2001/2002 BUDGET COMMENTARIES

Overall Comment

Financial Secretary's budget proposal for 2001/2002 announced yesterday contains no surprises or dramatic measures. As a whole, it is a solid proposal appropriate to the current situation of Hong Kong.

On Budget Strategy

The budget should be regarded as a balanced one, although it has a nominal deficit of $3 billion representing about 0.22% of our projected GDP for the next year. Such a small deficit if realized may have a slight expansionary effect on our economy, allowing the momentum of our recovery to continue. This budget strategy is in line with the proposal of our Institute and meets our expectation.

On Revenue Measures and Tax Concessions

New revenue measures proposed to mitigate the budget deficit are relatively mild. We believe the small increases in excise taxes on tobacco, alcoholic beverages, driving and vehicle license fees, parking charges and air passenger departure tax should not have significant impact on the livelihood of people. Altogether, these revenue measures will only bring in about $660 million. Although we have no strong objection to these measures, which may have symbolic significance, they are not in our view strictly necessary. Without such measures, our budget deficit will still be very low at around 0.25% of GDP; that is, our budget is practically balanced.

On tax concessions, we welcome the proposed reduction in stamp duty on stock transactions; we agree it would enhance the position of our capital market. We also appreciate the increase in self-education allowance to encourage life-long learning.

However, we would urge the government to reconsider the proposal of setting aside a fund of $300 million to support SMEs' training initiatives although we support whole heartedly the aim of this proposal. In our earlier budget submission, we proposed a tax concession for the same purpose: to allow a tax deduction for qualifying training costs at 150% of the expenses incurred. We believe our proposal is more effective and simpler to administer. For a tax expenditure of $300 million, employers will have to incur $1.25 billion in order to obtain the concession to the full extent. The tax leverage will therefore in effect give a training fund with a size more than 4 times the tax concession granted. Further, our proposal will have a longer-term effect in that employers will continue to be induced to provide funds out of their profits for staff training as long as the deduction is still in force; whereas, the $300 million fund is apparently only a one-off commitment.

Tax Review & New Tax Candidates

It is prudent for the government to defer introducing new taxes or making significant changes in our existing tax systems until the studies on the nature of our fiscal deficit is completed. The Financial Secretary also mentioned a number of potential taxes in his budget proposal and encouraged the public to debate on some new tax candidates such as the controversial land and sea departure tax, betting duty and environmental taxes. Further studies in these tax areas are meaningful both from a revenue structure and from social points of view. We will offer our views on these tax issues upon further studies. In the meantime, we would suggest the government to further consider our recommendation in the following areas:

- to have a more liberal interpretation of some existing profits tax provisions, such as source of profits, to attract investments;
- to enrich the provisions of the Inland Revenue Ordinance on transfer pricing;
- to remove undesirable tax implications for the front and back office operations for those companies with factories in Mainland China.

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All in all, our Institute is happy to endorse the Financial Secretary's budget proposal while we would suggest the approach to providing support and inducement for employers' staff training be reconsidered.