

## Widening Hong Kong's Tax Base - A Call for Consistency

**Richard S. Simmons**  
**Department of Accounting and Finance**

### 摘要

為擴闊稅基及減少財政收入水平的波動，在最近的財政預算中，政府越來越傾向於徵收銷售稅。但政府最近的一些舉動，如暫停削減基本免稅額等，卻放出相反訊號，從而阻礙了稅務政策的實施。

In his recent budget address, the Financial Secretary, Henry Tang, gave notice that widening the SAR's tax base remains an important policy objective of the government. In the address, he stated that "Hong Kong's tax base is too narrow. We need to broaden it to secure a steady source of revenue."

He is absolutely right. Hong Kong's tax base is extremely narrow in two respects. First, it is limited with respect to the number of persons caught within its ambit. Only around 37 percent of the territory's 3.5 million working population, or about 1.3 million people, are, in fact, taxpayers. Second, the tax base is narrow with respect to the range of taxes that are levied. Hong Kong has few taxes on goods and services, and no tax on dividend income, income from overseas sources, and capital gains. Both aspects of tax base narrowness are today highly unusual in developed economies. Most have instituted a broad range of taxes with a high incidence amongst the population to shield themselves from the wide fluctuations in government revenues that can occur when reliance is placed on a slim tax base.

In light of this, the introduction of a sales tax in Hong Kong is well overdue. Certainly, the government has long taken an interest in it. The first concerted efforts to launch it were made in the late Eighties, when the then Financial Secretary, Piers Jacobs, commenced the drafting of plans for its introduction, scheduled for the 1991/2 Budget. At that time, the underlying justification for this proposed tax reform was the same as it is today. Hong Kong's existing tax base, consisting largely of a comparatively small number of individuals and companies that pay salaries tax and profits tax, was too narrow. The tax base was, in difficult economic times, not sufficiently productive of revenue to fund government expenditure. A sales tax was considered a means by which government could stabilise its revenue over the economic cycle. Revenues from direct taxes alone were seen as too volatile over time, since employment income and profits are subject to much greater variation over the cycle than personal expenditure, on which a sales tax is levied.

After much debate, the government backed down, Piers Jacobs left office, and the proposal was shelved. However, the proponents of the sales tax remained convinced of its appropriateness and continued to make representations on its behalf. The government has continued to seek advice and opinions from the business community and the general public on the matter, setting up the Hong Kong Advisory Committee on New Broad Based Taxes that reported in 2002. The committee came down firmly in favour of a Goods and Services Tax (GST). The government has now stated that a further round of public consultation on the new tax will begin later this year.

The purpose of this article, however, is not to set out the advantages and disadvantages of the sales tax, as this has been done on numerous occasions before. It would seem that there is already something of a consensus in government circles in favour of the tax, and the die is now cast. The government is only waiting for the right time (a combination of low inflation and healthy economic outlook) to introduce the tax, while in the meantime preparing the machinery for its operation, a process that could still take several years. The point that I wish to make here is that if the government is determined to proceed with its objective of broadening the tax base, it should be more consistent in its tax measures. Unfortunately, there were two aspects of the recent budget address that were contrary to that objective.

First, the government failed to maintain the momentum it built up of bringing more of the population into the tax net through reductions in the level of personal allowances. A promising start was made in this direction last year, when it was announced that the basic allowance for individuals would be reduced in two yearly stages (from \$108,000 in 2002/3 to \$104,000 in 2003/4 and then to \$100,000 in 2004/5) to bring the level back to where it was before 1998/9. However, this year, no further reductions have been outlined or suggested for the future. The basic allowance (as well as other additional allowances) in Hong Kong remains extremely high by international standards, as a glance at the table below shows:

Country	Belgium	UK	Singapore	Australia	Hong Kong
Basic Personal Allowance	54,336	64,442	4,530	35,400	<b>100,000</b>

(HK\$ equivalent)					
-------------------	--	--	--	--	--

The other tax jurisdictions above are selected for comparison as they have levels of GDP per capita (measured on the purchasing power parity basis) that are very similar to Hong Kong's. The level of basic allowance in Hong Kong compared to other jurisdictions is striking; it is clearly much greater than is considered appropriate overseas. One wonders, therefore, how this situation developed in the SAR, the reason for this discrepancy between ourselves and elsewhere not being immediately apparent. It has been suggested that leaving the majority of the working population out of the tax net has been a way in which the government has been able to restrain costs of tax administration. If so, this would be a classic case, by no means unusual in Hong Kong, of the administration tail wagging the policy dog.

While a reduction in tax allowances could widen the tax base, it is not, on its own, an efficient or effective way of doing so. Consider the effect on the tax base if the individual tax allowance was brought back to a figure that is more in line with international standards, say by reducing it by half. This would, according to KPMG, an accounting firm, increase the number of taxpayers from around 1.3 million to 2.2 million, and generate an extra \$14 billion in tax revenues. However, ninety percent of tax revenue would continue to be paid by existing taxpayers, hardly a huge increase in the tax base for such a major adjustment in allowances. Politically, it would also be extremely difficult. It would increase civil service administration costs, which would be problematic in the current political and economic climate. In spite of all this, extending the reduction

in the basic allowance over time would have been an appropriate move, in that it would help relieve the budget deficit in future years while making its commitment to expand the tax base much clearer to the general public.

The second way in which the government has not been consistent in its objective to expand the tax base was the extension of tax allowances on mortgage interest payments, up to \$100,000 per year, from five to seven years. This move was one of the very few adjustments to the tax system in this year's budget speech and was something of a surprise, since the maximum amount of this tax break had been reduced two years previously.

The move is a step in the wrong direction. It essentially increases a government subsidy to investment in one particular type of asset, housing. In doing so, it extends a non-neutral tax policy that is inconsistent with the government's overall laissez-faire ideology. In the long run, it increases the chance of a dangerous reliance of government revenues on the property market. Most egregiously of all, it can be seen as another example of the government extending favours to the big property developers.

But maybe one should no longer be surprised by government intervention in the housing market. What is surprising is the timing of the move. The property market has been showing more than a few signs of heating up, and speculators are coming back into the fray. In such times, this government measure simply expands speculators' chances of making quick one-off profits, as increased public subsidies in housing translate into artificial rises in capital values. One wonders how such rises square

with the government's expressed intention of making Hong Kong internationally competitive again in terms of costs.

The government's now clear determination to introduce a sales tax in the near future needs to be better sold to the general public. In order to do so, the government must clearly explain the importance and fairness of broadening the SAR's tax base. It will not be able to do so effectively if it continues to maintain and promote other tax measures that are demonstrably inconsistent with that objective.