



To: taxreform@fstb.gov.hk
cc:
Subject: Other measures of broadening tax base

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Urgent

Return Receipt

Dear Sir,

We are students of City University of Hong Kong. We have done some research and concluded two viable options to broaden Hong Kong tax base. Attached is the report. Thank you for your kind attention.

Yours faithfully,
Shirley Wong



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Advice on tax measures to broaden Hong Kong's tax base

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Financial Secretary
Henry Tang**

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31 March 2007

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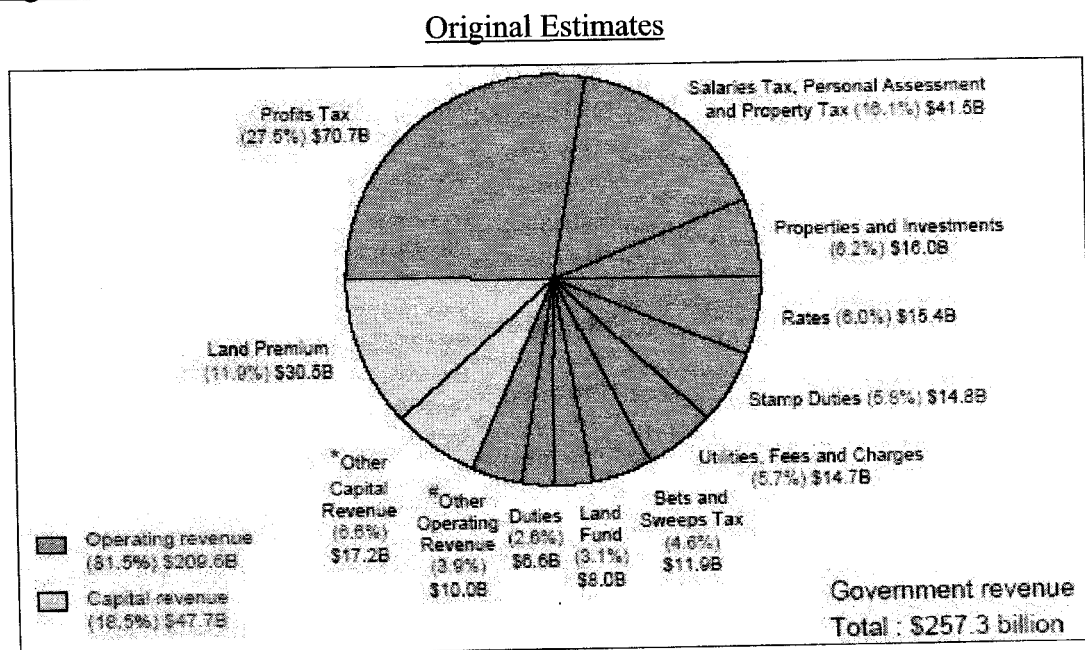
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1. Background: HK's tax base is narrow

By international standards, HK's existing tax base is very narrow. We heavily rely on limited types of tax and non-tax revenues to support our public expenditures. According to Figure 1, two major sources of revenue for 2006 – 07 are income tax on enterprises (i.e. profits tax) and income tax on individuals (i.e. salaries tax, personal assessment and property tax), they account for 43.6% of total revenue. Additionally, income from these sources varies widely and tends to fluctuate with economic conditions, while our expenditure is rigid. Thus, it is difficult to make long-term major investment and development plans.

By facing current international trend, especially in the Asia-Pacific region is towards lower direct taxes rate, HK needs to identify new sources of secure, steady income from a broader tax base. With a broader tax base, giving a room to cut Salaries and Profits Tax rates, and thus enhancing competitiveness in attracting and retaining talent. Moreover, because of rapidly ageing population, broadening our tax base is needed, so that our public finances can meet the major challenges in future.

Figure 1: Government's operating and capital revenue sources based on the 2006 – 07



(Source: Information Pack for the Financial Secretary's Consultations)

2. How to choose suitable tax measures for HK?

Internationally, there is a set of widely accepted principles of tax system. To choose a suitable tax measure, following requirements should be fulfilled:

1. Neutrality

Tax system should fairly distribute the tax burden while minimizing disincentive effects.

2. Fairness

Ensuring people with greater financial capacity will bear heavier tax liability without widening the wealth gap (i.e. consistent with the “capacity to pay” principle).

3. Certainty and simplicity

Tax system should be transparent, predictable, intelligible, and the rules should be clear and easy to understand.

