

36. Which of the following will widen the deflationary (output) gap of a country?

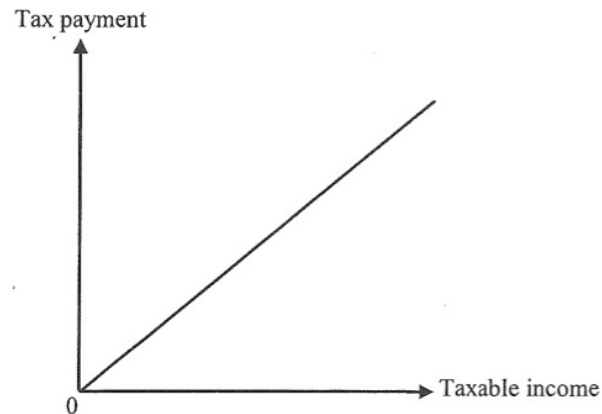
- A. Its trading partners experience an economic recovery.
- B. Credit cards are more widely used.
- C. There is a decrease in transfer payment.
- D. The central bank prints more money.

37. Which of the following may lead to a rise in aggregate output and an improvement in equity in Hong Kong at the same time?

- (1) a charity fund donating HK\$10 billion to set up non-governmental organisations in order to provide services for the underprivileged
- (2) a cash payout of HK\$10 000 to each permanent resident aged 18 or above by the Government
- (3) a 1% reduction in the standard tax rate of salaries tax

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

40. The following diagram shows the relationship between taxable income and tax payment in a tax system.



Which of the following statements about the above tax system is correct?

- A. It is in line with the equality principle put forth by Adam Smith.
- B. There is no tax allowance for the tax.
- C. Tax rate increases as taxable income increases.
- D. The tax system narrows the income gap between the rich and the poor.

5. Country D introduced a short-term capital gains tax (STCGT) on property market.

Capital gains (\$)	STCGT rate (%)
10 000 or below	8
10 001 to 50 000	16
50 001 to 100 000	24
100 001 or above	32

STCGT is a tax on capital gains from the sale of a property held for less than 1 year.

A spokesman of the tax department said that a new computer system had been developed for STCGT. Although the system cost more than 1 billion dollars, it allowed tax payers to check and pay the amount of STCGT online easily.

- (a) Evaluate the new tax in terms of **TWO** principles of taxation put forward by Adam Smith. (4 marks)
- (b) 'The introduction of STCGT would not relieve the problem of rising property prices.' Explain whether this is a positive statement or a normative statement. (2 marks)

2013/CE/II/3

(a) Nominal interest rate (R) = expected inflation rate + real interest rate (r) (3)

(b) No, R will be lower than r only when the expected inflation rate is negative. But the existence of actual deflation does not imply that the deflation is expected. (3)

OR

Yes, because people may expect deflation beforehand and an expected deflation will result in a nominal interest rate being lower than real interest rate. (3)

OR

Yes, because the real interest rate's real interest rate will be higher than the nominal interest rate when there is actual deflation. (3)

2014/125/II/25a(ii)

Martina would lose 20% of her

given the 15% rate of actual nominal return and the 3% rate of actual inflation, her actual real rate of return equals 10% (= 15% – 5%), which falls short of her expected real rate of return (12%). (3)

2000/CE/II/39

(a) Nominal interest rate. Since money is an non-income generating asset, nominal return = 0%. Holding money will give up nominal interest rate as income. (3)

(b) During deflation, the real value of purchasing power will decrease of the currency. (3)

Or

The currency is not generally acceptable as medium of exchange. (3)

## SECTION 3: GOVERNMENT BUDGET

### 3.1 PRINCIPLES OF TAXATION

#### Multiple Choice Questions

1994/CE/II/46

In Hong Kong, salaries tax is normally paid by two instalments and the tax payment can be made through the post. This practice agrees with the \_\_\_\_\_ principle of taxation.

- A. equality
- B. convenience
- C. certainty
- D. **economy**

1996/CE/II/40

A Japanese electronics firm produces and sells its products in Hong Kong. Therefore, it has to pay profits tax to the Hong Kong government. Hong Kong is applying the

- A. source principle.
- B. residence principle.
- C. equity principle.
- D. convenience principle.

1997/CE/II/47

Which of the following descriptions of Hong Kong's taxation system is true?

- A. Only incomes derived from Hong Kong are liable to tax.
- B. Rates is a direct tax.
- C. Import duties are imposed on some goods in an attempt to protect local industries.
- D. The profits tax rate of corporations is the same as the standard tax rate.

2000/CE/II/40

The payment of salaries tax and profits tax can be made by the Payment by Phone Service (PPS) by which taxpayers can transfer money from their bank accounts to the government. This practice satisfies the \_\_\_\_\_ principle of taxation

- A. source
- B. certainty
- C. convenience
- D. equity

2002/CE/II/39

Suppose the government of an economy announces that the people will have to pay a general sales tax of 2% of the selling price when they purchase any goods and services. The government also launches a series of programmes to make sure that the public understands the new tax. Which of the following taxation principles is illustrated by the above measures of the government?

- A. equality
- B. certainty
- C. convenience
- D. **economy**

2003/CE/11/44

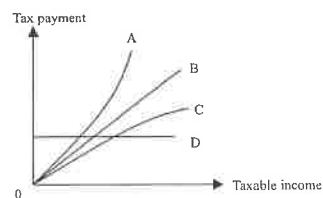
Which of the following statements about the tax system of Hong Kong is correct?

