A summary of the proposed GST package contained in the July 2006 Government Consultation Document, "*Broadening the Tax Base, Ensuring our Future Prosperity: What's the Best Option for Hong Kong?*"

(The full text of the Consultation Document can be found at: http://www.taxreform.gov.hk/

Proposed GST Framework

- A general consumption tax also known as "Value-Added Tax" (VAT) in some parts of the world.
- Credit-invoice based on destination principle:
    - Collected at each stage of the chain of production and distribution.
    - Imports are taxed and exports are zero-rated.
- Tourist Refund Scheme.
- Low and single rate: The example used is 5%.
- Registration Threshold: Businesses with annual turnover of $5 million and above.
- Broad base of tax with exemptions and zero-rated items kept to a minimum. So most household expenditure would be subject to GST.
- Particular treatment for financial services and immovable property:
    - Certain financial services defined as "financial supplies" to be zero-rated
    - Tax non-residential property and exempt residential property (both sales and rentals).
- Deferred GST Payment Scheme and Qualifying Exporters Scheme for imports / transshipments.

(Reference: Chapters 4 and 5)

Compensation / Offset Package

- Compensations for low-income households in the GST design:

- CSSA Households: Increase in Comprehensive Social Security Assistance (CSSA) payments according to the price adjustments due to introduction of GST.

- Non-CSSA Low-income Households:

    - GST allowance per household per year: $2,000.

    - GST credit for water and sewage charges per household per year for 5 years: $500.

    - GST credit for Rates per household per year for 5 years: $3,000.

➢ Other households:

- Possible Salaries Tax reduction (see below).

- GST credit for water and sewage charges per household per year for 5 years: $500 (also applicable to Non-CSSA Low-income Households).

- GST credit for Rates per household per year for 5 years: $3,000 (also applicable to Non-CSSA Low-income Households).

➢ Businesses:

- Possible Profits Tax reduction (see below).

- Set-up assistance provisions for SMEs and other voluntary GST registrants to help with compliance costs.

- Abolition of Capital Fee.

- Reduction in Motor Vehicle First Registration Tax.

- Reduction in Petrol, Diesel and Aircraft Fuel Duty.

- Reduction in Trade Declaration Charges.

- Abolition of Hotel Accommodation Tax.

- Reduction in Liquor Duty.

- Increase the tax deduction limit for charitable donations from the current 25% of assessable income / profits to a higher level, say, 50% of assessable income / profits.

➢ Adjustments to other existing indirect taxes to reduce distortions.

<u>Options for returning net GST funds to the community in initial five years</u>

- For example, reductions in direct taxes such as Salaries Tax and/or Profits Tax:

  - If Salaries Tax only: standard rate could reduced from 16% to 11%, marginal tax rate of 19% reduced to 14%, and the bandwidth increased from $30,000 to $75,000 (estimated cost: $20bn).

  - If Profits Tax only: Reduction of 5% in profits tax rate (estimated cost: $20bn).

- Alternative: Increase public expenditure.

Overview of budgetary implications

	Annual amount ($billion)
Gross GST revenue (at 5% GST rate)	**30.0**
Less Hotel Accommodation Tax abolished	(0.3)
Less Motor Vehicle First Registration Tax rates adjusted down	(0.5)
Less Duty on Liquor, Petrol, Diesel, Aircraft Fuel & Methyl Alcohol rates adjusted down	(0.8)
Net GST revenue	**28.4**
Less Administrative costs[1]	(0.5)
Net GST revenue after administrative costs available for tax relief or compensation measures	**27.9**

Balance of funds available for tax relief

	Annual amount ($billion)
Net GST revenue after administrative costs	27.9
Less Proposed household compensation package (excluding tax relief measures)	(7.2)
Less Proposed business and charities offset measures (excluding tax relief measures)	(0.3)
Remaining balance	**20.4**[2]

Note 1: International experience indicates that the ongoing administrative cost for the government to collect GST would be approximately 1% to 2% of the net GST revenue, but would be expected to be closer to 2% in the initial years, due to the need to set up and operate new systems, especially given Hong Kong's lack of the necessary infrastructure to collect GST.

Note 2: Taking first year extra cost of $0.2 billion into account, the balance for that year would be $20.2 billion.

(Reference: Chapters 6 and 7)