

Price impact would be modest and market-driven

149. Based on our calculations, we estimate that GST at 5% would result in a price effect of only around 3% in the short term³⁴. We therefore anticipate that a 5% GST would have only modest implications for household expenditure. For those households who bought food, clothing, personal and household services from small, unregistered establishments, the implications of GST would be even less. With the limited exception of regulated prices, prices in Hong Kong are determined by market forces. Price movements in response to GST introduction would largely be a function of market conditions, the level of competition, and the pricing and positioning strategy of various market participants. However, no prices should rise by more than the GST rate as a result of its introduction.

Price rises from unregistered businesses should be less than the GST rate

150. The expected price rises of goods and services purchased from unregistered businesses would depend on a number of factors, such as whether they had incurred GST on their purchases (which, not being registered, they could not reclaim) and the market conditions in which they operated. As a guide, prices charged by unregistered businesses should not rise as much as those of registered businesses as a result of GST.

Box 8 How would the introduction of GST affect typical household purchases?

The average price rise, as represented by the change in the Composite Consumer Price Index (CCPI), for household expenditure resulting from GST (and related tax changes) is estimated to be around 3% shortly after the proposed commencement of GST, assuming a GST of 5%.

Food and meals away from home would be anticipated to rise by up to the assumed rate of 5% when bought from registered sellers. Purchases from unregistered small shops and market stalls should rise by a lesser amount, as GST is not chargeable on those supplies.

Alcoholic products should not rise in price, due to a proposed corresponding reduction in excise duty.

Education, medical services, public transport fares and utility charges might rise in price by up to the assumed rate of 5%, depending on the GST registration status of the suppliers. Other services, such as hairdressing,

³⁴ Projected short-term GST impact on household expenditure is at Appendix C.

accounting, legal, tailoring and cleaning, might rise by the GST rate if the business was GST registered.

Rent for residential property should not initially rise as it would be exempt from GST, while Rates would not rise, as they would not be subject to GST.

The cost of clothing, footwear, electronics and household goods might rise by up to the GST rate if purchased from a registered business.

New motor vehicle prices and prices on petrol and diesel should not rise, as the existing tax and excise duty would be adjusted to take account of the GST rate.

Banking and interest charges should not change, as they would not be subject to GST³⁵.

The cost of international travel, i.e. airfares and tours to the Mainland and overseas countries, should not increase, as it would not be subject to GST.

Tax relief and compensation would be necessary for the community

151. Even allowing for the anticipated small price effect of GST introduction, we consider that relief measures would be critical and necessary, especially for the most vulnerable groups in our community. Assuming that a 5% GST rate was to be levied, the revenue so generated would allow the Government to provide meaningful tax relief and compensation measures for the community³⁶.

³⁵ Assuming the particular items fell within the proposed “financial supply” definition.

³⁶ For details of the revenue implications of GST, please refer to Chapter 8.

Illustration of impacts of GST on household spending

152. To assist in understanding the impacts of an assumed 5% GST rate on household spending, we have included the following illustrative examples, based on three different household income groups.

Example 1 Low-income household³⁷

Monthly expenditure³⁸, which is made up of³⁹:	\$7,990	Increase in percentage⁴⁰	Price effect due to GST⁴¹
Food	\$2,530	4.5%	\$114
Housing	\$2,440	0.5%	\$12
Electricity, Gas & Water	\$410	5.0%	\$21
Liquor & Tobacco	\$120	3.8%	\$5
Clothing & Footwear	\$240	4.8%	\$12
Durable Goods	\$290	4.9%	\$14
Miscellaneous Goods	\$420	4.9%	\$21
Transport	\$520	4.0%	\$21
Miscellaneous Services	\$1,010	4.2%	\$42
Increased cost of living due to GST (monthly)			+ \$262
Increased cost of living due to GST (annually)			+ \$3,144

³⁷ Belonging to the lowest 20% income households as listed at Appendix C.

