



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

30 March 2007

Dear Sir

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

On behalf of ACCA (Association of Chartered Certified Accountants) Hong Kong, we enclose our submission to the above consultation document for your consideration.

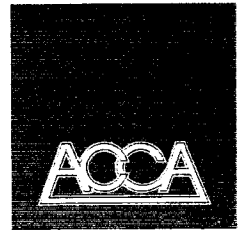
Should you wish to discuss any issue in further details, please do not hesitate to contact us at 2524 4988.

Yours faithfully

(Signed)

Dilys Chau  
President

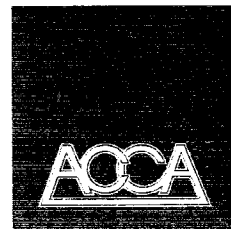
Enclosures



## **CONSULTATION RESPONSE**

# **BROADENING THE TAX BASE ENSURING OUR FUTURE PROSPERITY WHAT'S THE BEST OPTION FOR HONG KONG?**

Comments from ACCA Hong Kong  
30 March 2007



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ACCA (the Association of Chartered Certified Accountants) is the largest and fastest-growing global professional accountancy body with 296,000 students and 115,000 members in 170 countries.

We aim to offer the first choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management. ACCA works to achieve and promote the highest professional, ethical and governance standards and advance the public interest.

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## Executive Summary

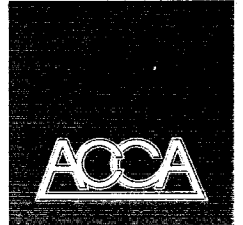
Although the Hong Kong Special Administrative Region (HKSAR) Government announced in December 2006 that Goods and Services Tax (GST) will no longer be advocated in view of an insufficient public support, the consultation on how to broaden Hong Kong's tax base will continue. As a global professional accounting body of over 17,000 members in Hong Kong, ACCA Hong Kong sees tax reform as a major issue that warrants a serious and careful response. It has engaged the services of the Centre for Public Policy Studies of Lingnan University to help design a questionnaire to reflect our members' views on this important subject. The views included in this document are drawn from the 1,245 replies to the questionnaire.

ACCA Hong Kong's members share the Government's view that Hong Kong's existing tax base is narrow by international standards. However majority of them believe that the narrowness is understandable as Hong Kong has a much higher degree of income disparity. 40% of members also felt that fluctuations do not constitute a problem because they consider that governments do not have to balance budgets on a year-to-year basis.

ACCA Hong Kong appreciates that Article 107 of the Basic Law requires the HKSAR Government to "follow the principle of keeping expenditure within the limits of revenue" and "to achieve a fiscal balance and avoid deficit". However, Hong Kong experienced huge budgetary deficits subsequent to the Asian financial crisis which was attributed to the narrowness of the tax base, and the limited number of taxes levied. It was estimated by the Financial Secretary that the surplus for 2006/07 will amount to \$55 billion, this further proves that Hong Kong's revenue is volatile and subject to economic ups and downs. ACCA Hong Kong recommends that this phenomenon needs to be addressed with a cautious approach. Effort needs to be put forward to stabilise Hong Kong's revenue such that the revenue will not be prone to economic downturn.

Several options were included in the questionnaire to seek ACCA Hong Kong members' views and over half of our respondents will consider the following options:

- Tax on luxury goods (69.2%)
- Green tax (64.8%)
- Goods and Services Tax (61.6%)
- Land and Sea Departure Tax (57.4%)



- Capital Gains Tax (54.9%)

Although the Government found that the public is strongly against GST, our survey reveals that around 60% of members will support GST provided that additional relief measures in addition to those proposed in the consultation document are introduced to alleviate the overall tax burden of the lower and middle income classes. Members consider that GST can be an alternative form of tax because some well-to-do people do not have income subject to tax under the current system but enjoy public services.

