

Broadening the Tax Base
Ensuring our Future Prosperity

Small Business



Consultation Document Leaflet

July 2006

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

This leaflet is specifically provided for reference by persons carrying on business in Hong Kong, (e.g. manufacturers, wholesalers and retailers) including persons who are self-employed (e.g. doctors, accountants and lawyers) but with annual turnover less than \$5 million, and is designed to supplement the information outlined in the Consultation Document.

1 Why do we need to reform our tax system?

We need to reform our tax system to ensure a steady revenue source to secure our future growth and prosperity.

Hong Kong has a very narrow tax base and volatile revenue. This position limits our ability to manage and plan our public finances and has serious economic implications for Hong Kong's future, particularly in times of economic downturn and adversity. We need a robust and secure revenue base to maintain our vibrancy, to remain competitive and to meet the challenges arising from our ageing population.

If we do not do anything to address the fundamental flaws in our tax system, and try to rely on our existing tax system to carry us through any economic uncertainties, then the worst-case scenario is that many of us will ultimately be worse off. Should another economic crisis occur, we would be faced with higher interest rates and a higher level of unemployment. This would have an impact on our living standards and would undermine our

attractiveness to foreign investment and skilled labour.

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

GST 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 would help maintain Hong Kong's competitiveness and its low tax environment for attracting foreign investment and talent.

3 What is GST and how does it work?

GST is a multi-stage indirect tax levied on local consumption. It is collected at each stage by registered vendors throughout the production and distribution chain. Under the GST mechanism, each registered vendor charges GST on his sales and reclaims credits for the GST paid on his purchases. Hence, vendors do not bear the GST. The total amount of GST collected by them would be equal to the amount of GST finally borne by consumers.

4 Would a small business have to register for GST?

No, under the proposed GST framework, only those businesses with an annual turnover above the registration threshold (proposed to be \$5 million) would be required to register.

The purpose of setting a high registration threshold for Hong Kong would be to exclude most small and medium-sized businesses from the

proposed GST system and therefore exclude them from GST compliance obligations. By doing so, small and medium-sized businesses would not be required to levy or collect GST. Nevertheless, businesses with turnover below the threshold could apply for voluntary GST registration.

The proposed exclusion of small and medium-sized businesses from mandatory registration acknowledges the fact that their accounting systems and manpower resources are generally not as sophisticated as large businesses. However, the cost of not registering would be that these businesses could not reclaim any input tax which they might have paid on their purchases. Nevertheless, should a small business decide to register for GST, the Government would provide a one-off set-up assistance to help that business meet the compliance costs associated with GST introduction. The assistance might take the form of a subsidy for the purchase of GST-related IT equipment and software.

5 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

- Tax Reform and Households
- Wholesale and Retail Sector
- Import/Export Trade and Logistics Sector
- Financial Services Sector
- Property Sector
- Tourism and Hospitality Sector