4. Flexibility

Tax system should be flexible to technological changes, commercial developments and other changes of HK’s economy.

5. Maintaining international competitiveness

Considering international trends in taxation and being clear, simple, and able to maintain HK’s attractiveness to capital and talent.

6. Revenue stability

Tax system should be able to provide stable and significant revenue for the Government to respond to challenges and needs of the community and create social harmony.

3. Argument on broadening tax base by Goods and Services Tax (GST)

Since the launch of the tax reform consultation in mid July 2006, there has been much discussion about this issue in HK. The Government supported the introduction of GST, as GST can fulfill the requirements mentioned above. While the public generally agrees there is a need to broaden tax base, the majority consider that GST is not the only appropriate option to solve narrow tax base problems.

According to the Interim Report of Public Consultation on Tax Reform¹, there are 60% of the public are opposed to GST while 30% support. Survey of the Views of Accountants on Goods and Services Tax² indicated that the majority of the public (62.8%) is against GST in HK. As they concern that it would complicate the simple and low-rate tax system, widen the wealth gap and adversely affect HK's economy.

Therefore, it is clear that there is insufficient public support for the introduction of GST. As to broaden the tax base, the Government should consider other tax measures.

4. Suggestions on other tax measures

A suitable tax reform option for HK should be able to broaden the tax base effectively. Here we suggest two tax measures: (1) Plastic-Bag Tax, and (2) Land and Sea Departure Tax.

4.1 Plastic-Bag Tax

4.4.1 Introduction

This is a kind of green and corrective tax. According to the Environmental Protection Department, HK people consume 8.4 billion bags annually (i.e. 23 million plastic bags each day), where a quarter of them supplied by major supermarkets. Disposal of bags costs the government about HK\$40 million annually. By introducing this tax can discourage people from using plastic bags as well as broadening tax base.

4.1.2 Implementation framework

This tax is imposed on consumers who use plastic bags at the point of sales. Consumers pay for each bag they consumed. Suggested charge per plastic bag is ranged from 30 cents to 50 cents.³

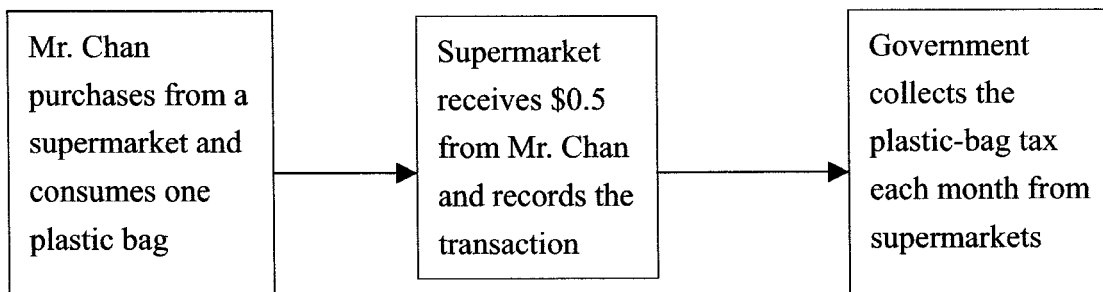
It is suggested to levy plastic-bag tax on supermarkets first. Supermarkets need to

¹ "Interim Report of Public Consultation on Tax Reform", the Financial Services and the Treasury Bureau, the HKSAR Government, December 2006:
<http://www.taxreform.gov.hk/eng/pdf/interim.pdf>

² Raymond C. L. Yeung. "Survey of the Views of Accountants on Goods and Services Tax", Honorary Visiting Academic East Asia Work-Based Learning Centre, Middlesex University, January 2007:
http://www.mandytam.com/download/en_survey_20070109.pdf

³ Survey conducted by Democratic party on April 2005:
<http://www.dphk.org/2003/images/thumbphoto/050424.ppt#6>

pass on the full amount of the levy as a charge to customers at the checkout, and it will be printed on invoices and receipts. An example is set as follow:



Exemptions of Plastic-Bag Tax⁴:

Smaller plastic bags that are used to store non-packaged goods such as:

- Dairy products
- Fruit, vegetables or nuts
- Confectionery
- Cooked food, whether it is hot or cold
- Ice
- Smaller plastic bags that are used to store fresh meat, fish and poultry, both packaged and unpackaged.

This tax revenue will be paid for environmental protection purpose first, such as Action Blue Sky Campaign. The remaining tax revenue will be used to finance government spending.