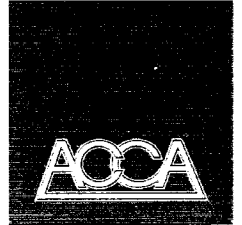
The finding that a majority of members agree to a tax on luxury goods is also in line with the findings on GST. Technically, a tax on luxury goods can be considered as another form of GST where basic necessities are exempt.

Amongst alternative forms of taxes to broaden the tax base other than GST, the Capital Gains Tax and the Land and Sea Departure Tax have attracted clear support from ACCA Hong Kong members. Provided that some mitigating measures are taken to minimise the negative side-effects, members consider these two taxes are fair.

In respect of profits tax, although 54.9% of our members consider that introducing progressive profits tax rate similar to salaries tax is fair, only 47.1% consider that that we should introduce progressive tax rate. 75.4% of members still think that the standard tax rate simplifies the Hong Kong tax system. Less than half of our members consider that increasing the marginal salaries tax rates on higher income earners is fair and support increasing the marginal salaries tax rates on higher income earners. ACCA Hong Kong appreciates that adjusting either the profits tax or salaries tax rate are only measures to help increase tax revenue, but cannot help broadening the tax base.

To conclude, GST could be an appropriate option to broaden Hong Kong's tax base provided that appropriate relief measures are built into the system. ACCA Hong Kong notes that there are a lot of concerns and worries on the introduction of GST which need to be properly addressed.

ACCA Hong Kong recommends that in order to draw public support of any new taxes, the design of the system as well as preparation work to ensure the public's understanding are of paramount importance. In addition, the Government should always ensure expenditure is incurred in an efficient manner.



## **INTRODUCTION**

Since the launch of the consultation document on “Broadening the Tax Base, Ensuring our Future Prosperity”, there has been a lot of concerns over the introduction of GST such as whether GST would widen the wealth gap and adversely affect general consumption and social harmony. In December 2006, the Government announced in its interim report on the public consultation that it would not further advocate GST on the ground that there was insufficient public support nor were the conditions right for the introduction of GST. However, the Government still hope the public will continue to provide their views on other viable options.

ACCA Hong Kong sees tax reform as a major issue that warrants a serious and careful response. It has therefore engaged the services of the Centre for Public Policy Studies of Lingnan University to help design a questionnaire that would accurately reflect our members’ views on this important subject. As the consultation now focuses on the direction for a tax reform in Hong Kong instead of detailed proposals of the GST mechanism, the questionnaire did not address the specific questions related to GST as set out in Chapter 3 to Chapter 9 of the consultation document although members’ overall view about GST was included.

The survey was done on-line during 18 January to 8 February 2007. Of the 17,006 members to whom the questionnaire was sent, 1,245 replies were received, representing 7.3% of the membership. This sample size is regarded sufficient for drawing conclusions regarding key variables about the entire ACCA Hong Kong membership. For the purpose of this report, we have referred to the view of the respondents as “views of our members”.

Our recommendations in this report are based on the findings of the survey.



## **IS HONG KONG'S TAX BASE TOO NARROW?**

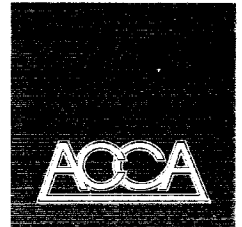
The public's awareness about the narrowness of Hong Kong's tax base arose since the study conducted by the Advisory Committee on New Broad-based Taxes (the Committee) in 2001. The Committee pointed out in its report that Hong Kong's revenue is heavily reliant on a limited range of taxes and hence not as neutral nor as reliable as the taxation systems in other comparable jurisdictions. This issue has been further brought up during the consultation period. As noted in the Interim Report on the Public Consultation on Tax Reform, the public generally has gained a better understanding of the problems of Hong Kong's narrow tax base.

