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- Urgent
 Return Receipt

To: taxreform@fstb.gov.hk
cc:
Subject: Broadening the Tax Base

Mr. Henry Tong
Financial Secretary
HKSAR Government

Dear Mr. Tong,

Broadening the Tax Base

In response to your consultation document named "Broadening the Tax Base, Ensuring Our Future Prosperity", I would like to express my opinions on the tax reform.

I cannot agree to the premise of the consultation paper that is: there is a problem with the ability of the present tax system to raise revenue; but I believe that the tax base is narrow in Hong Kong. However, I believe the tax system is generating far more revenue for the Government than is needed.

I think there are both pros and cons of the Goods and Services Tax (GST)
pros:

the tax base will be broadened;
promote stability in revenues

cons:

this tax will probably broaden the income gap between the rich and the poor;
it will cause loss to some businesses in Hong Kong;
the tourism may be affected; and
Hong Kong has its own uniqueness.

I would like to propose three ways to increase tax revenue. They are:

1. Lower the tax rate; and
2. Opening some monopolized markets.

Please refer to the enclosed file in MS-WORD Format for further details about my suggestions. Please feel free to contact me at
for further discussions. Thank you for your kind
attention.

Yours sincerely,

Wong Chun Shiu
Christian Alliance Cheng Wing Gee College



Consultation paper.doc

**Consultation paper
On
Tax Reform in Hong Kong**

**Wong Chun Shiu
F.6A (6)**

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Executive Summary

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Introduction

I am writing to submit my opinions on the consultation paper of tax reform in Hong Kong.

I believe that the present tax system is narrowly-based. Although the government is benefiting from the salaries tax, profit tax, stamp duty, and etc the tax base in Hong Kong is still narrow. However, I cannot agree to the premise of the consultation paper, which is there is a problem with the ability of the tax system to raise revenue.

Moreover, as mentioned in the consultation document Chapter 2, about the options of broadening the tax base, I cannot agree to the idea of introducing a new broad-based consumption or indirect tax, which is the Goods and Services Tax (GST).

There are other viable options to broaden the tax base so as to increase the tax revenue too and I believe that they are better ways which may not lead to so much controversy than the introduction of GST.

I will explain my points of view further below, about the present tax system, the options to broaden tax base as proposed by the government, the pros and cons of introducing the Goods and Services Tax, and my opinions of the ways to broaden tax base.

Is there a problem with the ability of the present tax system to raise revenue?

The consultation document presented in August 2001 have shown that using the measure of total tax revenue as a percentage of GDP, Hong Kong's tax levels are significantly lower than the Asia-Pacific and overall The Organisation for Economic Co-operation and Development averages and we are heavy reliance on taxation from corporate profits and property, as it is 32% and 24% of the tax revenue. This figure shows that the tax base in Hong Kong is very narrow. If this two tax revenue drop, Hong Kong may face many difficulties.

However, the fiscal reserves now exceed HK\$365 billion and the total net worth of Government well over HK\$900 billion. Also, Hong Kong has a large foreign currency reserve. In March, 2006, Hong Kong has a foreign reserve of US\$125 million and Hong Kong is among the top ten countries and districts of having the largest foreign reserve. Under this condition, the reserves can maintain the financial position of Hong Kong and there are no reasons to increase the tax burden.

Therefore, I believe that it is not reasonable for the Government to try to raise its revenue further as the tax system is generating far more revenue for the Government than is needed. So it is not reasonable to say that there is a problem with the ability of the present tax system to raise tax revenue.

However, due to the rapid change of global economic situation, the present tax system may not be useful in Hong Kong one day. But in my opinion, introducing GST and broadening the salaries taxpayer bases would not be good ideas. I will talk about the pros and cons of these options and propose my opinions of broadening the tax base in the following discussion.

The Pros and Cons of the Goods and Services Tax (GST)

As the GST is the new tax system in Hong Kong, the introduction of this tax system will help Hong Kong to have a wider tax base. Hong Kong can ill-afford the luxury of waiting for a crystallization of events prior to devising remedial measures for implementation when required. Having a portfolio of well thought-out, feasible strategies ready for implementation to hold economic instability at bay is essential.

