



Broadening the Tax Base
Ensuring our Future Prosperity
Tax Reform and Households

Consultation Document Leaflet



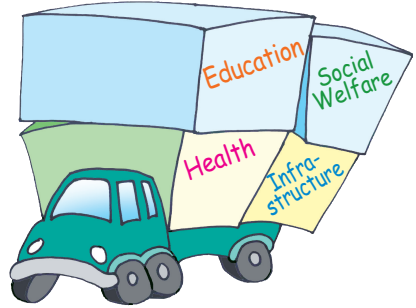
July 2006

Financial Services and the Treasury Bureau
The Government of the Hong Kong Special Administrative Region

1 Why do we need to reform our tax system?

- Our tax base is narrow and volatile, while our expenditure is rigid. As a result, the Government's ability to make long-term plans and major investment decisions for the sustained development of the community is limited.

- We need a tax system which has a broad and stable tax base to lessen the need to increase taxes or reduce expenditure on public services during any economic downturn.



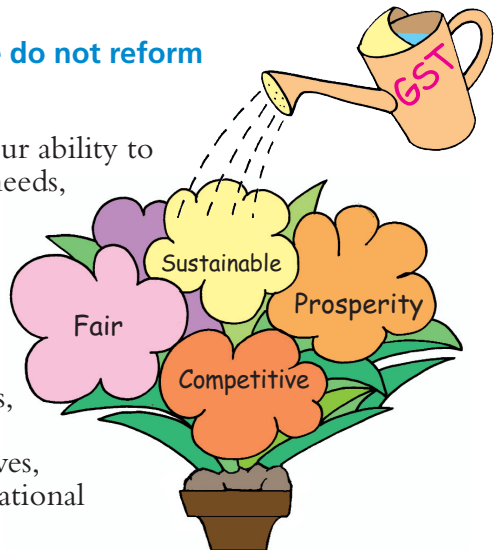
- Our rapidly-ageing population poses many challenges for us. The shrinking of the workforce will result in reduced revenue from Salaries Tax. Additionally, we will see an increasing demand for healthcare and services for the aged.

- Everyone has a civic responsibility to bear a fair share of the cost of public services and facilities.

2 What would happen if we do not reform our tax system?

- We could not be certain of our ability to meet our future expenditure needs, particularly in areas such as education, health, social welfare, and law and order.

- If another economic crisis was to occur, we might have no choice but to increase taxes, cut government expenditure, draw down on our fiscal reserves, or borrow money from international market to cover the shortfalls.



3 Why would Goods and Services Tax (GST) be an appropriate option?

- It can produce stable and predictable revenue that grows with consumption in the economy even with an ageing population.
- It is fair, as individual consumption determines the amount of tax paid. The more money one spends, the more tax that one has to pay.
- It will maintain Hong Kong's international competitiveness and its low-tax environment for attracting foreign investment and talent.

4 What is GST?

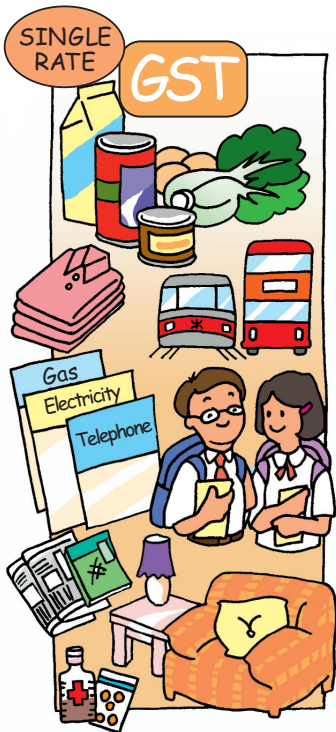
- GST is a multi-stage value-added tax levied on local consumption.



5 What household purchases would be subject to the proposed GST?

- Most household goods and services would be subject to a single low-rate GST. These include groceries, utility charges, public transport, medical services, education, newspapers, magazines, meals, clothing, electrical appliances and home furnishings. However, purchases of goods and services from non-GST registered businesses would not be subject to GST.
- Some financial services (such as mortgage payments, interest on bank accounts, purchase of shares and interest on loans), rental and purchase of residential premises would not be subject to GST.

6 What effect would GST have on prices?



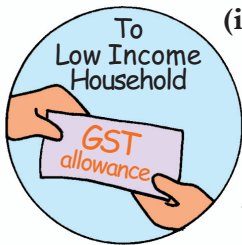
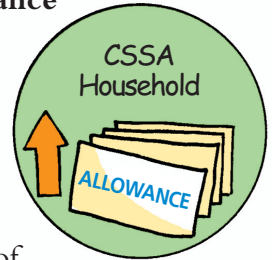
- Based on our calculation, an assumed GST rate at 5% would result in a rise in the price effect of only around 3% in the short-term. However it would be a one-off increase and would quickly dissipate.
- Any price movement would largely be a function of market conditions, the level of competition, pricing and market-positioning strategy of various market participants.
- Generally, items sold by registered businesses would increase by the GST rate while items sold by unregistered businesses would increase by a lesser extent. In any case, no price should rise by more than the GST rate. As an illustration, before the introduction of GST, a bag of rice purchased from a supermarket is \$40. After implementation of GST, the GST-registered supermarket will likely increase the price to \$42.

7 What offsetting measures would households receive were the proposed GST implemented?

The following offsetting measures are proposed for relieving the likely impact that a GST might have on households:

(i) Comprehensive Social Security Assistance (CSSA) households

- Upfront one-off “supplement” equal to the estimated GST impact would be provided.
- Through the existing actual price change mechanism for the annual adjustments of CSSA, households receiving these allowances would be properly compensated for any loss of purchasing power in subsequent years.

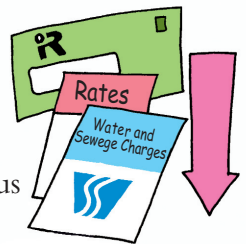


(ii) Non-CSSA low-income households

- An annual cash GST allowance of \$2,000 per eligible household would be paid upon application on an ongoing basis, plus
- An annual GST credit of \$500 per household to be used against water and sewage charges, plus
- An annual GST credit of \$3,000 per household to be used against Rates on residential premises.
- The above GST credits would be paid for an initial five-year period and then be subject to review.

(iii) All other households

- Tax reductions, plus
- An annual GST credit of \$500 per household to be used against water and sewage charges, plus
- An annual GST credit of \$3,000 per household to be used against Rates on residential premises.
- The above GST credits would be paid for an initial five-year period and then be subject to review.



8 What would be the proposed timetable for GST introduction?

We are aware that GST introduction would have widespread implications for Hong Kong. It is therefore necessary for us to progress this issue cautiously and carefully. We will listen to the views of the community extensively before making a recommendation to the Government of the next term to consider whether and if so, how Hong Kong should pursue tax reform and introduce a GST. Even if a decision was made by the Government of the next term to introduce a GST, it would take at least two to three years for this tax to be implemented in Hong Kong.

Additional Information Available

An electronic copy of this leaflet, the Consultation Document, as well as other relevant reports and leaflets are available at the website www.taxreform.gov.hk. Further information will be posted on to this website when appropriate.

Additional Leaflets

- Small Business
- Wholesale and Retail Sector
- Import/Export Trade and Logistics Sector
- Financial Services Sector
- Property Sector
- Tourism and Hospitality Sector