4.1.3 Supporting evidence of Plastic-Bag Tax

This has been introduced in an attempt to curb litter in Ireland since 2002 and has yielded a great success, by charging equivalent to HK\$1.50 per plastic bag. 3.5 million euros has been raised after the introduction of Plastic-Bag Tax in Ireland for 5 months, usage of plastic bags fell by 90%, from 1.2 billion a year to 91.6 million. In Taiwan, plastic-bag usage fell by 80% after a levy equivalent to 30 HK cents was introduced in 2002. This can raise tax revenue together with customers' consciousness about the role they play to preserve the environment.

⁴ Plastic Bag Environmental Levy in Ireland:
<http://www.mindfully.org/Plastic/Laws/Plastic-Bag-Levy-Ireland4mar02.htm>

4.1.4 Short term impacts on government income

Customers' habits in HK are different from that of Ireland and Taiwan. From the survey conducted by Democratic Party, it is estimated that the consumption of plastic bags will fall by 70%⁵, from 23 millions plastic bags to 6.9 millions each day. A quarter of them, 1.725 millions plastic bags, are from supermarkets. It is estimated that \$31 million will be raised in the first year after the introduction.

4.1.5 Long term impacts on government income

Three years after the imposition of Plastic-Bag Tax, it is estimated that the decline in consumption of supermarket plastic bags will be more stable. Consumption would be 5% of present, bringing tax revenue \$5.2 million to government per year.

4.1.6 Impact on HK economy as a whole

It tends to have less negative effects to the economy than other direct tax such as salaries tax. It is an environment tax and will not greatly affect the structure of HK tax base.

4.1.7 Impacts on sectors

Consumers

They need to pay this tax upon consumption at the point of sales. A charge of 50 cents per plastic bag would not adversely affect the income of consumers. They will consume less plastic bags and shift to use reusable bags.

Suppliers of plastic bags

Suppliers of plastic bags will experience a decline in their sales. They may shift to produce tougher plastic bags and reusable bags.

4.1.8 Plastic-Bag Tax is a "good" tax?

It can broaden HK tax base as it is a new tax. Everyone who consumes plastic bags need to pay the tax.

This tax is levied on 'users pay' principle. Consumers only need to pay tax upon consumption. The more one consume, the more one need to pay. In this term, the tax is fair. But with reference to the amount of income, the tax may not be fair as people with higher income do not need to pay higher tax.

⁵ Survey conducted by Democratic party on April 2005:
<http://www.dphk.org/2003/images/thumbphoto/050424.ppt#8>

For provision of stable and significant income, in short term, the amount of tax revenue generated will be significant. In long term, the decline of plastic bags consumption will be more stable. It can yield stable tax revenue for the government. The tax revenue will not be subject to fluctuation in economic situation as supermarket plastic bags are for the purchase of necessities.

It helps to raise public awareness towards environmental protection. People understand that they need to pay for the damaged environment. This tax can also help to develop environmental protection business and attract talents to HK.

This tax is simple as it is a fixed charge per plastic bag consumed. The tax revenue may not be certain as it is estimated there will be continuous decline in the consumption of plastic bags after the imposition of tax, resulting in a decrease in tax revenue. However, in the long run, the tax revenue may be certain as the decline trend will be stabilized.

4.2 Land and Sea Departure Tax

4.2.1 Introduction

HK's government would not like to have drastic implementation with any tax, thus, a modest introduction will be relatively more appropriate to the strategy set. Land and Sea Departure Tax is one of appropriate tax measures. As HK already has Air Departure Tax, it would be easier to expand to land and sea departures.

4.2.2 Implementation framework

Similar to the existing Air Departure Tax, it should be taxed at a fixed rate for all passengers. There could be some concessionary measures like charging children and elderly half of the tax. Different destinations could have different taxes, but it will cause much trouble to set the tax and will cause confusion. Thus, it is recommended that it should be a fixed rate regardless of destinations. The existing tax on air departure is \$120 per person. There is also departure tax if travel to Macau by sea, which is \$39 per person. The tax income generated from air departure is \$0.5 billion in the year of 2000. Thus, if Land and Sea Departure Tax sets at the range of \$39-120, tax income of \$1 billion or more will be secured.

4.2.3 Supporting Evidence

In HK, there is Sea Departure Tax for passengers traveling to Macau. This is the strongest evidence showing the possibility of implementation of Land or Sea Departure Tax.

