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

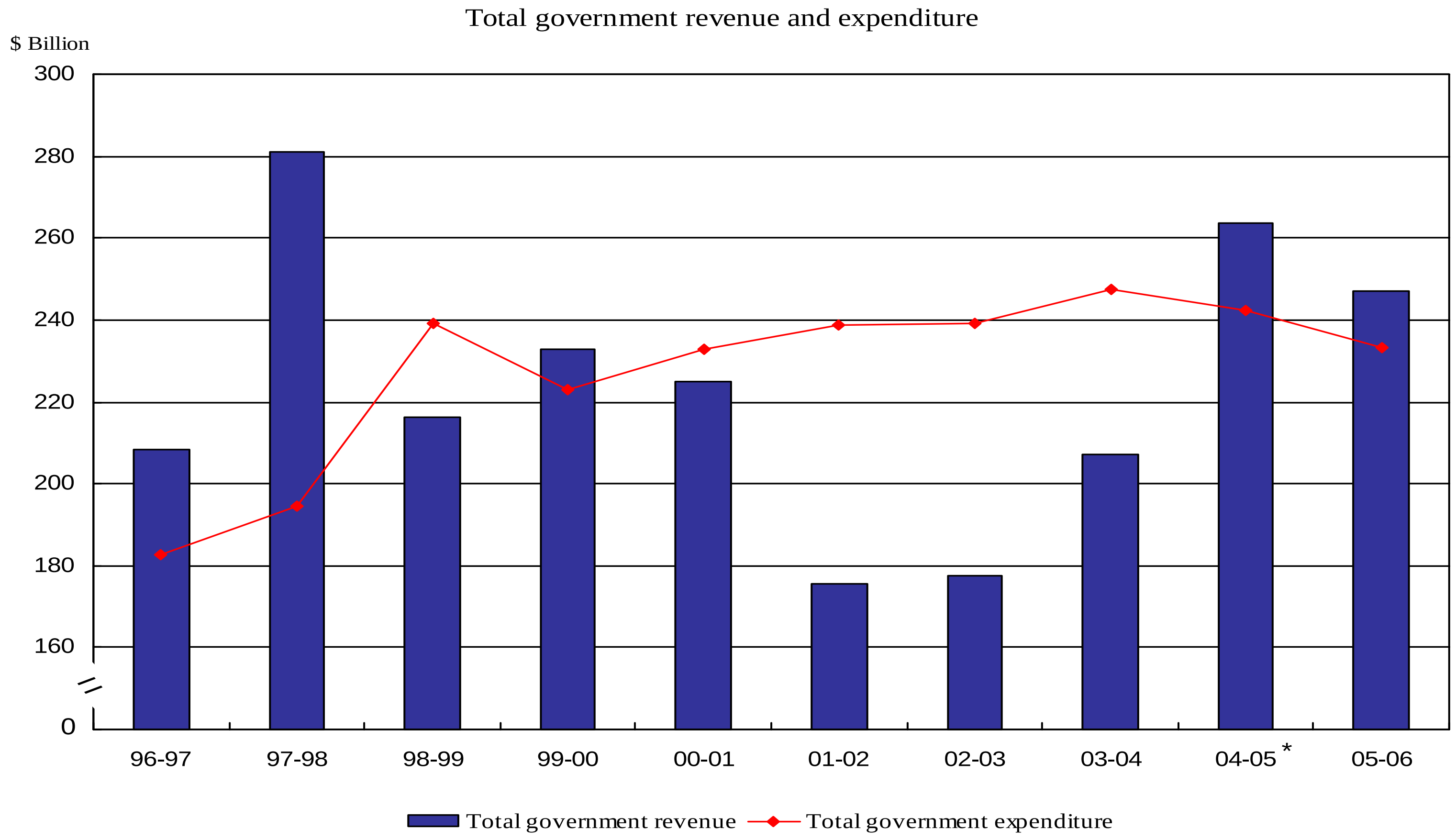
Reforming Hong Kong's Tax System Public Consultation

