CPA
Hong Kong Institute of
Certified Public Accountants
香港會計師公會

29 March 2007

By Hand

Our Ref.: C/GST, M49543

Tax Reform
Financial Services and the Treasury Bureau
4/F, Main Wing, Central Government Offices
Lower Albert Road, Central
Hong Kong

Dear Sirs,

Broadening Hong Kong's Tax Base

We wrote to the Financial Secretary ("FS") on 14 December 2006, attaching a summary of the results of the Institute's survey of members on broadening the tax base and a goods and services tax ("GST").

In the letter, we also indicated that the Institute would make a further submission on the government's consultation document, "Broadening the Tax Base, Ensuring our Future Prosperity – What's the Best Option for Hong Kong?" in which, in the light of the announcement by the FS on 5 December 2006, we would examine a range of options for broadening the tax base.

--- I now attach herewith the Institute's submission, which comprises two main parts: Part A examines various possible options other than a GST, while Part B considers the GST option, which we consider should remain on the table. There is also an executive summary. Our main conclusions are:

- Prima facie, there is no other option that, by itself, would be better able than a GST to meet the required objectives of broadening the tax base, reducing the volatility of revenues, achieving a substantial yield at a low rate of tax, etc.

- If the GST option is not to be pursued then there are other options, either alone or as part of a package, that merit further study.

- If GST is to be put forward again in future then there are a number of issues that would need to be addressed to alleviate significant uncertainties surrounding the proposals. The submission highlights some of these issues.

--- Attached also as Appendix 5 to the submission is the full report on the Institute's member survey, referred to above. This provides more detailed information on our members' responses to GST-related questions.

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We hope that you find the submission helpful and constructive. If you have any questions on it, please feel free to contact Peter Tisman, Director, Specialist Practices at or on

Yours faithfully,

(Signed)

Winnie C.W. Cheung
Chief Executive & Registrar

WCC/PMT/ay
Encls.

c.c. The Hon. Henry Tang, G.B.S., J.P., Financial Secretary

Broadening Hong Kong's Tax Base

March 2007

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Submission on the government's consultation document:

Broadening the Tax Base, Ensuring our Future Prosperity – What's the Best Option for Hong Kong?

Broadening Hong Kong's Tax Base

Executive Summary

Introduction

1. Following the release of the government consultation document, *Broadening the Tax Base - What's the Best Option for Hong Kong* in July 2006, the Institute conducted members' forums and set up a working group (the Working Group on Tax Reform ('working group"), originally called the GST Working Group) under the Taxation Committee to prepare the Institute's response, and also to help inform members about the main issues in the debate surrounding a goods and services tax ("GST") and to canvass views from members. The working group launched a dedicated website and issued a series of e-letters to members addressing key issues in the debate on reform of the tax base and a GST and inviting views on those issues through the website. In November 2006, the Institute commissioned an independent market research company to conduct a members' survey on broadening the tax base and a GST.

2. On 5 December 2006, the government published an Interim Report on the consultation and the Financial Secretary ("FS") announced that, in the light of the generally negative response to the consultation proposals, for the remainder of the period of public consultation until 31 March 2007, the government would not be advocating GST as the only or the main option to broaden the tax base.

3. The Institute subsequently held a members' forum on 11 December 2006 attended by the FS at which views were exchanged on other options. Shortly thereafter, on 14 December 2006, the Institute announced the results of its members' survey and submitted a summary of the survey results to the government. We also indicated that a further submission on the consultation document would be made in due course, which would examine a range of options for reform of the tax base. Since then, the working group has been working on a revised submission taking into account the change in the government's position.

4. The submission comprises two main parts: Part A looks at options other than a GST to broaden the tax base, while Part B considers the GST option. The detailed format is governed by the key questions contained in the government's consultation document, which the submission answers in the order in which they appear. The full results of the Institute's survey of members, which provides more information on the response to detailed GST-related questions than the summary sent to the FS in December 2006 are appended to the submission.

The submission

5. Having examined a number of different options to broaden Hong Kong's tax base, the Institute concludes that, prima facie, there is no option that, by itself, would be better able than a GST to meet the objectives of broadening the tax base, reducing volatility in revenues, causing minimal economic distortions, achieving a substantial yield at relatively low rates of tax, etc. However, if a GST is not to be pursued, there are other options that merit further study.

Part A

6. In Part A, the submission examines the following options:

- increasing rates of salaries tax and profits tax
- decreasing personal allowances
- payroll and social security taxes
- poll taxes
- increasing rates on tenements
- increasing stamp duty on property
- increasing stamp duty on stock transactions
- capital gains taxes
- taxation of interest income
- dividend tax
- tax on worldwide income
- wholesale or retail sales taxes
- air, land and sea departure tax
- taxes on mobile phones and signboards
- selective consumption taxes
- import/export levy
- financial transactions tax
- environmental or green taxes
- surcharge on utility supplies

7. For a variety of reasons, many of the above options were found to be unsuitable; for example, they continue to rely on the same narrow tax base and on direct taxation; they are too volatile or too easy to avoid; they conflict with the existing simple tax system because, for example, definitional and other technical difficulties would make them complex; they would provide a low yield (e.g., because Hong Kong taxes according to the source principle, so revenue from an overseas source would be non-taxable); the potential downside, possibly combined with other of the afore-mentioned factors make them unappealing.

8. Nevertheless, the Institute suggests that, in the absence of GST, certain options, mainly those indicated below, should be examined in more detail, either on their own, or as part of package of measures that together could achieve a yield of a similar order to a GST. These options are not without disadvantages, which we note.

- Payroll and social security taxes: Such taxes are fairly common overseas. This is a broad based form of tax and, if introduced in Hong Kong, could give more people a direct and visible stake in Hong Kong's future economic and social development. On the downside, such taxes would not reduce reliance on direct taxation. The Advisory Committee of New Broad-based Taxes ("Advisory Committee") calculated that each 1% in the form of a payroll tax would generate $5.8 billion annually.

- Increasing rates on tenements: The Advisory Committee noted that "rates do provide a broadly-based stable source of revenue that is relatively less affected by cyclical movements in business profits and, to a significantly lesser extent personal incomes. Rates are very much broader-based that either profits tax or salaries tax.... The mechanism to increase rates is simple and an increase in the level of rates generates meaningful additional revenue". However, the disadvantage is that Hong Kong already relies heavily on property-related taxes and a significant increase in rates might be a disincentive to businesses locating here.

- Increasing stamp duty on stock transactions: The duty currently stands at 0.2% per transaction shared between the vendor and the purchaser. While the trend internationally may be to reduce this form of taxation, Hong Kong can be distinguished from other markets as it has no capital gains taxes, no dividend tax, limited withholding taxes, etc. The growth in revenue from this source is due in part to the increase in market turnover resulting from Hong Kong's status as a capital-raising centre for Mainland enterprises. Stamp duty on stock and real property transactions in 2006/07 increased from an original estimate of HK$14.8 billion to a revised estimate as at 1 March 2007 of HK$23.4 billion. Much of that increase is believed to be from stock transactions. This form of taxation is quite broad based given the strong retail element in Hong Kong's securities market. On the downside, this will inevitably remain a relatively volatile source of revenue.

- Single stage retail sales tax ("RST"): RSTs have in the past been fairly common and they still operate in most of the individual states of the United States. A single-stage RST would be broad based and could be less complex than GST, particularly if charged on presumptive rather than individual transaction basis. At the same time, it would not have the self-checking feature of a multi-stage consumption tax, it could be seen as regressive in the same way as GST, and could give rise to disputes between taxable entities and the tax authorities, where retail sales form only part of a firm's business.

- Air, land and sea departure tax, in particular a tax on land crossings between Hong Kong and the Mainland: This form of tax was under consideration for several years, although the proposal was eventually dropped by the government. Such a tax would be broad based and, in our view, equitable. On the other hand, at a rate of about HK$20 per crossing to the Mainland, it would raise only around HK$2 billion and, were numerous exemptions to be given, e.g. to people who cross the boundary on a daily or frequent basis, the tax would become more complex to administer, more selective and less broad based.

- Environmental or green taxes: Revenue from environmentally related taxes averages roughly 2% of GDP in OECD member countries. This would amount to around HK$30 billion were Hong Kong to achieve the same, whereas we estimate that, in 2005/06, the actual figure was less than 1% in Hong Kong. While we recommend that a feasibility study should be carried out on introducing a comprehensive green tax regime in Hong Kong, green taxation would not provide an ideal alternative to a consumption tax, as the yield would be uncertain and the issue is complicated by the social policy objectives that would be inherent in any system of environmental taxation.

- Surcharge on utility supplies: A surcharge on utility supplies, such as gas and electricity, could be easily calculated and conveniently collected by the utility companies on behalf of the tax authorities. It would also be broadly based but, at a low rate, it would not generate large amounts of revenue. Based on the published accounts of electricity and gas companies for the year ended 31 December 2005, a levy of 5% would generate tax revenues HK$2.25 billion and each percentage of tax (levied on turnover) would generate between HK$450 million and HK$475 million.

- Dividend tax: A dividend tax may also be worth considering, although, on balance, it may well be that the disadvantages would outweigh the advantages. This would be the case particularly if the proposal were to involve an imputation system, to credit the recipient with the corporate tax paid on the profits from which the dividend derives.

<u>Part B</u>

9. Part B of the submission looks at a GST in the light of the reaction from the community and the findings of the survey of members of the Institute. The framework and design features proposed in the consultation document, such as exemptions, compensatory and assistance measures to households and businesses, are examined and commented upon.

10. While at the macro level, the Institute is broadly supportive of the framework proposed in the consultation document (which incorporates a number of the design features advocated by the Institute in a GST system), the main conclusion in this part of the submission is that, if the government is to revive the GST proposal in the future, then various issues need to be addressed which have not been covered in the current proposals or not in sufficient depth to remove the considerable uncertainties. These issues include:

- The lessons that should be learned from jurisdictions where a GST has been implemented fairly smoothly and also from problem implementations

- A commitment should be given to conduct more detailed economic and fiscal modelling and forecasting to test any proposed system

- Concerns expressed by the community during the consultation need to be addressed in greater depth, such as the impact of a GST on low- and fixed-income groups, including retirees and on Hong Kong's competitiveness

- More emphasis needs to be placed on education and information in the first instance, e.g., how moving away from direct taxation towards more indirect taxation provides the individual with greater choice and can encourage both saving and investment

  Consideration needs to be given to the type of GST system that might be more acceptable in Hong Kong. As the main objective at the outset is not to raise revenue, it could be introduced at a lower rate (e.g., 3%). Were a policy of minimal exemptions and zero-rated items to be adopted, more work would need to be done to explain the rationale to the community, and a review of the adequacy of the compensation package would need to be conducted, which would take account of e.g., the impact of taxing basic services

- More information is needed about the real costs to small and medium-sized businesses where they voluntarily register, and the implications for them where they do not register

- More information should be provided on the impact on the import/export trade

- Information should be provided as to the pre-GST educational programmes and pre- and post-GST support services that would be available to help manage the transition

- Answers should be given to questions about administration, both structural (e.g., who would administer the tax and how would staff be trained? Matters relating to investigation and enforcement and dispute resolution) and procedural (e.g., impact of group transactions and arrangements for bad debt relief).

11. In terms of the economic and industry sector impacts, the Institute feels that the direct and indirect impacts of the introduction of a GST in Hong Kong may have been underestimated in the proposals.

12. As regards returning the additional funds raised from GST back to the community, in principle the Institute supports reductions in profits and salaries taxes. However, the submission makes the point that the introduction of a GST should be part of a cohesive package of tax reforms, which should include incentives for business and offsetting benefits for different groups of taxpayers (including the middle income group) and for low income earners. A study on Hong Kong's competitiveness should be conducted to determine the most appropriate package of measures to maximise benefits to the overall economy.

PART A

Broadening the Tax Base – Options Other than a Goods and Services Tax

Introduction

1. Discussion about broadening the tax base has been taking place in Hong Kong for the past two decades. In the late 1980s, the Financial Secretary ("FS") expressed concern that too much reliance was being placed on direct taxation, resulting in considerable volatility in revenues. It was argued that there needed to be a better balance between direct and indirect taxation. A consultative paper on introducing a sales tax in Hong Kong was issued in 1989. However, due to public opposition, the proposal did not proceed at that time.

2. It is common knowledge that the bulk of tax revenue from profits and salaries tax is paid by a very small proportion of taxpayers, and that revenues from land premiums and land related taxes, such as stamp duty, which are also volatile, form another significant part of government income. The instability of the fiscal structure came to a head during the Asian financial crisis. During 1998/99 to 2003/04, there were deficits in the consolidated account in five out of six years, peaking at deficits of \$63.3b in 2001/02, \$61.6b in 2002/03 and \$40.1b in 2003/04.

3. The Institute highlighted the problem in its 2000/2001 budget proposals submitted to the FS in November 1999 and entitled, *Taxation in the 21 Century – The Case for a Fundamental Review*. In this submission, we drew attention to the narrowness of Hong Kong's tax base, suggested that the need to broaden the base was one of the key issues that needed to be addressed in a general review of the tax regime. Some specific options were also discussed.

4. Subsequently, the government established the Advisory Committee on New Broad-based Taxes ("Advisory Committee"), which during 2001-2002 conducted a public consultation on measures to broaden the tax base.

5. The government also set up the Task Force on Review of Public Finances ("Task Force"), tasked with investigating whether the series of fiscal deficits, which occurred at the end of the 1990s and into the new millennium, were cyclical or structural in nature. The Task Force issued its report in 2002. On the structural versus cyclical question, the report concluded:

   "The Task Force finds that Hong Kong is facing an ongoing and persistent fiscal problem. Some of the economic forces leading to this situation are believed to be structural in nature, although it is difficult, if not impossible, to discount the effects of all the cyclical factors..."

6. The Task Force went on to say that the recommendations of the Advisory Committee, which was to report shortly afterwards, should be carefully considered when the economic situation permitted.

7. In its final report to the FS, the Advisory Committee reviewed a number of different options and found that: "a GST [goods and services tax] is the only new tax with the long-term capacity to broaden the tax base which is not incompatible with Hong Kong's external competitiveness." The Advisory Committee also recommended that, "a policy decision to implement a GST or not should be taken as soon as possible", given the lead-time required for legislation and other preparatory work. From the political standpoint, the final report also acknowledged that there was never a popular time to introduce new taxes.

8. The Institute returned to this theme on several occasions, including in its submission on the consultation document issued by the Advisory Committee and in subsequent budget submissions to the FS, and called for a decision to be taken on the way forward following a full public consultation.

9. The government launched the current consultation in July 2006. The proposals contained in the consultation document, "*Broadening the Tax Base Ensuring our Future Prosperity – What's the Best Option for Hong Kong?*", focus primarily on the option of a GST. The Institute responded by conducting members' forums and setting up a working group to gather views and prepare a submission. The working group (the Working Group on Tax Reform ("working group"), originally called the GST Working Group) launched a dedicated website to inform members about the background to the subject and to solicit feedback. It also issued a series of e-letters to members addressing key issues in the debate on reform of the tax base and a GST and inviting views on those issues through the website. Taking account of the initial feedback from members, in November 2006, the Institute commissioned an independent market research company to conduct a members' survey on broadening the tax base and a GST.

10. Following a generally negative initial public reaction to the proposals, some people called for the government consultation to be curtailed. The Institute, however, remained supportive of the government's decision to continue with the consultation exercise at that point and to allow all sectors of the community to express a view. However, on 5 December 2006, the FS announced that, in view of the negative public reaction to the specific proposals for a GST, for the remainder of the consultation period (until the end of March 2007) the government would not be advocating GST as the only or the main option and that views on other options were welcome. An Interim Report was also published which explained the position in more detail. On 11 December, the Institute organised a further members' forum attended by the FS, at which views were exchanged on different options to broaden the tax base.

11. On 14 December 2006, the Institute held a media briefing to announce the results of its members' survey and wrote to the government to convey the findings survey and to pass on a summary report. The Institute also explained a further submission would be made, which would examine a range of options for broadening the tax base.

12. Against the above background, and in the light of the announcement on 5 December 2006, we propose in this submission to consider various options for broadening the tax base in Hong Kong. Non-GST options are considered in Part A while GST is considered in Part B.

13. In considering the options, we set out our response to the key questions raised in each chapter of the government's consultation document. Where appropriate, we also refer to the findings of the Institute's members' survey (see Appendix 5).

14. The order in which we address the various issues covered under this submission follows the order of the 15 questions raised in the consultation document. For reference, the list of questions asked under each of nine chapters in the consultation document, are set out in Appendix 1.

INSTITUTE'S POSITION ON KEY QUESTIONS RAISED IN THE GOVERNMENT'S CONSULTATION DOCUMENT

Chapter 1 - Is Tax Reform Required in Hong Kong?

Q1) Do you think that our existing tax base is too narrow?

15. Hong Kong's tax base is undoubtedly narrow. In 2006/07, salaries tax (including property tax) and profits tax were together forecast to contribute HK$112.2 billion or 43.6% of government revenue, 16.1% and 27.5% respectively.

16. The tax paying population was expected to drop from 1.33 million in 1997/98 to 1.26 million in 2006/07. It was estimated that over 43% of the working population would pay no salaries tax in 2006/07, the top 100,000 taxpayers would pay approaching 60% of the total salaries tax (compared with around 56% in 1997/98) and that the 1% of the working population (i.e. approximately 12,600 people) who pay salaries tax at the standard rate (currently 16%) would contribute 35.8% of the total salaries tax receipts[1].

17. In total in 2005, there were over 550,000 local and overseas companies registered with the Companies Registry. Of the 63,000 corporations that paid profits tax in 2004/05, the top 800 companies paid over 63% and the top 1300 companies (comprising 2% of corporate profits tax payers) paid 70% of total profits tax receipts.

Comparisons with international norms – OECD and Asia Pacific

18. Taxes generated from consumption of goods and services amount to 17.8% of tax revenue in Hong Kong, compared with an OECD average of around 32%[2a]; and an Asia Pacific benchmark of around 28% (12% on general consumption and 16% on

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[1] Figures extracted from the Information Pack for FS's Consultations on the 2007-08 Budget, November 2006

[2a] Consultation Document - "Broadening the Tax Base Ensuring Our Future Prosperity: What's the Best Option for Hong Kong?"

specific goods and services)[2b].

19. Tax on corporate income in Hong Kong at around 45% of tax revenues collected by the Inland Revenue Department ("IRD") is significantly higher than the OECD average of 9%[3].

20. Clearly the tax base is narrow. It is too narrow if this tax base, together with other sources of funding, cannot produce enough revenue over the medium to long term to fund Hong Kong's projected spending requirements.

Q2) Do you believe that Hong Kong needs a tax base where revenue is generated from diversified sources that are less susceptible to external shocks and cyclical economic conditions?

21. Revenue is currently generated from diversified sources although it is true that some of those sources are volatile, particularly land income, including land premiums and land-and property-related taxes, and investment income.

22. Between 1997/98 – 2004/05, tax revenue collected by the IRD represented between 55%- 65% of total government revenue (excluding an exceptional HK$120 billion transfer from the Land Fund in 2003/04). The principal sources of non-tax revenue are land premiums and investment earnings from the fiscal reserves. These are quite volatile sources of revenue. Government figures indicate that the former has fluctuated between 3% and 28% of government revenue over the past 10 years and the latter between 0.5% and 18%.

23. While revenue has fluctuated over the past ten years, this is mainly as a result of the downturn from the Asian financial crisis during the period 1999/2000 to 2002/03. The sharp increase in revenue in 1997/98 seems to have been due partly to the way in which land premiums were accounted for. What is evident is that expenditure has shown a steady rise throughout this period. So key questions are to what extent government expenditure, is fixed and what are the expenditure projections in the medium to long term.

24. The report of the Task Force (February 2002) ("Task Force Report") emphasised the need to give priority to controlling the growth of government expenditure. The Task Force also pointed out that, following the economic slowdown starting in 1997/98, the government had deliberately maintained expenditure growth above the growth in GDP. Paragraph 52 of the Task Force Report states: "This approach was consciously adopted as a **counter-cyclical fiscal measure** and justified on economic grounds". There was therefore scope to cut back spending after the downturn was over and this was subsequently done starting in 2004.

[2b] Advisory Committee on New Broad-based Taxes *Final Report to the Financial Secretary*, para.9
[3] See the Inland Revenue Department's Annual Report 2005-06. The OECD figure is taken from the Advisory Committee's *Final Report*, which quotes OECD statistics for 2000

25. While the Task Force projected budget deficits of HK$66 billion in 2001/02, $58 billion in 2006/07 and $114 billion by 2011/12, if there was no change in course, in practice, given the efforts to control expenditure, amongst other things, the budget was back in the black by 2004/05 and a surplus was achieved in both the operating and consolidated accounts in 2005/06. The fiscal reserves, which the Task Force's projected would fall to HK$104 billion by 2006/07 if no remedial action were taken, are now expected to be HK$365.8 billion by end March 2007. It may be argued that the severity of the negative effects of the Asian financial crisis and subsequent recession obscured any underlying trends. In this connection, the Task Force predicted structural changes in the property market leading to declining revenues from land and property, which had been an important source of government revenue in the preceding years. In fact, estimates for land premiums are back to the fairly steady levels achieved during 1993/4 to1996/97, before the speculative bubble of 1997/98 and the Asian financial crisis that followed shortly afterwards.

26. The Task Force also saw an increasingly unhealthy reliance on investment returns from the fiscal reserves and Exchange Fund, which reached 17.9% and 21% of operating revenue in 1998/99 and 1999/2000, respectively. It was acknowledged that this was due in part to the swelling of the fiscal reserves when the balance of the Land Fund, which had been set up as part of the handover transitional arrangements, was merged with the reserves. Nevertheless, the return on investment appears to be back to a reasonable proportion of overall operating revenue (6.2% in 2005/06 and 7.6% in 2006/07[4],). Furthermore as the fiscal reserves are in better shape than the Task Force projected, the situation of reduced returns from investments based on diminishing levels of reserves has not materialised.

27. To sum up, while there is some reliance on sources of non-tax revenue that may potentially be volatile, it is not clear that there is unreasonable reliance on these, or that the structural changes envisaged by the Task Force that would tend to undermine the efficiency of these sources of revenue, are as strong as believed at the time.

Q3) Do you think the Government should take action to reform the tax base to ensure our future growth and prosperity?

28. We may need to look at other factors, therefore, to understand why the existing tax base may not be sustainable in the long run. There may be a need to broaden the base due to:

a) structural changes that point to reductions in revenue from existing sources. For example, the aging of the population, which will result in fewer people paying salaries tax. This issue was touched on in the Task Force Report, but a more detailed analysis may be required to demonstrate the effects on revenues. On the other hand, introducing a broad-based consumption tax would tend to erode the savings of retirees, at a time when few will have built up any substantial sums in their mandatory provident fund schemes;

[4] Based on the figures quoted for "properties and investments" in the Information Pack for the FS's Consultations, in 2005 and 2006, respectively

b) increasing demands on the expenditure side, such as on health care, in view of the aging of the population, which cannot be met by achieving savings in other areas. If spending requirements are fairly rigid and there are increasing demands on expenditure, even if these additional demands can be met from growth in the economy, there may be a need for more stability in the sources of government revenue, to tide the community over any cyclical downturns. The government needs to explain its future spending requirements and forecasts more clearly;

c) the need for tax reform, to ensure that Hong Kong remains competitive. There is a clear trend in other jurisdictions to lower rates of direct taxation – profits tax and salaries tax. Some of Hong Kong's competitors also offer specific incentives, such as tax "holidays". Hong Kong cannot afford to lose its reputation as a low tax regime, and "low" is a relative term in the eyes of prospective investors;

d) in relation to Hong Kong's competitiveness there are also more indirect threats to the attraction of Hong Kong as a base for doing business in the Mainland, which may be (i) external, e.g. developments taking place in the Mainland itself, such as improvements in logistics and the movement of industry inland to cheaper areas, away from Hong Kong's hinterland in the Pearl River Delta, or (ii) internal, e.g. challenges facing Hong Kong, such as high levels of pollution. These threats tend to reinforce the need to "pull out all the stops", including tax incentives and concessions, to ensure that Hong Kong remains a magnet for overseas investors.

<u>Chapter 2</u> - Broadening the Tax Base: What are our Options?

Q4) Do you agree that there are only two viable options?

29. In its Final Report to the Financial Secretary, March 2002 ("Final Report"), the Advisory Committee considered 13 possible options (in addition to a goods and services tax or GST) to broaden the tax base, assessed against eight principles or factors of good tax design, namely: (1) broadness, (2) neutrality, (3) fairness, (4) effectiveness, (5) efficiency, (6) certainty and simplicity, (7) flexibility, (8) international competitiveness and (9) revenue stability/yield. In addition, the various options were measured against the factor of broadness (see the Final Report, pp 9 – 24):

<u>Existing taxes</u>

(i) Increase salaries tax rate
(ii) Increase profits tax rate (including in relation to (i) and (ii), progressive rates for higher income earners, which was not specifically considered by the Advisory Committee)
(iii) Reduce allowances and deductions under salaries tax
(iv) Increase stamp duty on real property
(v) Increase rates on tenements

Other possible options examined by the Advisory Committee

(vi) Capital gains tax
(vii) Tax on interest
(viii) Tax on dividends
(ix) Tax on worldwide income of businesses and individuals
(x) General consumption tax[5]
(xi) Payroll and social security taxes
(xii) Poll tax
(xiii) Air, land and sea departure tax
(xiv) Tax on mobile telephones and signboards

30. Although the Advisory Committee reviewed items (i) to (xiv) above, in the light of recent developments, we look once again at these possible taxes as well as the additional items referred to in (xv) to (xxii) below, bearing in mind the principles and factors referred to in paragraph 29 above.