- A. The rental income derived from properties overseas is subject to the property tax of Hong Kong.
- B. All the business organizations in Hong Kong have to pay at the same profits tax rate, as it is a proportional tax.
- C. Interest income from deposits denominated in Hong Kong dollars is subject to interest tax in Hong Kong.
- D. The estate duty in Hong Kong is a progressive tax.

(Note: The estate duty was abolished in 2006.)

2006/CE/11/41

The following lines A, B, C and D indicate different relationships between tax payment and taxable income. Which of these four lines shows a relationship in accordance with the taxation principle of equality put forth by Adam Smith?



- A. line A
- B. line B
- C. line C
- D. line D

2007/CE/11/41

The introduction of a 5% Goods and Services Tax on specified items of goods and services is regressive in nature and will incur large administrative costs.

The above statement is concerned with the \_\_\_\_\_ principle of taxation put forward by Adam Smith.

- (1) equity
- (2) certainty
- (3) economy

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2009/CE/11/40

Which of the following statements about the tax system in Hong Kong is correct?

- A. Capital gains from the trading of stocks are subject to capital gains tax.
- B. Rental income from a residential flat in Mainland China is subject to Hong Kong income tax.
- C. Gasoline consumption is not subject to tax.
- D. The estimated rental value of owner-occupied residential flats is not subject to property tax.

2009/CE/11/41

In Hong Kong, citizens are allowed to make their tax payments through the Internet. This practice is in line with the \_\_\_\_\_ principle of taxation put forward by Adam Smith.

- A. equity
- B. certainty
- C. convenience
- D. source

2013/DSE/1/35

In July 2009, the government introduced an environmental levy of 50 cents on each plastic shopping bag at the retail level, with the first phase covering chain or large supermarkets, convenience stores and personal health and beauty product stores. Small shops are exempted in the first phase. Customers can pay the levy, with the original amount of purchase of goods, by credit card, Easy Pay System (EPS) or cash.

The collection of the above environmental levy is **LEAST** in line with the \_\_\_\_\_ principle of taxation put forward by Adam Smith.

- A. equality
- B. economy
- C. convenience
- D. certainty

2020/DSE/1/39

The following is an extract of the mission of the Inland Revenue Department.

Our Mission

We are committed to

- collecting revenue efficiently and cost-effectively
- enabling staff to acquire the necessary knowledge, skills and attitude so that they can contribute their best to the achievement of our vision

The above mission is in line with the \_\_\_\_\_ principle of taxation put forward by Adam Smith.

- A. equality
- B. certainty
- C. convenience
- D. economy

Short & Structured Questions

1990/CE/I/5(a)  
Explain **THREE** principles which a government has to consider when introducing a new tax. (6 marks)

1993/CE/I/5(b)(ii)  
If Mr. Chan rents the flat to a tenant, he will have to pay property tax to the Hong Kong government for the rental income.  
From the view point of the taxpayers, property tax follows certain taxation principles. Give **TWO** such principles. (6 marks)

1999/CE/I/10(c)  
Mr. Ng is a Hong Kong citizen. He sets up a firm in Mainland China and earns profits.  
(i) Explain whether Mr. Ng needs to pay profits tax to the government of Hong Kong. (2 marks)  
(ii) Mr. Ng uses the Hong Kong International Airport when he flies to Mainland China. What tax does he have to pay to the government of Hong Kong? Which taxation principle is applied in this case? (2 marks)

2002/CE/I/8  
State and explain **TWO** principles of taxation put forward by Adam Smith. (4 marks)

2005/CE/I/8  
Apart from 'convenience' and 'economy', explain **TWO** principles of taxation put forward by Adam Smith. (4 marks)

2010/CE/I/6  
Apart from 'certainty' and 'convenience', briefly explain **TWO** taxation principles put forth by Adam Smith. (4 marks)

2014/DSE/II/6(a)  
Karen, a Hong Kong resident, works as a photographer in a media group in Shanghai.  
Would Karen's salary earned in Shanghai be taxed in Hong Kong? Explain your answer. (2 marks)

2017/DSE/II/6(b)  
Suggest **ONE** type of direct tax in Hong Kong that follows the tax principle of 'equality' put forward by Adam Smith.  
Explain your answer. (2 marks)

2018/DSE/II/6(b)  
The government proposes the following changes in the profits tax system.

Profit	Existing system	New two-tier system
On the first \$2 000 000	16.5%	8.25%
Remainder		16.5%

Evaluate the above changes in the tax system in terms of **ONE** principle of taxation put forward by Adam Smith. (2 marks)

**MARKING SCHEME**

1994/CE/II/46 B	2000/CE/II/40 C	2006/CE/II/41 B (59%)	2009/CE/II/41 C (92%)	2020/DSE/II/39 D
1996/CE/II/40 A	2002/CE/II/39 B (62%)	2007/CE/II/41 B (deleted)	2013/DSE/II/35 A (70%)	
1997/CE/II/47 A	2003/CE/II/44 D (54%)	2009/CE/II/40 D (41%)		

*Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.*

1990/CE/I/5(a)  
Equity –  
the rich should pay more than the poor i.e. the tax should be based on the ability to pay (proportional taxation / progressive taxation)  
Certainty –  
the government should state with certainty the tax obligation of the tax-payer, and not arbitrarily interpret or change it  
Convenience –  
the payment of tax should be convenient to the tax-payer and the government  
Economy –  
the cost of collecting and administering the tax should be small in relation to the total tax revenue raised (2@, max: 6)  
[Mark the **FIRST THREE** points only.]