Key messages

- **Implementing a GST in Hong Kong is about:**
  - Stabilising our public finances
  - Placing Hong Kong in a position to achieve sustainable economic growth to ensure our future prosperity
- **It is not driven by the need to generate additional tax revenue**
- **Our proposals are not meant to be conclusive, but are intended to stimulate discussion**
- **A period of about nine months has been set aside for consultation**

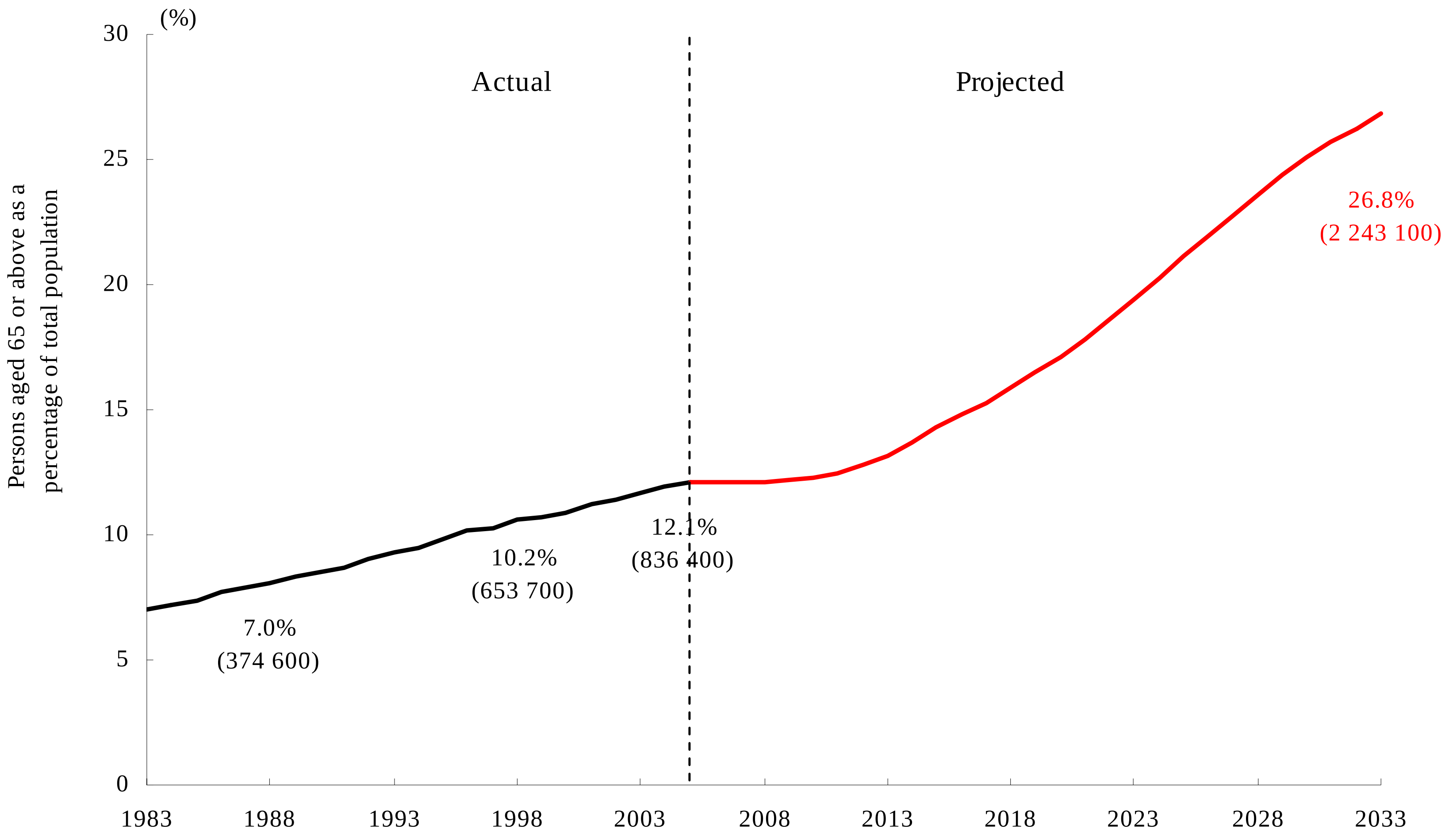
Problems of a narrow tax base

1. Constrains our ability to manage and plan our public finances



* Revenue income for 2004-05 includes the issuance of a $6 billion Toll Revenue Bond for the securitisation of general tolled tunnels and bridges and $20 billion bonds and notes. If this income is excluded, total government revenue for 2004-05 would be $238 billion, which is $4 billion less than the total government expenditure.

