

## **CHAPTER 7 BUSINESS AND OTHER ORGANISATIONS: IMPACTS AND OFFSETS**

### **GST is not borne by business, but enables cuts in other taxes and charges**

174. GST is not a tax borne by business because registered businesses can reclaim GST paid on their business inputs. Notwithstanding this, most jurisdictions embrace the prospect of the introduction of a GST to undertake wider tax reforms. Tax reform in Hong Kong would grant us the opportunity to redesign our tax base to enhance the competitiveness and sustainability of our tax system and improve future economic prosperity and growth. Moreover, should we implement a GST, it would be critical for it to interact appropriately with our existing taxes, fees and charges.

### **Direct tax cuts could enhance our competitiveness**

175. One of the main reasons for broadening the tax base would be to reduce Hong Kong's reliance on direct taxes, such as Profits Tax, and thereby improve the competitiveness of our tax system.

### **Proposed combination approach**

176. We consider that there are two approaches to reduce taxes on business. The first is to implement an across-the-board cut in certain business taxes. The second is to reduce or abolish fees or taxes that impact on a particular industry sector. We would propose to adopt a combination of both approaches as part of our broader tax reform.

### **Across-the-board cuts to business taxes**

#### Profits Tax cut: sharpening our competitive edge

177. Cuts in the Profits Tax rate would have the most significant and direct impact on Hong Kong's business sector. Profits Tax is the Government's largest single tax revenue item, raising approximately \$70 billion in 2005-06, and a low rate is a powerful sign of competitiveness.

178. As a result of tax cuts in competitor jurisdictions, Hong Kong's headline Profits Tax rate advantage has been narrowing in recent years. In light of this, a Profits Tax rate reduction should accompany any introduction of GST. The extent of any such reduction would depend on a number of factors, including the GST rate, other tax offsets and compensation measures that would be offered as a package, and the fiscal circumstances of the Government closer to GST commencement.

*Box 9 A Profits Tax rate cut*

Each percentage point reduction in the Profits Tax rate would cost approximately \$4 billion a year (by reference to the estimated company earnings in 2006/07). Obviously, the larger the reduction in the Profits Tax rate, the more competitive our tax system would be for business.

We are mindful of the international trend of shifting fiscal reliance from direct tax to indirect tax, and of the need to provide our businesses with an environment that is conducive to their operation. Keeping Profits Tax at a comparatively low rate would help maintain Hong Kong's attractiveness to business, and in turn would help sustain our future growth and development.

Set-up assistance provision: subsidy to small and medium-sized businesses

179. In addition to a cut in Profits Tax, we would propose to offer special set-up assistance to help businesses meet compliance costs associated with GST introduction. Our intention would be to provide this one-off assistance to small and medium-sized businesses and other organisations that voluntarily register for GST. The assistance might take the form of a subsidy for the purchase of GST-related IT equipment and software. We propose to set aside \$200 million for this purpose.

Capital Fee abolition

180. We would propose to abolish the Capital Fee, which is levied on companies' authorised share capital. This measure would encourage more businesses to incorporate in Hong Kong and be consistent with our objective of strengthening Hong Kong's position as a regional business centre. The abolition of the Capital Fee would cost the Government approximately \$30 million a year.

## **Industry-specific tax relief: enhancing our edge in international competition**

181. In drawing up a range of possible tax reductions, we consider it would be appropriate to target relief towards those sectors of the economy that were subject to more intensive international competition. In addition to the financial sector, the import and export trades, logistics industries and the tourism sector are all susceptible to keen international competition. In order to enhance external competitiveness, therefore we should take the opportunity to reduce or abolish those indirect taxes or charges that affect the competitiveness of Hong Kong.

## **Indirect tax adjustments to reduce economic distortion and revitalise competitiveness**

182. It is common international practice to adjust existing taxes following the introduction of a GST. In some circumstances, the failure to adjust an existing tax would result in a distortion of a particular industry's market dynamics.

183. Another reason for adjusting existing taxes is that some goods are already subject to high levels of duty/tax and a further increase in price as a result of GST makes them less competitive when compared to substitutes that are not taxed. For example, the duty on liquor in Hong Kong is comparatively high. Any further increase in the total tax burden may lead to visitors and residents alike reducing their consumption.

## **Principles for adjustment**

184. In considering how to adjust existing indirect taxes, we would adopt the following general principles:

- (a) tax-on-tax<sup>48</sup> should be avoided; and
- (b) 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 on such products.

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<sup>48</sup> This refers to the compounding of taxes, when one tax is levied on top of the other. For example, GST might be levied on the sale of a commercial property, and then Stamp Duty could be levied on the sale value including the GST component therein. If this were to happen, the Stamp Duty would effectively be charged on GST as well.