1993/CE/I/5(b)(ii)  
Equality principle –  
property-tax-payers pay taxes in proportion to their rental incomes.  
Convenience principle –  
the payment of property tax is convenient to the taxpayers.  
Certainty principle –  
property-tax-payers know their tax obligation clearly. (3@, max: 6)  
[Mark the **FIRST TWO** points only.]

1999/CE/I/10(c)  
(i) No, because (1)  
(according to the source principle,) the income earned is not derived from H.K. (1)  
(ii) Airport departure tax. (1)  
The certainty principle / convenient principle / economy principle. (1)

2002/CE/I/8

(Equality-)

The tax payments should be in proportion to the taxpayers' income.

(Certainty-)

The tax obligation (e.g., the time of payment, the manner of payment and the tax amount) of the taxpayers should be stated with certainty and not be arbitrarily interpreted or changed by the government.

(Convenience-)

The time and methods of the tax payment should be convenient to the taxpayers.

(Economy-)

The administrative costs of tax collection should be as small as possible relative to its yield. (2@, max: 4)

[Mark the **FIRST TWO** points only.]

2005/CE/I/8

(Equality-)

The tax payments should be in proportion to the taxpayers' income. (2)

(Certainty-)

The tax obligation (e.g., the time of payment, the manner of payment and the tax amount) of the taxpayers should be stated with certainty and not be arbitrarily interpreted or changed by the government. (2)

2010/CE/A/6

(Equality / Equity-) the tax payments should be in proportion to the tax-payers' income. (2)

(Economy-) the administrative costs of tax collection should be as small as possible. (2)

2014/DSE/II/6(a)

No, because (1)

according to the source principle, income not derived from HK would not be taxed by the HK government. (1)

2017/DSE/II/6(b)

Standard tax rate of salaries tax / profits tax / property tax, because every taxpayer has to pay the tax amount in the same proportion to these different sources (salaries / profits / rental income) of his income. (2)

[Mark the **FIRST** point only.]

2018/DSE/II/6(b)

Equality: The new tax is no longer proportional, meaning that it is inconsistent with the equality principle. (2)

Economy: The new tax system may incur a slightly higher administration cost, rendering it less in line with the economy principle. (2)

[Mark the **FIRST** point only.]

### 3.2 TAXATION IN HONG KONG

#### Multiple Choice Questions

1990/CE/II/31

Which of the following are indirect taxes?

- (1) excise duty
- (2) estate duty
- (3) rates
- (4) profits tax

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (4) only
- D. (3) and (4) only

1995/CE/II/44

In July 1994, Mr. Chan bought a new house in Shatin and moved in immediately. In this case, the taxes that Mr. Chan has to pay for the financial year 94-95 are:

- (1) stamp duty
- (2) property tax
- (3) rates

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

1997/CE/II/41

The following are the annual income of Peter in Hong Kong in 1996.

Type of Income	Amount (\$)
Salaries as a teacher in a secondary school	600 000
Interest from local deposits	4 000
Rental income from letting a flat to a Japanese	300 000

According to the taxation system of Hong Kong, Peter has to pay

- A. salaries tax only.
- B. salaries tax and interest tax.
- C. salaries tax and property tax.
- D. salaries tax, interest tax and property tax.

1998/CE/II/40

Mr Chan has the following incomes:

- (1) year-end bonus
- (2) dividend from shares
- (3) capital gain in foreign exchange speculation
- (4) rental income from leased properties

According to the tax system of Hong Kong, which of the above incomes are subject to taxation?

- A. (1) and (2) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (3) and (4) only

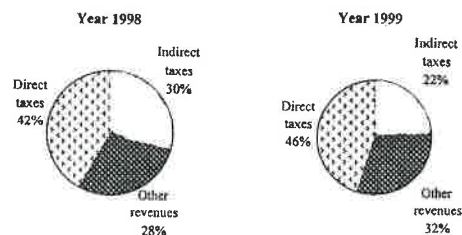
2000/CE/II/42

Which of the following is a direct tax in Hong Kong?

- A. estate duty
- B. rates
- C. interest tax
- D. sales tax

2001/CE/II/37

The following charts show the composition of the General Revenue Account of Hong Kong in 1998 and 1999.



Based on the above data, in the year 1999

- A. the ratio of direct taxes to indirect taxes increased.
- B. the total amount of tax revenue increased.
- C. the proportion of tax revenue in total government revenue increased.
- D. government revenue from rates decreased by 8%.

2002/CE/II/03

Mr Lee lives in his own house. He bears an opportunity cost from living in that house because

- (1) he could earn rental income from letting the house to others.
- (2) he has to pay property tax to the government.
- (3) he has paid a sum of money to buy the house.

- A. (1) only
- B. (1) and (2) only
- C. (1) and (3) only
- D. (2) and (3) only

2004/CE/II/44

Mr. Wong has the following expenses in Hong Kong:

- (1) three nights' room charge for a local hotel
- (2) bets on football at the Hong Kong Jockey Club
- (3) spending on cosmetics for his wife

Which of the above expenses are subject to an indirect tax in Hong Kong?

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2006/CE/II/40

In September 2005, Mr Chan bought 800 HSBC shares at \$120 per share and later sold them at \$130 per share on the Hong Kong stock market.

