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**The Canadian
Chamber of Commerce
in Hong Kong**

La Chambre de Commerce Canadienne à Hong Kong
香港加拿大商會

GST and the Canadian Experience

**The Canadian Chamber of Commerce in Hong Kong
submission on**

**“Broadening the Tax Base
Ensuring Our Future
What’s the Best Option for Hong Kong?”**

Submitted by:

The Canadian Chamber of Commerce in Hong Kong

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Submitted to:

The Government of Hong Kong

Special Administrative Region of The People’s Republic of China

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The Hong Kong Proposal for a GST

The Canadian Chamber of Commerce in Hong Kong is the largest Canadian business organization in the world outside of Canada. It is also the second largest international Chamber in Hong Kong. Our membership is not only comprised of Canadian firms operating in Hong Kong, but also Hong Kong and Chinese firms with Canadian interests and firms from third party countries that see significant benefit through membership in our inclusive community.

One thing all of our 1000+ members have in common is an interest in the Hong Kong business environment. These members range from massive technology and financial multinationals to one person consulting firms. The Chamber strives to represent those interests and give them common voice on issues of public policy. The introduction of the GST is one such issue.

The Canadian experience also has some relevance to Hong Kong and offers some lessons to be observed. With over 250,000 Canadians in Hong Kong, who have at least three years residency in Canada, this suggests that many Hong Kong residents have experience living under a GST regime. The vast majority of our members are corporate executives, professionals and entrepreneurs in Canada who not only experienced the GST as consumers, but also as business people. It is this experience we bring to bear in forming our opinions on what a GST may mean in Hong Kong.

We intend for this document to provide some insight to the relevant government officials and policy makers involved in the decision on whether or not to adopt (or re-introduce) such a tax, and if so, some design considerations.

There is a broader argument being made about the need for such a tax at all that will not be addressed in this document. However, given the government surpluses and the lack of reform in areas like healthcare, it seems unwise to create a new revenue stream through the mechanism of a GST that goes into general revenue. Others in the community have expressed a concern that a complicated system of tax would create additional burden on the lower income earners in Hong Kong. This concern is shared by members of the Chamber. Many are skeptical of the effectiveness of rebate programs for low income earners, as proposed in the consultation document. It is easy to lose money to government – very tough to get it back.

Canada's experience has much to offer when considering a tax for Hong Kong. Furthermore, that experience raises concerns for the Canadian business community represented by the Canadian Chamber. This brief will consider:

The Canadian Experience: An Open and Honest GST Why Canada's GST is Different

Tax on Tax

Threatening Hong Kong's low tax status.

Political Suicide

Social harmony and government effectiveness.

The Private Cost of Administration

Canadians know that the GST is a major hassle for business and won't believe otherwise.

Driving the Underground Economy

Rule of law is a prime concern of our membership.

The Canadian Experience: An Open and Honest GST

Canada is virtually unique in its application of the GST. First, some history. It is a national tax. In some provinces (New Brunswick, Newfoundland and Nova Scotia) it is 'harmonised' with a provincial sales tax. (PST). In the rest of Canada, it is calculated separately – except Alberta, which still has no PST.

The Canadian GST was ostensibly introduced to replace the previous Manufacturers' Sales Tax and the Federal Telecommunications Tax. Similar to our own proposed GST, the MST allowed manufacturers to claim back tax paid on inputs. That, and given that it was a hidden tax as far as the vast majority of the public was concerned, left it open to political manipulation. By the time the MST was abandoned, it was "highly complex in that it was subject to no fewer than 22,000 special provisions and administrative arrangements."¹

Given the resistance to a new tax, the 'open and honest' aspect was introduced. This aspect makes it, to our knowledge, unique. In practice, what this means is that when an item is purchased, it is listed with its sales price. The tax is added *at the till*. So if the cost of an item is \$100 on the shelf, its final price will be added at the point of purchase raising the price to \$107 (in Alberta) or about \$114 (depending on the provincial rate in the 'harmonised provinces'). In most other jurisdictions, the tax is hidden in the sales price, or, at best, broken out in the receipt.

The impact has been to keep consumers aware of the amount of tax being paid. This led to, in July 2006, the first known reduction of a GST anywhere. While the normal path of this easy money tax is upwards (witness Germany's proposed VAT increase to 19% and Singapore's successive jumps from 3% to 5% to 7%), Canada's unique approach has kept successive governments more accountable for the tax and prevented the runaway increases that plague most of Europe and other jurisdictions.

The Chamber would recommend that the current government, should it press ahead with the GST in the face of opposition, make it a visible tax to hold successive administrations to account for its continuing administration.

