



International Chamber of Commerce - Hong Kong, China 國際商會 - 中國香港區會

The world business organization

24th November, 2006

The Financial Secretary

Tax Reform

Financial Services and Treasury Bureau

4/F., Main Wing, Central Government Office,

Lower Albert Road, HK

Dear Sir,

We refer to the Administration's consultation document and should like to respond after having considered the matter carefully.

2. The document suggests ensuring future prosperity through broadening the tax base. This is a momentous issue which demands thorough study and discussion. Prosperity of course depends on many factors, not least a tax system which can attract talent and investment to come and stay in Hong Kong. For the past few decades, Hong Kong has been considered very successful in this regard. Therefore, any change to current arrangements will have to be viewed critically, lest it might undermine the basis upon which Hong Kong has progressed over the years.

3. The purpose of the GST is, according to the document, to change the tax system to establish for the government a steady and growing revenue source, to secure future economic growth and prosperity, to maintain vibrancy, international competitiveness, and to meet the needs of an aging population. The mechanism proposed to achieve this is to broaden the tax base, and the best means for this, the Administration argues, is to introduce the GST.

4. It is therefore necessary to prove that the GST is the right tool for the purpose. Unfortunately, there are clear reasons that the GST is not the right choice.

Taxation Issues

5. The GST is not equitable. It unfairly taxes the middle and low classes more and will widen the wealth gap which is already growing.

6. The GST does not tax according to the ability to pay which should be an important principle of taxation. It does not tax to reflect the distribution of income in the economy.



7. The GST is a complicated system. It invariably will have exclusions and compensations, and its implementation will necessitate spending more public resources for compliance and enforcement. As a result its productivity is often compromised.

Business Issues

8. Business currently pays profits tax on the profits made. The Administration now proposes business to pay the GST in addition. The GST is a tax on turnover which normally should include the element of profit. As a result business will be taxed twice on profits, where the GST cannot be passed on to the consumer in a competitive market. However, it may be deduced that monopolies or oligopolies are unlikely to have to shoulder the GST.

9. As business will have to bear the GST, the cost to business will rise, eating into profits, or worse increasing the loss burden. On the other hand, as the GST is a tax on consumption, it will discourage purchases where the demand for goods or services is elastic.



10. Business will have to make resources available to comply with the GST requirements, and this is an added cost to operation.

Public Revenue Issues

11. The imposition of the GST will induce business transactions to take place overseas to the detriment of the Hong Kong economy and of public revenue.

12. The GST will lead to the thriving of the tax avoidance industry which will be a leakage to the GST revenue due.

13. The GST will induce more “underground” economic activities which will lead to loss of public revenue in general.

Macro-economic Issues

14. Hong Kong's free port status has been an important contributor to its economic success. The GST will require controls on export and import, and impose such conditions which will hinder trade, contrary to the international trend of trade facilitation and liberalization. Meanwhile, China Mainland is conducting more and more direct trade with its overseas destinations, by-passing Hong Kong. The GST undermines rather than helps strengthen Hong Kong's free port status.

15. Hong Kong's simple and low tax system has also been an important contributor to attract and to keep talent and investment in Hong Kong. The GST cannot be considered to be a simple tax system and judging from overseas experience, it tends to rise over time. It will destroy Hong Kong's well-known asset for a favorable businesses environment and discourage investment and talent to move to or remain in Hong Kong.

16. Reference is made in the document that Hong Kong's advantage of low tax environment is diminishing internationally. In fact Hong Kong's profit tax and salaries tax are still low comparatively. Moreover, Hong Kong does not have a full income tax system as other tax jurisdictions. Therefore, Hong Kong is still competitive tax-wise without the GST. On the contrary, introducing the GST will be a negative asset to business operation or to attracting talent and investment.

17. The sectors which will particularly be hit by the GST will be the trade, logistics and retail sectors. SMEs will find it more difficult to operate. These are very important components for the future growth of the economy, as well as employment.

18. The GST will lead to cost inflation, but as it hurt business, it will reduce business activity and employment.

Social Issues

19. It goes without saying that the GST is regressive and is inequitable. It will create more social tension and contradiction, and will not be conducive to social harmony. The cost to the community will be far greater than the estimated cost to the Administration in establishing and running the GST system.

20. The GST does not enhance civic responsibility. It is an indirect tax, and as such, Hong Kong already has a number. Moreover, Hong Kong people have already been paying government fees and charges to foot the cost of the government for many years.

Conclusion

21. Given these considerations, the Council cannot support the institution of the GST. On the other hand, if it is considered Hong Kong's tax base has to be broadened, it will be necessary to understand how narrow Hong Kong's tax base is at the moment to justify broadening. Indeed, further broadening the tax base is only a means to provide the government with more and steady revenue. This naturally leads to the necessity of understanding the future plans of public revenue and public spending, apart from the inherent risks of forecasting or modelling. No doubt Hong Kong must be internationally competitive, and it is for this reason that we must be very careful when tinkering with the taxation system. Indeed,



the fact that Hong Kong does not have the GST makes it more attractive to business than other tax jurisdictions with the GST. Moreover, competitiveness is not just a product of taxation, but relies on the socio-economic environment including factors such as freedom, rule of law, minimum bureaucracy, living environment and education.

22. We should like to propose the Administration have a broader look at all these issues in pursuing future prosperity for a civil society. In this regard, the Council will be too pleased to work with the government.

Yours faithfully,

(Signed)

Mary Thomson

Secretary