Other possible options not examined by the Advisory Committee

(xv) Increase stamp duty on stock transactions
(xvi) Selective consumption taxes (e.g., on luxury goods)
(xvii) Extension of betting duty
(xviii) Wholesale or retail sales tax
(xix) Import / export levy
(xx) Financial transactions tax
(xxi) Environmental taxes
(xxii) Surcharge on utility bills

Possible options (other than a GST) examined by the Advisory Committee

Increasing Salaries Tax and Profits Tax Rates

31. Increasing salaries and profits tax rates would not widen the tax base and would place the burden of paying the additional tax only on those currently in the tax net. All of the additional revenue would be paid by existing taxpayers. In addition, this option would not address the issue of vulnerability to cyclical economic changes and, so, would not help to stabilise the tax base.

32. Furthermore, increasing salaries and/or profits tax rates would increase reliance on direct taxation at a time when, in order to maintain or enhance competitiveness, other jurisdictions are reducing rates of direct taxation (see the table at **Appendix** 2). Our low profits and salaries tax regime has been an important feature in attracting new businesses and skilled workers and, therefore, increasing rates of direct taxes could damage Hong Kong's ability to attract investment and high-calibre employees in future.

33. Introducing progressive rates of salaries and/or profits tax, if this meant imposing a higher rate of tax on higher levels of income/profits, would, to an even greater extent, make Hong Kong less competitive.

[5] Under this heading, the Advisory Committee examined GST.

Personal Allowances and Concessionary Deductions under Salaries Tax

34. Decreasing or abolishing the personal allowances and concessionary deductions under salaries tax would broaden the tax base by drawing into the tax net some salary-earners who are currently paying no salaries tax. The existing allowances are high by international standards, due in part to the fact that during economically buoyant periods, particularly 1993 to 1995, they were increased significantly above the level of inflation. This took a large number of employees outside of the tax net altogether. With hindsight, it would have been more prudent to have given one-off and temporary concessions and benefits to taxpayers and the wider community at that time. In addition, lowering of the marginal tax rates and widening the tax bands has had the effect of reducing the number of higher earners who pay tax at the standard rate. While this trend had begun to be reversed, in recent years, with improvements in the economy, concessions made in the 2006/07 and 2007/08 budgets, have again resulted in a reversion to the previous direction. The level of income necessary to trigger higher rates of taxation (i.e., the standard rate) is also very high by international standards, especially given the comparatively low level of the standard rate. As a result of measures announced in the 2007/08 budget, a single person will need to earn in excess of HK$2.7 million per annum before he or she becomes a standard rate taxpayer.

35. However, most of the additional revenue generated from lowering the personal allowances and/or increasing the marginal rates (and narrowing the bands) would come from existing taxpayers. Thus, while reducing personal allowances would broaden the tax base, it would also increase reliance on direct taxation and would not address the fundamental concerns about the volatility of the sources of Hong Kong's revenue. Therefore, it would not be appropriate for reductions in personal allowances to be considered as the sole or primary measure to broaden the tax base.

36. Nevertheless, the Institute believes that the personal allowances should be reviewed and placed on a firmer and more rational footing. Thereafter, any increases should be linked to specific economic triggers (e.g., increases in the Composite Consumer Price Index).

37. Once a more stable and broader tax base has been developed, the objective should be to reduce rates of direct taxation, including the standard rate of salaries tax.

Increasing Stamp Duty on Transactions in Real Property

38. The Advisory Committee noted that based on 2000/01 turnover figures, increasing stamp duty on property transfers by 20% would yield an additional HK$1 billion per annum. Based on 2006/07 projections that figure would increase to around HK$1.5 billion.

39. A moderate increase in the stamp duty on property transactions, therefore, would not, on its own, provide a very significant additional yield. A much more substantial increase would make property less affordable and could

have a negative effect on the property market, which, in turn, could have a knock-on effect on other areas of the economy. Furthermore, such a measure would not broaden the tax base and could have an adverse impact on Hong Kong's competitiveness, as Hong Kong is seen as a comparatively expensive place to do business.

Increasing Rates on Tenements

40. Increasing rates on tenements had not been listed as an option in the Advisory Committee's August 2001 consultation document, but was included in the Final Report because, during the consultation period, it had been put forward as a further possible option. Increasing rates generally fared quite well against the nine criteria, although it was noted that a significant increase in rates could act as a disincentive to businesses and skilled employees staying in or relocating to Hong Kong. While noting that Hong Kong already relied more heavily on property-related taxes than OECD or Asia Pacific averages, the Advisory Committee concluded:

> *"Nevertheless, rates do provide a broadly-based stable source of revenue that is relatively less affected by cyclical movements in business profits and, to a significantly lesser extent personal incomes. Rates are very much broader-based than either profits tax or salaries tax.... The mechanism to increase rates is simple and an increase in the level of rates generates meaningful additional revenue. The Advisory Committee considers that a moderate increase in rates may be used, especially as a short-term measure, to generate additional revenue."*

41. The Final Report of the Advisory Committee states:

> *"If necessary, the Advisory Committee further recommends an increase in rates, a reduction in personal allowances under salaries tax and the introduction of a land and sea departure tax, all of which are broad-based revenue options and relatively simple to administer, to bridge the gap pending the implementation of GST."*

42. It is not clear why, having pointed out the advantages of increasing rates on tenements, the Advisory Committee saw this option only as a possible stopgap measure. Each percentage point increase in rates, which are currently levied at 5%, would generate around HK$3 billion.

43. While we would not favour a poll tax (see below) one option that in our view might merit further consideration is a surcharge on the domestic rates that could be based at least partly on the number of persons ordinarily residing at the property.

Capital Gains Taxes

44. The Advisory Committee indicated that a capital gains tax would broaden the tax base but pointed out that, as capital gains taxes are by nature susceptible to adverse economic cycles, the additional revenue yields could be expected to be volatile.

45. Capital gains taxes are the norm in many other jurisdictions. However, we believe that the absence of any capital gains taxes is one of the cornerstones of our system and key advantages that Hong Kong enjoys over other markets overseas. If such a tax were to be levied at a significant level, and to be based on the source principle, it could have a disproportionately negative effect on Hong Kong's image overseas as a business-friendly location and act as a disincentive to investment and regional share listings in Hong Kong. While, in keeping with the rest of the system, it is more likely that a capital gains tax would be levied at a relatively low rate, this could add considerable complexity to the system without necessarily yielding a large amount of revenue. To ensure fairness, provision would also have to be made for offsetting capital losses. If a capital gains tax were to be residence-based, then it would be inconsistent with the existing system, which would in itself add complexity.

46. The Institute would, therefore, not recommend the introduction of a capital gains tax in Hong Kong as a means of broadening the tax base.

Taxation of Interest Income

47. Although, prima facie, it has the capacity to broaden the tax base, in practice, a tax on interest income could be avoided with considerable ease and the potential migration of deposits from Hong Kong could adversely affect the monetary system and Hong Kong's development as an international banking centre.

48. We would not support the introduction of such a tax.

Dividend Tax

49. Under the present system, it is possible for shareholder directors of large corporations, who may be very substantial income-earners, to escape personal taxation by receiving their income primarily through non-taxable dividends. A tax on dividends would, in principle, help to bring such people into the tax net and thus broaden the personal income tax base. A dividend tax would also ensure that foreign investors in Hong Kong-listed companies would, in practice, be required to make a fiscal contribution to Hong Kong, in return for the benefits that they accrue.

50. This form of taxation could generally be regarded as being fairly broad-based given the spread of shareholdings in Hong Kong.

51. However, as the Advisory Committee noted, modern dividend taxation arrangements often provide for a comprehensive dividend imputation system, whereby the corporate tax paid on the profits from which the dividend derives is credited to the recipient. Were such a system to be deemed to be a necessary element of any dividend tax in Hong Kong, such a tax would become potentially complex to legislate and difficult to administer. Given that rates of personal taxation in Hong Kong are lower than the standard rate of corporate tax, it has also been pointed out that there would be little or no yield from a dividend tax. On the other hand, the effective rates of

corporate tax on profits may in practice be considerably lower than 17.5%, given the various sources of income that are not currently taxed in Hong Kong, including for example offshore earnings, which comprise a large part of some Hong Kong corporation's overall profits. So consideration of a dividend tax should not be excluded on this basis alone.

52. Consideration could also be given to introducing a classical system of dividend taxation without any imputation arrangement. Systems of this type continue to exist in some jurisdictions (e.g. Canada and Korea). A supposed disadvantage of a classical system is that, as the underlying profits from which dividends are declared have already been subject to profits tax, imposing a tax on dividends without any tax credit would give rise to double taxation of the same monies, albeit not in the hands of the same taxpayer. However, a degree of double taxation also occurred in relation to estate duty, for example, which, although recently abolished, was in place in Hong Kong for many years. The issue of possible "double taxation" should be considered as only one factor to be weighed in the balance.

53. It might be possible in some cases to plan around a dividend tax. There would for example be no taxation where companies elected to re-invest profits. A further, perhaps more critical, disadvantage would be that imposing a dividend tax could reduce the attraction of Hong Kong companies to investors and have an adverse impact on their ability to raise equity funds. A system of withholding tax would also need to be put in place, which would introduce an additional element of complexity. (It might incidentally give other jurisdictions a greater incentive to enter into negotiations on double tax agreements with Hong Kong).

54. On balance, while we believe that the idea of a dividend tax merits some further consideration, it may be that the disadvantages would outweigh the advantages.

<u>Tax on Worldwide Income</u>

55. The territorial source principle is a fundamental feature of Hong Kong's taxation system and an important aspect of the simplicity of the system. Taxing foreign-sourced income would represent a departure from this basic principle and should be contemplated only in the context of a fundamental review of the whole system. It would be inappropriate to consider a change of this magnitude simply as one option for broadening the tax base, on a par with, say, introducing a general consumption tax, such as a GST.

56. In any event, as the Advisory Committee noted, in order to maintain international competitiveness, credits would need to be given for any tax paid on foreign-sourced income in the country from which the income derived, and a series of double taxation agreements would need to be negotiated with trading partners. Given Hong Kong's low tax rates, the amount of additional revenue raised may not be substantial. The cost of the administrative machinery needed to effectively enforce a system of worldwide taxation could also be significant.

57. Therefore, in the absence of a wider review of the source principle, the Institute would not support the option of taxing worldwide income. We remain open-minded on the issue of whether Hong Kong should in the long-term retain a taxation system based on the territorial principle. Given that business is increasingly commonly conducted on a multi-jurisdictional basis, it may be more and more difficult to determine when profit should be considered as having a Hong Kong source, unless very detailed rules are prescribed. Certainly, there are few jurisdictions around the world that levy taxes primarily on the basis of source. However, a fundamental review of the nature of the tax system is beyond the scope of the present exercise.

Payroll Taxes and Social Security Contributions

58. Some years ago, the Institute made the suggestion that all salary earners contribute a minimum amount to the maintenance of Hong Kong's social and economic well-being. This would be a broad based tax and would help to engage the community to a greater extent by giving more people a direct and visible stake in Hong Kong's future development. At the same time, it would also provide impetus for greater financial accountability, which is to be welcomed. The Advisory Committee calculated that each 1% in the form of a payroll tax would generate $5.8 billion annually.

59. Taxes of this kind are fairly common around the world, e.g. National Insurance contributions in the United Kingdom, social security tax and Medicare in the United States, Medicare in Australia and contributions to the Canada Pension Plan in Canada. As can be seen from these examples, they are often linked nominally to specific services, such as provision of pensions and healthcare services. Generally, they involve contributions from both the employer and the employee.

60. On the downside, similarly to salaries tax measures, this would not reduce Hong Kong's dependence on direct, more volatile sources of revenue. For employers, assuming both employers and employees contributed to the levy, it would add to the cost of doing business in Hong Kong, which is already seen as relatively high. As a compensatory measure for business, a reduction in the rate of profits tax could be considered as part of any overall package involving payroll taxes.

61. As regards the mechanism itself, the business sector is now used to the operation of the Mandatory Provident Fund Scheme ("MPF") and so the mechanism would not be entirely new conceptually, which should reduce the uncertainty arising from the unknown.

62. In principle, the Institute believes that, in the absence of a general consumption tax ("GCT"), the concept payroll and social security taxes merits further examination, especially if the additional revenues derived were to be earmarked for basic community services, e.g., education and re-training and health care.

Poll Taxes

63. The Advisory Committee noted that poll taxes (which are generally charged per head of household and may depend also on property values) have not been successfully implemented in any overseas jurisdiction. Somewhat similar forms of taxation do exist elsewhere, such as the UK Council Tax, but these may be local authority charges for the use of local community services. In the absence of a similar system of local authorities in Hong Kong, a poll tax would add complexity and, as the Advisory Committee also noted, would be difficult to police in a densely-populated place with a mobile population, like Hong Kong. The existing system of property rates offers a simpler option for raising more income on a household basis and we would favour this as opposed to introducing a new form of levy in the form of a poll tax.

Air, Land and Sea Departure Tax

64. Given that departures from Hong Kong by air and also, to the Mainland and Macau, by sea are already subject to a departure tax, it is in principle reasonable and equitable to consider imposing a tax on land and sea departures generally.

65. A tax on all land and sea departures from Hong Kong could provide a further broad-based source of revenue. We note, however, that if exemptions were to be given to, e.g. businessmen, schoolchildren, etc. who cross into the Mainland on a daily or frequent basis, as has been suggested by some people, the tax would become more complex to administer, more selective and less broadly based.

66. While the Advisory Committee suggested an expanded land and sea departure tax could be seen as interfering with the exchange and communication between the economies of the Mainland and Hong Kong, we believe that if the level of the tax is kept low and the administration kept simple (so as to minimise the costs of collection and not introduce new delays at border crossings) then these particular concerns could be addressed.

67. However, with a low rate of tax, say HK$20, the yield would not be more than around HK$2 billion and, as such, would not by itself make a very substantial contribution to stabilising revenues. On the other hand, as part of package of measures forming an alternative to a GST, it could have a role to play.

68. It is worth noting that, in the context of the Institute's survey, of all the possible tax broadening options listed, a land and sea departure tax was the only option supported by an overall majority of respondents (62%).

Taxes on Mobile Phones and Signboards

69. Whilst implementing taxes on mobile telephones and signboards might pose no great problems administratively, as the Advisory Committee noted, neither type of tax would raise any substantial amount of revenue on a stand-alone basis.

70. Although imposing such taxes would be unlikely to have any material impact on Hong Kong's competitiveness from an international perspective, questions could be asked as to why select these particular areas of business. Ease of collection may be one important factor but in practice it is not clear how straightforward it would be to enforce a levy on signboards. Furthermore, these particular business activities do not obviously give rise to any direct costs to society by, for example, giving rise to pollution, which might provide a more obvious rationale for imposing a levy.

71. Given in particular the low levels of revenue estimated to be generated from these sources, the Institute is of the view that it would not be appropriate to impose such taxes.

Possible options not examined by the Advisory Committee

Increasing Stamp Duty on Stock Transactions

72. While the Advisory Committee noted an international trend to move away from transaction taxes, such as stamp duties, and as a major international financial centre, Hong Kong must remain aware of developments in other markets aimed at enhancing their competitiveness, we must, at the same time, not overlook the unique qualities of the Hong Kong market. Unlike most of its competitors, for example, Hong Kong currently has no capital gains taxes, no dividend tax and limited withholding taxes.

73. Given the increasing turnover on the stock market over in recent years, the result not only of the economic cycle but also of Hong Kong's status as a capital raising centre for major Mainland enterprises, in principle at least, an increase in stamp duty on stock transactions has the capacity to produce significant additional revenue. Revenue from this source and stamp duty on real property transactions in 2006/07 was originally estimated to be around HK$14.8 billion but this was revised upwards, as at 1 March 2007, to HK$ 23.4 billion. It is likely that most of this additional revenue would have derived from stock transactions. The current levy is 0.2% per transaction, paid half by the vendor and half by the purchaser. Were the transaction levy to be doubled from 0.2% to 0.4%, in principle revenue in the range of HK$10 billion – over $30 billion would be achievable, on the assumption that overall turnover would not be significantly reduced by an increase of this order.

74. Stamp duty of stock transactions is also a fairly broad based form of tax, given that there is a very active retail financial market in Hong Kong.

75. While the revenue from this source may be potentially quite volatile, with Hong Kong's growing status as a key centre of capital raising for Mainland enterprises, a higher base level of turnover than in the past can be expected to be achieved. This would suggest that, generally, stamp duty on stock transactions can be relied upon to produce consistently a significant amount of revenue, even though the absolute amount raised may fluctuate year to year.

76. Although we acknowledge that many market participants may not support an increase in stamp duty, and indeed they may advocate further reductions, the Institute believes that, in the absence of a GCT, making more use of stamp duty on stock transactions as a form of taxation merits further consideration.

Selective Consumption Taxes

77. Hong Kong already has a number of selective consumption taxes, for example motor vehicle first registration tax and duties on fuel, alcohol and cigarettes. Suggestions have been made for a broader range of consumption taxes on luxury goods. However, it is not clear how "luxury" would be defined and whether in practice it would amount to much more than a retail sales tax with an exemption for "necessities" or "non-luxury items". If it were more selective than this, it is doubtful whether the yield would be very substantial unless the rates were very high, which would be inconsistent with maintaining a low-tax policy and could harm Hong Kong's reputation as a good place to shop.

Extension of Betting Duty

78. As one type of specific consumption tax, duty is currently levied on horse-racing and betting on soccer. Betting duty is a moderately broadly-based tax, which in 2006-07 was expected to yield around HK$12 billion. In principle, greater use could be made of betting duty as a source of government income. However, the industry commonly argues that the higher the tax, the more the incentive for gamblers to use illegal gambling rings, which have virtually none of the overheads of legal gambling.

79. If the industry's argument can be verified or accepted, then there is not much scope for raising the level of betting duties.

General Consumption Taxes - Wholesale or Retail Sales Tax

80. Here we consider forms of general consumption taxes other than a GST. Single level wholesale sales taxes ("WST") or retail sales/purchase taxes ("RST") exist in some countries and have in some cases been the precursor to GST/VAT-type taxes. Retail sales taxes still apply in the United States for example. Purchase taxes applied in the United Kingdom before the introduction of a VAT and a wholesale sales tax operated in Australia before the fairly recent introduction of a GST.

81. In the 1988-89 budget, the FS spoke of the need to broaden the tax base and alluded to the possibility of a sales tax. The nature of the discussion will sound very familiar to those who have followed the recent debate on GST. The government's objective was to produce a stable and significant revenue yield at a low rate of tax, which would cause minimal economic distortion and would be simple and not costly to administer. Opponents of the proposals argued that a sales tax would adversely affect lower income earners and would therefore impose an unfair tax burden. In addition, a sales tax was not needed at a time of substantial budget surpluses. Proponents of a

sales tax, on the other hand, maintained that, amongst other things, the stability of revenues would be less vulnerable to economic cycles and that a reduction in direct taxes, as a trade off, would increase investor confidence and enhance Hong Kong's competitiveness.

82. The Hong Kong Government issued a consultation paper in 1988 seeking views on a proposal for a WST. A WST was preferred over an RST because of the fewer number of traders who would be involved and, consequently, the comparative ease of administration and enforcement.

83. The proposal envisaged the registration of all persons carrying on business in Hong Kong who sold by wholesale (e.g., manufacturers and wholesale merchants). Small businesses (i.e. those not exceeding an annual sales threshold) would be exempt. The point in the distribution chain for the imposition of the tax would be the last wholesale disposal of goods, which would generally be the manufacturer's or wholesaler's sale to the retailer. If the manufacturer or wholesaler sold direct to consumers, the tax would be levied on those sales. A system of registration would be introduced to allow registered manufacturers and wholesalers to purchase goods free of tax to ensure that tax was levied only on the final wholesale of the goods, and so prevent "cascading".

84. Ultimately due to the strength of opposition within the community, the proposal was not pursued at that time. Looking at the issue now, for various reasons, we would not favour this form of taxation. While it has some advantages – for example, as regards administration, the tax would be collected by only a limited number of remitters – there are also a number of disadvantages. Firstly, it would cover only goods and not services, which, in heavily serviced-based economy would be a significant weakness. This means it would not be as broad based as a GST and, given also the limited number of taxable entities, the tax would have to be levied at relatively higher rate than, for example, an RST or a GST in order to generate the same level of revenue. Experience overseas has indicated that there may be classification and enforcement problems. In Australia, it was also found that five main sources provided 60% of all WST revenue (motor vehicles and parts accounting for over 26% alone)[6], so it may have a relatively narrow base. As the knock-on effect of a wholesale sales tax on retail prices would be less direct and less visible than a retail sales tax or GST, there may be greater scope for incidental price increases and any impact of inflation may be less predictable. In addition, as the rate of tax would need to be higher than for a GST or an RST, this would increase the incentive to try to avoid the tax.

85. Another alternative is an RST. While an RST would be broader based than a WST, it would arguably have the disadvantages of GST without the advantages. It would require a much larger number of registered businesses than a wholesale sale tax and be administratively complex, if it were transaction based, without having the multi-stage self-checking mechanisms of a GST. Questions of regressiveness would again arise,

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[6] Brian Andrew *"Hong Kong Tax Reform: A Low-rate Indirect Tax That Does Not Sacrifice Efficiency for Conformity"* Asia-Pacific Journal of Taxation (Winter 2005)

unless there were significant exemptions, which could lead to classification problems. Nevertheless, the International Monetary Fund ("IMF") notes, in a report issued in 2001, that "[a]lthough no major country now uses an RST at the national level as its preferred form of consumption tax, such taxes are still levied in 46 of the states of the United States (where they were introduced in the 1930s) and in some Canadian provinces"[7]. The IMF report also states in a footnote that "[t]he possible introduction of a federal RST has, however, been widely discussed in the United States in recent years".

86. It has been argued that an RST, charged on a presumptive basis (e.g., on the basis of flat rate on all a firm's overall retail sales, which would be subject to audit by the IRD, rather than on the basis of actual individual transactions) would be suitable for Hong Kong[8]. The argument is that an RST of this type offers a broad revenue base, can cover services and allow for a tax exemption for exports, and it would have lower administrative and compliance costs than a GST (having fewer taxing points, tax collectors and remitters). However, the scope for avoidance may be greater than with a GST and there would also seem to be significant scope for dispute between individual taxpayers and the IRD where retail sales form only a part of a firm's business. Overall, while an RST of this type might merit further consideration from a technical point of view, as regards of gaining support, it is not clear that it would be much easier for the community to accept than a GST.

87. We note in passing the assessment of the Tax Base Study, conducted as part of the research for the Advisory Committee, on an WST or RST, namely:

> *"A single stage sales tax is internationally regarded as more administratively complex, prone to tax avoidance and dispute, and not well suited to taxing services or other intangibles (which inevitably account for a greater share of economic activity over time)".*

Import/Export Levy

88. While the mechanism to collect a tax in this way is already in place (i.e. through the Trade Declaration Scheme), so the administrative cost should be very low, such a tax could be applied only to goods and not services. The base would therefore be relatively narrow. At any significant level, it would also potentially distort the market against imports in favour of locally manufactured goods. While there is now only a limited amount of manufacturing carried out in Hong Kong, so this might be less of a problem, as a new tariff, an import/export levy could nevertheless run up against World Trade Organisation rules. It could also make Hong Kong's exports less competitive. We would not favour this option.

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[7] IMF *Hong Kong SAR – Policy and Administrative Issues in Introducing a Goods and Services Tax*, January 2001, pp 40-41
[8] See footnote 6

Financial Transactions Tax

89. The concept of a financial transactions tax is a novel one, which has been considered in the United States Congress. Essentially, as proposed, it is tax on transactions through financial institutions. Attached at Appendix 3 is a Congressional Research Service ("CRS") Report (*Transaction Tax: General Overview*, December 2004), which considers this amongst other options. It would be very broad based, the collection mechanism should not be overly complex and the yield could be potentially substantial, and it would also extend to speculative activities. However, the CRS report notes that "[n]o major industrialised nation has adopted a broad-based transaction tax". Such a tax levied on all transactions through banks, etc. (with possible exemptions for transactions below a certain ceiling) would result in cascading and, more critically, it could provide an incentive for trading activities to migrate elsewhere. Under the circumstances, the risk associated with introducing such a tax in Hong Kong, even at a very low rate, would be high given Hong Kong's status as an international financial centre. Therefore, in our view, it would not make sense to further pursue this idea, which has not been adopted by other major markets.

Environmental or Green Taxes

90. There is clear international trend to impose environmental or green taxes on polluters. In our submission to the FS on the 2001 Budget, the Institute advocated that consideration be given to the introduction of green taxes on polluters and, in particular, that the feasibility study be carried out on introducing a comprehensive green tax regime. Such a regime could include specific ecological taxes, such as resource consumption taxes, taxes on non-biodegradable materials and landfill charges, as well as tax incentives for environmentally sound machinery, vehicles and systems. We have repeated this call several times in subsequent budget submissions.

91. One of the main objectives of introducing such a regime would be to encourage socially-responsible behaviour, which, in some instances, would have the effect of more efficient and potentially lower consumption, which might in turn result in a lower revenue (e.g. in the case of fuel duties). However, the experience of OECD jurisdictions indicates that environmental taxation can also provide a significant source of revenue.