¹ Key Economic Events. 1991: GST Introduced: A new tax on consumption. Government of Canada website
<http://canadianeconomy.gc.ca/english/economy/1991gst.html>

Tax on Tax

"In addition, GST is charged on the full pump price, gasoline taxes included. It is a tax-on-tax. As the pump price increases so too does the GST. Two years ago, the federal government collected \$1.4-billion in gasoline GST revenues. For every 10 cent increase in the price of gasoline, Ottawa's GST revenues rise by \$175-million. Due to soaring gas prices, Ottawa will collect \$1.8-billion in GST from gasoline in 2005/06, up \$400-million over the previous year."²

John Williamson, Canadian Taxpayers Federation

Much in Canada has been made of the fact that the tax is often applied on items that are already taxed by the federal government and that the tax applies on the post-tax price³. An example is on gasoline, where half the price is tax – upon which is applied a GST.

The Canadian Chamber would recommend that this tax not be applied to goods that are currently taxed. Alternately, the tax on those goods, such as alcohol, cars and cigarettes, could be eliminated.

² John Williamson, Canadian Taxpayers Federation. Press Release, May 18, 2006

³ For example, by the 72,000 member Canadian Taxpayers Federation.

The Private Cost of Administration

“Several observers think that the GST imposes a heavy administrative burden on government and small businesses. In 1991-92, administering the GST cost the federal government over \$486 million and required over 4,400 full-time equivalents (FTEs). Each net dollar collected as GST costs six times more in administrative costs than did the former federal sales tax (3.2 cents per dollar, as compared with 0.5 cents). To this figure must be added the private cost of administering the GST. On 17 December 1993, the Department of Finance published a report estimating this cost. According to this report, businesses whose income is less than \$100,000 spend 17 cents for each dollar they collect on behalf of the federal government; those with income between \$200,000 and \$299,000 spend 6.6 cents for every dollar collected; and those with income of over \$1 million spend 2.65 cents for every dollar collected. These estimated costs do not include the value of the time business people must spend administering the collection of money on behalf of the federal government, and are therefore lower than actual administrative costs. The Canadian Federation of Independent Business (CFIB) has estimated GST compliance costs at \$5,158 per registrant, not counting one-time set-up costs. The CFIB has estimated total compliance costs to Canadian businesses at \$6.642 billion in 1991 and \$4,573 [per registrant] in 1992, with the private cost to small businesses of administering the GST at 20 cents for every dollar collected.” (bold added)

The GST: An Overview of Some of the Alternatives
Richard Dominique, Economics Division, Depository Services Program
The Government of Canada
December 1993

Government claims that the tax will be simple to collect and administrate by business, especially small businesses, rings hollow to the many Canadians with experience of the tax in Canada. Many of our members in Hong Kong ran businesses in Canada and flatly do not believe assurances that their time and money will be minimally impacted by such a tax.

One of Hong Kong's major attractions to the investing community, both from Canada and by Canadians who choose to make Hong Kong their home, is the simplicity of the tax code. Low taxes are discrete, but usually partner to, simple taxes. The benefits from a simple tax code are realized in lower administrative costs and entrepreneur, executive and staff time.

Furthermore, it would be impossible to make such a tax revenue-neutral by offsetting the revenue by collecting less through other taxes. The creation of a new administration to collect the tax would leave previous tax collections regimes in place, processing the same number of applications, while collecting less. So two tax collection regimes collecting the same amount of tax would collect less – or need to collect more to compensate for the extra costs⁵.

The Chamber generally opposes costs imposed on business by government, direct or indirect. The GST will not be ‘simple’ for small and large businesses alike, contrary to statements made by Treasury bureaucrats and politicians. It will be a major administrative burden.

This contributes to the next item: the role GST plays in increasing the underground economy.

⁴ for easy reference <http://dsp-psd.communication.gc.ca/Collection-R/LoPBdP/BP/bp363-e.htm#THE%20GST>

⁵ Ignoring potential Laffer Curve effects.

Driving the Underground Economy

"The inescapable conclusion is that the GST was the primary catalyst triggering this growth."

Peter Spiro
1997

In 1997, Canada's leading public policy think tank, The Fraser Institute, published a report authored by Peter Spiro that examined a startling rise of the underground economy in Canada⁶. Their conclusion was that the GST was to blame.

Arguments in Hong Kong that the ability to claim rebates will diminish the incentive to cheat were also advanced in Canada. However, only two years later, it became clear that this was not the case. It was noted⁷ that while building contractors would claim full reductions on material input, the service component charged would be misreported – creating a new criminal class of tax evaders. In a service economy like Hong Kong, it is clear how this would be a problem. The same reports collect information from other jurisdictions, such as the UK, Belgium and the Netherlands, describing how retailers can easily avoid reporting sales while claiming full rebates.

One of the most attractive aspects of doing business in Hong Kong is that it has a strong tradition of respect for rule of law. Hong Kong is a legal haven in the Chinese business environment. Anything that would undermine this and place our law-abiding members in direct competition with those choosing to risk the underground economy is undesirable.