4.2.4 Impacts on government income and the economy

According to the study done by KPMG regarding the introduction of New Broad-based Taxes, it mentioned that the Finance Bureau has estimated, only a \$25 charge on land or sea departures, could bring around \$1 billion tax income to the government.⁶

While to HK's economy as a whole, this tax will have a relatively less negative effect compared to other direct tax such as GST or other consumption taxes. Thus, this tax will have a modest impact on the structural tax base requirements.

4.2.5 Land and Sea Departure Tax is a “good” tax?

This tax is taxed on all persons who depart from HK by land and cruise, so all people who leave using these two channels fall into the tax net. This tax surely has the capacity to broaden the tax base.

It should be a fixed charge to all people departing through the same channel, by land or by sea, regardless of their income level. Besides, at present, only people departing HK to Macau and Mainland by sea would be charged with Sea Departure Tax. Thus, if Land and Sea Departure Tax is introduced to all destinations, this will be fair to all people departing HK. This tax certainly demonstrates fairness.

It can provide stable and significant revenue, as its income depends on the number of people departing by land or by sea. So, only if the number of people departing decreases, the tax income decreases. Yet, there is significant increase in tourists visiting HK⁷. When they leave, they will encounter Land and Sea Departure Tax. The number of passengers leaving HK by land and by sea also increased for about 30%.⁸

⁶ KPMG Broad-Based Taxes

⁷ Hong Kong in Figures 2007:
<http://www.censtatd.gov.hk/FileManager/EN/Common/hkinf.pdf>

⁸ Tables from Hong Kong in Figures 2007

Arrivals and Departures of Passengers by Mode of Transport

Mode of transport	2001	2005	'000 2006
Arrivals			
By air	11 533	13 265	14 382
By sea ⁽¹⁾	9 779	10 029	10 903
By land	53 557	72 400	75 791
Total	74 869	95 694	101 076
Departures			
By air	11 488	12 700	13 683
By sea ⁽¹⁾	10 238	11 499	12 390
By land	53 080	71 443	74 964
Total	74 806	95 642	101 038

Note: (1) Including passengers to/from Macao by helicopters.

Hong Kong Resident Departures by Control Point

Control Point	2001	2005	'000 2006
Airport	5 012	5 456	5 739
Harbour Control ⁽¹⁾	274	245	240
Macao Ferry Terminal	3 765	4 018	4 476
Tuen Mun Ferry Terminal ⁽²⁾	—	—	19
China Ferry Terminal ⁽¹⁾	3 711	3 103	3 197
River Trade Terminal	†	†	†
Hung Hom Station	781	938	955
Lo Wu Control Point	41 164	38 192	39 039
Lok Ma Chau Control Point	5 319	18 090	19 758
Man Kam To Control Point	473	1 236	1 184
Sha Tau Kok Control Point	596	1 022	1 204
Total	61 096	72 300	75 812
	(+3.7)	(+4.9)	(+4.9)

Notes: Figures exclude drivers.

(1) Including passengers by cruises to high seas.

(2) Started operation as from 3 November 2006.

† Less than 500 persons.

In terms of maintaining international competitiveness, it is true that the introduction of Land and Sea Departure Tax does have some negative impact on inbound tourism. However, the negative impact surely is a lot less than the tax income it could brought, because the statistics shown that the number of tourists visiting is increasing continuously for the past 5 years.

Visitor Arrivals by Country/Territory of Residence

Country/Territory of residence	2001	2005	'000 2006
The mainland of China	4 449	12 541	13 591
Taiwan	2 419	2 131	2 177
South & Southeast Asia	1 747	2 413	2 660
North Asia	1 762	1 853	2 030
The Americas	1 259	1 565	1 631
Europe, Africa & the Middle East	1 171	1 726	1 917
Macao	532	510	578
Australia, New Zealand & South Pacific	387	620	668
Total	13 725	23 359	25 251
	(+5.1)	(+7.1)	(+8.1)

It is simple to implement this tax, since it is only a fixed rate charge to all the people who chose to depart through the same channel. The only difference could only be the destination for these passengers. Thus, this tax demonstrates certainty and simplicity to implement.

5. Conclusion

Introducing tax reform would have implications for the entire community, HK Government should progress this issue cautiously and carefully. As we have been worked with recommending what broad-based taxes could be introduced in HK by the Government, we recommended that Plastic-Bag Tax and Land and Sea Departure Tax are suitable for HK, and should be adopted.

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