92. Environmental taxes have been introduced to a varying extent in all OECD countries. According to a 2001 study on Environmentally Related Taxes in OECD countries, the revenue from environmentally related taxes averages roughly 2% of GDP in member countries[9]. In Hong Kong, in 2005/06, we estimate that environmental taxes accounted for under 1% of GDP. On the basis of a similar potential revenue yield, therefore, environmental taxes could provide a possible alternative to GST, as a measure to broaden the tax base, while also generating a positive environmental effect[10].

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[9] OECD Environmentally Related Taxes in OECD Countries Issues and Strategies, 2001, p. 9

[10] Netherlands Ministry of Housing, Spatial Planning and the Environment, Directorate-General for Environmental Protection, The Netherlands' Environmental Tax on Waste Questions and Answers, p.3

93. Environmental taxes support the "polluter pays principle", under which the costs of pollution prevention and control should be reflected in the price and output of goods and services that cause pollution as a result of their production and/ or consumption[11]. The nature of such taxes may gain more community support, given the increasing awareness of the need to enhance environmental protection, as demonstrated by the relative success of the Rechargeable Battery Recycling Programme[12] and Voluntary Agreement on Plastic Bag Reduction[13].

94. It is noted that the Environment, Transport and Works Bureau is proposing a product eco-responsibility scheme ("PRS"), a key policy tool for waste management[14]. The government has stated that the purpose of introducing a PRS is not to increase government revenue, but to implement the principle of "polluter-pays" so as to change the consumption-led lifestyle of the public[15].

95. The PRS sets out in the Policy Framework for the Management of Municipal Solid Waste considers six types of products, as listed below, with priority given to vehicle tyres and plastic shopping bags:

(i) Vehicle tyres
(ii) Plastic shopping bags
(iii) Electrical and electronic equipment
(iv) Packaging materials
(v) Beverage containers
(vi) Rechargeable batteries[16]

96. A number of OECD countries impose packaging taxes. For instance, Belgium, Denmark, Finland and Norway have taxes on beverage containers. Denmark, Korea and Norway also tax other packaging containers, with different rates for different materials used in the container[17]. According to the data from the Environmental Protection Department, 362,080 tonnes of plastic bag waste (including plastic shopping bags, plastic garbage bags and other plastic packaging bags) were disposed of at landfills in 2005[18]. If a similar duty on carrier plastic bags to that imposed in Denmark, at Euros 2.95 per kg[19] were to be imposed on Hong Kong's plastic bag waste at 2005 levels, potentially, a revenue of around HK$10 billion could be raised. Rubber tyres are another recyclable waste on which jurisdictions such as Denmark and Finland impose taxes, at Euros 0.54 to 24.16 per tyre and

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11 see footnote 9
12 Environment Protection Department, Rechargeable Battery Recycling Programme Annual Report 2005-2006, pp.3-4
13 http://www.epd.gov.hk/epd/english/environmentinhk/waste/prob_solutions/rpsb.html
14 Legislative Council Panel on Environmental Affairs, Proposed Legislation for Implementation of Producer Responsibility Schemes for discussion on 24 April 2006, CB(1)1300/05-06(04)
15 Environment, Transport and Works Bureau's Press Releases and Publications, LCQ2: Green taxes, 7 June 2006
16 see footnote 15
17 OECD Environmentally Related Taxes in OECD Countries Issues and Strategies, 2001, pp. 65-66
18 Environment, Transport and Works Bureau, Press Releases and Publications, LCQ11: Government policy on plastic bag reduction, 29 November 2006
19 OECD/EEA database on instruments used for environmental policy and natural resource management, http://www.2oecd.org/ecoinst/queries/index.htm

Euros 0.4207 to 0.976 per unit respectively[20]. In 2005, Hong Kong recovered 21,000 tonnes of recyclable rubber tyres[21].

Vehicle Taxes

97. Apart from waste management, environmental taxes may be imposed in relation to transportation. Hong Kong applies ownership restraint measures such as vehicle first registration tax ("FRT") and annual licence fee ("ALF"). The estimated revenue from FRT for 2006-07 is $4billion[22].

98. While such measures generate revenue, the nature of the tax base would to some extent determine whether they result in positive environmental effects. The tax bases are commonly differentiated by the weight or engine size of cars. However, [the OECD suggests] such differentiation will generally not be a close proxy for the environmental impacts of the vehicles[23]. Tax bases that are dependent on the age of the car may also be useful, for example, in Singapore there is a road tax surcharge for vehicles over 10 years' old[24].

99. We note that, in the 2007/08 budget, the FS announced the implementation of the government's proposals to lower the FRT on environmental-friendly vehicles. While this will provide an incentive to switch to less polluting models, the impact on the overall revenue generated from this FRT is uncertain.

100. Based on the Annual Transport Digest published by Hong Kong's Transport Department, the total number of private cars registered at the end of 2005 was 388,311[25]. Some international comparative figures on motor vehicle taxes imposed on private vehicles are at Appendix 4.

Taxes based on fuel-efficiency

101. A different tax base may be considered: for example, the United States and Denmark levy taxes based on fuel efficiency[26]. The estimated revenue from duties in Hong Kong for 2006-07 is $6.6billion[27], approximately 47%[28], amounting to $3.1billion, of which can be attributed to duties on hydrocarbons.

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[20] see footnote 19

[21] Environmental Protection Department, Monitoring of Solid Waste in Hong Kong, Waste Statistics for 2005, p.13

[22] Information Pack for FS' Consultations on the 2007-08 Budget

[23] OECD Environmentally Related Taxes in OECD Countries Issues and Strategies, 2001, pp. 61 & 63

[24] http://www.lta.gov.sg/motoring_matters/motoring_vo_tax_pte.htm

[25] http://www.td.gov.hk/mini_site/atd/2006/eng/section3_1_en.htm

[26] OECD Environmentally Related Taxes in OECD Countries Issues and Strategies, 2001, pp. 61 & 63

[27] Information Pack for FS' Consultations on the 2007-08 Budget

[28] http://www.customs.gov.hk/eng/statistics_revenve_e.html

Electronic road pricing (ERP)

102. ERP has been under discussion on and off for almost 20 years and a good deal of work has been done by the government to test it[29]. It was opposed when it was first put forward on the grounds of infringing privacy. However, similar schemes operate successfully elsewhere. The Congestion Charge implemented in London, for example, has reduced traffic congestion and associated pollution in central London, while raising about £200 million in revenue annually (£254m in 2005/06 and £218m in 2004/05 (HK$3.8 billion and HK$3.3 billion, respectively, at current exchange rates)[30]. In Hong Kong, ERP could help to improve traffic management, reduce air and noise pollution and traffic accidents in areas where there are many pedestrians and where many people work, and also reduce the need for further road construction. The arguments favour the introduction of ERP.

Fuel duty

103. Given the bad air pollution problem in Hong Kong, it is not understandable why the duty on diesel remains at less than 45% of the duty on petrol, in the case of light diesel oil and, by special concession, less than 20% in the case of ultra low sulphur diesel. The duty is waived in the case of buses. Equalising the rates of duty at the higher level, which could be done over a period, would give incentive to the users of diesel vehicles to use them in the most efficient way possible and it would also increase government revenues.

104. Overall, while we would like to see a more coordinated and extensive approach to environmental taxation, we would not see this as offering an ideal alternative to a GCT. There is no doubt that there is potential to raise more revenue through environmental taxation, but the yield would be uncertain and the issue is complicated by the social policy objectives that would also be inherent in any system of environmental taxation. Furthermore, in order to achieve those social policy objectives it may be more effective to offset environmental taxes against other tax concessions or reductions in direct taxation as means of incentivising good behaviour. This kind of "tax shifting" approach has been adopted in other jurisdictions. Certainly, Hong Kong should not continue to subsidise polluters, but at the same time it would be risky to rely heavily on environmental taxes as a means of broadening and stablising Hong Kong's tax base.

<u>Surcharge on Utility Supplies</u>

105. A surcharge on utility supplies, such as gas and electricity, has the merit that it can be easily calculated and conveniently collected by the utility companies on behalf of the tax authorities. If necessary the tax authorities could, for example, allow the utility companies to offset the cost of collecting the tax indirectly by arranging for the tax to be handed over at intervals, thus allowing the companies to make use of the monies for a short period of time.

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[29] Transport Department, Feasibility Study on Electronic Road Pricing Final Report
[30] Transport for London's Annual Report 2005/06 – Note 25 to the accounts – Congestion Charging

106. The possibility of levying a 1% surcharge on utility bills, e.g., gas and electricity, including the sale of electricity and gas to all commercial and industrial customers, could be considered. A tax on utilities would be broadly based, but would not at a low rate generate a large amount of revenue. Based on the published accounts of electricity and gas companies for the year ended 31 December 2005, a levy of 5% would generate tax revenue of HK$2.25 billion, while each additional percentage of tax (levied on turnover) would generate between HK$450 million and HK$475 million.

107. Whilst this may potentially affect the consumption of utilities, at a low rate, it would be unlikely to have a substantial effect and, in any event, a more economical use of energy could be regarded as environmentally beneficial. To ease the burden of the low-income sector, an exemption could be given in respect of monthly electricity and gas bills below a certain threshold (e.g., monthly electricity bills of less than $120 and gas bills of less than $60).

108. There may be some concerns regarding the sustainability of the tax base, as one aim of green taxes generally is often to reduce consumption by increasing the cost of that consumption. Thus a higher levy will lead to lower consumption and higher levies may be subject to diminishing returns.

Q5) Do you agree that a reduction in personal allowances is not a preferred option?

109. See paragraphs 34 - 37 above.

Conclusion to Part A: Possible Options (other than a GST) for Broadening Hong Kong's Tax Base

110. Having reviewed a range of options, the Institute considers that there is no option that, by itself, would be better able than a GST to meet the objectives of broadening the tax base, reducing volatility in revenues, achieving a substantial yield at relatively low rates of tax, while causing minimal economic distortions and not adversely affecting Hong Kong's international competitiveness, etc. However, if a GST is not to be pursued, there are other options that should be examined in more detail, either on their own or as part of package of measures that together could achieve a yield of a similar order to a GST. These options, which include new taxes and making more use of existing broad based taxes, are primarily the following:

- Payroll and social security taxes
- Increasing the use of rates on tenements
- Increasing the use of stamp duty on stock transactions
- Single stage retail sales tax
- Air land and sea departure tax
- Environmental or green taxes
- Surcharge on utility supplies
- Dividend tax

PART B

Broadening the Tax Base – A Goods and Services Tax

111. The answers to the following questions are predicated on the assumption that a GST is still one of the options that should be considered as a means of broadening Hong Kong's tax base. The Institute believes that this should be the case.

Chapter 3 – The Case for GST

Q6) Do you agree that GST is an appropriate option to broaden Hong Kong's narrow tax base?

112. Value Added Tax ("VAT")/GST-type taxes have been widely adopted around the world. The 1990s saw a particularly large increase in the adoption of VAT. There are now 136 countries that apply this form of taxation and it is a condition of entry into the European Union.

113. Only five countries have ever removed an existing VAT (Vietnam, Grenada, Ghana, Malta and Belize), and three of those (Ghana, Malta and Vietnam), have since reintroduced it, which suggests that it has proved to be an efficient form of taxation around the world[31].

114. In its recent report on Hong Kong, the IMF notes that, "Hong Kong SAR has amongst the most volatile revenue bases in Asia". Subsequently, the report states: "The introduction of a GST should limit the need for fiscal reserves, by providing a more stable revenue base as the population ages and by limiting revenue volatility", while noting that the extent to which it would reduce volatility would depend upon how it was implemented[32].

115. As indicated above, the Advisory Committee favoured a GST as the most suitable way of broadening the tax base without compromising Hong Kong's external competitiveness.

116. The Institute suggested, in its submission dated 29 October 2001 on the Consultation Document, *A Broader-based Tax System for Hong Kong?*, issued by the Advisory Committee, that, subject to the findings of the Task Force on the question of whether the deficits occurring at that time were structural or cyclical, a general consumption tax would be the most suitable method of maintaining and stabilising revenues. The Institute also suggested, e.g. in its Budget Proposals 2006/07, that the government should focus on broadening the tax base in Hong Kong, rather than continuing to rely on increases in direct taxes as the primary source of any future requirements for additional revenue in times of deficits.

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[31] *The Value Added Tax – Experiences and Issues*, Background Paper prepared for the International Tax Dialogue Conference on the VAT, Rome, March 15-16, 2005

[32] IMF Country Report No. 07/4, Part I, January 2008

117. GST has been implemented quite smoothly in various jurisdictions (e.g. New Zealand and Singapore). If the idea of a GST is pursued again in future, lessons should also be learned from problem implementations (e.g., Australia and Japan). The Institute pointed out that, given the differences between Hong Kong's economy and other economies, it would be important for a successful and, as far as possible, trouble-free implementation, for the government to conduct more detailed economic and fiscal modelling and forecasting, and to test thoroughly the proposed GST system. The objective would be to evaluate the revenue and other implications of introducing the system, so as to avoid any significant unforeseen effects that could have an adverse impact on its smooth implementation.

118. While some of the other broad based tax options that we have referred to above merit further study, particularly given the government's commitment to examining other options, other forms of tax, on their own, would generally not be able to match a GST in terms of the criteria specified by the Advisory Committee and referred to in paragraph 29 above. Regarding the yield, the government estimates that each one percentage point of a GST could raise around HK$ 6billion. The Advisory Committee's Final Report states in relation to a GST:

> *"Of all the options surveyed by the Advisory Committee, it is the only one that fits the primary criteria of being broadly-based and highly revenue-productive even when the tax is set at a level which, when compared with other economies, is low."*
>
> *"... the aging of the population will place an upward pressure on social security expenditure and medical and health services. The Advisory Committee has noted that many other mature taxation jurisdictions have all implemented GST (or a variant of it) to reform their tax system in the face of aging populations. With changing demographics, increasing community expectations for government services and the adverse effects on direct tax revenues of cyclical downturns in the economy, it has become increasingly untenable for governments to continue their heavy reliance on income taxes as the predominant revenue source... Taxing private domestic consumption provides an alternative form of revenue that is considerably better shielded from economic and demographic changes within the community."*

119. The Final Report includes the following recommendation:

> *"The Advisory Committee's opinion is that a GST is the only new tax with the long-term capacity to broaden the tax base which is not incompatible with Hong Kong's external competitiveness... It therefore recommends that if a need for additional revenue is identified because of structural deficits, GST should be adopted."*

120. While the Institute would not necessarily agree entirely with this statement, most of the possible alternative approaches would appear to require a mix of different measures, including new and existing taxes (e.g., utility surcharge, payroll tax, land and sea departure tax, reducing personal allowances,

relying more on rates in tenements or stamp duty on stock transactions), in order to achieve a similar objective, which would in aggregate tend to complicate the tax system more than a single solution. Furthermore, as indicated above, GST/VAT-type taxes are widely used and familiar to investors from around the world. While this is not itself an argument for introducing a GST in Hong Kong, it does suggest that, if steps are to be taken to broaden the tax base, careful thought would need to be given before to introducing other types of taxation, except very simple taxes, that may not be as familiar to overseas investors. Introducing broad based taxes that are not commonly adopted in other jurisdictions could in itself add a level of complexity to the system in Hong Kong.

121. Under the circumstances, we would recommend that, in addition to further study being undertaken of certain other of tax options, the GST option should be re-examined with a view to addressing the main concerns raised during the consultation period prior to the government's December 2006 announcement. As well as providing a fuller explanation of aspects of the proposal that were not fully explained in the consultation document, the overall strategy needs to be thought out carefully. For example, other jurisdictions that have introduced a GST/VAT may have already introduced self-assessment, which provides an impetus and framework for more systematic approach to record keeping and tax reporting. Should this be a precursor to major tax reform in Hong Kong?

122. Amongst the concerns that need to be addressed in more detail are the impact of GST (a) on low-income groups, including retirees; (b) on Hong Kong's competitiveness; (c) on the wealth gap.

123. Other concerns include (a) how to convince the community that the rate of GST would be kept low. It is noted that, in conjunction with a lowering of the rate of corporate profits tax, Singapore has recently increased its GST rate to 7%. It is not clear that Hong Kong people would be willing to accept a similar trade off; (b) what would be the real costs of compliance on businesses?

124. Greater emphasis should be placed on education and information, in the first instance; e.g., on how moving towards consumption-based taxes can serve as an encouragement to save and invest; on the greater ability they give taxpayers to choose how to spend their disposable income when compared with direct taxation. As the primary aim should not be to raise additional revenue, a GST could be introduced at a lower level than previously suggested (e.g. 3%). The commitment in the proposals to maintaining a ceiling on the rate of any GST for a number of years will be important and also to improving basic services that benefit the lower income groups.

125. Our member survey suggested quite strongly that the community wants to see more exemptions, even though we acknowledge that this will make the system relatively more complex and reduce the revenue yield. It is clear that more would need to be done to alleviate concerns over this issue.

<u>Chapter 4</u> – What is GST and How Does it Work?

Q7) Do you agree that GST is preferable to RST as a form of general consumption tax?

126. A more detailed analysis may need to be conducted of the relative advantages and disadvantages of an RST and a GST- or VAT-type tax if it is decided to proceed with a general consumption tax.

<u>Chapter 5</u> – A Proposed GST Framework for Hong Kong

Q8) What are your views on the proposed GST framework and design features as outlined in this chapter?

127. The Institute has previously put forward suggestions on a possible GST framework and design features in, e.g. its submission on the Consultation Document on "A Broader-based Tax System in Hong Kong?" and in its Budget Proposals 2006/07.

128. Many of the Institute's suggestions were taken on board in the GST framework and design features proposed by the government including:

- To adopt a single positive rate at the lowest end of the GST rates as adopted by other economies.
- A GST should be the credit-invoice type, i.e., collected at each stage of the chain of production and distribution.
- To adopt the "destination principle" of GST, which is used by almost all countries that have a GST as part of their tax regime, under which, imports are taxed and exports are zero-rated.
- In the interest of cost-effectiveness, the registration threshold should be set at a fairly high level, e.g., HK$5 million turnover, with an option to register below that level.
- The Institute has suggested that to provide medium to long-term predictability, the government should consider giving an undertaking not to increase the initial rate of a GST for 5-10 years. The consultation document proposes that:
    - ➢ for the first five years after GST introduction, all revenue so generated after deducting administrative costs would be returned to the community as tax relief and other compensation measures.
    - ➢ all key elements of the tax reform, once finalised and introduced, would remain unchanged for the first five years.

- To keep exemptions and zero-rated items to a minimum, so as to reduce complexities and disputes about whether particular items should qualify for special treatment. This has been a pitfall of the GST/VAT systems implemented in some jurisdictions (e.g., recently in Australia).

- To provide targeted compensations to reduce the burden on low income households.

- The Institute contemplated the provision of a tourist refund scheme – by pointing out that in a simple system, usually only exports (including tourist purchases) are zero-rated. In general, a tourist refund scheme requires initial payment of GST as part of the purchase price to the retailer, with the tourist reclaiming a refund on departure.

- The provision of an exemption for residential rental payments (to maintain parity with owner-occupied residential buildings):

  - ➢ as it is not feasible to tax the implicit rental values of owner-occupied buildings;

  - ➢ the implications for other property-related transactions should be carefully considered to ensure that the framework is suited to conditions in Hong Kong;

  The consultation document proposes to tax non-residential property and exempt residential property (both sales and rentals).

- Reduction in direct taxes such as salaries tax and profits tax to be introduced in parallel.

- To incorporate appropriate compensations for low-income households in the GST design, e.g.:

  - ➢ increases in Comprehensive Social Security Assistance (CSSA) payments;

  - ➢ annual special payments to low-wage-earners;

  - ➢ reduction or abolition of existing indirect taxes (e.g. vehicle first registration tax, hotel accommodation tax).

- The Institute suggested that the government should consider increasing the tax deduction limit for charitable donations from the current 25% of assessable income/profits to a higher level, say, 50% of assessable income/profits.

129. In addition, to ensure that there is no further narrowing of the tax base, the Institute suggested:

- undertaking a further review of specific personal allowances by reference to the adoption of a base year, with relevant allowances adjusted in line with the changes in the economy from the time (Budget Proposals 2006/07 p.16; 2005/06 p.14);

- that, in the longer term, there was an argument for the personal allowances to be reduced, either by positive action or, more gradually, by attrition (Budget Proposals 2002/03, p.33).

130. Evidence from around the world points to the importance of introducing a simple regime with a single rate, a high registration threshold, a short list of exemptions and efficient administration (so that, e.g., refunds are not delayed), in order to ensure a smooth implementation and few subsequent compliance problems.

131. In the light of the above, the Institute is broadly supportive of the framework and design features as proposed, subject to the following additional comments:

- Rate: We support a commitment to maintaining a single low rate that would not be altered for a certain number of years. The government should be flexible on the specific rate. Our survey of members suggested that, were a GST to be introduced, a figure of no more than 3% would be more acceptable than a higher rate.

- Registration threshold: We support a high registration threshold. However, it cannot be assumed that all small businesses with a turnover of less than the proposed threshold of HK$5 million would be able to remain outside the GST framework. If they dealt with larger GST registered businesses, they might be under pressure to register so that their trading partners could claim the input tax. Therefore, the concessions made available to small businesses that chose to register in respect of their start-up costs would be important. It should also be made clear how businesses whose turnover fluctuated above and below the threshold would be dealt with.

- Exemptions and zero-rated items: In principle, the Institute agrees that minimising the number of exemptions and zero-rated items would reduce the administrative burden and the complexity. However, our survey of members indicated that exemptions were seen as important by a significant majority of respondents. Specifically, education, health services, food and transport came out at the top of the list of items that should be exempted. While the Institute understands the argument for keeping exemptions to the minimum, the feedback suggest that were exemptions not to be provided for such items, more would need to be done in terms of explaining to and educating the community. This is all the more so given that, under the proposals, financial services, for example, would enjoy preferential treatment while daily necessities would not.

- Import/export trade: We support the proposal for a Deferred GST Payment Scheme and Qualifying Exporters Scheme with provision for approved temporary storage areas and bonded warehouses. However, more certainty needs to be provided as to how this would work in practice.

- Managing the changeover: Much more would need to be said and done about the transition to a GST, including information on the implementation arrangements, such as pre-GST educational programmes, and pre- and post-implementation support services.

- Administration: There are a number of unanswered questions regarding the administration of GST, concerning areas such as:

  Structural issues

  ✓ Who would administer GST within the government and how would this integrate with the existing tax administration system?

  ✓ System requirements within the administration, training of staff, etc. and lead times

  ✓ Investigation and enforcement powers.

  ✓ Dispute resolution

  ✓ Details of what would constitute a registrable entity? Would the turnover threshold be based on actual or expected turnover - in Hong Kong and outside? What would happen to the business registration system? Would GST follow the business registration system or vice versa?

  ✓ Would self-assessment be introduced before a GST was implemented?

  Procedural issues

  ✓ Timing of submission of GST returns? If quarterly, could a taxpayer choose to file monthly instead so as to smooth cashflows?

  ✓ Impact of group transactions?

  ✓ Standard methods for calculating the GST payable for partially exempt businesses (e.g. most developers) would be needed.

  ✓ Would there be GST supplies that are "outside of the scope" (e.g. foreign investments and dividend income)?

  ✓ Valuation problems. How would second-hand goods and part exchange/barter be dealt with?

- ✓ Would there be special retail schemes, so GST invoices would not need to be issued by all retailers to all customers?

- ✓ Detailed arrangements for the tourist refund scheme.

- ✓ Would goods sold at conventions and exhibitions/samples be exempted?

- ✓ Would there be any special arrangements for bad debt relief?

- ✓ Would Hong Kong-based banks require GST registration numbers before bank accounts were opened?

- ➢ We note the comments of the IMF that introducing a broad-based consumption tax in Hong Kong "does pose formidable administrative challenges..... Most notably, effective controls over cross-border flows of goods are currently lacking on account of Hong Kong SAR's status as a free port; and key revenue departments (i.e., the Customs and Excise Department (CED) and the Inland Revenue Department (IRD)) have no experience in administering broad-based consumption taxes. Overcoming these challenges would require the political will to reorient the mode and focus of the operations of both the CED and the IRD in a fundamental way, as well as careful and advance planning to execute such a change"[33]. How would these points be addressed?

<u>Chapter 6</u> - Households: Impacts and Offsets

Q9) Do you support providing tax relief and compensation measures for households if GST is introduced?

132. Yes. The Institute has previously suggested incorporating appropriate compensations for low-income households in the GST design (see above).

Q10) What are your views on the measures proposed in this chapter?

133. The consultation document notes the difficulty in identifying Group 2, i.e., non-CSSA low-income households. It is important that convincing assurances be given to the community that this group, including many retirees, would be properly identified and adequately compensated. It appears from the reaction of some sectors of the community that doubt remains as to whether the proposed relief for CSSA households would sufficiently offset the effects of a GST.

134. Further thought would need to be given to the package of compensatory measures, otherwise the demand for exemptions, at least in respect of basic necessities, could intensify. Consideration should be given to, e.g., the possible tax impact of the compensation measures and if they would increase the likelihood that a recipient will fall into the tax net for the first time or, as a result of other income, pay tax at a higher marginal rate. It might

[33] See footnote 8, Executive Summary of the IMF report

also be advisable to consider compensation measures for certain categories of retirees as a separate item.

135. One possible additional option for consideration, either in the context of returning funds to the public or specific compensatory measures for lower income groups, would be payments into individual MPF funds. It is the lower income groups who are likely to feel the largest impact, both as employees during their working lives and subsequently as retirees with limited means.

Q11) How do you think that Group 2 (non-CSSA low-income households) should be defined?