### **Survey findings**

60% of our members also agree that Hong Kong is relying too much on land-based revenue which fluctuates wildly and is unreliable. However only 50% of ACCA Hong Kong's members agree or strongly agree that the existing tax base is narrow by international standards and there is a need to broaden Hong Kong's tax base. More members see this as a result of Hong Kong's exceptionally wide income disparity. Thus, members express stronger agreement to the importance of ensuring people pay their fair share of taxes than to enlist more people as taxpayers.

### **Conclusion**

ACCA Hong Kong is of the view that Hong Kong's tax base is narrow in terms of its heavy reliance on land-based revenue which renders government revenue highly susceptible to the ups and downs of the economic cycle. And when compared to international benchmarks, i.e. the average of countries in the Organisation for Economic Cooperation and Development (OECD), Hong Kong only relies on a limited number of taxes levied.



## **SHOULD THE GOVERNMENT TAKE ACTION TO REFORM THE TAX BASE?**

The fact that Hong Kong's tax base is narrow as compared to other jurisdictions is beyond reasonable doubt. ACCA Hong Kong echoes the view that the ageing of Hong Kong's population poses challenge to Hong Kong's economy and public finances. We also note from the interim report that the public shares the view that the government should stabilise its revenue by broadening the tax base.

### **Survey findings**

Although 60% of ACCA Hong Kong members agree that Hong Kong is relying too heavily on land-based revenue which fluctuates wildly and is unreliable, over 40% of members believe that fluctuations do not constitute a problem because governments do not have to balance budgets on a year-to-year basis. 54.7% of members also consider that during times of recession, it is quite acceptable to have a fiscal deficit as leaving more money in citizens' pockets during recession will alleviate the economic pain and will not hurt the government's long term finance. In addition, 43.8% of our members believe that, compared to land-based revenue, a direct tax on profit or income tends to distort investment and work incentives.

### **Conclusion**

Although the survey finds that less than half of members regard broadening Hong Kong's tax base necessary, ACCA Hong Kong appreciates that according to Article 107 of the Basic Law, the HKSAR Government has to "follow the principle of keeping expenditure within the limits of revenue" and "to achieve a fiscal balance and avoid deficit". And in the long run, ageing erodes the tax base as the relative size of the working population falls. It is clear that health and social welfare costs associated with the ageing of the population will increase which will bring greater pressure to increase government expenditure.

As such, ACCA Hong Kong agrees that further in-depth studies need to be conducted in how the tax base should be reformed and what are the acceptable options to help broaden Hong Kong's tax base.





## **INITIATIVES TO BROADEN THE TAX BASE**

In considering the acceptable options to expand Hong Kong's tax base, almost 75% of ACCA Hong Kong members reject an attempt to have the non-working, elderly population share the tax burden as these people have paid their fair share during their working lives. Hence, the need to broaden our tax base does not imply that there is a need to widen the tax net beyond the working population.

### **Options to broaden Hong Kong's tax base**

The following options, most of which are suggested in the consultation for a broader-based tax system for Hong Kong conducted by the Committee in August 2001, are raised in the questionnaire for members' comments:

- Goods and services tax (GST)
- Capital Gains Tax
- Land and Sea Departure Tax
- Tax on interest income
- Tax on dividend income
- Tax on luxury goods
- Green tax
- Introduction of progressive profits tax rate
- Increasing the marginal salaries tax rates on higher income earners

### **Survey findings**

Members comment that "any proposed tax reform should not result in enlarging the existing gap between the high and low income groups". It is therefore clear that members are concerned about fairness and the impact on wealth gap for any new tax to be introduced. "Equity should be the first thing to consider."

Amongst the options suggested in the questionnaire, members generally agree that GST is worth considering as an option to broaden the tax base on the ground that some well-to-do people do not have income subject to tax under the current system but they enjoy public services. They consider that it is more important to ensure people pay their fair share of taxes than to enlist more people as taxpayers. However, a clear majority of members disagree with widening the tax net through GST to incorporate lower income people. Hence members will only support GST if adequate relief measures are introduced to alleviate the tax burden of the low and middle income classes.