³⁸ As the “monthly expenditure” is rounded to the nearest \$10, it may not add up to the total due to rounding.

³⁹ The household spending patterns on individual expenditure items have been drawn from the “Household Expenditure Survey 2004/05”.

⁴⁰ These percentages are based on the annual short-term GST impact on household expenditure as shown at Appendix C.

⁴¹ The price effect due to GST is calculated based on the annual short-term GST impact as shown at Appendix C. As this is rounded to the nearest \$1, it may not add up to the total due to rounding.

Example 2 Middle-income household⁴²

Monthly expenditure, which is made up of :	\$15,540	Increase in percentage	Price effect due to GST
Food	\$4,760	4.4%	\$209
Housing	\$4,340	0.6%	\$26
Electricity, Gas & Water	\$640	5.0%	\$32
Liquor & Tobacco	\$170	3.6%	\$6
Clothing & Footwear	\$640	4.8%	\$31
Durable Goods	\$710	4.9%	\$35
Miscellaneous Goods	\$770	4.9%	\$38
Transport	\$1,270	3.7%	\$47
Miscellaneous Services	\$2,230	3.7%	\$83
Increased cost of living due to GST (monthly)			+ \$507
Increased cost of living due to GST (annually)			+ \$6,084

Example 3 High-income household⁴³

Monthly expenditure, which is made up of :	\$37,750	Increase in percentage	Price effect due to GST
Food	\$7,490	4.4%	\$330
Housing	\$12,660	0.7%	\$89
Electricity, Gas & Water	\$900	5.0%	\$45
Liquor & Tobacco	\$120	2.1%	\$3
Clothing & Footwear	\$1,830	4.8%	\$88
Durable Goods	\$2,000	4.9%	\$98
Miscellaneous Goods	\$1,710	4.9%	\$84
Transport	\$4,230	2.8%	\$118
Miscellaneous Services	\$6,820	2.9%	\$198
Increased cost of living due to GST (monthly)			+ \$1,053
Increased cost of living due to GST (annually)			+ \$12,636

⁴² Belonging to the third 20% category as listed at Appendix C.

⁴³ Belonging to the highest 20% category as listed at Appendix C.

Defining target groups for design of offset package

153. In designing an offset package for households, we have identified different target groups to be compensated on the basis of their need and consumption pattern. Broadly speaking, our community could be classified into three groups for the purpose of designing a GST household compensation package.

Group 1 CSSA households — fully compensated

154. The first group could be Comprehensive Social Security Assistance (CSSA) households. They are one of the most vulnerable groups in the community and would require assistance upon GST introduction. The Government's commitment would be that this group of households should be fully compensated for the introduction of GST through the proposed compensation measures.

Group 2 Non-CSSA low-income households — targeted compensation

155. The second group could be those low-income households that were not in receipt of CSSA, but whose incomes were still low enough to warrant targeted compensation in order to alleviate the impact of GST on their livelihood. The household in Example 1 could be indicative of this group.

Group 3 All other households — relief available

156. The third broad group would embrace all other households and include existing taxpayers⁴⁴, who currently bear a significant share of the tax burden. The households in Examples 2 and 3 could be indicative of middle and higher income households respectively in this group.

All groups would receive offsets, one way or another

157. The Government would provide offsets to all groups. Overseas experience shows that, to be fair and effective, a relief package should comprise a combination of general measures, which are applicable to all groups, and some other measures that are targeted towards specific groups.

⁴⁴ "Taxpayers" would include those individuals paying Salaries Tax, Personal Assessment, Profits Tax and Property Tax.

Delivering relief to the target groups

Group 1 CSSA households — upfront supplement available

158. Group 1 would receive an upfront supplement equal to the estimated GST impact on the Social Security Assistance Index of Prices (SSAIP) were GST introduced. In this way, CSSA households would be fully compensated for the GST impact on their livelihood from Day One. Through the existing “actual price change” mechanism for annual CSSA adjustments, recipients would be properly compensated for any loss of purchasing power in subsequent years. To implement this proposal, we would expect it to cost approximately \$800 million a year.