136. This is not an area in which the Institute has particular knowledge or expertise and we are not in a position to know what kind of data is available on individual households in Hong Kong. In principle, reference should be made to, e.g., a ceiling in respect of annual household income. One category of persons that should be included is employees earning below or just above the MPF contribution threshold, who do not qualify for CSSA payments.

<u>Chapter 7</u> - Business and Other Organisations: Impacts and Offsets

Q12) Should we use the opportunity of tax reform to enhance business competitiveness in Hong Kong, by reducing existing taxes and charges on business if GST is introduced?

137. Yes. The Institute has previously suggested a number of measures, including reducing the rate of profits tax and providing for other tax offsets, e.g. concessions for regional offices and the introduction of group relief/loss relief. However, a fuller study of Hong Kong's business competitiveness in regional and global terms should be undertaken, and a clear long-term strategy developed, in which the tax system would constitute one element, to ensure that Hong Kong remains competitive.

Q13) What are your views on the measures proposed in this chapter?

Set up assistance provision

138. The Institute supports the proposal to provide assistance to small and medium-sized enterprises ("SMEs") and other organisations that voluntarily register to help meet the compliance costs associated with the introduction of GST. It is not clear however that the amount to be set aside, i.e., HK$200 million would be adequate. Under the circumstances, we believe that the government could afford to be more generous.

Indirect tax adjustments to reduce economic distortion and revitalise competitiveness

139. It is proposed to adjust existing taxes according to the principles of (a) avoiding tax on tax and (b) to ensure that for those products currently subject to high levels of indirect tax (e.g. motor vehicles and alcohol, although it is noted that the duty on the latter has been reduced significantly in the 2007/08 budget) the introduction of a GST would not lead to an increase in the total taxation on such products. In a later example, as an illustration of how tax on tax would be avoided, it is explained that the stamp duty on the sale of a (commercial) property would be applied to the GST-exclusive value of the property. However, in the example, it is proposed that both stamp duty and GST would be charged on the sale of the property, which would seem to contradict the principle of not increasing the overall level of tax.

Relief measures

140. We support the relief measures proposed in table 12 to ensure that the overall level of tax would not increase, provided these are across-the-board. It is not entirely clear, for example, what is meant by suggesting that the logistics and trade sector would be the sectors to benefit from a reduction in the motor vehicle first registration tax. We assume the proposal is not for the reduction to apply only to those sectors, which we would not support, but only that they would be the sectors, which in practice would be likely to derive the most benefit from this general measure. We agree with the proposed increase in the ceiling on deduction for charitable donations. The Institute has previously suggested such a measure to encourage more business support of charities.

Chapter 8 - Options for Returning the Funds from GST to the Public

Q14) What are your suggestions on how to return the remaining balance of available funds to the community?

141. In principle we would support reductions in profits tax and salaries tax. However, were a GST to be introduced, it should be part of a cohesive package of tax reforms that included e.g. incentives for business and offsetting benefits for different groups of taxpayers and low income earners. At present there is arguably insufficient analysis of the affect on the middle-income group. A study should be carried out on Hong Kong's competitiveness to determine the specific form that tax reductions should take to maximise the benefits for Hong Kong's economy. There is also a case for some expenditure increase in key areas, which would benefit lower income groups, such as health services and education.

142. Our member survey indicated that there is still concern over the overall level of government spending which, in view of the reductions that appear to have been achieved over the past few years suggests, at the very least, a need for increased transparency and accountability in this area and more sensitivity

towards the views of the community in relation to major development projects. In this regard, the repercussions of the lower population forecasts revealed in the results of the recent by-census should be made clear.

143. The Institute believes that, were a GST to be introduced, the opportunity should be taken to conduct a structural review of public expenditure and revenue and, in particular, assuming less reliance would be placed on land revenues, to consider whether it is time for a change to be made to the system that perpetuates high land prices. A lower cost of land would have a knock-on effect throughout the economy. It could have a fundamental and positive impact on the cost of doing business and cost of living in Hong Kong, which could more than offset any negative impact on prices resulting from the introduction of GST.

Chapter 9 - Economic and Industry Sector Implications

Q15) What are your views on the economic and industry sector impacts of a GST in Hong Kong?

144. The Institute believes that the direct and indirect impacts of the introduction on a GST may have been underestimated to some extent. The increase in prices, assuming a GST rate of 5%, is characterised as a "one-off spike" of around 3%, which is "expected to dissipate quickly". While the long-term effect on inflation might be limited, clearly there would be some long-term price shift as many items which were previously not taxed would be taxed, although obviously the lower the rate of GST the less the change in prices. This would be applicable both to domestic consumers and tourists, although tourists should be able to obtain a partial refund for their more expensive purchases.

145. Also it is suggested there would not be an overall increase in prices of 5% because, for example, many SMEs would be outside the GST system and would not be charging GST on their output. Nevertheless, as they would not be able to reclaim the GST on their inputs, their own costs would increase and, if possible, they would want to pass on this increase to the consumer or to their trading partners. As has often been found in other jurisdictions when major structural changes have taken place in the economy, depending on market conditions at the time, some suppliers and retailers might take the opportunity to round up prices or to raise prices generally. Again, the lower the rate of GST, the less room there would be to capitalise on the changes.

146. The figures quoted for the annual costs of compliance seem quite low, but they tell only part of the story. For some businesses there would need to be a culture change and the overall cost to them should include all the start-up costs as well as ongoing administrative costs, including the preparation time required, the need for system changes (both hardware and software) and, possibly, the need for additional staff. Furthermore, average costs do not necessarily reflect the relative difficulties for individual businesses, and could be more reflective of larger, well–run, and international companies, to which

the requirements would already be familiar or at least easier to grasp and implement.

Trade, transport and logistics

147. The increased burden of the changes for importers and exporters is alluded to. On the face of it, there would need to be much greater control than there is now over the flow of goods and the border. The impact of this should be explained and discussed more clearly, particularly in the light of the rapidly growing competition from logistics operations on the Mainland.

Property and construction

148. While the GST on the sale and rental of commercial property could be reclaimed by GST-registered business, as mentioned above, GST will be another tax, in addition to stamp duty (although under the proposals, stamp duty will not be charged on the GST element) and would add to the upfront cost of commercial property, which is already high in Hong Kong. For non-GST-registered businesses, a GST in this context would add to their financial burden.

Conclusion to Part B: The GST Option for Broadening Hong Kong's Tax Base

149. The Institute believes that GST should remain an option for broadening Hong Kong's tax base and the overall pros and cons should be weighed up against other possible options once the latter have been examined more closely.

150. As regards the design details of the proposed GST system in the consultation document, in broad terms, the Institute is supportive of the framework proposed (which incorporates a number of the design features advocated by the Institute for a GST system). However, if it is decided to put forward the GST option again in the future, then a good deal more information and explanation will need to be provided and various issues will need to be addressed, which have not been covered in the current proposals or not in sufficient depth to remove the considerable uncertainties that exist. We have outlined a number of these issues above.

Hong Kong Institute of Certified Public Accountants
March 2007

Appendix 1

Questions Raised in the Government's Consultation Document

CHAPTER 1 Is tax reform required in Hong Kong?

1. Do you think that our existing tax base is too narrow?
2. Do you believe that Hong Kong needs a tax base where revenue generated from diversified sources that are less susceptible to external shocks and cyclical economic conditions?
3. Do you think the Government should take action to reform the tax base to ensure our future growth and prosperity?

CHAPTER 2 Broadening the tax base: what are our options?

4. Do you agree that there are are only two viable options?
5. Do you agree that a reduction in personal allowances is not a preferred option?

CHAPTER 3 The case of GST

6. Do you agree that GST is an appropriate option to broaden Hong Kong's narrow tax base?

CHAPTER 4 What is GST and how does it work?

7. Do you agree that GST is preferable to RST as a form of general consumption tax?

CHAPTER 5 A proposed GST framework for Hong Kong

8. What are your views on the proposed GST framework and design features as outlined in this Chapter?

CHAPTER 6 Households: impacts and offsets

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

CHAPTER 7 Business and other organisations: impacts and offsets

12. Should we use the opportunity of tax reform to enhance business competitiveness in Hong Kong, by reducing existing taxes and charges on businesses if GST is introduced?
13. What are your views on the measures proposed in this Chapter?

CHAPTER 8 Options for returning the funds from GST to the public

14. What are your suggestions on how to return the remaining balance of available funds to the community?

CHAPTER 9 Economic and industry sector implications

15. What are your views on the economic and industry sector impacts of a GST in Hong Kong?

<u>Appendix 2</u>

Comparing corporate tax rates between Hong Kong and other economies

Jurisdiction[34]	2000 Company Profits Tax Rate	2005 Company Profits Tax Rate	Change in percentage points
OECD	33.6%	29.8% (2004)	-3.8
European Union	about 35%	about 25%	about -10
South Korea*	30.8%	27.5%	-3.3
Austria	34%	25%	-9
Singapore*	26%	20%	-6
Iceland	30%	19%	-11
Hong Kong	**16%**	**17.5%**	**+1.5**
Hungary	18%	16%	-2
Lithuania	24%	15%	-9
Ireland	24%	12.5%	-11.5
Macau*	15.75%	12%	-3.75
Cyprus	15%	10%	-5

(Extracted from *"Broadening the Tax Base Ensuring Our Future Prosperity – What's the Best Option for Hong Kong?"* Consultation Document, The Government of the Hong Kong Special Administrative Region, July 2006.)

* These jurisdictions also offer tax incentives or holidays that can reduce the effective tax rate.

[34] Jurisdictions that compete for high value-added services have been selected for comparison. OECD and EU averages are included as a reference point for developed economies.

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Transaction Tax: General Overview

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Transaction Tax: General Overview

Summary

In recent years a number of alternative taxation mechanisms have been proposed to augment or replace income taxes and other traditional revenue sources. This report describes the economics of one of the proposals — a broad-based transaction tax or fee. On February 3, 2004, Representative Fattah introduced H.R. 3759 ("Transform America Transaction Fee of 2004") that required a study of replacing current federal taxes with a broad-based transaction fee. This report provides relevant background information on transaction taxes or fees in general and discusses some of their more notable economic aspects.

A broad-based transaction fee or tax is triggered by any transaction and is imposed either as a percentage of a transaction's full value, or as a flat fee. Most items are resold several times during the production process, and every such transaction would be taxed. This pyramiding effect makes the tax different from other consumption-based taxes, such as sales and use taxes or value-added taxes.

Historically, transaction taxes have been applied to a limited number of transactions, such as trades in various financial instruments. While they were used in the United States and abroad, they were never a major revenue source.

A transaction tax or fee may generate additional revenues for the federal government or substitute for existing ones. In doing so, it may reduce or eliminate existing distortions in the economic system, but introduce distortions of its own. For example, a transaction tax burden would fall more heavily on industries that involve large numbers of transactions. Its introduction might induce firms to vertically integrate production, which may not be beneficial from a social standpoint. Imposing the transaction tax in the financial market could possibly cause a significant loss of trading volume to competing overseas markets.

On the other hand, the transaction tax or fee might eliminate a great deal of complexity from the taxation system. It could be easier to administer and result in lower compliance and other related social costs. It may also prevent excessive speculative trading in financial instruments. In addition, it would be a means to tax underground economic activities.

Several tentative revenue estimates included in this report illustrate the revenue-generating potential of a broad based tax. For example, a 0.5% tax on stock transfers would yield no more than $65.6 billion a year, and a 0.00006% tax on foreign exchange transactions would bring in just $4.3 billion. In order to replace all federal receipts with the transaction tax revenues, the rate would have to be set at about 4.3% per transaction, possibly more. This estimate does not account for new federal programs envisioned by H.R. 3759.

This report provides general background information, but it does not evaluate any specific legislative proposal. The report will not be updated.

Contents

Transaction Tax: General Overview

Introduction

In recent years a number of alternative taxation mechanisms have been proposed to augment or replace income taxes and other traditional revenue sources. This report describes the economics of one of them — a broad-based transaction tax. On February 3, 2004, Representative Fattah introduced H.R. 3759 ("Transform America Transaction Fee of 2004") that required the Department of the Treasury to study replacing the current federal taxes with a broad-based transaction fee. This report provides background information on transaction taxes and fees. It uses these terms interchangeably, since their economic impacts are identical.

Mechanics of the Transaction Tax

The transaction tax is triggered by a transaction that uses any kind of a payment instrument: check, cash, credit card, or anything else. The tax may be collected on retail and wholesale sales, purchases of intermediate goods, and financial or other intangibles' transactions. Taxpayers would become liable for the tax at the moment they are able to exercise control over a piece of property or a servicc regardless of the payment method.

The transaction tax may appear similar to the sales and use tax — one of the major revenue sources for state and local governments — but there is a major distinction: sales tax is charged only on sales to the final consumer of the product, while the transaction tax would apply to intermediate users as well. It also differs from a value added tax (VAT), commonly uscd by European countries, since the VAT is imposed only on a portion of a transaction's value, roughly the difference between an item's selling price and its cost, thus avoiding multiple layers of taxation.[1]

Transaction taxes may be assessed as a percentage of the value of the transaction (ad valorem) or as a flat fee per transaction. For example, when a person buys $100 worth of groceries under the fixed ratc transaction tax, the tax due would amount to $5, using a 5% rate for illustration. By the same token, a money management firm buying $1 million worth of bonds would incur a $50,000 liability. An example of a fixed fee would be $1 fee for any transaction, whether valued at $100 or $1 million. Computation of tax liabilities may become more cumbersome in the case of a

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[1] For further information, scc CRS Issue Brief IB95060, *Flat Tax Proposals and Fundamental Tax Reform: An Overview,* by James M. Bickley.

complex multi-party transaction, such as a real estate purchase financed through a bank, where several transactions may be required to complete the sale.

The tax could be collected by the seller or financial institution servicing the transaction and transferred to the U.S. Treasury just as sales and use taxes are transferred to state treasuries today, or handled in some other manner prescribed by law. Economic theory suggests that who bears the burden of the tax (i.e. whose income is effectively reduced) depends on market forces and not on whether the buyer or seller is legally responsible for the tax.

The transaction tax does not have to be as broad as described above. It may be limited to certain segments of the economy. There is some history of imposing transaction taxes on narrowly-defined segments of the economy.

Background and Historical Information on Transaction Taxes

Transaction taxes have some precedents in the United States and abroad, although the existing transaction taxes are limited in scope. No major industrialized nation has adopted a broad-based transaction tax.

At the federal level one of the historical examples of a transaction tax was a stock transfer tax (STT) effective from 1914 to 1966. In 1966 the rates were 0.1% at security issuance and 0.04% on transfer. At the present time the federal government still levies a small tax on share issuance and transfers at the rates of 0.028% and 0.0033%, respectively, for the primary purpose of financing the activities of the Securities and Exchange Commission (SEC). In 2000 this tax raised revenues of $2.2 billion,[2] although after recent enactment of rate reductions, the revenues are expected to drop.[3]

In the late 1980s and early 1990s, several ideas to introduce additional securities transaction taxes in the U.S. were floated, though none was implemented.[4] Some of the proposals were targeted to narrow segments of financial markets, such as trades in derivatives, while others were broader and covered most financial transactions.

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[2] Robert Pollin and James Heintz, *Evaluation of a Proposal to Reinstate the New York Stock Transfer Tax*, research report (Political Economy Research Institute, University of Massachusetts, Amherst, April 2003), p. 5.

[3] For further information see CRS Report RS20953, *Reducing Securities Transaction Fees: Effects on Collections of H.R. 1088 and S. 143*, by Mark Jickling.

[4] For further information see CRS Report 90-415, *Taxation of Securities Transactions to Discourage Short-Term Investment: a Selected Bibliography*, by Louis Alan Talley; CRS Report 90-350, *The Securities Transactions Tax: an Overview of the Issues*, by Donald W. Kiefer; and CRS Report 93-474 E, *A Tax on Large-Dollar Wire Funds Transfers?*, by William Jackson. These reports are archived, but available on request.

Other federal taxes on transactions include excise taxes, such as the 3% tax on telephone services and the 3% luxury passenger vehicle tax. Some excise taxes are levied on a per-transaction or per-unit basis, irrespective of an item's value, such as alcohol or tobacco taxes.[5] Unlike the transaction tax, the existing excise taxes apply only once for each product, avoiding a pyramiding effect.

In addition to federal taxes, many state and local governments impose levics on such transactions as sales of real property and vehicles or provision of telecommunication services. The rates and exact definitions of taxable events differ by jurisdiction.

Worldwide, many governments impose some kinds of transaction taxes, for example, on securities transfers. Specifics vary by country.[6] In many cases revenues raised are insignificant, but in some instances they become noticeablc. For example, the STT generated 4.2% of the government general account revenue in Japan in 1988.[7] However, by 1993 this share fell back to 0.96% as most of the speculative trading moved to the trading floors in much-less-taxed locations. In many countries STTs were either reduced or completely eliminated over the last decade.

Recently, the Peruvian government imposed a temporary 0.10% tax on banking transactions. The tax became effective in March 2004 and was expected to raise revenues equal to about 0.7% of the country's gross domestic product (GDP).[8]

The ongoing discussions in the economic literature on transaction taxes are focused in narrow areas such as currency exchange or the STT. For example, James Tobin put forward an idea of taxing currency transactions, which came to be known as the "Tobin tax," in order to stabilize exchange rates, not to raise revenues.[9] However, other proponents of the tax would like to tap its revenue potential. Most

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[5] CCH Editorial Staff Publication, *2003 U.S. Master Tax Guide* (Chicago: CCH Incorporated, 2002), pp. 46-48.

[6] See Appendix in CRS Report 90-350 and Table 1 in Bob Pollin, "Applying a Securities Transactions Tax to the US: Design Issues, Market Impact, Revenue Estimates," in *Debating the Tobin Tax,* James Weaver, Randall Dodd, and Jamie Baker, eds. (Washington, DC: New Rules for Global Finance Coalition, 2003), p. 122, visited online on Feb. 20, 2004, at [http://www.new-rules.org/Docs/tobintax/debatingthetobintax.pdf].

[7] Peter M. Garber, "Issues of Enforcement and Evasion in a Tax on Foreign Exchange Transactions," in *The Tobin Tax: Coping with Financial Volatility*, Mahbub ul Haq, Ingc Kaul, and Isabelle Grunberg, eds. (New York, Oxford: Oxford University Press, 1996), p. 130.

[8] Robin Emmott, "Bank Tax Seen as Little Help for Peruvian Economy," Reuters, Dec. 5, 2003; "Peru Cabinet May Proposc Bank Tax Changes Soon-PM," Reuters, March 1, 2004; Lucien O. Chauvin, "Peruvian Finance Minister Says New Tax On Banking Transactions Revealing Evasion," *Daily Tax Report,* No. 106, June 3, 2004, p. G-3.

[9] James Tobin, "Prologue," in Mahbub ul Haq, Inge Kaul, and Isabelle Grunberg, pp. ix-xviii.

recently Belgian Parliament approved a national Tobin tax, but it is unclear whether it would ever become effective.[10]

Impact of a Transaction Tax on Economic Behavior

Generally speaking, any tax changes behavior of economic agents since it alters costs and benefits associated with decisions they make. Consequently, imposing taxes in a competitive market typically leads to economic inefficiency. However, the taxation mechanism does affect how economic agents respond to it, and tax burden per se is just one part of the equation. Different tax structures can raise exactly the same revenues, and yet create very different sets of incentives.

If the transaction tax revenues replace some other federal receipts, the aggregate tax burden on the U.S. economy as a whole would remain constant. At the same time separate taxpayers' burdens may end up higher or lower.

By eliminating or reducing some existing federal taxes, the transaction tax may cut efficiency losses and distortions associated with them. For example, if revenues from the new tax allow a reduction in marginal income tax rates, firms might be willing to undertake projects that were not economically profitable in the past and workers would be more willing to supply labor than before. On the other hand, the transaction tax would introduce its own distortions into the economic system. Its burden would still fall on both labor and investment income, although burden shares may shift.

A transaction tax may be imposed several times on an item as manufacturers and distributors buy and sell it before it finds its way to the final consumer. This pyramiding effect occurs because the tax applies to the full transaction value, without any credit for the previously paid taxes. At every stage of the production chain the tax becomes a cost ultimately incorporated in the output prices. Therefore, even though the nominal tax rate can be set at a relatively low level, the effective rate may end up being a multiple of that rate.

These multiple layers of taxation would affect different sectors of the economy in different ways. For example, offering legal services may require a minimal supply chain, with a correspondingly low total transaction tax bill. In contrast, an aircraft manufacturer would have to include in the final price transaction taxes paid by all of its suppliers, from mining companies to electronics vendors. Thus the effective tax rate would differ across goods, and generally such variation is likely to create more distortions than a tax imposed at a uniform effective rate.

A transaction tax creates incentives to minimize the number of transactions necessary to manufacture a product and bring it to the final consumer. One of the fundamental tenets of economics suggests that specialization and trade are two of the key driving forces of economic development, because through specialization

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[10] "Belgium Set to Approve 'Tobin Tax' Despite Protests From EU Officials," *Daily Tax Report*, No. 228, Nov. 29, 2004, p. G-4.

resources are used efficiently. Taxing transactions discourages economic agents from gaining specialized skills. In the absence of transaction taxes, each firm can choose between in-house production or outsourcing, taking into account actual costs associated with every option. After imposition of a transaction tax, this choice would become artificially skewed towards internalizing production, even though there is no advantage to the society as a whole in this mode of operation.

Transaction tax liability is present regardless of whether a company makes or loses money. Many sectors of the economy are cyclical in nature. The necessity to pay the tax may become a significant burden for companies, especially in cyclical industries and start-ups. Knowing that they have to pay the tax even if the venture is unprofitable may discourage companies from taking entrepreneurial risks. In addition, companies would have to keep larger cash reserves to service their tax liability in a bad year, which implics a lower return on capital and economic inefficiency.

Many of the problems discussed above are present regardless of changes in individual taxpayers' absolute tax liabilities. Their total transaction taxes may be lower than the taxes they currently face, yet this lower absolute burden would not eliminate the above distortions.

Imposition of the tax may put at a disadvantage domestic financial markets that compete internationally. In essence, the largest financial centers in New York, Tokyo, and London operate globally around-the-clock, and geographic location of buyers and sellers is of little importance. The industry turnovers are huge. For example, average daily foreign exchange gross turnover in the U.S. was $287 billion in April of 2001.[11] In the same year, total market value of equity and options sales on the U.S. exchanges exceeded $13 trillion.[12] Tiny fluctuations in securities' prices generate huge cross-border capital flows.

As a result of a transaction tax, trading activity might flee the U.S. in favor of other sites. For example, Umlauf[13] cites the historical example of Sweden, which increased its STT to 2% in 1986. By the end of the decade, half of the volume in Swedish shares traded in London. Furthermore, attracting back once-lost activity may be extremely difficult after alternative trading sites emerge.

On the positive side, introduction of the transaction tax, if accompanied by complete elimination of income taxation, might create an opportunity to address a major concern with the existing law: its complexity, reflected in high compliance,

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[11] Bank for International Settlements, Statistical Annex in *Triennial Central Bank Survey 2001*, March 2002, visited on Feb. 20, 2004, at [http://www.bis.org/publ/rpfx02a.pdf].

[12] U.S. Securities and Exchange Commission, Appendix in *2002 Annual Report*, visited on Feb. 20, 2004, at [http://www.sec.gov/pdf/annrep02/ar02appendix.pdf].

[13] Steven R. Umlauf, Transaction Taxes and the Behavior of the Swedish Stock Market, *Journal of Financial Economics*, vol. 33, issue 2, April 1993, pp. 227-240 as cited in R. Glenn Hubbard, "Securities Transactions Taxes: Tax Design, Revenue, and Policy Considerations," *Tax Notes*, Nov. 22, 1993, pp. 985-1000, also available at [http://www.taxanalysts.com].

administration, and other costs. The Internal Revenue Service (IRS) net cost of operations in 2002 was over $10 billion,[14] but this is just a part of the total economy-wide cost. While estimates vary, most show that the societal total compliance costs are much larger than the IRS budget. The Office of Management and Budget estimates that taxpayers spend 6.7 billion hours annually to comply with the Internal Revenue Code.[15] Assuming labor at $30 an hour, it implies a cost in excess of $200 billion.[16] Scott Moody of the Tax Foundation estimated the 2001 compliance burden at $140 billion in his testimony to the House Ways and Means Committee.[17] The Office of Tax Policy Research at the University of Michigan Business School, directed by Joel Slemrod, provides an estimate of over 3 billion hours and as much as $100 billion annually.[18]

Replacing federal individual and corporate taxes with a transaction tax may eliminate substantial portions of this burden to society. For example, most individual taxpayers may no longer need to file an annual federal tax return. The magnitude of this cost reduction would depend on exact implementation of the reform and on other factors, such as whether states follow suit and repeal their income taxes or whether any tax preferences remain under the new system.

A transaction tax would discourage short-term speculative trading in financial markets in favor of long-term investments. In any time period short-term traders execute far more trades than long-term investors, and therefore would pay proportionately more in transaction taxes. This was the rationale behind the "Tobin tax." Tobin first proposed it to prevent short-term trading that led to excessive exchange rate volatility and by many accounts exacerbated currency crises. To the extent these assertions are valid, a transaction tax could improve overall welfare. At the same time many researchers believe that frictionless financial markets are essential to an efficient allocation of resources.

A transaction tax may capture some of the revenues from an underground economic activity that currently evades taxation. Since illicit income remains undeclared, the federal government does not collect any taxes on it. However, proceeds from illegal operations eventually are used to buy legitimate goods and

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[14] U. S. General Accounting Office, *Financial Audit. IRS's Fiscal Years 2002 and 2001 Financial Statements*, GAO Report to the Secretary of the Treasury, GAO-03-243 (Washington: Nov. 2002), p.74.