In this case, which of the following taxes should Mr Chan pay to the government of the HKSAR in the financial year 2005-06?

- A. stamp duty
- B. capital gains tax
- C. profits tax
- D. All of the above.

2008/CE/II/40

The following are Mary's sources of income and wealth in Hong Kong in 2008. Which is subject to taxation in Hong Kong?

- A. the rental income from letting her flat
- B. dividends earned from her shares in a listed company
- C. an estate inherited from her grand father
- D. the interest received from her time deposit in a bank

2010/CE/II/40

In 2009, Mr. Ng has the following kinds of income:

- (1) interest income from his bank deposits
- (2) money left to him by his deceased aunt
- (3) rental income from letting his house

According to the taxation system in Hong Kong, Mr. Ng has to pay

- A. property tax only.
- B. property tax and interest tax only.
- C. interest tax and estate duty only.
- D. estate duty and property tax only.

2012/DSE/I/33

Serine has the following incomes:

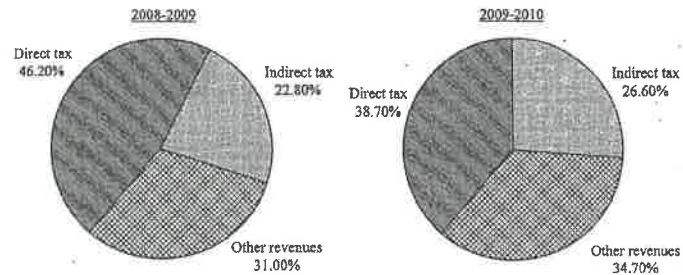
- (1) rental income from a leased flat
- (2) dividends from a local listed company
- (3) a gratuity (酬金) after completion of contract as a manager
- (4) commission received as an agent

According to the tax system of Hong Kong, which of the above incomes are subject to taxation?

- A. (1) and (3) only
- B. (2) and (4) only
- C. (1), (3) and (4) only
- D. (1), (2), (3) and (4)

2012/DSE/I/35

The following charts show the composition of the General Revenue Account of Hong Kong in years 2008-2009 and 2009-2010.



Based on the above data, in the year 2009-2010,

- A. there was an economic recession in Hong Kong.
- B. the ratio of direct taxes to indirect taxes increased.
- C. the total amount of tax revenue decreased.
- D. the proportion of tax revenue in total government revenue decreased.

2015/DSE/I/34

Which of the following are indirect taxes in Hong Kong?

- (1) Property tax
- (2) Rates on property
- (3) Stamp duty on transfer of stock
- (4) General sales tax

- A. (1) and (2) only
- B. (2) and (3) only
- C. (1), (3) and (4) only
- D. (2), (3) and (4) only

2016/DSE/I/35

Mr Lam earns \$1 000 000 as a mobile app designer of an IT firm in Hong Kong. Also, he earns a \$50 000 dividend by holding shares issued by a local company. He buys a second-hand racing car and flies to the Maldives to spend his vacation through the Hong Kong International Airport.

Based on the above information, Mr Lam needs to pay \_\_\_\_\_ to the Hong Kong government.

- (1) salaries tax
- (2) dividend tax
- (3) first registration tax
- (4) air passenger departure tax

- A. (1) and (4) only
- B. (2) and (3) only
- C. (1), (2) and (4) only
- D. (1), (3) and (4) only

2018/DSE/I/40

A Hong Kong resident works for a Mainland company located in Shenzhen and he earns a monthly wage. He receives dividend from Hang Seng Bank and rental income from a leased apartment in Mongkok as well. He took a flight to Seoul departing from the Hong Kong International Airport last month. Which type(s) of direct tax does he need to pay in Hong Kong?

- (1) property tax
- (2) profits tax
- (3) salaries tax
- (4) air passenger departure tax

- A. (1) only
- B. (1) and (4) only
- C. (1), (2) and (3) only
- D. (2), (3) and (4) only

2020/DSE/I/40

Mr. Chan runs a factory in mainland China and earns a huge profit. Recently he has bought a flat and a second hand electric car in Hong Kong, and received dividends from his shares of HSBC.

According to the above information, which type(s) of tax does he need to pay to the Hong Kong government?

- (1) Property tax
- (2) Stamp duty
- (3) Profits tax
- (4) First registration tax

- A. (2) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (1), (3) and (4) only



Mr Li is a major shareholder of a Hong Kong listed company which makes huge profits. He has sold some of his residential properties, and received rental income from some leased commercial buildings.

According to the above information, which types of tax does Mr Li need to pay to the Hong Kong government?

- (1) profits tax  
(2) stamp duty  
(3) property tax
- A. (1) and (2) only  
B. (1) and (3) only  
C. (2) and (3) only  
D. (1), (2) and (3)

### Short & Structured Questions

1991/CE/I/1(a)

The following table gives the relative share of different sources of government revenue in Hong Kong:

Fiscal Year	Direct Taxes (%)	Indirect Taxes (%)	Other Sources (%)
85/86	35.4	25.8	38.8
86/87	35.6	28.7	35.7
87/88	37.0	28.5	34.5
88/89	41.0	26.0	33.0
89/90	43.0	24.0	33.0

- (i) Give **ONE** example of **EACH** source of government revenue. (3 marks)
- (ii) Based on the above data, what was the trend of the relative share of direct taxes in government revenue over the five years? (2 marks)
- (iii) Explain how **EACH** of the following would affect the relative share of indirect taxes in government revenue:
- (I) the introduction of a sales tax (4 marks)
- (II) a recession in Hong Kong (8 marks)

1994/CE/I/7

(a) State whether each of the following taxes is a direct tax or an indirect tax:

- (i) property tax  
(ii) rates

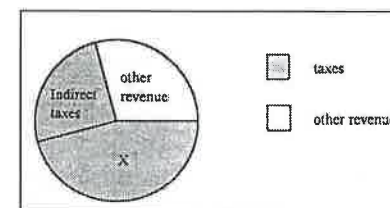
(2 marks)

(b) Explain the difference in the tax incidence between property tax and rates.