The same paper cites vast empirical evidence that increasing tax collection and broadening the tax base leads to an increase in the underground economy – a financial version of Kelling and Coles⁸ 'broken window' philosophy. Previously law-abiding citizens 'cross the line', perhaps leading to a general diminution of respect for the rule of law, our competitive advantage.

The members of the Chamber value the respect for the rule of law in Hong Kong and have grave concerns about increasing the level and complexity of taxes in a manner that has been shown to increase the underground economy in jurisdictions where it has been enacted.

⁶ Spiro, Peter. "Taxes, Deficits and The Underground Economy". from *The Underground Economy: Global Evidence of Its Size and Impact*. Ed by Peter Spiro and Michael Walker. The Fraser Institute. Vancouver, Canada. 1997

⁷ Spiro, Peter "Evidence of a Post-GST Increase in the Underground Economy." *Canadian Tax Journal* vol. 41, no. 2, pp.247-258. 1993

⁸ popularized by Rudolph Giuliani's application in New York policing, the original book arose out of a 1982 article in *Atlantic Monthly* by Kelling and Wilson. The book: Kelling, Gordon L. & Coles, Catherine M. *Fixing Broken Windows: Restoring Order and Reducing Crime in our Communities*. The Free Press. 1996.

Political Suicide

"There is little ambiguity regarding Canadians' views on the GST; most abhor it."

Jason Clemens, Director of Fiscal Studies, The Fraser Institute
Winnipeg Free Press, 02 December 2005

It should be noted that the introduction of the GST was considered one of the biggest factors contributing to the decimation of the Progressive Conservative Party in Canada. The unprecedented second majority of 151 seats was reduced to only 2 in a Parliament of 308 seats. It also contributed to the animosity towards the elite-supported constitutional reform the previous year, resulting in a bitter referendum defeat for the ruling party. It should be noted that the worst of the animosity was in the province that was not accustomed to such a tax – Alberta.

Very few issues have proved so divisive within governments. When it was introduced, the Progressive Conservative party had Members of Parliament in their caucus who refused to vote for the tax and were expelled from the Party. The newly elected Liberals, who promised in their campaign to eliminate the tax, found the 15-20% of government revenue it provided too attractive and reneged on their promise. Two of their most popular members were expelled or quit the party on principle.

The only way to avoid political suicide in Canada was to deliver on modest promises to reduce and eventually do away with the tax. Animosity towards the tax drove animosity towards all government projects, culminating in referendum and election disaster for the party that introduced it.

The lesson here is that, especially in low tax jurisdictions, the GST was unpopular in its introduction and maintenance leading to general dissatisfaction with all government policy. The business community, individual consumers, and lobby groups, 13 years after its introduction, still vigorously oppose the tax.

Given the initial overwhelming resistance in Hong Kong, there is a concern that other important government initiatives may be stymied due to general opposition to government generated by the introduction [or re-introduction] of a GST.

Conclusion

There is a concern that the GST in Hong Kong is on one hand, completely unnecessary given the strength of government finances. Furthermore, increasing revenue streams available without undertaking major reforms in areas of government spending like healthcare seems irresponsible. Many have made these arguments and will continue to do so.

This document examines some particular concerns of the Canadian business community in Hong Kong and experiences in Canada that have relevance to the current debate.

The conclusions are highlighted here:

The Canadian Experience: An Open and Honest GST

The Chamber would recommend that the current government, should it press ahead with the GST in the face of opposition, make it a visible tax to hold successive administrations to account for its continuing administration.

Tax on Tax

The Canadian Chamber would recommend that this tax not be applied to goods that are currently taxed. Alternately, the tax on those goods, such as alcohol, cars and cigarettes, could be eliminated.

The Private Cost of Administration

The Chamber generally opposes costs imposed on business by government, direct or indirect. The GST will not be 'simple' for small and large businesses alike, contrary to statements made by Treasury bureaucrats and politicians. It will be a major administrative burden.

Driving the Underground Economy

The members of the Chamber value the respect for the rule of law in Hong Kong and have grave concerns about increasing the level and complexity of taxes in a manner that has been shown to increase the underground economy in jurisdictions where it has been enacted.

Political Suicide

Given the initial overwhelming resistance in Hong Kong, there is a concern that other important government initiatives may be stymied due to general opposition to government generated by the introduction of a GST.

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The Canadian Chamber of Commerce in Hong Kong is generally opposed to the introduction of a GST. It will complicate and add a major cost to doing business in Hong Kong, drive the underground economy, and increase political discord.

However, should the administration push ahead in the face of opposition, we recommend that they use the Canadian 'pay at the till' approach that has held successive Canadian governments accountable for the continuing application of the tax. Furthermore, the government should avoid 'tax on tax' by exempting or removing the tax on currently taxed goods.

For and behalf of The Canadian Chamber of Commerce in Hong Kong

(Signed)

Victor Apps
President