2. Unable to meet the challenges of an ageing population



Note : Figures in brackets represent number of persons

3. Erosion of our international competitive edge

Jurisdiction	2000 Corporate Profits Tax Rate	2005 Corporate Profits Tax Rate	Change in Percentage Points
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
Singapore *	26%	20%	- 6
Iceland	30%	19%	- 11
Hong Kong	16%	17.5%	+ 1.5
Hungary	18%	16%	- 2
Lithuania	24%	15%	- 9
Ireland	24%	12.5%	- 11.5
Macau *	15.75%	12%	- 3.75
Cyprus	15%	10%	- 5

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

4. **Many citizens are not contributors to the costs of public services and facilities provided by the Government**
5. **If we suffer another economic downturn, we would be forced to increase taxes and cut government expenditure on public services, draw down on our reserves and borrow money from the international markets**

Alternatives for broadening the tax base

Alternatives for broadening the tax base

- **Introduce a GST**
  - Could produce stable and growing revenue
  - Could be levied at a low rate with a broad base to produce significant revenue
  - Would be fair, as individual consumption determines the amount of tax paid
  - 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

Proposed GST framework

Proposed GST framework

- **Design features**
  - Low, single GST rate
  - High registration threshold
  - Broad GST tax base, with few exemptions

Proposed GST framework

- **Low, single GST rate**
  - Would be very low by international standards
  - Consistent with our low and simple tax system
  - Would minimise the price effect (for a rate of 5%, CCPI expected to rise by only 3%)

Proposed GST framework

- **High registration threshold**
  - Proposed to be $5 million annual turnover (out of 750,000 registered businesses, only 65,000 businesses have an annual turnover of $5 million or above)
  - Businesses below the threshold could voluntarily register for GST
  - Would exclude most small and medium-sized businesses from GST collection
  - Reduce / eliminate compliance costs for small and medium-sized businesses
  - Unregistered businesses would not be able to reclaim GST on their inputs

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 low

Proposed GST framework

- **Rentals and sales of immoveable properties:**
  - Commercial properties: Subject to GST
  - Residential properties: Exempt
- **Exports and transshipments would be zero rated (i.e. no need to charge GST on outputs and could reclaim input taxes)**
- **A Tourist Refund Scheme would be implemented**
- **Charities would be able to register for GST to reclaim input tax**
- **Generous deferred GST payment schemes would be introduced to relieve the impact on the import / export trade and logistics sector**

Proposed household compensation package

Proposed household compensation package

All HK households are classified as target groups to be compensated on the basis of their need and consumption pattern.

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

Proposed household compensation package

- **Group 1 – CSSA households**

  Would be fully compensated for the impact of GST

  - An upfront one-off supplement would be provided
  - Through the existing mechanism for the annual adjustment of CSSA, CSSA households would also be properly compensated in subsequent years

Proposed household compensation package

- **Group 2 – Low-income households not drawing on CSSA**
  - An annual cash GST allowance of $2,000 per household to be paid; plus
  - Across-the-board measures:
    - An annual GST credit of $500 per household to be used against water and sewage charges that would be reviewed after five years; plus
    - An annual GST credit of $3,000 per household to be used against Rates that would be reviewed after five years
- **Group 3 – All other households**
  - Across-the-board measures as for Group 2 above; plus
  - Tax reductions

Other proposed tax changes (including business tax offsets)

