CHAPTER 2 BROADENING THE TAX BASE : WHAT ARE OUR OPTIONS?

52. Over the years, in considering whether our tax base should be broadened, members of the community and a number of organisations, including the Advisory Committee on New Broad-based Taxes, IMF and various credit rating agencies, have provided valuable suggestions and recommendations on a range of alternatives. Recently, we have re-examined these options with a view to identifying the best one. These options are summarised in the following paragraphs.

Increasing rates for existing taxes would not broaden the tax base

53. Increasing Salaries Tax and Profits Tax rates, Stamp Duty on property-related transactions and Rates would increase the tax burden on existing taxpayers but would not broaden the tax base. Therefore, any proposals to increase rates for existing taxes are not feasible alternatives for addressing the fundamental problems of our narrow tax base.

Increasing tax rates against international trend

54. Increasing Salaries Tax and Profits Tax rates would go against the international trend of lowering income taxes and risk losing mobile labour and capital to more competitive jurisdictions. As noted in Chapter 1, the rapidly-ageing population means that fewer and fewer salaries taxpayers will shoulder more and more of the tax burden in the coming years; hence narrowing the tax base.

Increasing property-related taxes would decrease competitiveness

55. Increasing Rates, currently payable in respect of all rateable property, would further increase our significant reliance on property-related taxes as outlined in Chapter 1. On the other hand, increasing Stamp Duty on immovable property would have a negative impact on property market values. Additionally, increasing property-related taxes would further decrease our competitiveness, especially in the context of business premises and accommodation costs.

Expanding existing taxes would compromise Hong Kong's global position

56. The options to expand existing income taxes include taxing capital gains, dividends and non-business interest income. These options would have the adverse impact of compromising Hong Kong's simple and competitive tax system. Moreover, imposing such taxes would have a detrimental impact on Hong Kong's status as an international financial and commercial centre. This is because investors would choose or relocate to other jurisdictions, which do not impose such taxes, as a base for their investments.

Is a radical worldwide income tax suitable?

57. A more radical option is to tax worldwide income and abandon our traditional territorial taxation model. This option could theoretically broaden our tax base but would have a far-ranging impact. It would also go against the international trend of reducing or eliminating the effective taxation of worldwide profits. Moreover, in recent years many competitive jurisdictions have moved to exempt foreign source income[12]. As one of Hong Kong's key differentiators is its territorial source concept of taxation, any move to give up this long-standing policy would have a major negative impact on Hong Kong's ability to attract and retain local and international investment.

Options to introduce new taxes

58. Over the years, a host of new tax options for Hong Kong has been raised, including payroll and social security taxes, poll tax, general consumption tax, as well as a number of specific purpose taxes, such as "green" taxes. Many of these options could not significantly broaden the tax base or would add to the cost of doing business in Hong Kong and therefore are unsuitable. They were considered in detail by the Advisory Committee, which did not recommend the introduction of these taxes, with the exception of a general consumption tax. Its findings remain relevant today. As explained in paragraphs 59 and 60 below, although there are two alternatives that can broaden our tax base, we concur with the Advisory Committee's findings that only a general consumption tax is worthy of further consideration in this context.

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[12] Singapore and Malaysia exempt most foreign source company income from taxation. Ireland, the United Kingdom and Australia have also introduced similar exemptions for specified business income.

Our initial conclusion: two viable options

59. We have looked into various options carefully and consider that in the context of broadening our tax base, only two alternatives can meaningfully achieve this objective. They are:

(a) **broadening the salaries taxpayer base** by significantly reducing personal allowances, so that most of the workforce pay tax on their Hong Kong earnings; or

(b) **introducing a new broad-based consumption or indirect tax**, such as a Goods and Services Tax (GST), so that individuals pay tax on their Hong Kong purchases or private consumption expenditure.

Why not reduce personal allowances to broaden the tax base?

60. Using a drastic reduction in personal allowances as a means to broaden the tax base is not the preferred approach for the following reasons:

(a) **Hong Kong uses its personal allowances as a mechanism for providing financial relief** to individuals and households with dependants and in the event of their removal would need to adopt an alternative approach, such as direct government payments, similar to that used in many OECD jurisdictions. This would involve increased government welfare outlays and administrative expenses;

(b) **this would draw wage earners currently paying no Salaries Tax into the tax net**. However, much of the additional revenue would come from existing taxpayers who do not pay tax at the standard rate. It would make Hong Kong less attractive to international talent, and hamper our competitiveness;

(c) **as the workforce shrinks with the ageing population, the salaries tax base would shrink** and become less productive;

(d) **raising more revenue from direct income tax would still leave Hong Kong prone to income volatilities**; and

(e) **disproportionate additional administrative resources would be required** as a huge number of new taxpayers would need to lodge returns, generally for relatively low tax amounts.

Questions

✧ Do you agree that there are only two viable options?

✧ Do you agree that a reduction in personal allowances is not a preferred option?