[15] U.S. Office of Management and Budget, Office of Information and Regulatory Affairs, *Managing Information Collection and Dissemination (Fiscal Year 2003),* visited on Feb. 20, 2004 at [http://www.whitehouse.gov/omb/inforeg/2003_info_coll_dism.pdf].

[16] Methodology follows Chris Edwards, Simplifying Federal Taxes: the Advantages of Consumption-Based Taxation, *Policy Analysis,* No. 416, Oct. 17, 2001, visited on Feb. 20, 2004, at [http://www.cato.org/pubs/pas/pa416.pdf].

[17] Tax Foundation, "Cost of Complying with Federal Income Tax Will Reach $140 Billion in 2001," July 17, 2001 release, visited on Feb. 20, 2004, at [http://www.taxfoundation.org/pr-compliancetestimony.html].

[18] The Office of Tax Policy Research, "Hot Topics in Taxation, Compliance Costs," visited on Feb. 20, 2004 at [http://www.otpr.org] or [http://www.otpr.org/compliance_costs.html].

services that would become subject to the tax under the plan. On the other hand, the transaction tax may induce broader use of undocumented cash payments to reduce tax liability.

The Transaction Tax's Revenue-Raising Potential

How much revenue can be raised by applying the tax to specific sectors of the economy, that either were subject to such taxes historically, or were considered as candidates for this tax? What would be the transaction tax rate necessary to substitute all current federal revenue sources as envisioned by H.R. 3759? The analysis in this section attempts to provide some ballpark estimates to answer these questions.

In a static world estimating the revenue potential would be as simple as multiplying the tax rate by the total domestic transactions turnover. In reality, however, the tax would alter economic agents' behavior, with a corresponding change in the total volume of transactions. The response to the levy would not be uniform across economic sectors, and would depend on specifics of the law. Thus, the rate estimates in this section try to capture just the most potent dynamic effects and are highly tentative.

One of the industries historically subject to transaction taxes is the financial sector. Imposition of the tax may cause a dramatic reduction in its transaction volumes. The most sensitive markets are likely to be foreign exchange. A number of estimates of the maximum rate that does not shut down trading in the market were developed in the past. For example, Garber points out that for a tax on transactions in foreign exchange markets imposed unilaterally, 6/1000 of a basis point (or 0.00006%) is a realistic maximum magnitude.[19] Assuming that the rate of 0.00006% causes no reduction of trading volume, the tax on foreign currency exchange transactions would yield just $4.3 billion a year, despite an annual turnover in dozens of trillion dollars.

Other financial markets are somewhat less prone to cross-border migration and therefore the tax rate ceilings are higher. As mentioned above, the United States currently imposes the tax on securities transactions at a 0.0033% rate. In the U.K. a similar tax, known as a stamp duty, has a 0.5% rate[20] and in some countries it is even higher than that. It is unclear, though, if these rates are sustainable in the long run, given increasing economic openness worldwide.

Assuming a 0.5% rate on over $13 trillion in stock and options transactions, the static revenue estimate is $65.6 billion, but most likely actual revenues would fall far short of this figure. The revenues depend on transaction volume, and it would fall because of the negative relation of turnover to transaction costs, described

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[19] Garber, p. 135.

[20] Stephany Griffith-Jones, "Institutional Arrangements for a Tax on International Currency Transactions, " in Mahbub ul Haq, Inge Kaul, and Isabelle Grunberg, p. 147.

numerically by elasticity. Elasticity is (a negative of) a ratio of relative change in turnover to relative change in transaction costs. The value of an elasticity of 1.5 means that, say, a 5% increase in transaction costs would result in a 7.5% reduction in transaction volume. Hubbard lists some of the elasticity estimates ranging from 0.26 to 1.7, with the 0.26 estimate being obtained in 1976 before industry deregulation.[21] Since the elasticity value typically is not constant across cost ranges, the estimates would work well only for a relatively small change in transaction costs. By contrast, a 0.5% tax can easily exceed the bid-ask spread (the difference between a stock's selling and buying prices), implying a percentage change in transaction costs of more than 100%. Therefore, one might expect a significant turnover reduction and lower federal revenues.

Trading in other financial assets, such as non-governmental bonds and swaps, would generate additional revenue. However, it may be difficult to establish a rate pattern that would treat all financial instruments equally. Without such an equality trading is likely to concentrate in the most-favored market, since it is often possible to substitute one type of security for another. For example, an investor can buy a derivatives portfolio that would replicate a regular stock share. This tax-minimization behavior would further drain revenues.

The rates of 0.00006% and 0.5% were selected as illustrations of realistic rates for the unilaterally imposed tax. Setting higher rates might virtually shut down financial markets in the United States and move the activity abroad. However, in the case of a coordinated international tax policy, it could be possible to set them higher.

From the technical standpoint, the tax on financial instruments would be relatively easy to implement. It can piggyback on the existing tax on share issuance and transfers levied by the federal government or on similar taxes levied by individual states. In fact, the ease of a transaction tax's technical implementation and enforcement attracted some of the countries with weak collection enforcement systems.

Levying the tax on transactions going through the Federal Reserve Bank system (Fed) would be one of the most technically feasible implementation options for a broad-based transaction tax described in H.R. 3759. The Fed estimates the daily volume of payments at more than $3 trillion, which puts the annual total at over $750 trillion.[22] However, this is the composite of all payments, including Fedwire and Clearing House Interbank Payment System, two payment systems used primarily by the banks and other participating institutions for large-value funds transfer and U.S. government securities transactions. In 2000 such payments totaled $671.9 trillion.[23]

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[21] R. Glenn Hubbard, 1993, Appendix.

[22] The Federal Reserve Board, "Payment Systems," visited on Feb. 20, 2004 at [http://www.federalreserve.gov/paymentsys.htm].

[23] Geoffrey R. Gerdes and Jack K. Walton II, "The Use of Checks and Other Noncash Payment Instruments in the United States," *Federal Reserve Bulletin*, Aug. 2002 and The Federal Reserve Board, "Payment Systems," visited on Feb. 20, 2004 at [http://www.federalreserve.gov/pubs/bulletin/2002/0802_2nd.pdf], p. 370.

The total of these transfers is so large in part because many members engage in overnight transactions, which probably would not become a part of the taxable base. Such transactions are performed every business day, and sincc cvery one of them would carry a tax or a fee, the effective levy rate may get prohibitively high, even though the nominal rate is set low. For example, at the nominal rate of 0.01%, the effective annual rate ends up at 5%, rendering many transactions useless.[24]

One of the less elastic parts of the daily turnover is retail noncash payments. "Retail" in this context means payments made by individuals, businesses and government entities, but not large-value funds transfers discussed above. Gerdes reported that in 2000 the value of retail noncash payments was $46.6 trillion.[25] This figure does not include "on us" checks — checks deposited at the same institution on which they were drawn — estimated at 29% of the total check transactions, or about $11.4 trillion.

There are two more missing parts. Some portion of payments in the United States are processed by private networks and may never pass through the Fed. It is difficult to put a specific number on the value of these transactions, due to the lack of consistent data and potential double-counting.

Another missing piece is cash payments. According to some estimates, retail cash transactions equaled less than $1 trillion in 1999.[26] In addition, they are predominantly small payments that are most likely to be underreported. For this reason and due to the lack of data on total cash transactions value, the estimate does not account for them.

In 2000 federal government payments that presumably would not be subject to the transaction tax constituted about 1.5% of all retail non-cash payments.[27] Subtracting them from the sum of reported retail noncash payments and "on us" checks gives the taxable base of $57.3 trillion, more than five and a half times the annual GDP. The Congressional Budget Office (CBO) reported federal revenues of $1,991.2 billion in 2001.[28] A transaction tax at the flat rate of 4.3% would theoretically raise sufficient revenues to replace existing taxes, based on the debatable assumption that there would be little reduction in retail transaction volume in response to the tax introduction. This estimate does not account for new federal programs envisioned by H.R. 3759.

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[24] For further information see CRS Report 93-474 E, *A Tax on Large-Dollar Wire Funds Transfers?*, by William Jackson. This report is archived, but available on request.

[25] Ibid., p. 361.

[26] Ronald J. Mann, Credit Cards and Debit Cards in the United States and Japan, *Vanderbilt Law Review*, vol. 55, No. 4, May 2002, p. 1,072.

[27] Geoffrey R. Gerdes and Jack K. Walton, p. 369.

[28] U.S. Congressional Budget Office, Appendix F in *The Budget and Economic Outlook: Fiscal Years 2005-2014*, Jan. 26, 2004, visited on Feb. 20, 2004, at [http://www.cbo.gov/showdoc.cfm?index=1821&sequence=0#table1].

A flat fee approach probably would not yield much revenue. The bulk of all transactions are relatively low in value. For example, almost half of all checks in 2000 were written for $100 or less, about 87% did not exceed $1,000, and over 98% were below $10,000.[29] Therefore, even a relatively low fee may become a prohibitive tax burden on low-value transactions. For example, a person buying a bottle of soda for $1.50 would face a 67% tax, if the fee was set at just $1.00 per transaction. These considerations put a cap on the revenue potential under this approach.

Introducing a progressive fee schedule would also not solve the problem. Most taxpayers would be able to avoid higher fees by splitting up their transactions into small payments, subject to lower fees. On the other hand, technical implementation of such a mechanism becomes considerably more difficult.

The general nature of this report does not allow an evaluation of each option in greater detail. For the same reason it is difficult to address some of the important issues, such as tax preferences or distributional effects. Implementation of the transaction tax would represent a major change of the taxation system and it would require a careful study to make sure its implications are well understood.

[29] Geoffrey R. Gerdes and Jack K. Walton, p. 367.

Appendix 4

Comparing motor vehicle tax imposed on private vehicles between Hong Kong and other economies

Country	Name of Tax		Amount
	Recurrent Annual Fees		
Hong Kong[35]	Vehicle licence	*Petrol*	HKD3,929 to HKD11,329 per year
		Diesel	HKD 5,389 to HKD 12,789 per year
Singapore[36]	Road tax *(for petrol-driven cars)*		SGD200 per 6-month to SGD1,525 + 1.0x(EC – 3,000) per 6-month
	Diesel tax *(in addition to road tax)*		6 times or 4 times (for Euro IV diesel cars) the road tax of an equivalent petrol-driven car.
	Annual road tax surcharge *(for vehicle over 10 years)*		10% to 50%
Denmark[37]	Motor vehicle weight tax	*Petrol*	227.91 € per year to 49.34 € per 100 kg per year
		Diesel	335.17 € per year to 77.22 € per 100 kg per year
	Passenger car fuel consumption tax	*Petrol*	2474.86 € to 34.86 € per year
		Diesel	3359.70 € to 21.45 € per year
Finland[38]	Vehicle tax	*Basic tax* *(registered on or after 1 Jan 1994)*	127.75 € per year
		Driving power tax *(other than petrol-driven)*	24.45 € per 100kg per year
Ireland[39]	Motor vehicle tax		151.00 € to 1343.00 € per year
	One-off Initial Fee		
Hong Kong[40]	First registration tax		Graduated rates from 35% to 100% of taxable value
Singapore[41]	Additional registration fee *(from Mar 2004 tender exercise and onwards)*		110% of open market value
	Certificate of entitlement		Bid in categories A, B or E
	Excise duty		20% of open market value
Denmark[42]	Motor vehicle registration duty	*Large*	8834.96 € + 180% of tax value over 8835€
		Small	105 % of taxable value.
Finland[43]	Car tax	*Not diesel*	28% of retail value minus 650 €
		Diesel	28% of retail value minus 450 €
Ireland[44]	Vehicle registration tax		13.3% to 30.0% of open market sales price, subject to a minimum €125 to €315.

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35 Details extracted from http://www.td.gov.hk/public_services/fees_and_charges/index.htm
36 Details extracted from http://www.lta.gov.sg/motoring_matters/motoring_vo_tax_pte.htm
37 Details extracted in March 2007 from OECD/EEA database on instruments used for environmental policy and natural resource management. http://www.2oecd.org/ecoinst/queries/index.htm
38 see footnote 37
39 see footnote 37
40 Details extracted from http://www.td.gov.hk/public_services/licences_and_permits/vehicle_first_registration/guidelines_for_importation_and_registration_of_mot/index.htm
41 see footnote 36
42 see footnote 37
43 see footnote 37
44 see footnote 37

Appendix 5

Member opinion survey on the issues of broadening the tax base and GST

Detailed report

Hong Kong Institute of CPAs

Prepared by:	**Cimigo Limited** 2608, 26/F Admiralty Centre Tower 1, 18 Harcourt Road, Hong Kong
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Date	**12th of December, 2006**

Table of contents

1.0 Background and Methodology

1.1 Objectives of this research

- The GST Working Group of the Hong Kong Institute of CPAs ('the Institute') will make a submission to the HKSAR Government outlining the Institute's position on the government's consultation document "Ensuring our future prosperity - what's the best option for Hong Kong" and in particular the proposal ('the proposal') for tax reform and a Goods and Services Tax ('GST'). The submission will include representation of members' opinion on the topic of broadening the tax base and GST as a form of taxation.

- To this end, the GST Working Group has undertaken broad member consultation - soliciting questions, views and opinions of members on GST related matters via a dedicated website. This includes disseminating background information to members about the key issues associated with GST.

- To provide a quantitative and objective picture of member opinion, the Institute commissioned independent research agency, Cimigo, to conduct a survey amongst all its members. The purpose of the survey is to record members views in aggregate about the GST. The guiding principles in designing this survey were that the survey should be:

  (i) Accessible to all members of the Institute

  (i) An unbiased, neutral and faithful representation of their opinions

  (i) Relevant to the key issues broadly addressed by the GST working group and to the issues of broadening the tax base and GST in Hong Kong.

- This document reports on the findings of the survey of members of the Institute.

1.2 Methodology

1.2.1 Target audience for the research

- The target audience for the research was all current members, excluding student members. At present, there are approximately 26,000 members of the Institute.

1.2.2 Questionnaire

- The survey questionnaire was designed by Cimigo in consultation with the GST Working Group. The questionnaire canvassed opinion on the following broad areas of investigation:

  - Hong Kong's fiscal situation
  - The issue of broadening the tax base
  - Attitudes to presentation of the government Consultation Document
  - Implementation issues for GST
  - Overall support for a GST in Hong Kong

1.2.3 Data collection

- The Institute membership was invited to participate in the survey either using an online questionnaire (where email contact details were available) or otherwise by surface mail (via an hardcopy questionnaire with reply paid envelope). This was to ensure that each member received only one format of invitation.

- Initially, 22,169 invitations were sent to members by email and 3,881 by post on Monday, 13th of November, 2006. After the first round of emails, 1,260 members were also postal mailed a hardcopy questionnaire because the email invitation failed to deliver. Therefore, the final distribution of invitations was as follows:

  - Email invitation 20,909
  - Surface mail invitation 5,141

- Two reminders were delivered to members via email to encourage participation.

- All respondents invited to complete the survey were assured of anonymity. A randomly generated login ID and password were generated for each member to ensure non-duplicate responses. Those completing the survey could access the survey only after entering their unique identifier. All hardcopy questionnaires included a printed unique identifier which was used to ensure there were no duplicate hardcopy entries.

- The survey was hosted by Cimigo and the Institute was not able to know which members had completed and submitted their questionnaires. This ensured confidentiality.

- Members completing the survey were advised they had 14 days to complete the survey online from the 13th of November to 27th of November. To allow for the postal lead time, those completing the questionnaire in hardcopy were asked to return their survey by 25th of November.

1.2.4 Details of the sample and response rate

- At the completion of the allotted period for survey completion a total of **1,980** surveys had been returned. The number of returns by email and post and the response rate are as follows:

Emails sent	20,909		
Online questionnaires completed			1,619
Response rate		**7.7%**	
Questionnaires mailed	5,141		
Hardcopy questionnaires completed			361
Response rate		**7.0%**	
Total invitations sent	26,050		
Total completed surveys			1,980
Total Response rate		**7.6%**	

1.2.5 Interpretation of the sample

- It is generally accepted that a market research sample should generate of response rate of not less than 10% to be considered representative of the population from which it is drawn.

- The response rate of this survey of 7.6% falls beneath this threshold. In addition, as an opt in survey, many members who had no opinion or did not wish to express their opinion are not represented in the sample. Therefore it is not considered valid to extrapolate the survey results to the population of Institute members.

- The survey results should therefore be considered as the collective opinion of members with an opinion on the topic, who wished to express it.

2.0 Executive Summary

2.1 Opinions about Hong Kong's fiscal situation

Most accountants feel Hong Kong has a fiscal problem, that the tax base needs to be broadened and that government spending is too high.

- Most respondents feel that Hong Kong has a fiscal problem - purely structural (23%) or both structural and cyclical (46%). A minority of 18% believe Hong Kong has a purely cyclical problem (8%) or do not believe Hong Kong has a fiscal problem at all 18%.
- Most (65%) also feel that government spending is too high - either much too high (21%) or somewhat too high (44%). A minority of 20% feel that spending is appropriate and 11% think it is too low.
- Just under two-thirds (64%) believe that Hong Kong's tax base does need to be broadened and 33% feel it does not need to be broadened.
- However, whilst most respondents favour a broadening of the tax base, this has not translated into widespread support for a GST in Hong Kong.
- Those not naturally receptive to a need for an additional tax (i.e. those who indicated that spending is too high / no structural problem exists) are strongly anti-GST.
- Those expected to be receptive to GST (i.e. see a need to broaden the tax base) have not been swayed sufficiently by the government's Proposal.
- These two factors are reflected in the fact that 67% overall feel the government has not adequately explained its proposal and that amongst those who feel the proposal is sufficiently explained, the case made is not compelling - only 49% of this group actually supporting a GST.

2.2 Options to broaden the tax base

Most accountants oppose introduction of GST to Hong Kong. Whilst a Land and Sea Departure Tax is favoured by the majority as a means to broaden the tax base, there is no consensus about what is the best way to broaden the tax base. Whilst 20% feel GST is the best means to do so, four out of five accountants think there are other better alternatives.

- 59% of accountants surveyed opposed the introduction of a GST to Hong Kong and 35% supported it. Those opposing a GST tended to particularly vehement in their opposition - 15% <u>strongly</u> support GST whilst almost three times as many, 42% <u>strongly</u> oppose GST.
- When asked how strongly they favour or oppose various measures to broaden Hong Kong's tax base, 62% responded favourably towards a Land and Sea Departure Tax. The second most favourable option is a Capital Gains Tax (46% favour). GST is favoured by 34% of accountants surveyed (fifth most favoured).
- When asked what is the <u>best</u> way to broaden Hong Kong's tax base, the story is quite different. One in five (20%) favoured GST and 19% favoured Capital Gains Tax.

- The key to understanding this response is that there was no consensus support for a single means to broaden the tax base. Thus, whilst respondents are most likely to support GST, most prefer other alternatives, but no single tax measure to broaden the tax base dominates as best.

- For this reason, a Land and Sea Departure Tax stands out as being not strongly seen as the best option (9% thought it was best), but as the only option acceptable to most. It may, therefore, represent one potential means forward to broaden the tax base, (with which most respondents agree), whereas most will not accept a GST. Further research is advised amongst other constituencies in Hong Kong.

2.3 Views on the government's proposal

Most feel the government has not sufficiently explained its GST proposal. Around half of accountants surveyed cannot say if GST will result in various benefits or drawbacks. The only area where there is a majority opinion is that implementation of the GST proposal will overly complicate Hong Kong's tax regime.

- Respondents were asked to choose between pairs of opposite statements about the potential positive and negative aspects of the GST proposal.
  - 52% are uncertain whether the GST proposal will be fair for all or not fair for some sections of the community.
  - 51% are uncertain as to whether the GST would be easy to avoid or difficult to avoid.
  - 50% are unsure if the GST proposal will result in increased or damaged international competitiveness
  - 49% are unsure if the proposed GST would be compatible with Hong Kong's low tax regime
  - 47% are uncertain about whether the revenue produced would be stable or unstable.
  - The only aspect of the GST proposal where there was a majority opinion was that 60% believed the proposal will overly complicate Hong Kong's tax regime. Amongst those opposing a GST, the figure was 82%. Amongst those supportive of GST in general, the proposal was seen by a significant minority to potentially damage competitiveness (23% agreed) and 24% felt it will overly complicate the tax regime.

2.4 Implementation

If a GST were implemented, most would prefer some form of offset - in terms of Salaries Tax but for some in terms of Profits Tax. There is widespread support for various compensatory relief measures, particularly GST credits for households to offset increases in water, sewage and rates and refunds for purchases by tourists. Most would prefer a low rate of GST (below 3%), exemptions for certain items (particularly health and education), and compensatory measures for low income households. There was no consensus about the level at which the Registration Threshold should apply

- 47% of accountants surveyed indicated they would prefer to reduce only Salaries Tax if GST is implemented and 27% would prefer to reduce both Salaries and Profits Tax.

- 73% would favour GST credits for all households to offset increase in water, sewage and rates and 70% would favour refunds for purchases by tourists.
- The most desirable features of a GST, if it were implemented, are a low rate of GST (82% favour), offsetting measures for Salaries Tax payers (77%), exemptions for certain items (77%) and compensatory measures for low income households (74%).
- The most strongly supported exemptions are education (79%), health services (71%) and food (65%). 60% also supported exemption of transport services and 56% of rental of residential property. 59% favoured zero-rating of exports and 67% favoured zero-rating of financial services.
- 46% preferred a rate of less than 3% and 27% supported a rate of 3%.

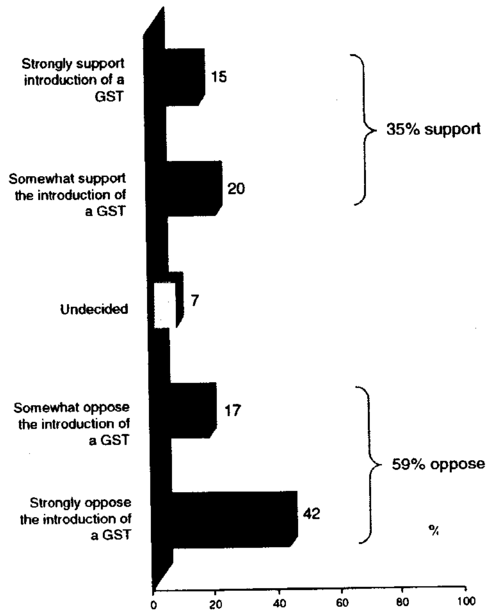
3.0 Results in Detail

3.1 GST in Hong Kong

3.1.1 Attitudes towards introduction of GST in Hong Kong

Accountants are divided about whether Hong Kong should introduce a GST in some form, although a majority oppose the move.

- 35% of accountants surveyed support the introduction of a GST to Hong Kong, with 15% strongly supporting introduction of a GST and 20% somewhat supporting it.
- 59% of accountants responding indicated that they oppose the introduction of a GST to Hong Kong, with 42% strongly opposing it and 17% somewhat opposing it.
- 7% of accountants are undecided.
- These results suggest that as well as carrying a majority, opposition to a GST is a more strongly held opinion amongst the membership. Those who oppose GST tend to oppose more strongly than those who support a GST, support it.



Q15. Overall, what is your opinion on the introduction of a GST in some form to Hong Kong? Would you say you...?
Base: All respondents
N=1,980

The table overleaf shows the cross analysis of opinions on key survey variables against support for GST. Significant differences identified are as follows:

- Majority support for a GST is to be found amongst those who feel the tax base needs to be broadened (53%) and who feel Hong Kong has a purely structural fiscal problem (51%).
- Majority opposition for a GST is to be found amongst those who feel Hong Kong has a purely cyclical fiscal problem (81%) or no fiscal problem (92%), who feel that the tax base does not need broadening (94%), who feel spending is too high (63%) or did not feel the government sufficiently explained its proposal (65%).

Reviewing the interplay of these factors suggests that the overall opposition to a GST is a result of:

- 26% believe there is no fiscal problem or only a cyclical problem and they strongly oppose GST, presumably because they don't see a need to raise additional revenue and don't see broadening the tax base as important.
- 33% don't believe Hong Kong's tax base needs to be broadened and 94% of this group oppose GST.
- 65% feel that government spending is too high and 65% of this group oppose GST, presumably because they feel that any fiscal issue can be addressed through reduced spending
- Although the majority 64% feel that Hong Kong's tax base needs to be broadened, only 53% of this group support a GST.