(4 marks)

1997/CE/I/7

The following figure shows different sources of government revenue in Hong Kong.



- (a) Name X. (1 mark)
- (b) Explain why the government revenue from the source X is unstable. (4 marks)

2003/CE/I/8

Give **TWO** reasons to explain why the direct tax revenue of the Hong Kong government would decrease in times of economic recession. (4 marks)



2004/CE/1/9(a)

Hong Kong is facing a huge fiscal deficit and deflation.

Explain how government expenditure and government revenue are affected by Hong Kong's

(i) economic downturn.

(4 marks)

(ii) ageing population.

(4 marks)

2005/CE/1/11(b)

Two measures included in the Closer Economic Partnership Arrangement or 'Cepa' are:

- I. Zero tariff on 90% of Hong Kong-made products to the Chinese mainland
- II. Faster / easier market entry to the Chinese mainland for Hong Kong-based service providers in 18 service sectors

As a result, overseas companies not based in Hong Kong can take advantage of Cepa by partnering with a Cepa-qualified manufacturer or service provider in Hong Kong.

Source : Hong Kong SAR Government, 8 January 2005

Explain how the above measures would affect the direct tax revenue of Hong Kong.

(4 marks)

2006/CE/1/11(b)

There are two issues for discussion concerning the public finance of Hong Kong : 'the tax base is narrow' and 'the government revenue is unstable'.

(i) (I) Suppose a general sales tax is introduced in Hong Kong. Explain its effect on the tax base of Hong Kong.

(2 marks)

(ii) Explain how the government revenue generated from profits tax and salaries tax would be affected when there is a strong economic recovery.

(4 marks)

2007/CE/1/9

General sales tax has generated a lot of discussion.

(a) Explain how the introduction of a general sales tax will affect the ratio of direct to indirect tax revenue (i.e., direct for revenue divided by indirect for revenue) in an economy.

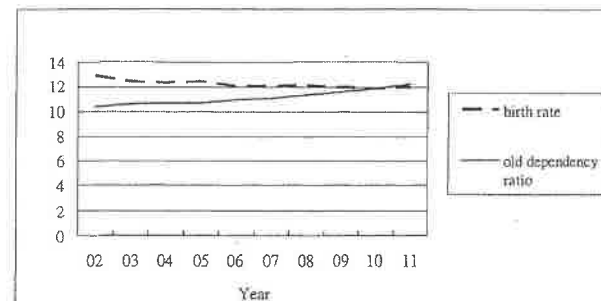
(2 marks)

(b) Suppose economic depression occurs in an economy with a general sales tax. Explain how the economic depression will affect the ratio of direct to indirect tax revenue in this economy.

(5 marks)

2014/DSE/11/10(a)

Aging is a serious problem in China. Source 1 below shows the trends of the old dependency ratio\* and the birth rate\*\* of China from 2002 to 2011.



\* Old dependency ratio refers to the ratio of the elderly population to the working-age population (expressed in percentage)

\*\* Birth rate refers to the total number of births per 1 000 population.

With reference to the trends shown in Source 1, briefly discuss the possible changes on

(i) government tax revenue in the future.

(ii) public health and welfare expenditure in the future.

(4 marks)

2015/DSE/11/11(b)

An accountant commented that the tax base of Hong Kong is narrow and suggested the government should introduce new types of indirect tax. Explain, with **ONE** example, how the introduction of a new indirect tax would broaden the tax base.

(2 marks)

2017/DSE/11/6(a)

Why can the introduction of a general sales tax stabilise government revenue in times of economic downturn?

(2 marks)

2019/DSE/11/10

The following table shows the changes in the individual income tax system in China effective from October 2018.

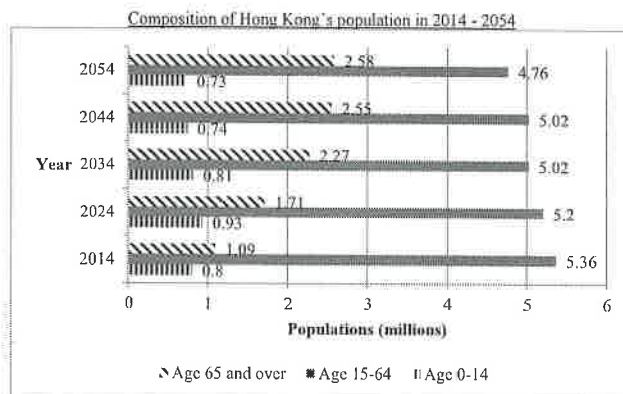
Average tax rate	Range of monthly taxable income, in Renminbi (RMB)	
	Old brackets	New brackets
3%	Less than or equal to 1500	Less than or equal to 3000
10%	1501 – 4500	3001 – 12000
20%	4501 – 9000	12001 – 25000
25%	9001 – 35000	25001 – 35000
30%	35001 – 55000	Unchanged
35%	55001 – 80000	Unchanged
45%	Greater than 80000	Unchanged

(a) Is the individual income tax in China progressive, proportional, or regressive? Explain your answer.