Other proposed tax changes

Indirect tax	Proposed adjustment
Stamp Duty on sale / lease of commercial immoveable property	Stamp Duty rate unchanged, but calculated on GST-exclusive value of sale / lease
Stamp Duty on Hong Kong shares transfer	No change
Rates Government Rent	No change – Not subject to GST
Hotel Accommodation Tax	Abolish with GST introduction to avoid double taxation
Motor Vehicle First Registration Tax Duty on Liquor Duty on Petrol, Diesel and Aircraft Fuel Duty on Methyl Alcohol	Rates adjusted down to take account of GST imposition, so total tax take would not increase

Other possible tax changes

- **Profits Tax reduction**
- **Abolition of Capital Fee**
- **Reduction in Trade Declaration Charges for imports and exports**
- **Increased tax deduction limit for charitable donations**
- **Special set-up assistance for voluntary registrants**
  - Subsidy for the purchase of GST-related IT equipment and software

Options for the additional revenue

Options for the additional revenue

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

Options for the additional revenue

- **There would be many options for returning the additional funds to the community in the form of tax reductions**
- **Option 1: Reduction in Salaries Tax only**

2006 / 07		Possible adjustment	
1st $30,000 income	2%	1st $75,000 income	1%
Next $30,000 income	7%	Next $75,000 income	2%
Next $30,000 income	13%	Next $75,000 income	8%
Remainder	19%	Remainder	14%
Standard Rate	16%	Standard Rate	11%

- **Option 2: Reduction in Profits Tax only**
  - We could reduce the Profits Tax rate by five percentage points with reference to 2006-07 estimated company earnings.

Options for the additional revenue

- **Increase public expenditure in important areas:**
  - Education
  - Health
  - Social welfare
  - Law and order
  - Infrastructure

Timeframe for public consultation

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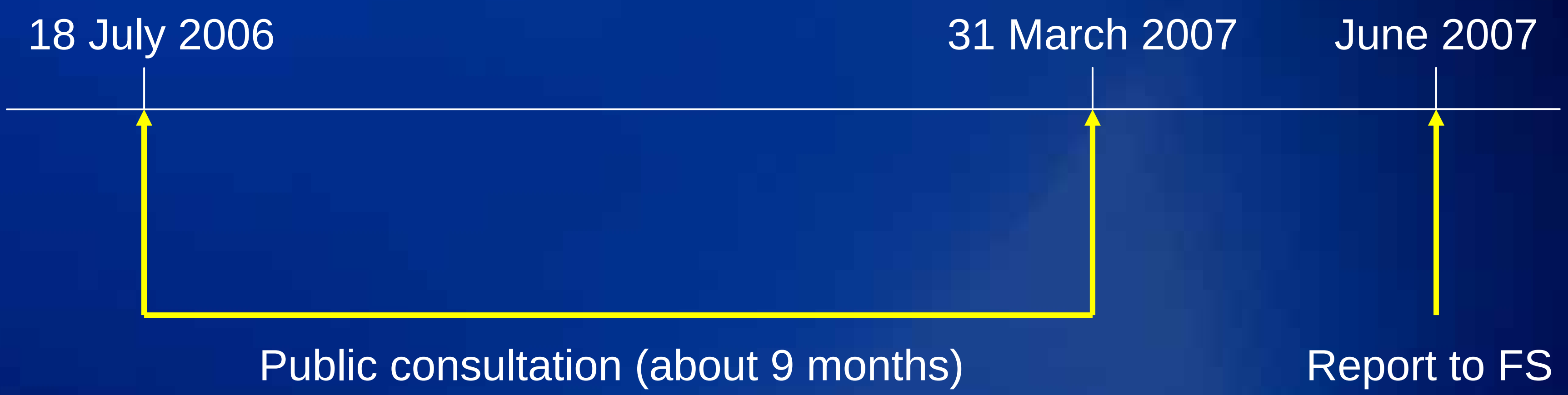

- **Decision for GST introduction to be made by the Government of next term**
- **If a decision is made to introduce GST, preparation work would be expected to take at least 2 to 3 years from the date of decision**

Please contribute to the debate