	Q1. Opinion on Hong Kong fiscal outlook				Q3. Attitudes to tax base		Q2 Attitudes to government Spending		Q6. Gov. proposal sufficiently explained?	
	Purely structural problem (n=453) %	**Purely cyclical problem (n=156) %**	**Both structural and cyclical (n=903) %**	**No fiscal problem (n=356) %**	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	**Net too high (n=1,280) %**	**Net too low (n=212) %**	Yes (n=475) %	No (n=1,331) %
Strongly support introduction of a GST	23 ▲	5	18 ▲	1	0	23 ▲	13	18	27 ▲	11
Somewhat support the introduction of a GST	27 ▲	7	26 ▲	5	2	30 ▲	18	26	22	18
Net support	**51 ▲**	**12**	**44 ▲**	**6**	**2**	**53 ▲**	**31**	**45 ▲**	**49 ▲**	**29**
Undecided	8	6	7	2	4	7	6	8	4	6
Somewhat oppose the introduction of a GST	16	22	18	11	16	16	15	22	10	19 ▲
Strongly oppose the introduction of a GST	25	58 ▲	30	81 ▲	77 ▲	24	48 ▲	25	37	46 ▲
Net Oppose	**42**	**81 ▲**	**49**	**92 ▲**	**94 ▲**	**40**	**63 ▲**	**47**	**47**	**65 ▲**

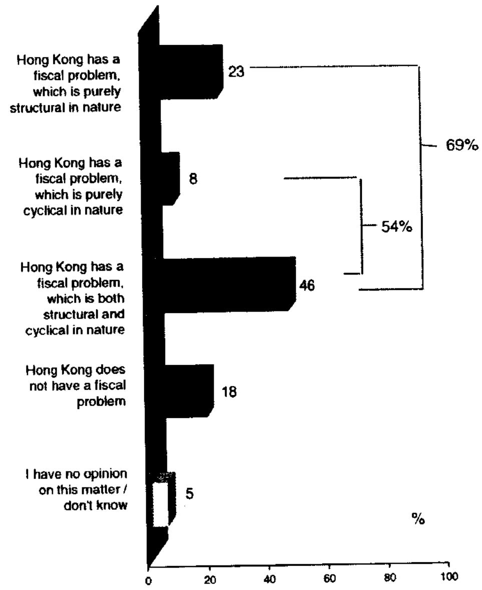
▲ Significantly higher at 95% C.I.

3.2 The fiscal situation in Hong Kong

3.2.1 Hong Kong's fiscal outlook

The majority of accountants feel that Hong Kong has a fiscal problem, most likely both structural and cyclical in nature.

- 46% of responding members indicated that Hong Kong has a fiscal problem which is both structural and cyclical in nature.
- 23% of respondents feel that Hong Kong has a fiscal problem which is purely structural in nature. Therefore, 69% of members feel that there is some structural problem with Hong Kong's finances.
- Relatively few (8%) feel that Hong Kong has a fiscal problem which is purely cyclical in nature, indicating that 54% see a problem that is at least in part, cyclical.
- Slightly less than one in five (18%) feel that Hong Kong does not have a fiscal problem and 5% are unsure about the underlying fiscal situation in Hong Kong.



Q1. Which of the following best describes your opinion on Hong Kong's fiscal outlook?
Base: All respondents
N=1,980

The table overleaf shows the cross analysis of opinions of Hong Kong's fiscal outlook with other key variables. Significant differences identified are as follows:

- Those supporting a GST are more likely to feel Hong Kong has a fiscal problem which is either structural in nature or both structural and cyclical. Those who oppose the GST are more likely to feel Hong Kong either has a cyclical problem only or no fiscal problem at all.

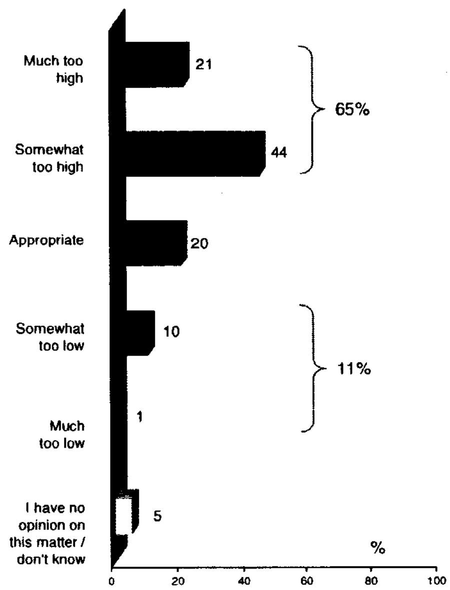
- Those who feel the tax base does not need to be broadened are more likely to feel Hong Kong has a cyclical fiscal problem or no fiscal problem whilst those who feel the tax base does need to be broadened are more likely to feel there is a structural fiscal problem or a structural and cyclical fiscal problem.
- Those who feel the government has adequately explained its position are more likely to say that Hong Kong has a purely structural fiscal problem.

	Q15. Opinion on GST		Q2 Attitudes to government Spending		Q3. Attitudes to tax base		Q6. Gov. proposal sufficiently explained?	
▲ Significantly higher at 95% C.I.	**Net Support GST (n=686) %**	**Net Oppose GST (n=1,162) %**	Net too high (n=1,280) %	Net too low (n=212) %	**Does not need broadening (n=655) %**	**Needs broadening (n=1,260) %**	Yes (n=475) %	No (n=1,331) %
Hong Kong has a fiscal problem, which is purely structural in nature	**34 ▲**	**16**	23	28	**13**	**28 ▲**	28 ▲	21
Hong Kong has a fiscal problem, which is purely cyclical in nature	**3**	**11▲**	9	3	**14 ▲**	**5**	7	9
Hong Kong has a fiscal problem, which is both structural and cyclical in nature	**58 ▲**	**38**	44	49	**27**	**56 ▲**	43	46
Hong Kong does not have a fiscal problem	**3**	**28 ▲**	20 ▲	11	**40 ▲**	**7**	18	19

3.2.2 Level of Government spending

Two thirds of accountants believe that Government spending in Hong Kong is too high, with one in five saying it is much too high.

- Around two-thirds of respondents (65%) indicated that, given the current and likely future state of the Hong Kong economy and the need for Government to deliver services, spending is too high. Twenty-one percent feel that spending is much too high and 44% are of the opinion that spending is somewhat too high.
- One in five (20%) believe that spending is appropriate
- One in ten (11%) feel that spending is too low - either somewhat too low (10%) or much too low (1%).
- 5% of respondents have no opinion or were unable to answer this question.



Q2. Given the current and likely future state of Hong Kong's economy and the need for Government to deliver services, do you believe that the current levels of Government spending in Hong Kong are?
Base: All respondents
N=1,980

The table overleaf shows the cross analysis of opinions of government spending with other key variables. Significant differences identified are as follows:

- Those opposing a GST in Hong Kong are more likely to indicate that spending is too high. Those who support a GST are more likely to feel that spending is appropriate.
- Those who feel there is a purely cyclical fiscal problem and those who believe there is no fiscal problem are more likely to feel that the current levels of

government spending are too high (those who see no fiscal problem, are more likely to say much too high). Conversely, those who feel there is a purely structural problem or part structural and part cyclical problem are more likely to feel government spending is too low (although this opinion is held by only a minority in any case, most people feel spending is in general, too high).

- Respondents who feel the tax base does not need to be broadened are more likely to indicate that spending is much too high, while those who feel the tax base does need to be broadened are more likely to feel that spending is somewhat too high.
- Whether respondents feel that the government has sufficiently explained its GST proposal has no impact on perceptions of the government spending.

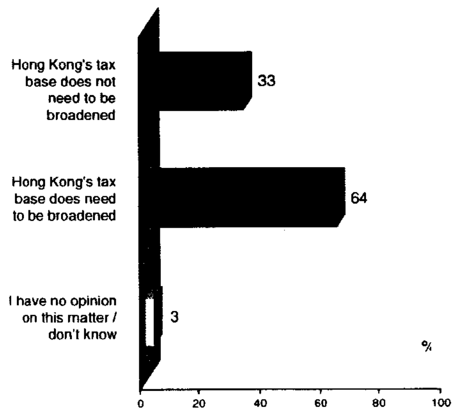
	Q15. Opinion on GST		Q1. Opinion on Hong Kong fiscal outlook				Q3. Attitudes to tax base		Q6. Gov. proposal sufficiently explained?	
	Net Support GST (n=686) %	**Net Oppose GST (n=1,162) %**	Purely structural problem (n=453) %	Purely cyclical problem (n=156) %	Both structural and cyclical (n=903) %	No fiscal problem (n=356) %	**Does not need broadening (n=655) %**	**Needs broadening (n=1,260) %**	Yes (n=475) %	No (n=1,331) %
Much too high	13	26 ▲	21	21	17	33 ▲	33 ▲	15	20	22
Somewhat too high	44	44	43	52	45	40	37	47 ▲	42	45
NET TOO HIGH	57	70 ▲	64 ▼	72 ▲	62 ▼	73 ▲	70	62	62	67
Appropriate	25 ▲	17	19	21	21	19	18	21	26	18
Somewhat too low	13	8	12	4	11	6	8	11	9	10
Much too low	1	1	1	1	1	1	1	1	0	1
NET TOO LOW	14	9	13 ▲	4 ▼	11 ▲	7 ▼	9	12	9	11

▲ Significantly higher at 95% C.I.

3.2.3 Broadening of Hong Kong's tax base

Two thirds of Hong Kong accountants polled feel that Hong Kong's tax base needs to be broadened.

- Respondents were advised (see text below right) that the Advisory Committee on New Broad-based Taxes concluded that Hong Kong's tax base is narrow and were asked their view
- 64% of accountants indicated that Hong Kong's tax base does need to be broadened.
- One in three (33%) feel that Hong Kong's tax base, contrary to the Advisory Committee's report, does not need to be broadened.
- 3% of respondents had no opinion or were unable to answer this question.



The Advisory Committee on New Broad-based Taxes, which reported in 2002, concluded that Hong Kong's tax base is narrow in composition due to a heavy reliance on a limited range of taxes. It recommended that action be taken to broaden Hong Kong's tax base

Q3. Which of the following best describes your opinion on Hong Kong's tax base?

Base: All respondents
N=1,980

The table below shows the cross analysis of opinions of broadening Hong Kong's tax base with other key variables. Significant differences identified are as follows:

- Ninety-eight percent of respondents supporting a GST say that Hong Kong's tax base needs to be broadened, versus 43% of those who oppose GST. Clearly, perceptions of whether the tax base needs to be broadened is strongly associated with support for GST, although many of those who support a broadening of the tax base do not support GST.
- Those who feel the economy has a purely structural problem or a mix of structural and cyclical problems are more likely to indicate Hong Kong's tax base does need to be broadened (79% and 78% respectively), while those who see the problem as only cyclical in nature or that there is no problem are more likely to feel that the tax base does not need to be broadened.
- Those who feel the government has sufficiently explained its proposal are more likely to feel that Hong Kong's tax based needs to be broadened (68%).

	Q15. Opinion on GST		Q1. Opinion on Hong Kong fiscal outlook				Q2 Attitudes to government Spending		Q6. Gov. proposal sufficiently explained?	
	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Purely structural problem (n=453) %	Purely cyclical problem (n=156) %	Both structural and cyclical (n=903) %	No fiscal problem (n=356) %	Net too high (n=1,280) %	Net too low (n=212) %	Yes (n=475) %	No (n=1,331) %
Hong Kong's tax base does not need to be broadened	2	53 ▲	19	59 ▲	19	73 ▲	36 ▲	27	31	34
Hong Kong's tax base does need to be broadened	98 ▲	43	79 ▲	37	78 ▲	26	61	69	68 ▲	62

▲ Significantly higher at 95% C.I.

3.3 Approaches to broadening the tax base

3.3.1 Attitudes towards tax broadening measures

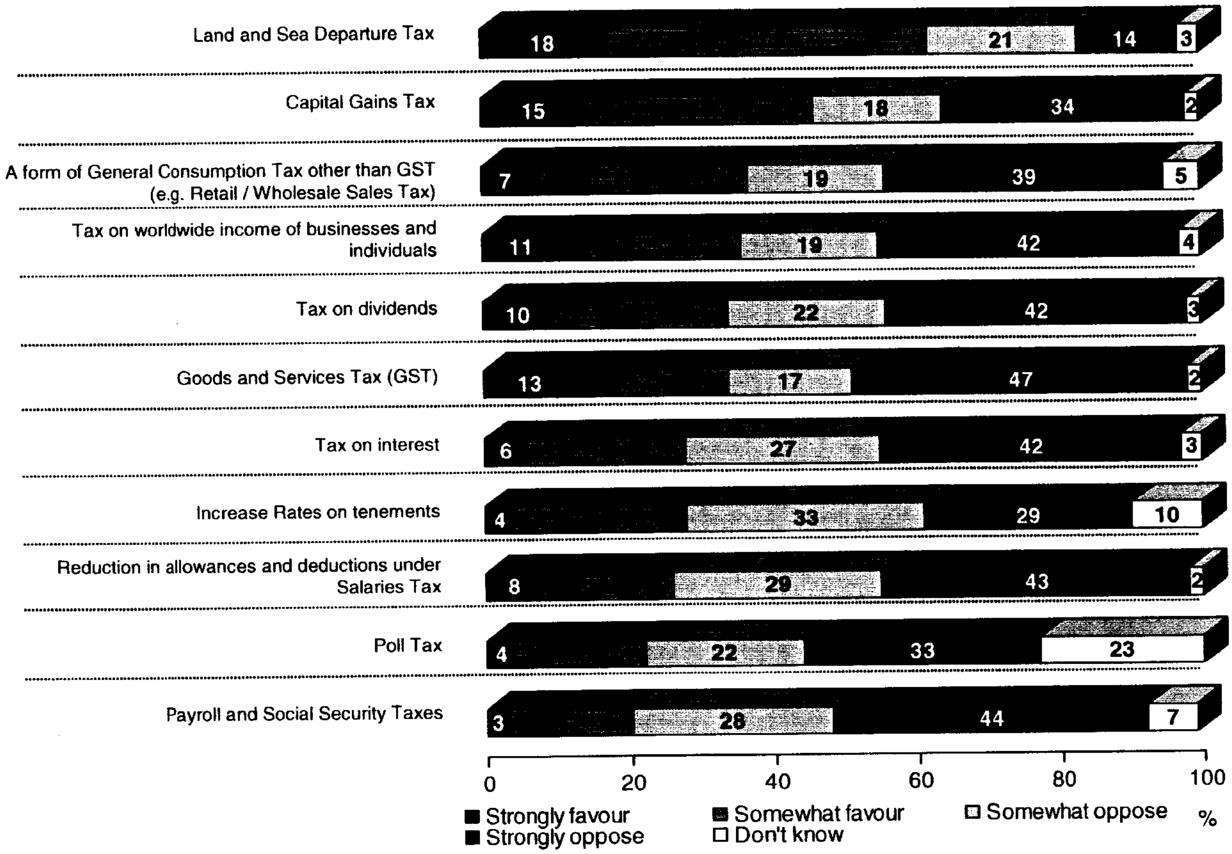
A majority of accountants support a Land and Sea Departure Tax as a means to broaden the tax base. Most accountants oppose any other forms of additional taxation to broaden the Hong Kong tax base.

- The table right shows the aggregate proportion of respondents favouring or opposing various tax measures that could be used to broaden Hong Kong's tax base. The chart overleaf shows a detailed breakdown of ratings for each form of taxation.
- 62% of accountants favour a Land and Sea Departure Tax to broaden Hong Kong's tax base
- At the other end of the spectrum, only 20% would support Payroll and Social Security Taxes.
- Support for a GST is towards the middle of all potential taxes (35% support), while there is slightly higher support (37%) for alternative forms of general consumption tax.

	Net Favour Tax (%)	Net Oppose Tax (%)	Don't know (%)
Land and Sea Departure Tax	62	35	3
Capital Gains Tax	46	52	2
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	37	58	5
Tax on worldwide income of businesses and individuals	36	60	4
Goods and Services Tax (GST)	34	64	2
Tax on dividends	34	64	2
Increase Rates on tenements	28	62	10
Tax on interest	28	69	3
Reduction in allowances and deductions under Salaries Tax	26	72	2
Poll Tax	22	55	23
Payroll and Social Security Taxes	20	72	7

Q4. Below are listed different tax measures that could broaden Hong Kong's tax base. How strongly do you favour or oppose the following measures to broaden the tax base?
SINGLE RESPONSE
Base: All respondents
N=1,980

The chart below details the full results.



The table overleaf shows the cross analysis of support for different tax broadening measures with support for GST and with perceptions of Hong Kong's fiscal situation. Significant differences identified are as follows:

- Those supporting a GST in general are more likely to favour a form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax) (75%) and GST (91%) as a specific measure to broaden the tax base.
- Those opposing GST are more likely to favour Capital Gains Tax (49%), tax on dividends (36%), tax on Interest (31%), increased rates on tenements (31%) and a reduction in allowances and deductions under Salaries Tax (30%), as means to broaden the tax base. However, it should be noted that the only broadening measure favoured by a majority of those opposing GST is a Land and Sea Departure Tax, favoured by 61% of those opposing GST (49% favoured Capital Gains Tax).
- Those who see Hong Kong as having a purely structural fiscal problem are more likely to favour a General Consumption Tax other than GST (52%) and a GST (49%) as means of broadening the tax base.
- Those who believe there is a purely cyclical fiscal problem are more likely to favour a reduction in allowances and deductions under Salaries Tax (36%) and less likely to favour either a GST (12%) or form of General Consumption Tax other than GST (16%).
- Respondents who believe Hong Kong has a fiscal problem which is both structural and cyclical in nature are more likely to favour both the GST and a form of General Consumption Tax other than GST (44% and 45% respectively).
- Respondents who see no fiscal problem generally had lower favourability towards for most forms of tax broadening measures, particularly Land and Sea Departure

Tax (although 54% still favour it), GST (only 7% support it) and a form of General Consumption Tax other than GST (11%).

	Q15. Opinion on GST		Q1. Opinion on Hong Kong fiscal outlook			
% Favour (strongly or somewhat)	**Net Support GST (n=686) %**	**Net Oppose GST (n=1,162) %**	Purely structural problem (n=453) %	Purely cyclical problem (n=156) %	Both structural and cyclical (n=903) %	No fiscal problem (n=356) %
Land and Sea Departure Tax	63	61	60	63	66	54 ▼
Capital Gains Tax	39	49 ▲	46	40	47	43
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	75 ▲	13	52 ▲	16 ▼	45 ▲	11 ▼
Tax on worldwide income of businesses and individuals	31	38	36	33	38	34
Tax on dividends	28	36 ▲	32	29	34	32
Goods and Services Tax (GST)	91 ▲	2	49 ▲	12 ▼	44 ▲	7 ▼
Tax on interest	23	31 ▲	26	29	29	28
Increase Rates on tenements	24	31 ▲	24	29	30	27
Reduction in allowances and deductions under Salaries Tax	23	30 ▲	25	36 ▲	26	29
Poll Tax	22	22	19	26	25	17
Payroll and Social Security Taxes	20	21	21	23	20	20

▲ Significantly higher at 95% C.I.

The table overleaf shows the cross analysis of favourability of different tax broadening measures with attitudes to the tax base, government spending and views on whether the government proposal has been sufficiently explained. Significant differences identified are as follows:

- Respondents who believe the tax base does need to be broadened, not surprisingly, favour most tax broadening measures to a greater extent than those who feel the tax base need not be broadened. The tax broadening measures gaining comparatively more favour amongst the former group were a Land and Sea Departure Tax (66%), GST (53%), a form of General Consumption Tax other than GST (53%), Capital Gains Tax (49%), tax on dividends (35%) and tax on interest (31%). Amongst the latter group (i.e. does not need broadening), the only tax which a majority favour is a Land and Sea Departure Tax (favoured by 53%).
- Predictably, those who feel government spending is too low tend to favour tax broadening measures more than those who feel government spending is too high. Favourability was significantly higher amongst those who think spending is too low for Capital Gains Tax (53%), a form of General Consumption Tax other than GST (48%), tax on worldwide income of businesses and individuals and GST (47%).
- Those who feel the government has sufficiently explained its proposal are more likely to favour both GST (48%) and a form of General Consumption Tax other than GST (43%). However, it should be noted that there was not a majority amongst this group favouring either tax (48% favour GST and 43% favour a form of General Consumption Tax other than GST).

% Favour (strongly or somewhat)	Q3. Attitudes to tax base: Does not need broadening (n=655) %	Q3. Attitudes to tax base: Needs broadening (n=1,260) %	Q2 Attitudes to government Spending: Net too high (n=1,280) %	Q2 Attitudes to government Spending: Net too low (n=212) %	Q6. Gov. proposal sufficiently explained?: Yes (n=475) %	Q6. Gov. proposal sufficiently explained?: No (n=1,331) %
Land and Sea Departure Tax	53	66 ▲	56	63	61	62
Capital Gains Tax	41	49 ▲	45	53 ▲	41	48 ▲
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	9	53 ▲	34	48 ▲	43 ▲	34
Tax on worldwide income of businesses and individuals	33	37	35	47 ▲	30	38 ▲
Tax on dividends	29	35 ▲	32	39	31	35
Goods and Services Tax (GST)	2	53 ▲	31	47 ▲	48 ▲	29
Tax on interest	23	31 ▲	29	25	24	30
Increase Rates on tenements	28	28	28	24	26	29
Reduction in allowances and deductions under Salaries Tax	28	26	28	20	27	27
Poll Tax	18	23	21	25	19	23
Payroll and Social Security Taxes	18	22	20	24	19	21

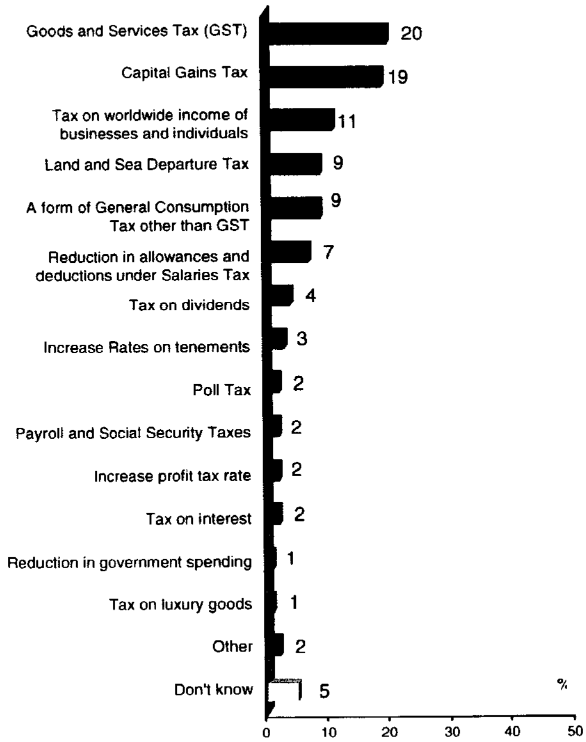
▲ Significantly higher at 95% C.I.

3.3.2 Best option to broaden the tax base

Although GST is not a generally favoured means to broaden the tax base, when asked to choose, GST was selected by one in five accountants as the best means to broaden the tax base, the most support of all alternatives.

- Under a hypothetical scenario where the government proceeds with measures to broaden the Hong Kong tax base, the most often favoured option amongst accountants to do so, would be a Goods and Services Tax (GST). However, notably only 20% of accountants see this as the best option, just 1% above Capital Gains Tax (19%). Evidently, there is little consensus within the profession on which is the best means to broaden the tax rate.

- Land and Sea Departure Tax was seen as the best option by only 9% of respondents, despite being the only option favoured by the majority (see preceding question Q4). This indicates it is favoured by many, but is seldom seen to be the best means of broadening the tax base.



Q5. If the government were to proceed with measures to broaden Hong Kong's tax base, which of the following would in your view be the best option?
SINGLE RESPONSE
Base: All respondents
N=1,980

The tables following show the cross analysis of the perceived best option of the tax broadening measures with support for GST and perceptions of Hong Kong's fiscal situation. Significant differences identified are as follows:

- Amongst respondents who support GST, support was higher for both GST (55%) and a form of General Consumption Tax other than GST (16%) compared to those who oppose GST. Just over half (55%) of those who support introduction of GST to Hong Kong feel it is the best option to broaden the tax base. Amongst those against a GST, the preferred means to broaden the tax base is a Capital Gains Tax (25% support this option), tax on worldwide income of businesses and individuals (15%) and Land and Sea Departure Tax (11%).
- Those who perceive Hong Kong to have a purely structural fiscal problem or a mix of structural and cyclical problems displayed higher levels of support for both GST (30% versus 25% respectively) and a form of General Consumption Tax other than GST (12% and 11% respectively). Those perceiving a purely structural problem had only half the level of support for a Land and Sea Departure Tax (6%) than those who see a purely cyclical problem (13%). The latter group and those who see no fiscal problem had significantly lower support for GST (8% and 1% respectively).

	Q15. Opinion on GST		Q1. Opinion on Hong Kong fiscal outlook			
% best	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Purely structural problem (n=453) %	Purely cyclical problem (n=156) %	Both structural and cyclical (n=903) %	No fiscal problem (n=356) %
Land and Sea Departure Tax	5	11 ▲	6 ▼	13 ▲	10	9
Capital Gains Tax	9	25 ▲	17	21	18	22
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	16 ▲	4	12 ▲	5	11 ▲	2 ▼
Tax on worldwide income of businesses and individuals	4	15 ▲	10	10	11	13
Tax on dividends	3	6	5	7	4	5
Goods and Services Tax (GST)	55 ▲	1	30 ▲	8 ▼	25 ▲	2 ▼
Tax on interest	0	3	2	2	1	3
Increase Rates on tenements	1	4	2	2	3	5
Reduction in allowances and deductions under Salaries Tax	3	9 ▲	6	11	4 ▼	11 ▲
Poll Tax	1	3	1	4	2	3
Payroll and Social Security Taxes	0	3	2	3	1	4

▲ Significantly higher at 95% C.I.

- Amongst the segment that feels Hong Kong's tax base needs to be broadened, a GST was seen to be the best option by 31%, followed by a form of General Consumption Tax other than GST (13%)

	Q3. Attitudes to tax base		Q2 Attitudes to government Spending		Q6. Gov. proposal sufficiently explained?	
	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %	Yes (n=475) %	No (n=1,331) %
Land and Sea Departure Tax	11	8	9	10	11	8
Capital Gains Tax	21	18	19	23	13	22 ▲
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	2	13 ▲	8	11	9	8
Tax on worldwide income of businesses and individuals	14 ▲	9	11	12	8	12 ▲
Tax on dividends	5	4	4	4	6	4
Goods and Services Tax (GST)	1	31 ▲	17	23	30 ▲	16
Tax on interest	2	1	2	1	1	2
Increase Rates on tenements	6 ▲	1	3	3	2	3
Reduction in allowances and deductions under Salaries Tax	10 ▲	5	8 ▲	3	7	6
Poll Tax	4	1	3	1	1	2
Payroll and Social Security Taxes	4	1	2	1	3	2

▲ Significantly higher at 95% C.I.