(2 marks)

2018/DSE/II/13(a)(ii)

The source below shows Hong Kong's population projection.



With reference to the above source, briefly discuss the possible effects of the change in composition of population on fiscal balance in the future. (3 marks)

#### MARKING SCHEME

1990/CE/II/31 B	2000/CE/II/42 A	2006/CE/II/40 A (40%)	2012/DSE/I/35 D (69%)	2020/DSE/I/ A
1995/CE/II/44 B	2001/CE/II/37 A	2008/CE/II/40 A (66%)	2015/DSE/I/34 B (20%)	2021/DSE/II/41 C
1997/CE/II/41 C	2002/CE/II/03 A (50%)	2010/CE/II/40 A (59%)	2016/DSE/I/35 A (57%)	
1998/CE/II/40 B	2004/CE/II/44 A (34%)	2012/DSE/I/33 C (56%)	2018/DSE/I/40 A (24%)	

Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.

1991/CE/II/1(a)

(i) Give 1 mark to a correct example of each of the three sources of government revenue. (3)

Direct taxes: salaries tax, profits tax, property tax

Indirect taxes: rates, motor vehicles first registration tax, tobacco duty, etc.

Other revenue: revenue from land sales, fines & penalties, fees and charges collected from different types of licences, etc.

(Mark only the **FIRST** example of each source.)

(ii) Increased (2)

(iii) (I) Sales tax is an indirect tax in consumer expenditure. (2)

∴ the relative share of indirect taxes increases. (2)

(II) Recession ⇒ income ↓ ⇒ direct tax revenue ↓ (3)

Recession ⇒ income ↓ ⇒ consumption ↓ ⇒ indirect tax revenue ↓ (3)

Recession ⇒ other revenue, e.g. revenue from land sales, may decrease. (2)

The relative share of indirect taxes will increase / decrease / remain unchanged, depending on the magnitude of the changes of the three sources of government revenue (2)

(max: 8)

1994/CE/II/7

(a) (i) Property tax - direct tax (1)

(ii) Rates - indirect tax (1)

(b) Property tax: the tax burden can't be shifted from the property owner onto the lessee (2)

Rates: the tax burden can be shifted onto the lessee (2)

1997/CE/II/7

(a) Direct taxes (1)

(b) Direct taxes (e.g. salaries tax and profits tax) vary with income / are progressive or proportional to incomes (earnings and profits). (2)

∴ When economic conditions change (good), incomes will change (high), direct tax revenue will also change (high). (2)

2003/CE/II/8

Unemployment ↑ or salary cuts ⇒ salaries tax revenue ↓

Less profits earned or some firms closed down ⇒ profits tax revenue ↓

Rental income ↓ or less tenants ⇒ property tax revenue ↓

[Mark the **FIRST TWO** points only.] ((1+1)@, max: 4)

2004/CE/II/9(a)

(i) Economic downturn

⇒ ↑ expenditure on public assistance, unemployment benefits (1)

⇒ government expenditure ↑ (1)

Economic downturn

⇒ more people become unemployed ⇒ salaries ↓, profits ↓, rental income ↓ (1)

⇒ government revenue ↓ (1)

(ii) Ageing population

⇒ ↑ demand for social services (1)

⇒ government expenditure ↑ (1)

Ageing population

⇒ declining proportion of the population in the workforce (1)

⇒ government revenue ↓ (1)

2005/CE/II/11(b)

Increase in investment will increase employment,  
and thus increase salaries tax revenue.

More businesses will increase profit,  
and thus increase profits tax revenue.

Increase in demand for office premises will increase rental income,  
and thus increase property tax revenue.

(1)  
(1)  
(1) (max: 3)  
(1)  
(1)  
(1)

∴ increase in direct tax revenue

(1)

2006/CE/II/11(b)

(i) (1) [Providing that consumption expenditure, profit, employment, salaries will not be greatly adversely affected,]

The tax base will be widened because

most goods and services are untaxed before the introduction of the GST but will be subject to tax under the GST. (1)

(1)

(ii) Employment ↑ ⇒ wages ↑

(1)

⇒ salaries tax revenue ↑

(1)

More business / investment ↑ ⇒ profits ↑

(1)

⇒ profits tax revenue ↑

(1)

2007/CE/II/9

(a) The ratio of direct to indirect tax revenue will fall, because  
the indirect tax revenue will increase

(1)

(1)

(b) Economic recession has the following phenomena:

Employment & wages ↓ / profits ↓

⇒ Direct tax revenue ↓ (e.g. profits tax revenue ↓ / salaries tax revenue ↓)

(2)

Private consumption ↓ / transaction volume and price of property and shares ↓

⇒ Indirect tax revenue ↓ (e.g. general sales tax revenue ↓ / revenue from stamp duty ↓)

(2)

However, consumption expenditure being generally less volatile than income may lead to a decrease in the ratio of direct to indirect tax revenue.

(1)

2014/DSE/II/10(a)

(i) A declining birth rate implies a slower growth in the size of the work force and possibly a shrinking working population in the future. As fewer workers are there to pay taxes, future tax revenue may be reduced.

