



Opportunity **knocks**

By Mike Hurle

“We expect to achieve balance in the Consolidated Account in 2007-08, one year ahead of target. While we will persevere in restoring fiscal balance, we have proposed a number of tax concessions to relieve the burden on some taxpayers.”

► **Henry Tang**, financial secretary
March 2005 budget speech

The economic recovery of the past two years looks set to continue in 2006, but can we expect the government to offer any meaningful tax breaks when it announces its budget later this month?

On 22 February, Hong Kong financial secretary Henry Tang will set out his third budget, with expectations both for tax cuts and more substantial fiscal reforms. Tang has hinted at some concessions to the middle class, who have perceived a growing tax burden over recent years. “There is certainly pressure on Tang this time round,” says Tim Lui, tax partner at PricewaterhouseCoopers (PwC). “He stated quite openly after the last budget that he would make concessions if the economy continued to improve.”

George Leung, senior economist at HSBC, foresees improvement, predicting a small surplus for the government in the current fiscal year. “We expect revenues from both direct and indirect taxes to be above the government’s original forecasts,” he notes. “The government is achieving a balanced position earlier than expected.”

Whether that translates into tax concessions is another matter. Leung believes there is the potential for some concessions, but thinks the government should consider any adjustment carefully. “We think it would be more beneficial to directly adjust the tax rate, rather than offering a threshold adjustment or rebate. At this stage in the cycle we should be thinking about ways to enhance our long-term competitiveness, rather than provide short-term stimulus.”

And what of the risks of a downturn? The possibility of an outbreak of avian flu or economic disruption on the Mainland might give Tang enough reason to continue in the cautious vein of his first two budgets. But as Leung points out, risks will always exist in some form. “Even if there were a sudden

downturn, this is unlikely to lead to a huge deficit,” he says.

Rates and reforms

Economists and tax practitioners share a desire to keep Hong Kong competitive through a good tax structure. Many competing economies have been lowering their tax rates in recent years, so a straightforward reduction in direct tax might send out the clearest message to investors. “Hong Kong’s profits tax is at an historic high,” notes David Southwood, a tax principal at Grant Thornton. “I’d like to see a commitment to reduce it over time, and to aim for a basic rate of 15 percent.”

There are more fundamental issues threatening Hong Kong’s advantageous position. Many tax specialists believe Hong Kong must improve the way it defines source of income. “Some of these rules have changed over the years, and they are not getting any clearer,” says Peter Tisman, director of special practices at the Hong Kong Institute of CPAs. The Institute announced its own proposals for simplifying tax definitions at a press conference on 12 January and will be adding its commentary when the budget is announced on 22 February.

Southwood largely shares these views. “There is a lot of uncertainty in the legislation right now,” he says. “I don’t see the need for a general review of the Inland Revenue Ordinance, but I see many specific areas that need to be tightened up. For example, people shouldn’t have to wait six years to finalise their tax assessments. If they have followed the law there should be a way for them to draw a line under things more quickly.”

Lui of PwC isn’t convinced the government is ready to radically tackle the issue of tax reform head on. “Many of these issues hinge on legal definitions,” he notes, “so they are not necessarily the kind of specific items Tang will be inclined to address in his budget.”

The old GST debate

The Institute, along with all the big accounting firms, sees the goods and services tax (GST) as the most effective way to broaden Hong Kong’s narrow tax base. “When the economy is faring well, the temptation is to put GST on the back burner, when quite the opposite should happen. Making reforms now will give us the underlying strength to cope with a downturn in the future,” says Southwood.

Leung at HSBC says there is room for more public debate. He believes there must be a clear proviso that a GST is accompanied by a reduction in income taxes, so any change should only follow a thorough appraisal of Hong Kong’s tax base.

Such questions may not be satisfactorily resolved in the budget, but it is a chance for the government to set out some new initiatives. “At the moment we are in a cyclical recovery,” says Leung, “but so far there hasn’t been much evidence that structural issues are being reformed. The government now has the opportunity to address these fundamental issues.”

While the Institute focuses on the broad policy issues facing Hong Kong, many accountants will, like the wider population, be waiting to hear if they stand to gain personally when the budget is laid out. **A+**