In addition, this tax system promotes stability in revenues. It is because economic activity is cyclical and not all taxes are equally immune from downturns in economic cycles. A taxation system that is less sensitive to economic cycles enhances the overall fiscal system.

However, there are some disadvantages if introducing the GST. Firstly, the GST is a regressive tax. This kind of tax will probably broaden the income gap between the rich and the poor. It is because both rich people and poor people have to pay the same amount of tax if they buy the same product. It is similar to the situation of how cigarettes are sold now. Some may think that as the rich consume more, the poverty gap will not be broadened. However, some necessities may subject to the GST too. As both the rich and the poor need to consume these goods, the poverty gap will undoubtedly be broadened. The Government is always stressing on the issue of the importance of eliminating the poverty gap. How can it be done if the GST is introduced?

Secondly, if GST is introduced, most of the goods and services available in Hong Kong will be subjected to tax. So every Hong Kong people, will need to pay a certain amount of tax. From a consumer's point of view, the goods and services have become more expensive and the consumption plan will be affected. According to the law of demand, as price goes up, quantity demanded will fall, so people will consume less. As a consequence, the retail industry and some service sectors will be affected. As people find the goods and services more expensive, they may go to buy things in the mainland China such as Shenzhen. Then it will cause loss to some businesses in Hong Kong. As the profit of the retail industry and some service sectors fall, the profit tax revenue falls too.

Thirdly, Hong Kong is always benefiting from its simple tax system and low tax rate. Many foreign investors and tourists are attracted because of this reason. And this is what other countries are envious of. The introduction of the GST may prevent tourists coming to Hong Kong due to the higher price of goods and services here. Also, we have to face the competition with the mainland China. Many places in China are developing rapidly and the goods and services that they are providing have improved qualities and standards. So we must not give up our advantage, in order to protect the repute of Hong Kong as a “heaven of shopping”.

The Government has pointed out that many countries have sales tax and uses this as a reason for introducing the GST. Nevertheless, every county has the own policy, depending on its economic and tax structure. Hong Kong has its own uniqueness. So why should we follow others’ steps instead of having our own steps in developing our economy?

Recommendation-Other ways to increase tax revenue

The Government has proposed one way to broaden the tax base and increase the tax revenue that is, introducing the Goods and Services Tax. Nonetheless, in my opinion, there are other viable options too. They are:

1. Lower the tax rate;
2. Opening some monopolized markets.

1. Lower the tax rate

Why lowering the tax rate can increase the tax revenue? It seems that it is very strange, but the reason behind is because of the elasticity of demand. Some may think that increasing tax rate can raise tax revenue. However, people may strongly affected by the increased tax rate, they will work less, the productivity of labour will fall, income will fall and there will be unemployment. Although the tax rate is increased, the tax revenue may be lesser. Therefore, we should decrease the tax rate in order to raise tax revenue.

Let use the profit tax as an example. Profit tax is the tax which the entire firm should pay. Oversea firms will consider the local tax rate as the main consideration if they want to set up firms. Therefore, the tax rate is the same as price, the lower the price the higher the demand for Hong Kong. If the demand curve is gentle, it means the elasticity is high, lower tax rate can raise tax revenue, visa versa. Hong Kong is an international city, oversea firms have the choice to set up firms or not and the more and more advanced information technology, the mobility of different people and companies is high. Therefore their elasticity of demand is high too. The lowered tax rate is therefore very attractive to them.

The approach of lowering tax rate to increase tax revenue was successful in the US after the President Reagan proposed this idea. And this approach and its effect are therefore termed "Reagonomics". The fiscal deficit has been decreasing since the proposal of lowering tax rate.

2. Opening some monopolized markets

Many industries in Hong Kong are monopolist. For example, the bus companies and the MTR are monopolist. Although these companies still need to pay profit tax, they are still earning a large amount of profit due to their franchise. The tax revenues from these companies are not so high too as there are only a few companies in these markets. If the monopolized markets can be opened, there will be more competitions and more tax payers. So, even if the tax rate is lowered, the tax revenue may rise due to a higher flexibility in tax revenue. Some may claim that as there is more competition, the earnings of the firms will fall. And it will lower the profit tax revenue. However, as there is more firms paying profit tax, the total profit tax revenue will rise.

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