(2)

(ii) A rising old-age dependency ratio implies higher percentage of the elderly in the population. The elderly may have lower (or even zero) income and greater needs for medical services. They may thus require more government support in terms of social welfare and public health, implying an increase in public expenditure on such programs.

(2)

2015/DSE/II/11(b)

Introduction of new types of indirect taxes, such as general sales tax or value-added tax,  
would make more people or commodities fall into the tax net, thus broadening the tax base.

(1)

(1)

2017/DSE/II/6(a)

Fluctuation in consumption is smaller than that of income. Sales-tax revenue generated from consumption would fall (proportionately) less than income-tax revenue generated from income, thus stabilizing total government revenue, during economic downturn.

(2)

**OR**

Introduction of a general sales tax broadens the tax base, so that the tax revenue collected would fluctuate less.

(2)

2018/DSE/II/13(a)(ii)

The fiscal balance may be worsened.

(1)

Government revenue may drop, as the working-age population, which accounts for a major portion of taxpayers, drops.

(1)

Government expenditure may increase, as the government spends more on medical services and transfer payments to the growing old-age population.

(1)

2019/DSE/II/10

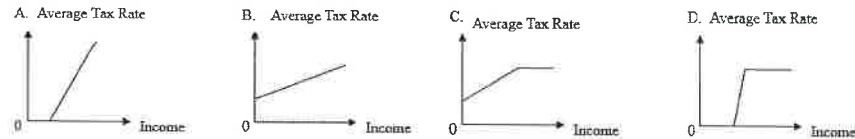
(a) It is a progressive tax because higher average tax rate is charged for tax payers with higher income.

### 3.3 CLASSIFICATION AND EFFECTS OF TAXES

#### Multiple Choice Questions

1990/CE/II/47

Which of the following diagrams approximates the structure of salaries tax in Hong Kong?



1990/CE/II/55

Mei Ling's income has increased from \$50 000 to \$60 000 this year. The income tax is progressive if it increases from

- A. \$1 000 to \$1 200
- B. \$2 000 to \$2 500
- C. \$3 000 to \$3 600
- D. \$4 000 to \$4 700

1991/CE/II/37

A sales tax on food is regarded as \_\_\_\_\_ tax.

- A. a direct and regressive
- B. an indirect and regressive
- C. a direct and proportional
- D. an indirect and progressive

1992/CE/II/36

Suppose the government asks everybody to pay a tax of \$100 a year. This is an example of

- A. regressive tax.
- B. proportional tax.
- C. income tax.
- D. indirect tax.

1993/CE/II/45

Which of the following is a correct description of direct tax?

- A. Direct tax is regressive.
- B. The cost of collecting direct tax is greater than that of indirect tax.
- C. The revenue from direct tax will drop if there is a recession.
- D. Raising direct tax rates will lead to inflation.

1994/CE/II/47

If the amount of tax increases as income increases, the tax may be considered a \_\_\_\_\_ tax.

- (1) progressive
- (2) proportional
- (3) regressive

- A. (1) only
- B. (1) or (2)
- C. (2) or (3)
- D. (1) or (2) or (3)

1995/CE/II/45

Direct taxes differ from indirect taxes in that

- A. direct taxes are collected directly from the taxpayers but indirect taxes are not.
- B. direct taxes are progressive whereas indirect taxes are regressive.
- C. the tax burden of direct taxes cannot be shifted but that of indirect taxes can.
- D. the direct tax revenue fluctuates with national income but the indirect tax revenue does not.

1995/CE/II/46

Study the following information carefully:

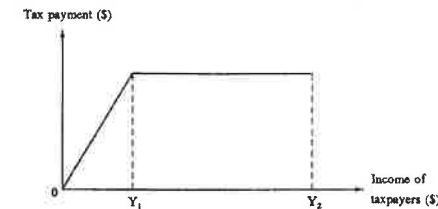
Taxable income (\$)	Total tax payment (\$)
10 000	1 000
20 000	3 000
30 000	x

If the tax is progressive, x must be larger than

- A. 3 000.
- B. 3 500.
- C. 4 000.
- D. 4 500.

1995/CE/II/48

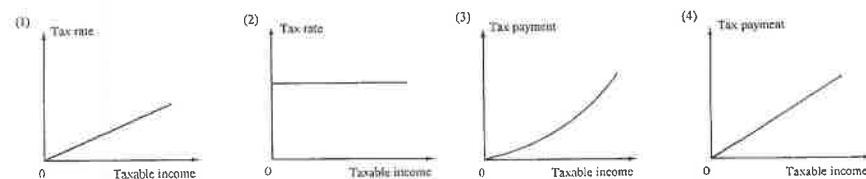
The following diagram shows the tax structure of Tax X:



Tax X is \_\_\_\_\_ within the income range OY<sub>1</sub>, and \_\_\_\_\_ within the income range Y<sub>1</sub>Y<sub>2</sub>.

- A. proportional ..... progressive
- B. proportional ..... regressive
- C. progressive ..... proportional
- D. progressive ..... regressive

1996/CE/II/41



Which two of the following diagrams describe a progressive tax?

