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 Urgent Return Receipt

To: taxreform@fstb.gov.hk

cc:

Subject: Comments on Consultation Document in respect of "Broadening the Tax Base, Ensuring our Future Prosperity, What's the Best Option for Hong Kong?"

Dear Sir

I am a Tax Accountant in Hong Kong and have pleasure in reading the captioned Consultation Document.

First of all, I would like to thank the Government for taking the initiative of issuing this Consultation Document. I believe the subject of the Consultation Document had always been one of the most controversial topics in the past few decades. Hence, I appreciate the Government for taking up its responsibility and having the political courage to take the lead in discussing this debatable topic.

### Comment

There are two topical questions mentioned in the Consultation Document namely "Is tax reform required in Hong Kong?" and "Broadening the tax base: what are our options?". My answers to these two questions are quite similar to the Government's view. That is, I agree that a tax reform is required in Hong Kong and GST is one of the ways, and maybe the most efficient and effective one, to broaden the tax base of Hong Kong.

Hence, in principle, I agree to implement GST in Hong Kong.

However, I have the following concerns if GST is implemented in Hong Kong.

#### 1. Use of revenue collected from GST

In the Consultation Document, the Government mentioned that the revenue collected from GST after the deduction of the administrative costs and the proposed compensation to household, business and charities may be used in three different manners:

- (i) Reduction in Salaries Tax;
- (ii) Reduction in Profits Tax; and
- (iii) Increase public expenditure.

As mentioned in the Consultation Document, the Government explicitly stated that the purpose of implementing GST is not to generate additional revenue to the Government (Chapter 8). Hence, the revenue generated from GST should be used to reduce the revenue collected from other means. According to paragraph 195, the Government proposed that "For the first five years following the introduction of a GST, all revenue so generated, after government administrative costs relating to its collection had been met, **would be returned to the community as tax relief or compensation or other measures.**" As such, I object to the proposed use of revenue to increase public expenditure, as (iii) mentioned above.

In addition, the Government has always been criticised that the resources were not spent in an

efficient and effective manner. There are also some critics expressing their view that, after the implementation of GST, the Government will not put much effort in controlling public expenditure because it is so easy to collect revenue by increasing the GST rate. I believe that this is also the concern of many of the middle-class who has reservation in supporting the implementation of GST in Hong Kong.

On the contrary, the Government should give confidence to the community that it will continue to control its public expenditure as in prior years no matter whether GST will be implemented or not. Besides, the Government should also demonstrate its ability to allocate the resources appropriately to build up more confidence from the community on the Government's methodology in public finance.

**If the revenue collected from GST will be wholly or partly used to increase public expenditure, I shall disagree to the implementation of GST.**

2. Reduction in profits tax rate for zero-rated sector

Under the proposed GST system, there are some zero-rated sectors such as financial services, export and international supplies, etc.

In this case, the businesses in these sectors do not contribute to the revenue of GST, neither as a withholding agent nor a payer of GST. Accordingly, on a fair basis, they should not be the beneficiaries of the reduction in profits tax rate after the implementation of GST.

According to paragraph 107 of the Consultation Document, the financial services sector accounted for about 12.2% of Hong Kong's GDP. On one hand, I appreciate their contribution to Hong Kong's business development. On the other hand, they are also using the infrastructure available in Hong Kong to run their businesses and earn their profits. Hence, the proposed zero-rated sectors will be benefiting from the GST at the expense of the other sectors of the economy. This is no doubt against one of the most important criteria of a good tax policy – fairness. If the revenue collected from GST will be returned to the community solely by way of reduction of profits tax, I suggest that the zero-rated sectors be excluded from the reduction. Subject to further economic analysis, their exclusion may also allow the Government to reduce the profits tax rate applicable to the other sectors by say a further 1%.

**I suggest that businesses in the zero-rated sectors should not enjoy any direct benefit from return of GST revenue.**

3. Direct cash relief to low-income household

In Example 1 (paragraph 152, page 60) of the Consultation Document, it is estimated that the annual price effect due to GST is approximately HK\$3,144 for each low-income household. However, there is no precise definition of low-income household, such as the monthly income, composition of the members of the household.

For example, is household with monthly income of HK\$6,000 consists of a couple and a child considered as low-income household? Also, is household with monthly income of HK\$15,000 consists of a couple and four children all below 10 year-old considered as low-income household? I consider that both of them are low-income household because the

monthly income per headcount is below HK\$3,000.

When comparing to Example 1, in the former case, that low-income household is unable to spend HK\$7,990 per month because the monthly income is just HK\$6,000. Cash relief of HK\$2,000 may be enough. However in the latter case, the monthly spending may be more than HK\$7,990. How can the cash relief of HK\$2,000 help this household under the proposed GST?

**Hence, a more comprehensive relief system should be considered in order to compensate the impact of GST on low-income households.**

E.g.

No of members of low-income household	Cash relief (HK\$)
2-3	2,000
4-5	4,000
6	6,000

#### 4. Detailed calculation of the proposed GST

The Consultation Document said that the estimated revenue from GST at 5% is approximately HK\$30 billion, i.e. HK6 billion per 1% of GST.

However, there is no detailed calculation of how the above revenue is arrived at. This would diminish the persuasiveness of the proposed GST.

One of the major arguments against the implementation of GST is that if the Government overestimates the revenue generating impact of GST, the Government can always increase the GST rate after the five-year guarantee time period. Hence, the proposed 5% rate is almost meaningless.

Another response would be for the Government to show its detailed calculation of how the estimated revenue is arrived at. This would allow the public to evaluate the basis and assumptions used. If the basis, assumptions and calculation are considered to be reasonable, it would increase public confidence in the introduction of GST.

**Hence, I suggest the Government should provide more details about the calculation of the proposed GST.**

#### 5. Calculation of other alternatives

In Chapter 2 of the Consultation Document, it has mentioned that there are a number of other alternatives to broaden the tax base, such as increasing property-related taxes, expanding the scope of the existing taxes, worldwide income tax, introduction of new taxes, broadening salaries taxpayer base.

Although some reasons are given to justify that these alternatives may not be viable, no detail

is given in the Consultation Document about the revenue that may be collected from these other alternatives. As such, I suggest that **the Government should provide more details of those alternatives so that the community can discuss and compare these alternatives instead of focusing the discussion on the implementation of GST.**

6. Introduction of system to reduce GST rate

After the implementation of GST and the reduction of profits tax rate, the overall business environment may be improved. The profits tax so collected may be increased. The overall revenue of the Government may then be increased.

**It is therefore important for the Government to promise the introduction of system to reduce the GST rate if the overall revenue reaches certain target.**

7. Guarantee against GST rate hike

In order to get the public's acceptance to the introduction of GST, the Government makes a promise not to increase the 5% GST rate in the next five year. Although the Government may succeed in getting the public's acceptance, this is purely a political measure but is a poor economic management skill by the Government. If the Government has overestimated the revenue impact of GST, and the increase in tax revenue by all means is imminent, limiting the raising of the much needed revenue by GST would only reduce the Government's flexibility, given that ultimately the revenue would need to be raised from somewhere.

Hence, in addition to the consideration of item 6 above, **it is not suggested the Government should give any promise to freeze the GST rate.** Instead, **the Government should prepare the estimation as realistic as possible .**

The above are my comments on the Consultation Document. Please feel free to contact me if you need further details.

Yours faithfully

Wilson Cheng