## Proposed indirect tax adjustments

*Table 11 Proposed indirect tax adjustments*

<b>Indirect tax</b>	<b>Proposed adjustment</b>
Stamp Duty on immovable property conveyance on sale	Nil adjustment. Stamp Duty rate to be calculated on GST-exclusive value for sale of commercial property <sup>49</sup> .
Stamp Duty on immovable property lease	Nil adjustment. Stamp Duty rate to be calculated on GST-exclusive value for commercial property lease.
Stamp Duty on shares transfer	Nil adjustment. No GST would be applied to shares as they are a form of financial supply.
Rates	Nil adjustment. Not subject to GST. GST credit as a relief measure would be available (please refer to paragraph 163).
Government Rent	Nil adjustment. Not subject to GST.
Hotel Accommodation Tax	Abolish with GST introduction to avoid double taxation.
Motor Vehicle First Registration Tax	Adjust rates down to take account of GST imposition.
Duty on Liquor	Adjust rates down to take account of GST imposition.
Duty on Petrol, Diesel and Aircraft Fuel	Adjust rates down to take account of GST imposition.
Duty on Methyl Alcohol	Adjust rates down to take account of GST imposition.

185. To avoid tax-on-tax complications, Stamp Duty on immovable property conveyance on sale would be applied on the GST-exclusive value. For example, if one were to purchase a commercial building for \$100 million plus a \$5 million GST, the Stamp Duty of 3.75% would only apply to the \$100 million but not the \$5 million GST.

186. It should be noted that, to the extent excise duties were reduced to make allowance for the GST rate, registered businesses that acquired these goods, such as liquor, petrol, diesel and aircraft fuel, would be effectively making a saving in operating their businesses as they would be able to reclaim any input tax for the GST they incurred. By replacing a non-creditable tax (or part thereof) with a creditable GST, the cost to consumers would remain the same but the cost of purchase to registered businesses would decrease.

<sup>49</sup> GST would not apply to sale and leasing of residential properties.

187. For example, if the total tax (including excise duty and GST) levied on a litre of petrol were to be kept the same as before introduction of GST, the GST component, which would be creditable, could allow registered businesses to lower their operating costs, thus enhancing their competitiveness and profitability.

188. We would also intend to abolish Hotel Accommodation Tax at the same time as GST implementation to avoid double taxation on the provision of hotel accommodation.

### **Offsets for not-for-profit organisations**

189. We would propose that set-up assistance (as referred to in paragraph 179) be provided to eligible not-for-profit organisations to reduce their compliance costs. Not-for-profit organisations include charities, clubs as well as other community organisations that may not qualify for charitable status.

### **Profits Tax cut**

190. At the same time, clubs and associations that pay Profits Tax would benefit from any cut in the Profits Tax rate.

### **Increase tax deduction limit for charitable donations**

191. Another measure that would be considered as part of the tax reform package for approved tax-exempt charities would be to increase the tax deduction limit for charitable donations. In other words, we could consider increasing the tax deduction limit for charitable donations from the current 25% of assessable income/profits to a higher level, say 50% of assessable income/profits.

192. While this would cost approximately \$100 million a year, such an approach would benefit approved tax-exempt charities (around 4,500 in total) and would support the Government's policy of encouraging greater philanthropy. We will consult the charity sector on this proposal during the public consultation.

## Summary of relief measure options

193. As part of the public consultation process, we welcome your views on these or other proposed compensation measures to relieve business and other organisations. Table 12 summarises the possible tax and fee reduction measures which we propose to implement with GST and the sectors that would benefit from these relief measures.

*Table 12 Proposed relief measures for business and other organisations*

<b>Proposed relief measures</b>	<b>Sectors to benefit</b>
Reduction in Profits Tax rate	All businesses
Abolition of Capital Fee	Incorporated businesses
Reduction in Motor Vehicle First Registration Tax	Logistics and trade
Reduction in Petrol, Diesel and Aircraft Fuel Duty	Logistics and trade
Reduction in Trade Declaration Charges <sup>50</sup>	Import and export trades
Abolition of Hotel Accommodation Tax	Tourism and hospitality
Reduction in Liquor Duty	Tourism and hospitality
Increased tax deduction limit for donations	Charities
Set-up assistance to voluntary registrants	Small and medium-sized businesses and other organisations

### Questions

- ✧ Should we use the opportunity of tax reform to enhance business competitiveness in Hong Kong, by reducing existing taxes and charges on businesses if GST is introduced?
- ✧ What are your views on the measures proposed in this Chapter?

<sup>50</sup> A reduction in Trade Declaration Charges by say 25% would cost approximately \$200 million a year.