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To: taxreform@fstb.gov.hk

cc:

Subject: On the proposed GST taxes

After reading the government's document on supporting a GST taxes, I must say the argument for adopting a GST tax is less than convincing.

On your point a) (in executive summary), I fail to see the need to further reduce the already low corporate tax of HK. Your Table I already shows it has one of the lowest corporate tax rate of Asia, with the exception of Macau. But Macau is hardly a valid or fair comparison as its small size and lack of financial and import/export infrastructure makes it a non-competitive location for a financial and trading center.

I am sure you will agree that there are many factors that make a place competitive - a low corporate tax rate being only one of them. It is clear that Hong Kong already has a very competitive corporate tax rate, and together with its rule of law and its advanced financial and physical infrastructure makes it one of the most attractive places for businesses in the world. Your point about Hong Kong's eroding competitiveness because its corporate tax rate needs to be reduced is therefore overstated at best.

As an aside, in comparing the financial systems of US to that of Hong Kong, I find that the financial competitiveness of Hong Kong can be further improved including 1) reducing the transaction costs of financial trading. Despite proposals to deregulate the commissions of stock trading, the commission costs remain regulated at a high level (compared to US). (I suspect special interests are at work to the detriment of the overall financial being of Hong Kong) 2) introducing financial derivatives (such as options market) for market hedging and improved liquidity for the market. 3) Improving corporate governance. Despite the negative coverage of financial derivatives by the media in the US, financial derivatives provide a very useful function for a stable and advanced financial market. The government has not done much in recent years to make any progress in the aforementioned 3 areas to further improve its financial system.

Your point on the fairness of GST is misleading. Any reasonable comparison on the relative burden of GST on the various income groups would compare the food expenditure as a % of household income, not household expenditure. While higher-income groups may spend more, in absolute terms, than lower-income families (as your Table 6 shows), it is clear that they spend far less, in percentage points, than lower-income families. It is precisely this point that why GST is considered regressive. Foods are indeed necessities that need to be purchased even if they make up a large percentage of one's income for lower-income families. A GST tax would only add to this burden, a burden that a low-income family could ill afford.

One negative factor about a GST tax is the ease with which governments can raise revenue by raising the rates once it has been introduced. At the introduction of GST tax, a government may have every intention of keeping its tax rate low. However, over time, it is almost always more politically expedient to raise the tax rate once a

GST or a sales tax is in place, rather than to cut government expenditure to make the government more efficient. History has amply shown that one seldom, if ever, witness a GST or sales tax rate goes down. Rather, it has almost always gone up. I still remember the sales tax rate in California was about 4% 30 years ago. Now it's up to a not insignificant 8.25%. The point about a broad-based sales tax bringing stability to government revenue was not true in California. It had a significant shortfall in government revenue in the early 2000's despite having a sales tax. It shows that while GST is broader based, it is no panacea.

While having a prohibitively high personal income tax may discourage competitiveness and entrepreneurship, Hong Kong is quite extreme in the lack of taxation of high income and net-worth individuals compared to other developed countries. Certainly in the US, there is no lack of entrepreneurship and competitiveness, the income tax rate is far higher and capital gain tax provides a significant portion of the government's revenue. The elimination of estate tax is definitely a step in the wrong direction. Although I am against heavy taxation by the government (especially on the middle class), the superrich can definitely be taxed higher without harming the competitiveness of Hong Kong.

Based on the above discussion, the case for a GST tax to improve competitiveness is not too convincing. There are other ways to improve competitiveness such as ways to make the financial system more efficient and advanced. That it is a broader-based tax is true although it is no panacea and shortfalls in government revenue will still occur, as was the case in California.

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