- Amongst the minority who feel the government has sufficiently explained its proposal, 30% (notably in the minority) support a GST as the best option to broaden the tax base compared to 16% of those who disagree. Those who do not feel the government has sufficiently explained its proposal are most likely to see Capital Gains Tax (20%) and GST (16%) as best.

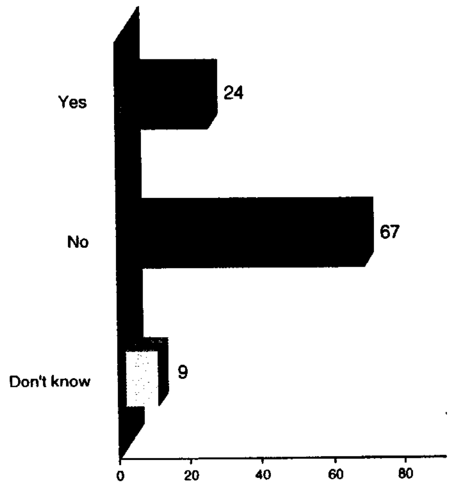
▲ Significantly higher at 95% C.I. % see as best option ↓	Q4 Net Favour GST (n=683) %	Q4. Net oppose GST (n=1,258) %	Q4. Net Oppose GST & Q3. favour broadening (n=685) %
Land and Sea Departure Tax	4	11 ▲	12 ▲
Capital Gains Tax	9	25 ▲	28 ▲
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	17 ▲	5	8
Tax on worldwide income of businesses and individuals	4	15 ▲	16 ▲
Goods and Services Tax (GST)	56 ▲	1	1
Tax on dividends	2	6	6
Increase Rates on tenements	-	4	3
Tax on interest	-	3	2
Reduction in allowances and deductions under Salaries Tax	3	9	8
Poll Tax	1	3	2
Payroll and Social Security Taxes	-	3	3

3.4 Attitudes to presentation of the Government Consultation Document

3.4.1 Sufficiency of government's explanation of its GST proposal

Two thirds of accountants participating in the survey do not feel the Hong Kong government has sufficiently explained its GST proposal.

- 24% of all survey respondents feel that the Hong Kong government has provided a sufficient explanation of its GST proposal, while 67% believe the government has not. Nine percent were unable to comment.
- Only 34% of those who support a GST, feel the government has adequately explained its proposal compared to 19% amongst those who oppose GST.



Following consultation, the government may decide to proceed with a Goods and Services Tax ("GST"). The following questions re your specific opinions about the proposed GST.

Q6. Do you think the government has provided sufficient explanation of its GST proposal? SINGLE RESPONSE

Base: All respondents
N=1,980

The tables following show the cross analysis of the perceived sufficiency of the governments' explanation of its proposal against key measures on the survey. Significant differences identified are as follows:

- Respondents supporting GST were more likely than those opposing GST to agree that the government has sufficiently explained its proposal (30% vs 19%). However, it is notable that most GST supporters (56%) believe the government has not sufficiently explained its proposal.
- Those who feel that Hong Kong's tax base does not need to be broadened are less likely to feel the government has explained its proposal sufficiently than those who feel the tax base needs to be broadened.

	Q15. Opinion on GST		Q1. Opinion on Hong Kong fiscal outlook			
	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Purely structural problem (n=453) %	Purely cyclical problem (n=156) %	Both structural and cyclical (n=903) %	No fiscal problem (n=356) %
Explained sufficiently - Yes	34	19	30	21	22	24
Explained sufficiently - No	56	74	62	74	68	71

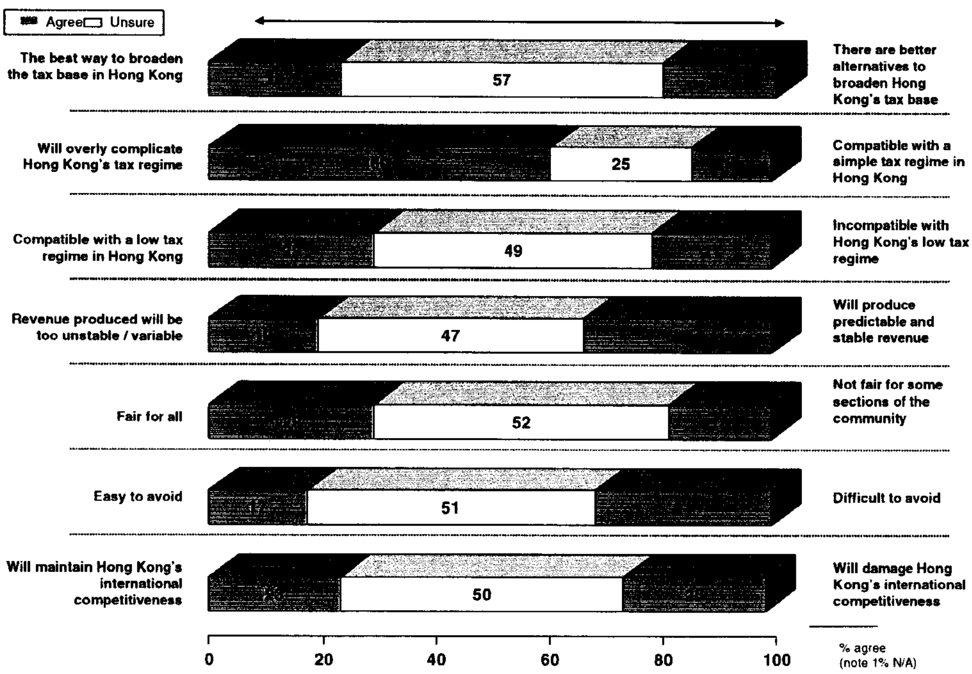
	Q3. Attitudes to tax base		Q2 Attitudes to government spending		Q6. Gov. proposal sufficiently explained?	
	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %	Yes (n=475) %	No (n=1,331) %
Explained sufficiently - Yes	23	26	23	21	100	-
Explained sufficiently - No	70	65	70	72	-	100

▲ Significantly higher at 95% C.I.

3.4.2 Views on government's GST proposal

There remains great uncertainty about the pros and cons of GST amongst accountants. Whilst consistently around half are uncertain about the benefits or otherwise of GST, a majority do believe a GST will overly complicate Hong Kong's tax regime.

- All respondents were asked to choose the most applicable of two paired statements which describe seven aspects of the government's GST proposal.
- The chart below, which details the results, shows that in most respects, accountants are uncertain as to the pros and cons of the government's GST proposal. Specifically:
  - 57% are uncertain as to whether the GST proposal is the best way to broaden the tax base or there are other better alternatives
  - 52% are uncertain whether the GST proposal will be fair for all or not fair for some sections of the community.
  - 51% are uncertain as to whether the GST would be easy to avoid or difficult to avoid
  - 50% are unsure if the GST proposal will result in increased or damaged international competitiveness
  - 49% are unsure if the proposed GST would be compatible with Hong Kong's low tax regime
  - 47% are uncertain about whether the revenue produced would be stable or unstable.
- The areas where the proposal has generated greatest certainty is that the GST proposal will overly complicate Hong Kong's tax regime (60% agree and 14% feel that the GST is compatible with Hong Kong's simple tax regime).



Q7. Below are some opposite pairs of statements about the government's GST proposal. For each pair of statements, please select the option that best reflects your view on the GST as a form of taxation.
Base: All respondents
N=1,980

The table overleaf shows the cross analysis of attitudes towards the government's GST proposal with support for GST and with perceptions of Hong Kong's fiscal situation. Significant differences identified are as follows:

- Those supportive of a GST are more positive generally towards the government's proposal. Sixty-two percent agreed it is the best way to broaden the tax base (vs. 1% of those opposing GST), 66% feel it is compatible with Hong Kong's low tax regime (vs. 8% of those opposing GST), 66% also feel it is fair for all and 59% feel it will maintain Hong Kong's international competitiveness. Amongst those supporting a GST, the area of most concern with the government's proposal is that it will damage Hong Kong's competitiveness (23% indicated this option) and 25% feel it would overly complicate Hong Kong's tax regime. The areas of greatest uncertainty towards the government's proposal amongst GST supporters are whether the tax will be easy or difficult to avoid (63% unsure) and the stability or otherwise of the revenue base (70% unsure). These areas can therefore be considered as particular deficiencies where the government has not succeeded in reassuring its most naturally receptive audience.
- Those opposing GST are generally unsure about the pros and cons of the government's proposal in most respects, but particularly if it is the best way to broaden the tax base (76% unsure), whether competitiveness would be maintained (71% unsure) whether it is fair for all (69% unsure) and if the proposal is compatible with Hong Kong's low tax base (67% unsure). Amongst those opposing GST, the most negative view of the government's proposal is that it will overly complicate Hong Kong's tax regime (82% agreed). A further 28% of those opposed to GST also feel the revenue generated would be unpredictable/unstable. In summary, it can be seen that a key deficiencies of the government's Proposal are that it has apparently not conveyed benefits to those opposed to GST and has reinforced a perception that GST will be overly complicated.
- Respondents who feel that Hong Kong has a purely structural or partly structural partly cyclical fiscal problem are generally more favourable towards the government's GST proposal than those who see no fiscal problem or a cyclical problem only. In particular, more were inclined to agree that the proposal is the best way to broaden the tax base, is compatible with Hong Kong's low tax regime, is fair for all and will maintain Hong Kong's competitiveness. However, it should be noted that for most aspects of the proposal, this group are unsure about the pros and cons.
- Those who say Hong Kong has a purely cyclical or no fiscal problem are more likely to feel that there are better alternatives to the government's GST proposal, it will overly complicate Hong Kong's tax regime, and is not fair some in the community. This group is divided in their opinion of whether the proposal would result in stable or unstable revenue streams and are more likely to be unsure whether the proposal is compatible with Hong Kong's low tax regime, is fair for all and/or will maintain Hong Kong's competitiveness.

▲ Significantly higher at 95% C.I.	Q15. Opinion on GST		Q1. Opinion on Hong Kong fiscal outlook			
	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Purely structural problem (n=453) %	Purely cyclical problem (n=156) %	Both structural and cyclical (n=903) %	No fiscal problem (n=356) %
Best way to broaden tax base	62 ▲	1	34 ▲	10 ▼	28 ▲	4 ▼
Unsure	25	76 ▲	52 ▼	64 ▲	52 ▼	67 ▲
There are better alternatives	13	22 ▲	13 ▼	22 ▲	19 ▼	28 ▲
Will overly complicate tax regime	24	82 ▲	50 ▼	76 ▲	51 ▼	85 ▲
Unsure	50 ▲	10	31 ▲	15 ▼	31 ▲	8 ▼
Compatible with simple tax regime	25 ▲	7	18 ▲	6 ▼	17 ▲	6 ▼
Compatible with low tax regime	66 ▲	8	42 ▲	14 ▼	35 ▲	9 ▼
Unsure	19	67 ▲	42 ▼	55 ▲	44 ▼	66 ▲
Incompatible with low tax regime	13	24 ▲	16 ▼	28 ▲	20	24
Revenue produced unstable/variable	6	28 ▲	14 ▼	22 ▲	17 ▼	29 ▲
Unsure	70 ▲	33	57 ▲	38 ▼	50 ▲	31 ▼
Revenue predictable / stable	23	37 ▲	29 ▼	35 ▲	31 ▼	38 ▲
Fair for all	66 ▲	7	42 ▲	16 ▼	35 ▲	9 ▼
Unsure	25	69 ▲	44 ▼	59 ▲	50 ▼	62 ▲
Not fair for some in community	8	23 ▲	14 ▼	22 ▲	15 ▼	28 ▲
Easy to avoid	11	21 ▲	15	19	15 ▼	27 ▲
Unsure	63 ▲	44	55 ▲	46 ▼	55 ▲	37 ▼
Difficult to avoid	26	33 ▲	30	31	29	34
Maintain competitiveness	59 ▲	3	33 ▲	8 ▼	29 ▲	7 ▼
Unsure	16	72 ▲	43 ▼	65 ▲	44 ▼	66 ▲
Damage competitiveness	23	24	24	22	26	27

The table overleaf shows the cross analysis of attitudes towards the government's GST proposal with other key variables. Significant differences identified are as follows:

- Those who feel that Hong Kong's tax base does not require broadening are more likely to be unsure or negative about the proposal than those who feel the tax base does need to be broadened. In particular, the former group are more likely to be unsure of whether the proposal is the best way to broaden the tax base (72% unsure), is compatible with Hong Kong's low tax regime (66% unsure), is fair for all (67% unsure) and will maintain Hong Kong's competitiveness (71% unsure). They are also more likely to agree than those who desire a broadening of the tax base that the proposal is incompatible with Hong Kong's low tax regime (24%), not fair for some in the community (25%) and that there are better alternatives (24%).
- Of those who see a need for broadening of the tax base, 41% feel the proposal is fair for all, 40% feel it is compatible with Hong Kong's low tax regime and 34% feel the government proposal is the best way to broaden the tax base. Aside from the high level of general uncertainty about the proposal amongst this group, the main area of criticism of the proposal is that it will overly complicate Hong Kong's simple tax regime (48% agreed).
- Interestingly, many of those who feel the government's explanation of its GST proposal is sufficient, remained are nonetheless uncertain about key outcomes of the proposal, namely if the proposal will produce stable revenue (50% unsure), is the best way to broaden the tax base (50% unsure), easy to avoid (50% unsure), maintain competitiveness (43% unsure) and compatible with low tax regime (41% unsure).

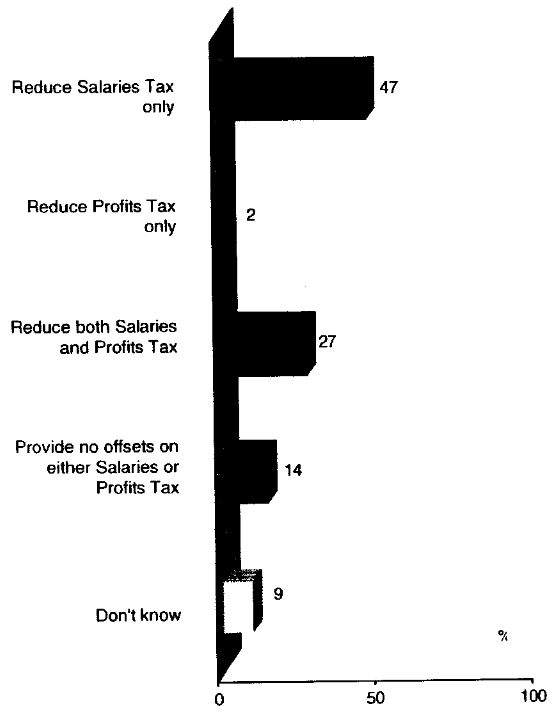
▲ Significantly higher at 95% C.I.	Q3. Attitudes to tax base: Does not need broadening (n=655) %	Q3. Attitudes to tax base: Needs broadening (n=1,260) %	Q2 government Spending: Net too high (n=1,280) %	Q2 government Spending: Net too low (n=212) %	Q6. Gov. explanation sufficient?: Yes (n=475) %	Q6. Gov. explanation sufficient?: No (n=1,331) %
Best way to broaden tax base	2	34 ▲	20	28 ▲	34 ▲	18
Unsure	72 ▲	49	58	57	50	60 ▲
There are better alternatives	24 ▲	17	21 ▲	15	15	21 ▲
Will overly complicate tax regime	83 ▲	48	65 ▲	46	51	64 ▲
Unsure	10	33 ▲	21	37 ▲	34 ▲	22
Compatible with simple tax regime	6	18 ▲	13	16	14	13
Compatible with low tax regime	8	40 ▲	26	38 ▲	44 ▲	24
Unsure	66 ▲	40	52	45	41	53 ▲
Incompatible with low tax regime	24 ▲	18	21	16	14	21 ▲
Revenue produced unstable/variable	29 ▲	14	20	22	13	22 ▲
Unsure	30	56 ▲	45	54 ▲	55 ▲	44
Revenue predictable / stable	38 ▲	29	33 ▲	24	31	33
Fair for all	7	41 ▲	26	33 ▲	39 ▲	24
Unsure	67 ▲	44	53	55	46	55 ▲
Not fair for some in community	25 ▲	14	19 ▲	12	14	19 ▲
Easy to avoid	22 ▲	15	19 ▲	12	17	18
Unsure	41	56 ▲	49	65 ▲	50	50
Difficult to avoid	35 ▲	28	30 ▲	23	31	30
Maintain competitiveness	3	35 ▲	21	27	36 ▲	19
Unsure	71 ▲	39	52	50	43	54 ▲
Damage competitiveness	24	25	26	22	21	26 ▲

3.5 Implementation

3.5.1 Preference for GST offsets

Accountants are most likely to favour Salaries Tax reductions to offset GST, mostly solely and for some in conjunction with a reduction in Profits Tax.

- Respondents were advised that the government has indicated that GST should be revenue neutral for at least five years and that additional revenue generated should be returned to the community.
- With this in mind, just under half of accountants (47%) believe the government should reduce only Salaries Tax to offset GST, if it were introduced. A further 27% feel that any GST should be offset with reductions in both Salaries and Profits Tax and 14% that neither Salaries nor Profits Tax should be reduced.
- Relatively few (2%) favour a reduction in Profits Tax only to offset GST.



The government has indicated that GST should be revenue neutral for at least five years and the additional revenue generated should be returned to the community.

Q8. Which of the following best reflects your preference with regards to possible GST **offsets**?
Base: All respondents
N=1,980

The table below shows the cross analysis of the preference for GST offsets with key attitudinal variables on the survey. Key results are as follows:

- Of those supporting GST, 54% indicated that offsets should include reduction in Salaries Tax only and 33% feel that both Salaries and Profits Tax should be reduced.
- Amongst those advocating a broadening of the tax base, 52% favour a reduction of Salaries Tax only, while 29% would prefer both a reduction in Salaries and Profits Tax.
- Attitudes to government spending does not impact on opinions towards potential GST offsets.

	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government Spending	
	Net Support GST (n=686) %	Net Oppose GST (n=1,182) %	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %
Reduce Salaries Tax only	54 ▲	44	41	52 ▲	47	50
Reduce Profits Tax only	2	2	3	1	2	3
Reduce both Salaries and Profits Tax	33 ▲	24	24	29 ▲	26	26
Provide no offsets on either Salaries or Profits Tax	9	18 ▲	18▲	12	15	15

▲ Significantly higher at 95% C.I.

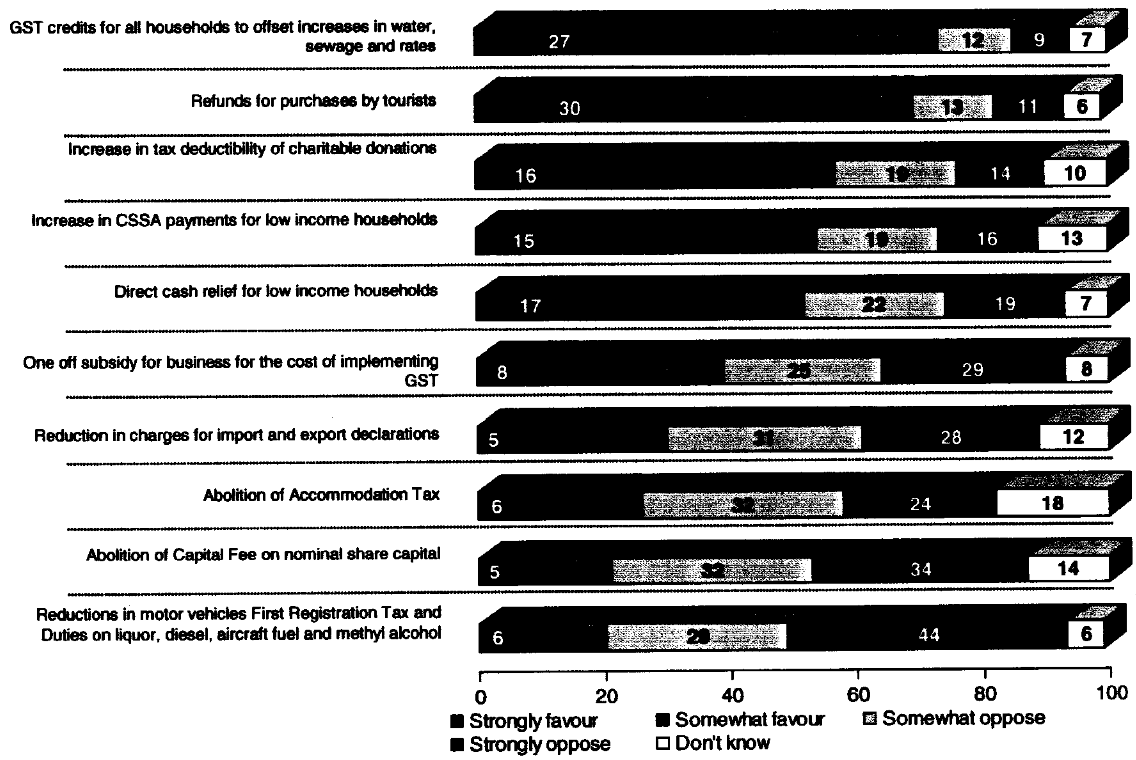
3.5.2 Support for compensatory / relief measures

If a GST were introduced, the most favoured compensatory / relief measures would be GST credits for all households and refunds for purchases by tourists.

- The table right shows the aggregate favourability (strongly or somewhat favour) for a range of potential compensatory and relief measures for GST.
- As can be seen, there was widespread support for compensation and relief should GST be introduced, particularly for GST credits for all households to offset increases in water, sewage and rates (73% favour), and refunds for purchases by tourists (70%).
- The least supported compensatory and relief measures are abolition of accommodation tax (27% support / 56% oppose), abolition of capital fee on nominal share capital (21% support, 66% oppose) and reductions in motor vehicles first registration tax, and duties (21% support, 73% oppose).

	Net Favour (%)	Net Oppose Tax (%)	Don't know (%)
GST credits for all households to offset increases in water, sewage and rates	73	21	7
Refunds for purchases by tourists	70	25	6
Increase in tax deductibility of charitable donations	57	33	10
Increase in CSSA payments for low income households	53	34	13
Direct cash relief for low income households	52	41	7
One off subsidy for business for the cost of implementing GST	39	53	8
Reduction in charges for import and export declarations	30	59	12
Abolition of Accommodation Tax	27	56	18
Abolition of Capital Fee on nominal share capital	21	66	14
Reductions in motor vehicles First Registration Tax and Duties on liquor, diesel, aircraft fuel and methyl alcohol	21	73	6

The table below shows the full results to this question



The table on the following page shows the cross analysis of potential compensatory / relief measures with key attitudinal variables on the survey. Key results were as follows:

- Amongst those supporting a GST for Hong Kong, most prefer to implement a range of compensatory and relief measures. The most strongly supported are refunds for purchases by tourists (83%), GST credits for all households to offset increases in water, sewage and rates (77%) increase in CSSA payments for low income households (66%) and increase in tax deductibility of charitable donations (65%). Least supported are reductions in motor vehicles First Registration Tax and Duties on liquor, diesel, aircraft fuel and methyl alcohol (25%) and abolition of Capital Fee on nominal share capital (26%).
- Amongst those who believe the tax base ought to be broadened, the pattern was similar to those who support GST.
- Amongst those who feel government spending is too low (11% of respondents), there was stronger support for a range of relief measures, such as increase in tax deductibility of charitable donations (65%), increase in CSSA payments for low income households (64%), direct cash relief for low income households (30%), reduction in charges for import and export declarations (38%), abolition of Accommodation Tax (35%) and abolition of Capital Fee on nominal share capital (28%).

	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government spending	
% favour (strongly or somewhat)	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %
GST credits for all households to offset increases in water, sewerage and rates	77 ▲	70	66	76 ▲	73	74
Refunds for purchases by tourists	83 ▲	62	57	77 ▲	69	74
Increase in tax deductibility of charitable donations	65 ▲	52	48	62 ▲	55	65 ▲
Increase in CSSA payments for low income households	66 ▲	46	41	60 ▲	50	64 ▲
Direct cash relief for low income households	60 ▲	48	45	39 ▲	45 ▲	30
One off subsidy for business for the cost of implementing GST	53 ▲	30	26	46 ▲	38	44
Reduction in charges for import and export declarations	35 ▲	26	25	32 ▲	28	38 ▲
Abolition of Accommodation Tax	32 ▲	24	25	28 ▲	26	35 ▲
Abolition of Capital Fee on nominal share capital	26 ▲	17	18	22 ▲	20	28 ▲
Reductions in motor vehicles First Registration Tax and Duties on liquor, diesel, aircraft fuel and methyl alcohol	25 ▲	18	18	22 ▲	20	28 ▲

▲ Significantly higher at 95% C.I.

3.5.3 Support for potential features of a GST in Hong Kong

Referring to the government's proposal, the most important features are seen to be a low rate of GST, offsetting measures for salaries Tax payers, exemptions for certain items and compensation measures for low income households.

- The table right shows the proportion of respondents rating each potential feature of the government's GST proposal as important (very or somewhat) or unimportant (very or somewhat).