Across-the-board measures for Groups 2 and 3 households

159. We are considering some across-the-board measures which aim to compensate the other two groups. Two possible measures which lend themselves to delivering relief to households in an “across-the-board” manner would be reducing water and sewage charges and reducing Rates. It should be noted that both these forms of relief have been used in the past to relieve the financial burden on households.

“GST credit” for water and sewage charges at \$500

160. A reduction in water and sewage charges is one option that would benefit most households. It would not, however, be feasible to provide significant annual relief through this mechanism to all households, as some might pay little or no charges, due to the existing subsidy and low consumption levels.

161. A credit in water and sewage charges could be provided to each household to set off against their actual consumption in the current year. Approximately half of all households incur less than \$500 in water and sewage charges a year, hence we would propose to set the GST credit per household at \$500 a year.

“GST credit” for Rates at \$3,000

162. The option of a GST credit for Rates on residential premises would benefit almost every household. The GST credit could be paid as a flat annual amount, which would provide the greatest benefit to lower and middle-income households. However, an issue would be how to ensure that the saving was passed on to private tenants that did not pay Rates directly (i.e. where monthly rental was all-inclusive). One option would be to require tenants to endorse any Rates credit before the landlord could claim the GST credit, and therefore offset the credit against their rent for the relevant period. With respect to public housing tenants, discussions would be held with the Housing Authority to ensure that the proposed relief was delivered as intended.

163. As Rates apply to most households, either directly as owners or tenants, or passed on indirectly by the Housing Authority and other landlords in rentals, we would propose to set the GST credit per household at \$3,000 a year. As the average Rates payment is approximately \$3,000 a year for each domestic unit, the proposed amount would provide sizeable relief to all households, but it should particularly benefit lower and middle-income households, many of whom would end up paying no Rates after taking account of this measure.

164. We would propose to provide the above across-the-board measures for an initial period of five years. After this period, the effectiveness and efficacy of these forms of relief would be subject to review before any decision was made whether to continue or modify them.

Specific measures for Group 2 — Non-CSSA low-income households

165. Group 2 households might face impacts from GST on their cost of living similar to Group 1 households, but without resort to the social security compensation mechanism. This group would include some of the lowest-income and most-vulnerable households. We would be keen to ensure that the impact of GST on the living standards of these households would be mitigated.

166. For the purposes of this consultation exercise, we assume that Group 2 households would be those who were not drawing CSSA, but with household income within the lowest 20%. If this definition was used, then approximately 400 000 households would be covered by measures aimed at this group, i.e. GST allowance (see paragraphs 167 and 168 below). We welcome community views on how this group should be defined with respect to its income levels.

GST allowance – direct cash relief at \$2,000 a year

167. Although the proposed across-the-board measures as described above should provide satisfactory compensation for this group, there might be circumstances in which households could not fully avail themselves of those benefits. In Example 1, a 5% GST would increase the cost of living of Group 2 households by approximately \$3,144 a year. Some low-income households, however, do not pay water and sewage charges⁴⁵, while many lower-income households in private and public housing pay Rates of less than \$3,000 a year. Therefore, to ensure lower-income households received compensation that could at least make up for the impacts of GST, we would propose to make available to such households a special “GST allowance” in direct cash. Currently, we would propose to set the annual GST allowance at \$2,000 per household.

168. Accurate identification of those households that would receive the GST allowance is, however, not easy. The Social Welfare Department does not have their income records, and neither does any other government department or agency. We therefore intend to employ a self-identification system whereby these households would have to apply to the Government. The applications would be assessed against a set of objective criteria designed to target compensation towards only those genuinely in need. Subject to applicants meeting the criteria, the GST allowance would then be granted to their families. To minimise administrative work, the assessment system would need to be kept simple.

⁴⁵ Based on 2006 actual water and sewage charges, around 15% of households using these services were not charged.

