THE AMERICAN CHAMBER OF COMMERCE IN HONG KONG

Response to Advisory Committee on New Broad-based Taxes and Consumption Tax Issues

The American Chamber of Commerce in Hong Kong has been asked to respond to the Hong Kong SAR Government's August 2001 Consultation Document entitled "A Broader-based Tax System for Hong Kong?". The following paper outlines our initial response to the issues raised in that consultation document.

We believe that the Document has been prepared using the premise that a broader tax base is required in Hong Kong. We understand the political imperatives that may be driving that concept as the SAR moves towards more broadly representative government. We are concerned, however, that the debate on new taxes is incomplete before the findings of the Task Force on Review of Public Finances now examining the possible nature of future deficits are released. We will have to defer a firm view on the need for any new taxes until that element of the review process is also complete. In this context, we hope that due attention will also be given to the contribution made to any deficits by the apparently substantial increase over the past few years of public sector expenditure as a proportion of Hong Kong's total economy.

We do, however, understand that a great deal of time has been given by the Advisory Committee to the consideration of alternative taxes for Hong Kong and would like to respond on these:

<u>Consumption Tax/GST</u>

This clearly offers as broad a reach into the population as is available for any tax and therefore meets the first objective of broadening the tax base. There are also clear benefits in administering a 'self-policing', cascading system such as the GST outlined by the Committee. We also believe that there may be competitive benefits to Hong Kong in the Profits and Salaries tax reductions which would accompany the introduction of a GST and which are proposed in Scenarios 2 and 3 on p.30 of the Consultation Document.

We do, however, have serious concerns about the impact of a GST on Hong Kong. These include:

- It is highly regressive and would have the greatest impact on those sectors of the community least able to afford it;
- It will be complex for business to administer. One key attraction for companies to locate in Hong Kong is the simplicity of its tax system. Administrative

complexity, particularly for SMEs, has already been dramatically increased with the introduction of the MPF system. A GST would represent a substantially greater layer of complexity.

- The introduction of a GST would further weaken Hong Kong's retail competitiveness compared with the towns and cities in the Pearl River Delta. Many Hong Kong people are already making a substantial number of their regular purchases outside the SAR. The introduction of a consumption tax could only exacerbate that trend.
- There are dangers in the ease with which a GST could be gradually increased. Our understanding is that the level of GST/VAT in most countries which have introduced taxes of this type is now substantially higher than when they were first introduced. This is an 'easy target' for politicians as it is less visible than salaries or profits tax increases. There is also the clear danger, as seen in Japan, that sales tax increases used to balance government accounts during times of economic hardship can actually contribute to much slower recovery.

We do not accept that the fact that Hong Kong is the only OECD country without some kind of consumption tax is a problem. In fact, we believe this to be one of Hong Kong's unique competitive advantages and the government should not eliminate that advantage lightly.

<u>Alternatives</u>

The Consultation Document looks at a number of alternatives to a consumption tax. We would like to see more attention paid to the options which would bring a greater number of wage earners into the tax system while ensuring that those in the lowest income groups are well protected.

It may be worthwhile further reviewing whether the bottom limits of salaries tax are currently too high. A substantial reduction in the basic tax allowances combined with a reduction in overall rates would achieve the government's overall goal of broadening the tax base without the highly regressive elements inherent in a consumption tax. The report concludes that only a small number of additional tax payers would be achieved by taking this approach. That would, though, presumably be entirely dependent upon the ways in which the tax schedules were revised and we believe it is worth reviewing a radical restructuring which would capture all but the lowest paid groups.

We also question whether the concept of a 1% payroll tax has been dismissed too lightly. The mechanism is now in place, following the implementation of the MPF scheme, to collect deductions from payrolls. We are also unclear as to why this would impact on competitiveness as suggested by the Consultation Document. In fact, it could be argued that the administrative impact of such a tax on business would be far less than the imposition of a new sales tax system. Again, the lowest-paid groups in society could more easily be protected by structuring the payroll tax so that it only applies above an agreed monthly salary level.

While all of the schemes outlined in the Document are proposed as ‘revenue neutral’, we note that reference to “deficit” is made no fewer than four times on the introductory page. It also appears unlikely that the political considerations to which we have alluded in our first paragraph will be sufficient to carry public opinion in favour of any new taxes. It is essential, therefore, that this debate be carried out with a clear view of the fiscal implications to the SAR Government of the restructuring of the economy now under way. Once that view is clear, Amcham will be happy to consider these issues further.

Prepared by Paul Woodward

10 September 2001