

CHAPTER 3 THE CASE FOR GST

61. After considering all the options available, we believe that GST is the most viable option for broadening the tax base, because:

- (a) **it can produce stable and predictable revenue** as it is based on consumption expenditure, which does not fluctuate to the same extent as income or asset values;
- (b) **it is very broad based** and thus can be levied at a low rate to produce significant revenue;
- (c) **it is fair**, as similar and competing forms of economic activity are taxed in the same way. Individual consumption determines the amount of tax to be paid. The more money one spends, the more tax one has to pay;
- (d) **avoidance is difficult**, due to its multi-stage taxing and crediting mechanism, and all those who purchase from registered businesses have to pay the tax irrespective of their background, income level or other circumstances. Even if their source of income is not liable to tax, they will still be taxed when they spend;
- (e) **it is capable of growing in line with consumption** in the economy, even with an ageing population; and
- (f) **it would maintain Hong Kong's competitiveness** and its low-tax environment for attracting foreign investment and talent.

Many organisations and studies continue to recommend GST as the best option for Hong Kong

62. The Advisory Committee, in its report submitted to the Financial Secretary in February 2002, recommended that GST would be the best option for broadening the tax base, because:

“GST is the only new tax with the long-term capacity to broaden the tax base which is not incompatible with Hong Kong's external competitiveness.”

63. International organisations have also come to the same conclusion:
- (a) “The introduction of a goods and services tax is the best option to broaden the tax base and stabilise revenues in the medium term.” (IMF Article IV Consultation Report on Hong Kong issued in May 2003);
 - (b) “A goods-and-services tax (GST)... would set public finances on firmer ground...” (Standard and Poor’s, May 2005); and
 - (c) “To strengthen Hong Kong’s public finances, [IMF] staff has for some time supported the introduction of a GST as an appropriate tax reform.” (IMF Article IV Consultation Report on Hong Kong issued in February 2006).

Overall, the Government believes that GST is the best option to broaden Hong Kong’s narrow tax base, while not compromising our competitiveness

64. GST can stabilise our public finances by ensuring that they are not as susceptible to economic cycles as our current tax base. Tax reform with a low-rate GST is capable of generating significant revenue that can be used for meaningful tax relief and compensation measures.

65. From a macro-economic standpoint, GST would help place Hong Kong’s public finances on a more secure footing so that we could avoid again relying on increases in Salaries and Profits Taxes, borrowing money from international financial markets or further running down our fiscal reserves. Moreover, GST is widely regarded as an efficient, fair and robust tax, and has been implemented in at least 135 jurisdictions around the world.

Is GST a fair tax?

66. A common criticism against GST is that it is a regressive tax, which has the effect of taxing the poor more heavily than the rich in proportion to income.

67. However, the measurement of fairness should not be restricted to income alone. Based on the “capacity to pay” principle, GST is a fair tax as it is based on consumption, which is arguably the best indicator of an individual’s standard of living. Thus, the higher the spending - which is generally the case for the higher income and wealthier groups - the higher the amount of tax paid.

68. Overall, what determines fairness is not just the impact of any particular tax but the interaction of the tax system and public spending policies and its end result. A tax system is fair if the revenue generated is used to finance appropriate programmes for the welfare of the community, with emphasis on care for the underprivileged and provision of public services, such as education, healthcare, welfare and law and order.

The GST proposed for Hong Kong is a fair tax as it would be simple, low-rate and accompanied by tax offsets and compensation measures, which will be explained in Chapters 6, 7 and 8.

Question

- ◇ Do you agree that GST is an appropriate option to broaden Hong Kong’s narrow tax base?