Alternative forms of taxes to broaden the tax base other than GST are, in order of members' preference, the tax on luxury goods, green tax, the Land and Sea Departure Tax and the Capital Gains Tax. These four taxes attracted clear support among ACCA Hong Kong members who tend to agree that these taxes are fair and they agree with the ability to pay principle.

ACCA Hong Kong members generally oppose to the introduction of a tax on interest income or on dividend income as majority of them do not consider that these two taxes are fair.

#### Tax on luxury goods

Nearly 70% of members support a tax on luxury goods, and over 70% of members consider it a fair tax. There is no particular concern about the administrative burden incurred or concern of whether the definition of a luxury good is arbitrary.

In the consultation document launched in July 2006 regarding GST, it was proposed that basic necessities such as food, education and health expense will not be exempt. It is clearly seen from members' responses that the objective of GST is not to include lower income group in the tax net. As such, it could easily be understood that a tax on luxury goods is more acceptable to members who believe the rich should pay more. Nearly 60% of members will support GST provided that additional relief measures other than those proposed in the consultation document are introduced to alleviate the overall tax burden of the lower and middle income classes. A tax on luxury goods is another form of GST, which ACCA Hong Kong members will be more willing to accept. It is commented by members that "GST should be imposed on luxury goods but not on necessities".

#### Capital Gains Tax

As mentioned in the consultation put forward by the Committee, Capital Gains Tax helps broaden the tax base. However, the tax is directly influenced by the state of property and stock markets and revenue yields will be susceptible to cyclical volatility. Although there is a concern that the tax could adversely affect the property and stock markets, 56.5% of members consider that if the tax rate is low enough and if pure inflation gains are exempt, the undesirable side effects of the Capital Gains Tax will be mitigated. 63.6% of members also



consider that the Capital Gains Tax effectively taxes the well-to-do and agrees with the “rich pay more” principle.

In particular, members are of the view that land and property prices are already too high in Hong Kong. Non-property owners indirectly pay a levy by means of a higher cost of living and a higher cost of doing business due to the high land costs. As such, members consider it appropriate to introduce Capital Gains Tax so that property owners could contribute to the revenue pool on capital gains other than pure inflation gains.

#### Green tax

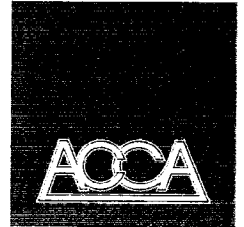
64.8% of members feel that we should introduce green tax for different / mixtures of reasons. Majority of members (over 70%) consider green tax because it benefits the environment, whereas 54% of members consider that a green tax will benefit Hong Kong's economy.

#### Land and Sea Departure Tax

Land and Sea Departure Tax was proposed in 2003/04's budget. It was estimated that \$18 per departure will yield approximately \$900 million a year. Although the Financial Secretary recently expressed that due to the relatively low revenue yield of the tax, this is unlikely to be introduced, 57.4% of members consider it an appropriate option. Only 19.2% of members think that this tax will adversely affect the economy. As departures from Hong Kong by air and travelling to Macau or the Mainland by sea are currently subject to a departure charge, it is fair for a levy to be imposed on all land and sea departures from Hong Kong.

#### Goods and Services Tax (GST)

Although it was reported in the interim report that there is insufficient public support for GST, over 60% of ACCA Hong Kong members support GST, with or without conditions. 49.7% of members think that GST is worth considering as an option on the ground that some well-to-do people do not have income subject to tax under the current system but they enjoy public services. The findings reveal that 70% of members do not support the proposals put forward in the consultation document but would support a GST provided that adequate relief measures are introduced to alleviate the overall tax burden of the low and middle-income classes.



Members supporting GST think that it is a fair tax. As the standard tax rate under salaries tax benefits the higher income group, GST or a tax on luxury goods can ensure the rich who have more ability to pay do pay their tax. There is also a general comment that GST is only acceptable if salaries tax rates are to be reduced, and the government should cut its spending.