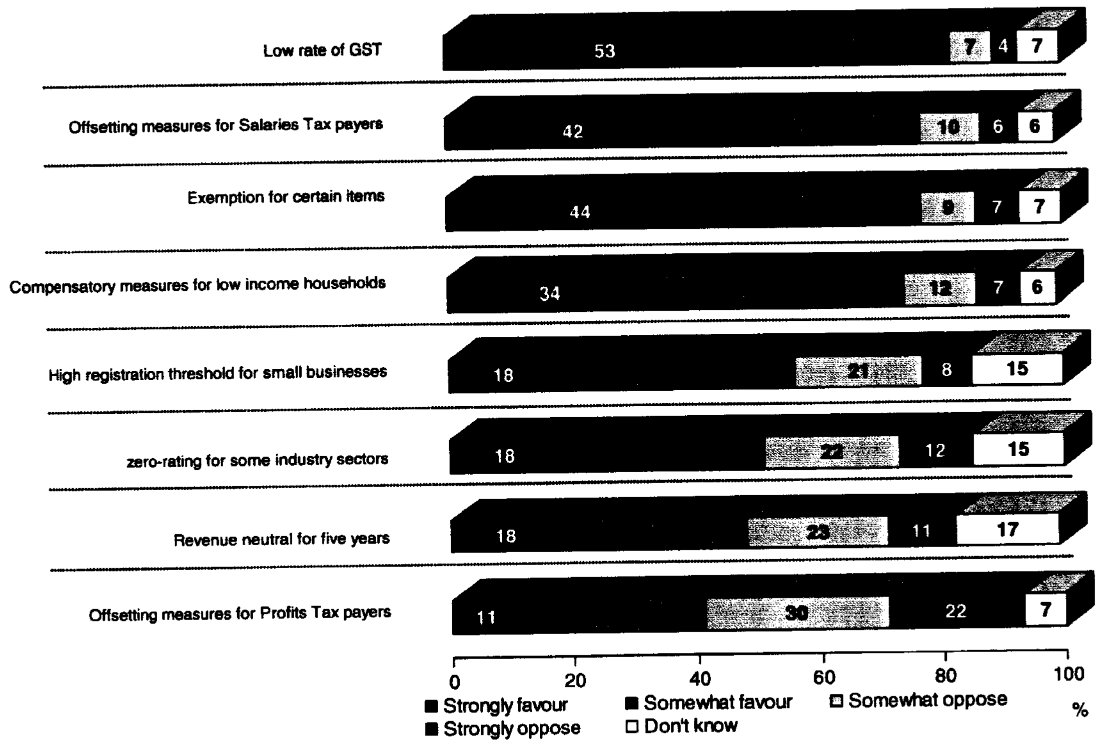
- A low rate of GST was most likely to be considered as important by respondents (82%) followed by offsetting measures for Salaries Tax payers and exemptions for certain items (both 77% net important). Around three quarters (74%) feel that compensatory measures for low income households are also important.

- The least important aspects of the proposal are offsetting measures for Profits Tax payers (41% important / 52% unimportant and perhaps surprisingly revenue neutral for five years (48% important and 34% unimportant).

	Net Important (%)	Net Unimportant Tax (%)	Don't know (%)
Low rate of GST	82	11	7
Offsetting measures for Salaries Tax payers	77	16	7
Exemption for certain items	77	16	6
Compensatory measures for low income households	74	19	6
High registration threshold for small businesses	56	29	15
zero-rating for some industry sectors	51	34	15
Revenue neutral for five years	48	34	17
Offsetting measures for Profits Tax payers	41	52	7

Q10. Please rate the importance of the following features of the proposed GST, using a scale from 1 to 4 where 1 means 'very important' 2 means 'somewhat important' 3 means 'somewhat unimportant' and 4 means 'very unimportant'. Base: All respondents
N=1,980

The table following shows the results to this question



The table below shows the cross analysis of potential features of a GST with key attitudinal variables on the survey. Key results were as follows:

- Supporters of GST in Hong Kong tended to strongly favour a range of offsets - 92% favour a low rate of GST, 84% favour either/or offsetting measures for Salaries Tax payers and exemptions for certain items and 82% favour compensatory measures for low income households. Least favoured was offsetting measures for Profits Tax payers (45% favour).
- Responses amongst those supporting a broadening of the tax base were consistent with those supporting GST.

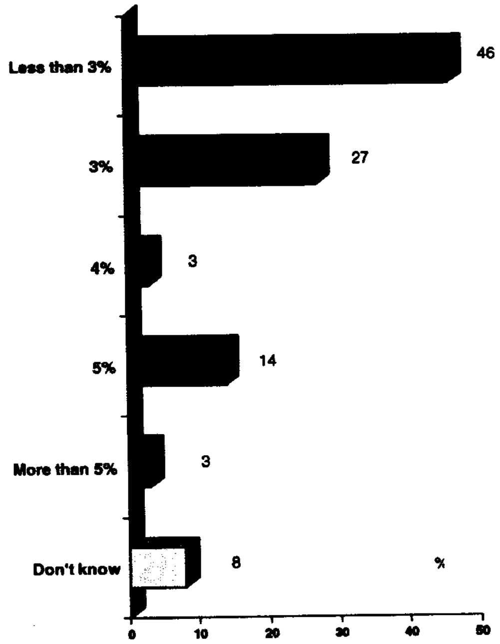
	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government spending	
% Net important (very or somewhat)	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Does not need broadening (n=[illegible]) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %
Low rate of GST	92 ▲	76	72	88 ▲	81	84
Offsetting measures for Salaries Tax payers	84 ▲	73	68	82 ▲	76	83
Exemption for certain items	84 ▲	73	69	82 ▲	77	78
Compensatory measures for low income households	82 ▲	71	65	80 ▲	72	81 ▲
High registration threshold for small businesses	60 ▲	52	51	58 ▲	55	57
zero-rating for some industry sectors	58 ▲	47	[illegible]	54 ▲	50	52
Revenue neutral for five years	57 ▲	43	41	52 ▲	49	46
Offsetting measures for Profits Tax payers	45 ▲	38	37	43 ▲	40	43

▲ Significantly higher at 95% C.I.

3.5.4 Best option for the level of GST

Most accountants surveyed are of the opinion that GST, if introduced, should have a rate at or preferably below 3%.

- Just under half (46%) of accountants participating in the survey believe that the best option for a GST rate would be something less than 3%. A further quarter (27%) indicated that 3% is the appropriate level for GST.
- In aggregate 20% indicated a preference for a GST rate of more than 4%, with three percent indicating 4%, fourteen percent a 5% GST and three percent a GST of greater than 5%.
- Around one in ten (8%) of respondents were unable to or chose not to answer this question.



Q11. A low, single rate of GST has been proposed. If a GST were introduced in Hong Kong, which of the following levels would in your view be the best option?
Base: All respondents
N=1,980

The table below shows the cross analysis of the best option for the level of GST with key attitudinal variables on the survey. Key results were as follows:

- Supporters of a GST are split in their preferences for a rate of GST with 42% preferring a rate of 3% and 28% preferring a rate of 5%. Not surprisingly, those who oppose a GST would prefer that if one were introduced, the rate be below 3%.
- Interestingly , those who support a need to broaden Hong Kong's tax base are more likely to support a rate of below 3% (36%) than those who prefer a GST specifically. This most likely reflects that amongst those that support broadening the tax base, but not a GST as the means to do so (48% of this category of respondents), a lower rate is seen as desirable should a GST be implemented.

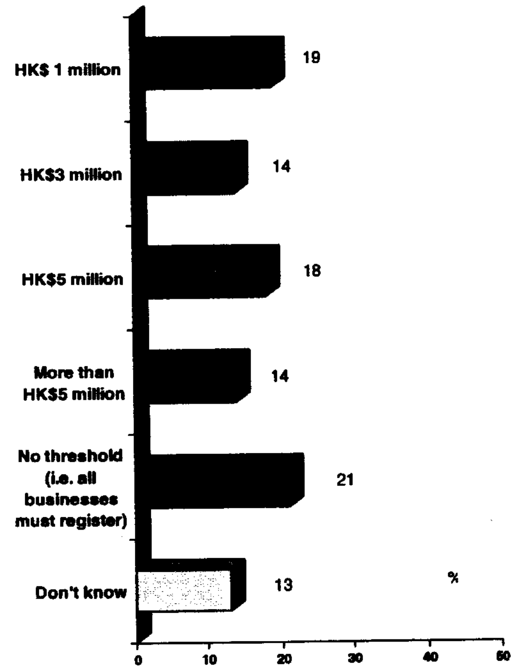
	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government spending	
	Net Support GST (n=686) %	Net Oppose GST (n=1,162) %	Does not need broadening (n=[illegible]) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %
Less than 3%	22	60 ▲	63 ▲	36	47	43
3%	42 ▲	17	13	34 ▲	26	28
4%	4	2	1	4	2	3
5%	28 ▲	7	6	19 ▲	13	17
More than 5%	2	3	3	2	3	2

▲ Significantly higher at 95% C.I.

3.5.5 Level believe GST Registration Threshold should apply

Opinion on what is an appropriate registration threshold for GST varied widely with no consensus view. Of note is that one in five feel there should be no threshold for business registration.

- 19% of accountants surveyed believe the registration threshold for GST registration for businesses should be HK$1 million.
- 14% feel that the threshold should be HK$3 million, 18% indicated it should be HK$5 million, whilst 14% indicated that the threshold should be above HK$5.
- One in five (21%) feel there should be no threshold and that all businesses must register for GST.
- 12% of respondents were unable to or chose not to answer this question.



Q12. If a GST were introduced, the government has proposed that registration for GST be optional for businesses with turnover below a certain level known as the 'GST registration threshold'. At which of the following levels of annual turnover do you believe the registration threshold should apply?
Base: All respondents
N=1,980

The table below shows the cross analysis of the level of GST Registration Threshold with key attitudinal variables on the survey. Key results were as follows:

- There is no consensus amongst supporters of GST as to the appropriate GST registration threshold for businesses, although relatively few believe that the threshold should be more than HK$5 million (8%). Approximately equal numbers of respondents favour HK$1 million, HK$3 million and HK$5 million. One in five also favour all businesses registering with no threshold.
- The pattern of responses amongst those in favour of broadening the tax base was consistent with those who support GST.

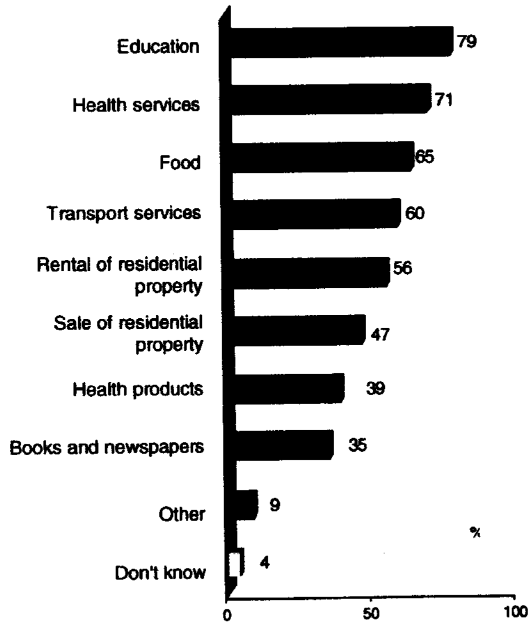
	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government spending	
	Net Support GST (n=688) %	Net Oppose GST (n=1,162) %	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %
HK$1 million	21	18	17	20	17	18
HK$3 million	20 ▲	10	9	16 ▲	14	17
HK$5 million	23 ▲	16	13	21 ▲	17	19
More than HK$5 million	8	18 ▲	21 ▲	11	15	14
No threshold (all must register)	21	23	22	21	23	20

▲ Significantly higher at 95% C.I.

3.5.6 Preferred exemptions from GST

Accountants favour a wide range of exemptions from GST with the majority supporting exemptions of education, health services, food, transport services and rental of residential property.

- 79% of accountants polled support the exemption of education from any GST. Just under three quarters (71%) favoured the exemption of health services and around two-thirds (65%) favoured exemption of food. Both transport services (60%) and rental of residential property (56%) are favoured as exemptions by a majority.
- Of the remaining potential exemptions, there was minority support for the exemption of sales of residential property (47%), health products (39%) and books and newspapers (35%).



Q13. The government's proposal is that only the sale and rental of residential property should be **exempt** from GST. Which, if any, of the following items do you believe should be **exempt** from GST?
Base: All respondents
N=1,980

The table below shows the cross analysis of preferred exemptions from GST with key attitudinal variables on the survey. Key results were as follows:

- As would be expected, those opposing GST and/or rejecting a need to broaden the tax base generally preferred more offsets than those favouring GST and/or accepting a need to broaden the tax base.
- Amongst those supporting GST, the most widely supported exemptions are for basic services such as education (76%) and health services (64%). In addition, 57% support the exemption of rental of residential property and just under half (49%) support the exemption of food. Relatively few support the exemption of books and newspapers (20%) or health products (24%).

	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government spending	
% selected	**Net Support GST (n=686) %**	Net Oppose GST (n=1,162) %	Does not need broadening (n=658) %	Needs broadening (n=1,260) %	**Net too high (n=1,280) %**	**Net too low (n=212) %**
Education	**76**	81 ▲	80	79	**78**	**84**
Health services	**64**	76 ▲	76 ▲	68	**70**	**75**
Food	**49**	74 ▲	75 ▲	60	**65**	**65**
Transport services	**44**	69 ▲	69 ▲	54	**59**	**63**
Rental of residential property	**57**	55	56	55	**56**	**54**
Sale of residential property	**50**	46	48	46	**48**	**47**
Health products	**24**	49 ▲	51 ▲	33	**39**	**39**
Books and newspapers	**20**	45 ▲	42 ▲	28	**35**	**31**

▲ Significantly higher at 95% C.I.

- Amongst those who perceived exemptions to be important, the general pattern of responses was similar to those who did not see exemptions as important, although the number preferring each type of exemption was expectedly higher. Of those feeling exemptions are important (very or somewhat), 83% support exemption of education (vs. 67% of those who see exemptions as unimportant) and 76% favour exemptions of health services.

- Only a minority of those seeing exemptions as important favour exemptions on books and newspapers (35%) and health products (40%).

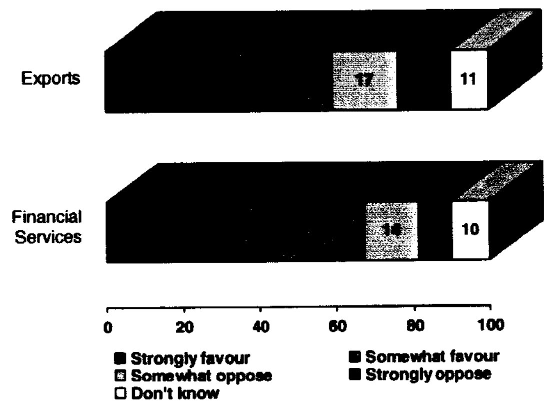
	Exemption for certain items Q10(iii)					
Response to Q10(iii)→	Net Important (n=289) %	Very important (n=877) %	Somewhat Important (n=651) %	Net unimportant (n=289) %	Somewhat unimportant (n=179) %	Very Unimportant (n=133) %
Education	83	87	78	67	75	56
Health services	76	82	68	53	59	44
Food	69	77	59	47	53	38
Transport services	64	70	55	42	48	33
Rental of residential property	59	63	53	46	49	41
Sale of residential property	49	52	44	40	40	41
Health products	40	46	33	31	30	32
Books and newspapers	35	43	25	30	30	30

▲ Significantly higher at 95% C.I.

3.5.7 Support for zero-rating of items

A majority of accountants support zero-rating both exports and financial services as aspects of the government's GST proposal.

- Of those surveyed 59%, favour the zero-rating of exports as a component of the government's proposal whilst around a third (31%) oppose this.
- Results for zero rating of financial services are similar, with 67% in aggregate supporting zero-rating (25% strongly) and 23% opposing it.



Q14. The government's proposal is for exports and financial services to be **zero-rated**. How strongly do you favour or oppose zero-rating these items?
Base: All respondents
N=1,980

The table below shows the cross analysis of support for zero-rating of items with key attitudinal variables on the survey. Key results were as follows:

- Three quarters of those supporting the implementation of GST favour the zero-rating of exports and 64% favour the zero-rating of financial services.

	Q15. Opinion on GST		Q3. Attitudes to tax base		Q2 Attitudes to government spending	
% favour (strongly or somewhat)	Net Support GST (n=688) %	Net Oppose GST (n=1,162) %	Does not need broadening (n=655) %	Needs broadening (n=1,260) %	Net too high (n=1,280) %	Net too low (n=212) %
Exports	74 ▲	63	64	69	68	65
Financial Services	64 ▲	56	56	60	59	58

▲ Significantly higher at 95% C.I.

APPENDIX 1 – QUESTIONNAIRE

REF:

Hong Kong Institute of Certified Public Accountants
香港會計師公會

Hong Kong Institute of CPAs Member Questionnaire on GST

Q1. Which of the following best describes your opinion on Hong Kong's fiscal outlook?

[☑ TICK **ONE** BOX ONLY]

Hong Kong has a fiscal problem, which is purely structural in nature.................................❑1
Hong Kong has a fiscal problem, which is purely cyclical in nature.....................................❑2
Hong Kong has a fiscal problem, which is both structural and cyclical in nature..................❑3
Hong Kong does not have a fiscal problem ....❑4
I have no opinion on this matter / don't know..❑9

Q2. Given the current and likely future state of Hong Kong's economy and the need for the Government to deliver services, do you believe that the current levels of government **spending** in Hong Kong are...?

[☑ TICK **ONE** BOX ONLY]

Much too high...❑1
Somewhat too high..❑2
Appropriate...❑3
Somewhat too low...❑4
Much too low ....❑5
I have no opinion on this matter / don't know..❑9

The Advisory Committee on New Broad-based Taxes, which reported in 2002, concluded that Hong Kong's tax base is narrow in composition due to a heavy reliance on a limited range of taxes. It recommended that action be taken to broaden Hong Kong's tax base.

Q3. Which of the following best describes your opinion on Hong Kong's tax base?

[☑ TICK **ONE** BOX ONLY]

Hong Kong's tax base does not need to be broadened...❑1
Hong Kong's tax base does need to be broadened..❑2
I have no opinion on this matter / don't know..❑9

Q4. Below are listed different tax measures that could broaden Hong Kong's tax base. How strongly would you favour or oppose the following measures to broaden the tax base?

[☑ TICK **ONE** BOX ONLY FOR EACH TAX MEASURE]

POSSIBLE TAX MEASURES	Strongly Favour	Somewhat Favour	Somewhat Oppose	Strongly Oppose	Don't know/ Unsure
(i) Reduction in allowances and deductions under Salaries Tax	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(ii) Payroll and Social Security Taxes	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(iii) Poll Tax	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(iv) A Goods and Services Tax (GST)	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(v) A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax)	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(vi) Increase Rates on tenements	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(vii) Capital Gains Tax	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(viii) Tax on dividends	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(ix) Tax on interest	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(x) Tax on worldwide income of business and individuals	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(xi) Land and Sea Departure Tax	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9

Q5. If the Government were to proceed with measures to broaden Hong Kong's tax base, which of the following would in your view be **the best option**?

[☑ TICK **ONE** BOX ONLY]

Reduction in allowances and deductions under Salaries Tax .... ❑1
Payroll and Social Security Taxes .... ❑2
Poll Tax .... ❑3
Goods and Services Tax (GST) .... ❑4
A form of General Consumption Tax other than GST (e.g. Retail / Wholesale Sales Tax) . ❑5
Increase Rates on tenements .... ❑6
Capital Gains Tax .... ❑7
Tax on dividends .... ❑8
Tax on interest .... ❑9
Tax on worldwide income of business and individuals .... ❑10
Land and Sea Departure Tax .... ❑11
Other (Please specify________________________) .... ❑12
Don't know .... ❑13

Following consultation, the Government may decide to proceed with a Goods and Services Tax ("GST"). The following questions relate to your specific opinions about the proposed GST.

Q6. Do you think the Government has provided sufficient explanation of its GST proposal?

[☑ TICK **ONE** BOX ONLY]

Yes .... ❑1
No .... ❑2
Don't know .... ❑9

Q7. Below are some opposite pairs of statements about the **Government's GST proposal.** For each pair of statements, please select the option that **best** reflects your view on GST as a form of taxation.

[☑ TICK **ONE** BOX ONLY FOR EACH PAIR OF STATEMENTS]

Option 1	**[☑ TICK ONE BOX ONLY]**			**Option 2**
The best way to broaden the tax base in Hong Kong	❑1	❑ 9 Unsure	❑2	There are better alternatives to broaden the Hong Kong tax base
Will overly complicate Hong Kong's tax regime	❑1	❑ 9 Unsure	❑2	Compatible with a simple tax regime in Hong Kong
Compatible with a low tax regime in Hong Kong	❑1	❑ 9 Unsure	❑2	Incompatible with Hong Kong's low tax regime
Revenue produced will be too unstable / variable	❑1	❑ 9 Unsure	❑2	Will produce predictable and stable revenue
Fair for all	❑1	❑ 9 Unsure	❑2	Not fair for some sections of the community
Easy to avoid	❑1	❑ 9 Unsure	❑2	Difficult to avoid
Will maintain Hong Kong's international competitiveness	❑1	❑ 9 Unsure	❑2	Will damage Hong Kong's international competitiveness

The Government has indicated that GST should be revenue neutral for at least five years and the additional revenue generated should be returned to the community.

Q8. Which of the following best reflects your preference with regards to possible GST **offsets**?

[☑ TICK **ONE** BOX ONLY]

Reduce Salaries Tax only .... ❑1
Reduce Profits Tax only .... ❑2
Reduce both Salaries and Profits Tax .... ❑3
Provide no offsets on either Salaries or Profits Tax .... ❑4
Don't know .... ❑9

Q9. The following are proposed **compensatory/relief measures** if a GST were introduced in Hong Kong. How strongly would you favour or oppose the following measures?

[☑ TICK **ONE** BOX ONLY FOR EACH MEASURE]

COMPENSATORY/RELIEF MEASURES	Strongly Favour	Somewhat Favour	Somewhat Oppose	Strongly Oppose	Don't Know/ Unsure
(i) Increase in CSSA payments for low income households	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(ii) Direct cash relief for low income households	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(iii) GST credits for all households to offset increases in water, sewage and rates	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(iv) One off subsidy for business for the cost of implementing GST	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(v) Abolition of Capital Fee on nominal share capital	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(vi) Reductions in motor vehicles First Registration Tax and Duties on liquor, diesel, aircraft fuel and methyl alcohol	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(vii) Reduction in charges for import and export declarations	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(viii) Abolition of Accommodation Tax	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(ix) Increase in tax deductibility of charitable donations	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(x) Refunds for purchases by tourists	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9

Q10. Please rate the importance of the following features of the proposed GST, using the scale shown.

[☑ TICK ONE BOX ONLY FOR EACH FEATURE]

FEATURES OF PROPOSED GST	Very Important	Somewhat Important	Somewhat Unimportant	Very Unimportant	Don't know
(i) Low rate of GST	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(ii) High registration threshold for small businesses	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(iii) Exemption for certain items	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(iv) Zero-rating for some industry sectors	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(v) Revenue neutral for five years	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(vi) Compensatory measures for low income households	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(vii) Offsetting measures for Salaries Tax payers	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(viii) Offsetting measures for Profits Tax payers	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9

Q11. A low, single rate of GST has been proposed. If a GST were introduced in Hong Kong, which of the following levels would in your view be the best option?

[☑ TICK ONE **BOX ONLY]**

Less than 3%...❑1

3% ....❑2
4% ....❑3
5% ....❑4
More than 5%...❑5
Don't know...❑9

Q12. If a GST were introduced, the Government has proposed that registration for GST be optional for businesses with turnover below a certain level known as the '**GST registration threshold**'. At which of the following levels of annual turnover do you believe the registration threshold should apply?

[☑ TICK **ONE** BOX ONLY]

HK$1 million ....❑1
Hk$3 million...❑2
HK$5 million ....❑3
More than HK$5 million...❑4
No threshold (i.e., all businesses must register)...❑5
Don't know...❑9

Q13. The Government's proposal is that only the sale and rental of residential property should be **exempt** from GST. Which, if any, of the following items do you believe should be **exempt** from GST?

[☑ TICK **AS MANY** AS APPLY]

Rental of residential property .... ❑1
Sale of residential property .... ❑2
Food .... ❑3
Health services .... ❑4
Health products .... ❑5
Education .... ❑6
Transport services .... ❑7
Books and newspapers .... ❑8
Other (Please specify ________________________).❑9
Don't know .... ❑99

Q14. The Government's proposal is for exports and financial services to be **zero-rated**. How strongly do you favour or oppose zero-rating these items?

[☑ TICK **ONE** BOX ONLY FOR EACH ITEM]

ZERO-RATED ITEMS	Strongly Favour	Somewhat Favour	Somewhat Oppose	Strongly Oppose	Don't know/ Unsure
(i) Exports	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9
(ii) Financial services	❑ 1	❑ 2	❑ 3	❑ 4	❑ 9

Q15. Overall, what is your opinion on the introduction of a GST in some form to Hong Kong? Would you say you...?

[☑ TICK **ONE** BOX ONLY]

Strongly support introduction of a GST .... ❑1
Somewhat support the introduction of a GST .... ❑2
Undecided .... ❑3
Somewhat oppose the introduction of a GST .... ❑4
Strongly oppose the introduction of a GST .... ❑5

Thank you for your assistance. Please check that you have filled in all questions.
Kindly return the questionnaire by replied paid envelope by
Monday 27th November 2006.