Group 2 households no worse-off after GST implementation

169. In summary, the combination of measures proposed for Group 2 means they should receive up to \$5,500 compensation per household. This amount and the methods proposed should result in these households being no worse-off following the proposed implementation of the GST package.

Specific measures for Group 3 – All other households

170. Group 3 would constitute all households not covered by Groups 1 and 2. It would include individual taxpayers as well as those who were earning modest incomes that did not require them to pay individual tax, e.g. Salaries Tax or Personal Assessment. This group is by far the largest group and, to varying degrees, bears most of Hong Kong's tax burden. We propose that compensation for this group would be delivered through the following means:

- (a) across-the-board measures as described in paragraphs 160 to 164; and
- (b) relief for taxpayers.

171. A reduction in the tax rates paid by individuals, including tax rates for Salaries Tax, Personal Assessment, Property Tax and Profits Tax for unincorporated businesses, would provide the most direct and effective relief to taxpayers. With the introduction of a GST that provided the Government with a broader tax base and a more stable source of revenue, we could give further significant personal tax relief. For details, please refer to Chapter 8.

Table 9 Summary of proposed household relief measures

Group 1 CSSA households

An upfront one-off supplement equal to the estimated GST impact on the SSAIP would be provided.

Through the existing “actual price change” mechanism for the annual adjustment of CSSA, households receiving these allowances would be properly compensated for any loss of purchasing power in subsequent years.

Group 2 Non-CSSA low-income households

An annual cash GST allowance of \$2,000 per eligible and self-identified household would be paid on an ongoing basis, plus

Across-the-board measures:

- i) An annual GST credit of \$500 per household against water and sewage charges that would be paid for an initial five-year period and then be subject to review, plus
- ii) An annual GST credit of \$3,000 per household to be used against Rates that would be paid for an initial five-year period and then be subject to review. Tenants could benefit from lower rents due to the reduction in Rates.

Group 3 All other households

Tax reductions, plus

Across-the-board measures as for Group 2 above.

172. Table 10 sets out the likely impact that the GST tax reform package might have on different households.

Table 10 Possible impact of GST tax reform package

Household description	Package impact
CSSA household	The impact of GST on your cost of living would be fully offset by an upfront supplement to your CSSA and subsequent regular inflation adjustments.
Non-CSSA low-income household	The across-the-board relief measures, being an annual credit of water and sewage charges, an annual credit of Rates, and an annual direct cash allowance would mostly offset the GST impact on your living standard.
Non-taxpaying lower-middle-income household	Your household would benefit from the annual credit of water and sewage charges, and an annual credit of Rates. These measures would mitigate the impact of GST on your livelihood.
Upper-middle-income taxpayer ⁴⁶ with own flat	The tax reform package would reduce your tax burden, give you a credit to reduce your Rates and provide an annual credit to reduce your water and sewage charges.
Retiree with income only from property ⁴⁷	The impact of GST would be alleviated by the annual credit of water and sewage charges, the annual credit on Rates and a reduction in your property tax bill.

⁴⁶ Taxpayers include salaries taxpayers, plus property taxpayers and profits taxpayers who elect for Personal Assessment, and are taxed at Salaries Tax rates and thus would benefit from any reductions in these rates.

⁴⁷ Some retirees who receive a monthly pension are required to pay Salaries Tax if their income is above the personal allowance level. They would also benefit from the reduction in Salaries Tax.

Purposes of offsets? Sharing tax reform benefits, mitigating adverse GST impacts

173. Our ultimate objective in offering these relief measures would be to share the benefits of tax reform as well as to mitigate any adverse impact of GST on the community. We fully understand that increased prices would reduce the purchasing power of households. We nevertheless believe that through introduction of the proposed measures, the adverse short-term effects of GST would be alleviated. We welcome community views on these proposed measures.

Questions

- ✧ Do you support providing tax relief and compensation measures for households if GST is introduced?
- ✧ What are your views on the measures proposed in this Chapter?
- ✧ How do you think that Group 2 should be defined?