#### Tax on interest income and tax on dividend income

ACCA Hong Kong members generally oppose a tax on interest income or on dividend income. Less than half of members consider either a tax on interest income or a tax on dividend income is fair.

#### Other suggestions

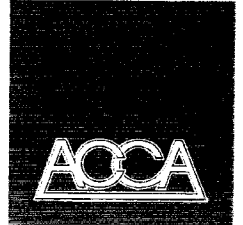
The survey also seeks members' views on the introduction of a progressive profits tax rate or increasing the marginal salaries tax rate for higher income earners. As 75% of members consider that the standard tax rate under profits tax simplifies the Hong Kong tax system, the introduction of progressive profits tax rate draws less than half of members' support. In respect of salaries tax, 58.9% of members consider that the standard tax rate under the current salaries tax system simplifies the tax system, and only 27% of members agree to the removing of the standard tax rate. In particular, older members with higher income tend to reject this proposal. Less than 50% of members support an increase in the marginal salaries tax rates on higher income earners.

#### **Conclusion**

It can be clearly seen from members' responses that they tend to support taxes which they consider fair and agree with the "rich pay more" principle. Amongst the various options, members tend to agree to the introduction of a tax on luxury goods, green tax, Capital Gains Tax, and Land and Sea Departure Tax. Members will only consider GST provided that adequate relief measures are built into the GST system.

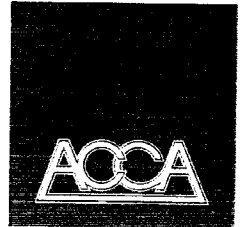
ACCA Hong Kong considers that a tax on luxury goods can be a different version of GST. However, we appreciate the technicalities involved in the definition of a "luxury" good.

In respect of green tax, ACCA Hong Kong also recommends the adoption of tax measures as an integral part of the anti-pollution strategy. Green tax agrees with the "polluters pay" principle that those who contribute to the



environmental damage should shoulder a tax burden, and it is environmentally and socially justifiable. However, we note that in terms of broadening Hong Kong's tax base, it may not achieve a significant revenue yield and hence may not be highly effective.

GST could be an appropriate option to broaden Hong Kong's tax base. It taxes virtually all personal consumption, and hence everyone pays the tax as they consume. However, the effectiveness of the GST system depends on the well-design and preparation for the system and relevant supporting measures.



## **SUMMARY**

Compared with other developed economies, Hong Kong is more reliant on property-related and non-tax revenue such as land sales and investment income, which are however subject to the economic ups and downs. The Government's capability to raise adequate revenue during economic downturns is further restricted by the limited types of taxes. This narrow tax base contributes to our budget deficit during the past years when our economy suffered a setback and operating revenue was significantly reduced. It is therefore no doubt that our tax base needs to be broadened.

Amongst the various options, a tax on luxury goods, green tax, Capital Gains Tax and Land and Sea Departure Tax are welcomed by ACCA Hong Kong members on the ground that these taxes could achieve fairness, one of the widely accepted principles of good taxation systems. In respect of GST, members generally feel that it is worth considering. However, this will only draw support if adequate relief measures are provided to alleviate the overall tax burden of the low and middle income classes.

ACCA Hong Kong recommends that before any implementation of new taxes, there should be adequate time to ensure that the general public is well-informed of the exact impact of the new tax as how it would affect them.

Often, opposing voices against the introduction of new taxes are directed at the inefficient management of public expenditure. Members even consider that cutting expenditure should be of a higher priority than broadening the income base. ACCA Hong Kong proposes that a mechanism should always be in place to ensure the cost effectiveness of public spending and better transparency on Government's policy on expenditure as well as improvement of Government services (value for money) will help to reduce these opposing voices. Under no circumstances, should additional tax revenue become a means for a lax control on public expenditure.