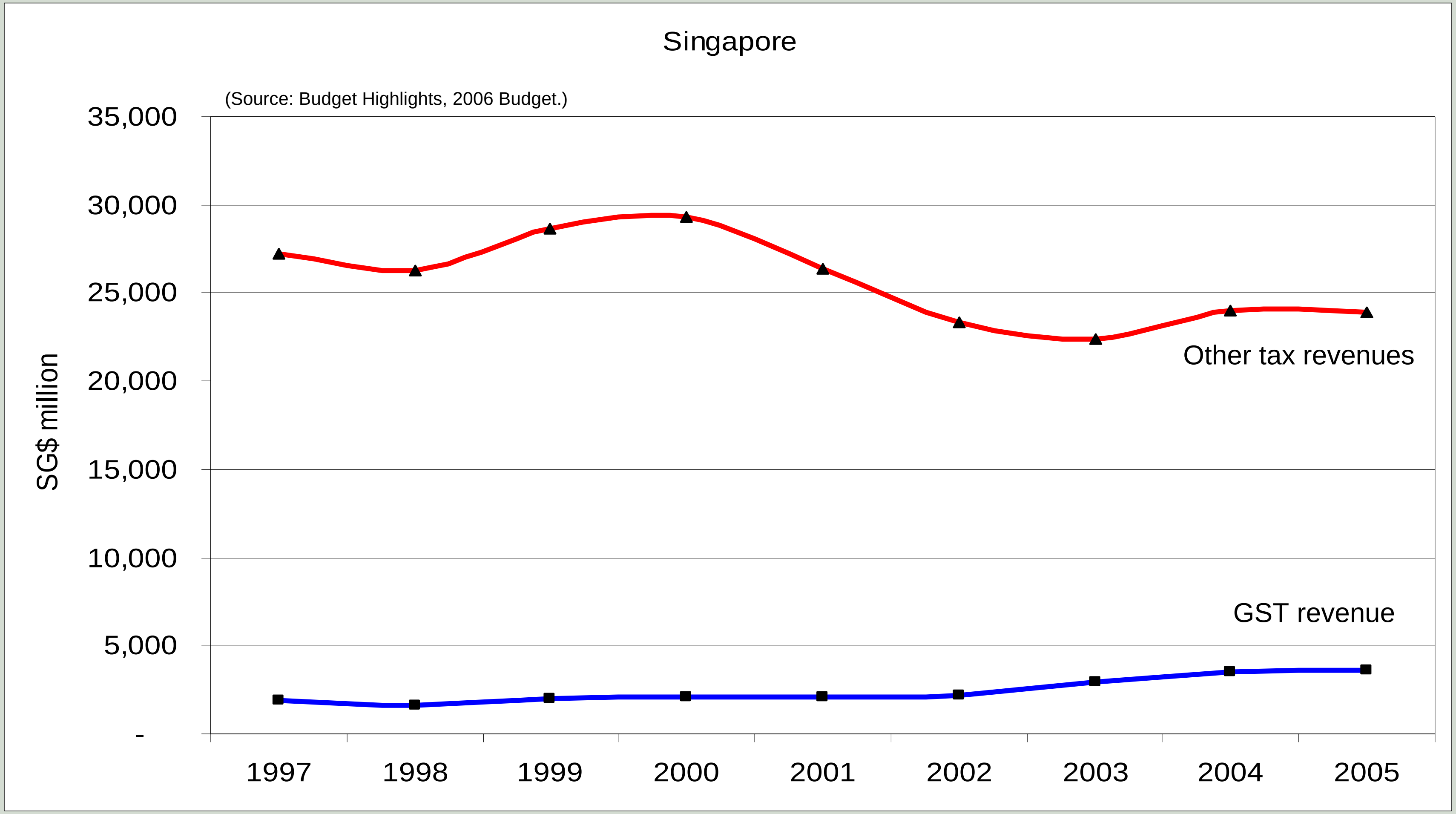

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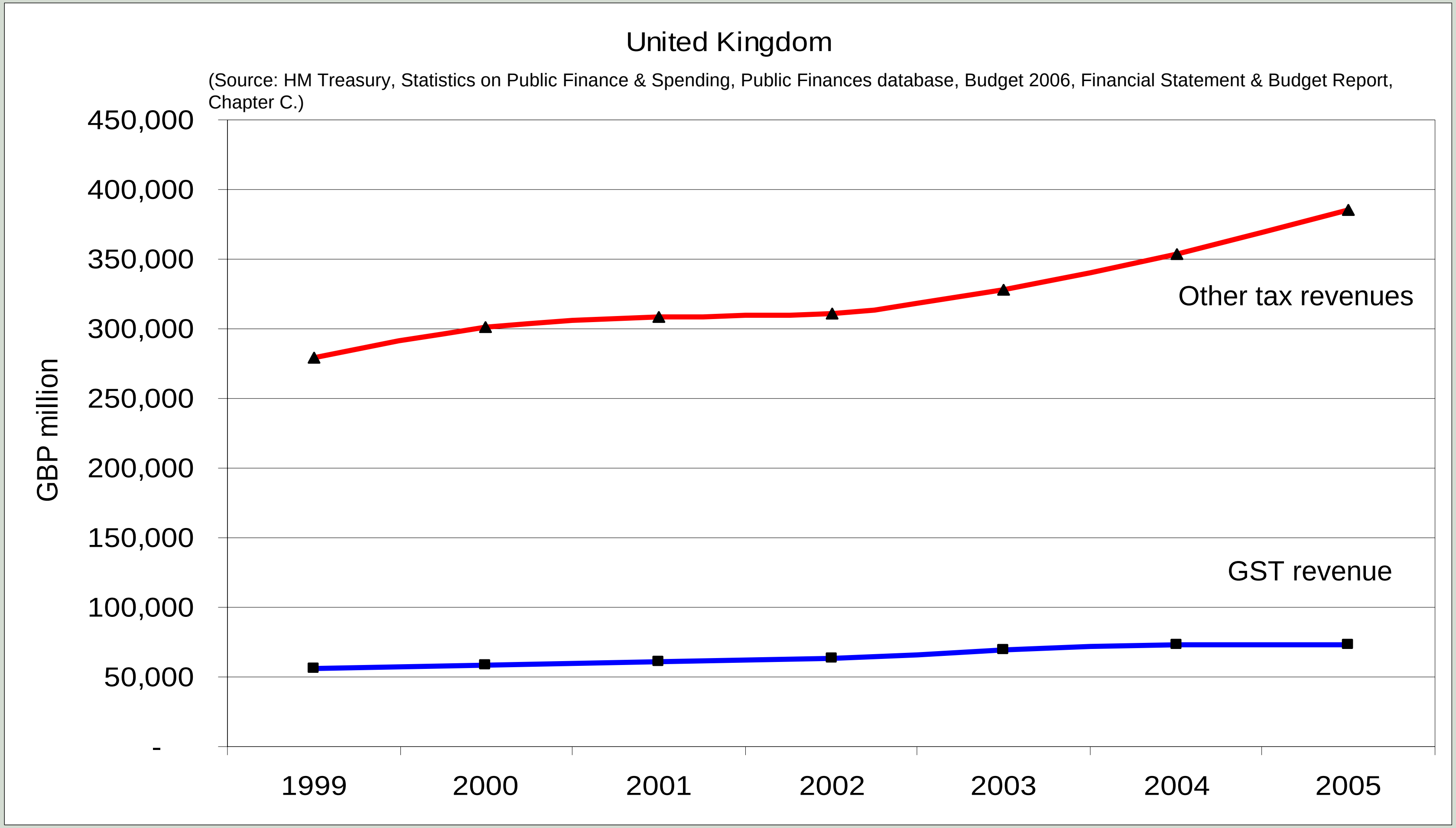

Proposed GST framework

Proposed GST framework

- **Design features**
  - Low, single GST rate
  - High registration threshold
  - Broad GST tax base, with few exemptions in order to minimize administrative cost and to keep the tax system simple

Proposed GST framework

- **Low, single GST rate**
  - The tax rate proposed to be set at a low level
  - Consistent with the existing simple and low tax system
  - Expected to have minimal and short-term price effect (for a rate of 5%, CCPI expected to rise by only 3%)

Proposed GST framework

- **High registration threshold**
  - Proposed to be at an annual turnover of $5 million (out of 750,000 registered businesses, only 65,000 businesses have an annual turnover of $5 million or above)
  - Would exclude most small and medium-sized businesses from GST compliance obligations
  - Reduce / eliminate compliance costs for small and medium-sized businesses
  - Unregistered businesses could not reclaim any input tax paid on their purchases
  - Businesses with annual turnover below the threshold could voluntarily register for GST
  - Special set-up assistance for voluntary registrants
    - Subsidy for the purchase of GST-related IT equipment and software

Proposed GST framework

- **Broad GST tax base, with few exemptions**
  - Could minimise complexity and compliance costs for businesses and administrative costs for the Government
  - Would allow the GST rate to be kept at a low level

Proposed GST framework

- **Exports and transshipments would be zero rated (i.e. not subject to output tax and eligible for re-claiming input tax)**
- **A Tourist Refund Scheme would be implemented**
- **“Financial supplies” would be zero rated**
- **Rentals and sales of immoveable properties:**
  - Commercial properties: Subject to GST
  - Residential properties: Exempt
- **Generous deferred GST payment schemes would be introduced to relieve the impact on the trade and logistics sector**
- **Charities could register for GST to reclaim input tax**

Proposed household relief package

Proposed household relief package

All households are divided into different target groups for designing relief measures on the basis of their needs and consumption patterns.

- **Group 1** – CSSA households
- **Group 2** – Non-CSSA low-income households
- **Group 3** – All other households

Proposed household relief package

- **Group 1 – CSSA households**

  The impact of GST would be fully offset

  - An upfront one-off cash supplement would be provided
  - It would be ensured, through the existing CSSA annual adjustment mechanism, that the purchasing power of CSSA households would not be affected

Proposed household relief package

- **Group 2 – Low-income households not drawing on CSSA**
  - An annual cash GST allowance of $2,000 per household to be paid to those households which apply to the Government and meet the criteria; plus
  - Across-the-board measures:
    - An annual GST credit of $500 per household for water and sewage charges would be provided, subject to review after five years; plus
    - An annual GST credit of $3,000 per household for Rates would be provided, subject to review after five years

Proposed household relief package

- **Group 3 – All other households**
  - Across-the-board measures for Group 2; plus
  - Tax reduction measures

Other proposed tax changes (including business tax offsets)

Other proposed tax changes

- **Principles**
  - Tax-on-tax should be avoided; and
  - for those products currently subject to high levels of indirect tax, the introduction of GST would not lead to an increase in the total taxation of such products.

Options for returning the additional revenue to the public

Options for returning the additional revenue to the public

Assuming a 5% GST rate, it would be capable of generating $30 billion in gross revenue. After deducting all administrative costs and the costs of providing the proposed relief measures, there would be room for tax reductions.

Options for returning the additional revenue to the public

- **If we were to return the additional revenue to the community by way of tax reduction, we could :**
  - reduce the Salaries Tax rates; or
  - reduce the Profits Tax rates

- **We could also consider increasing public expenditure on important policy areas**

(We welcome public's views on the most preferred combination)

Timeframe for public consultation

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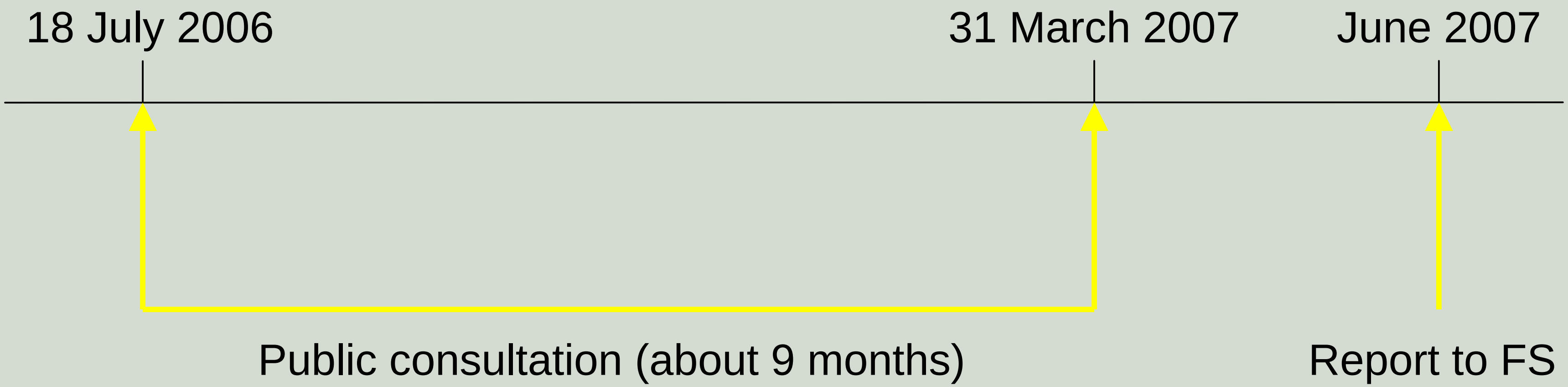

- **Decision for GST introduction to be made by the Government of the next term**
- **If a decision is made to introduce GST, preparation work would be expected to take at least 2 to 3 years from the date of decision**

Please contribute
your views and suggestions