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

1996/CE/II/44

Suppose that inflation occurs and that money income increases at the same rate as inflation. A taxpayer under a proportional tax system will pay

- (1) a larger amount of tax.
  - (2) the same amount of tax.
  - (3) more tax in terms of purchasing power.
  - (4) the same amount of tax in terms of purchasing power.
- A. (1) and (3) only
  - B. (1) and (4) only
  - C. (2) and (3) only
  - D. (2) and (4) only

1997/CE/II/40

The below tax is a

Taxable income (\$)	Tax payment (\$)
10 000	4 000
20 000	7 000
30 000	9 000
40 000	10 000

- A. progressive tax.
- B. proportional tax.
- C. regressive tax.
- D. lump-sum tax.

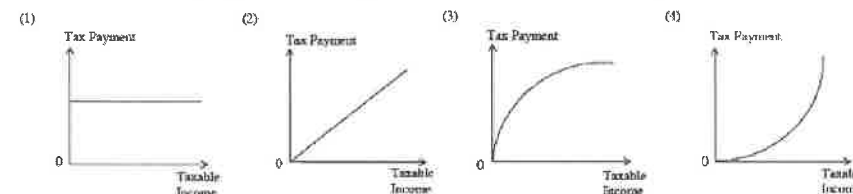
1998/CE/II/39

Which of the following statements about tax is correct?

- A. Progressive tax has higher tax rate than regressive tax.
- B. Progressive tax is tax on income while regressive tax is a tax on goods.
- C. The tax payment of a regressive tax decrease as the taxable income increases.
- D. The percentage of income as tax of a progressive tax increases when taxable income increases.

2000/CE/II/41

Which two of the following diagrams illustrate a regressive tax measured in terms of an average tax rate?



- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

2000/CE/II/43

Taxable income (\$)	Tax payment (\$)
200 000	22 000
250 000	25 000
300 000	27 000

From the above information, we can conclude that

- A. The tax is a progressive tax as the tax payment increases with taxable income.
- B. The tax payment takes a decreasing portion of taxable income as taxable income increases.
- C. The taxation system helps to reduce the income gap.
- D. The taxation system reduces the work incentive.

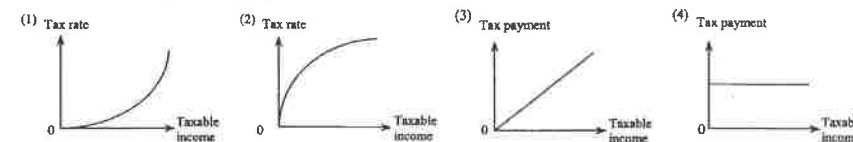
2002/CE/II/43

Tobacco duty in Hong Kong is a kind of

- A. direct and proportional tax.
- B. direct and regressive tax.
- C. indirect and proportional tax.
- D. indirect and regressive tax.

2003/CE/II/38

Which of the following taxes are progressive?



- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (4) only
- D. (3) and (4) only

2004/CE/II/41

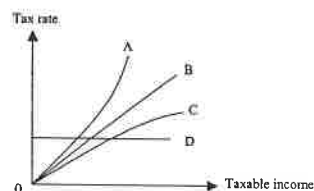
Taxable income (\$)	Tax payment (\$)		
	Tax A	Tax B	Tax C
10 000	500	800	1 000
20 000	1 000	1 700	1 000
30 000	1 500	2 700	1 000

According to the above table, which of the following statements is correct?

- A. None of the above taxes is a regressive tax.
- B. The taxation principle of equity put forth by Adam Smith applies to all the above taxes.
- C. Tax A is the most effective in achieving a more even income distribution.
- D. Tax B is a progressive tax.

2004/CE/II/42

Which of the following lines A, B, C or D shows the relationship between the tax rate and the taxable income under the profits tax system in Hong Kong?



- A. line A
- B. line B
- C. line C
- D. line D

2005/CE/II/39

Study the following data:

Taxable income (\$)	Tax amount (\$)
0	0
10 000	1 500
20 000	x

If the above tax is progressive, the value of x must be

- A. smaller than 3 000.
- B. equal to 3 000.
- C. greater than 3 000.
- D. There is not sufficient information to do the calculation.

2005/CE/II/40

Which of the following is/are the difference(s) between a direct tax and an indirect tax?

- A. The tax burden of a direct tax cannot be shifted onto other people, but the tax burden of an indirect tax can.
- B. A direct tax results in a more even income distribution, but an indirect tax results in a less even income distribution.
- C. The tax base of direct taxes is narrower, but the tax base of indirect taxes is broader.
- D. All of the above are correct.

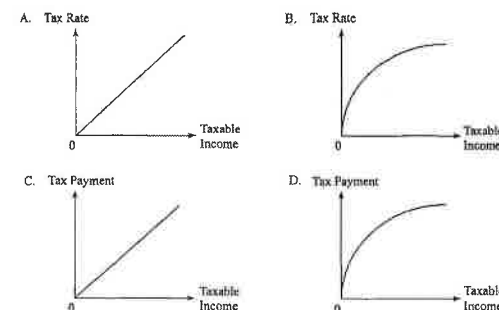
2007/CE/II/40

Which of the following taxes in Hong Kong is both 'direct' and 'progressive'?

- A. stamp duty
- B. profits tax
- C. property tax
- D. salaries tax

2008/CE/II/43

Which of the following diagrams describes a regressive tax?



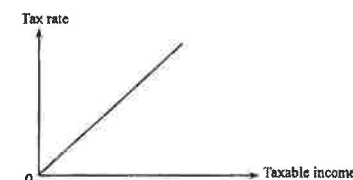
2009/CE/II/42

An economy levies a 5% general sales tax on all goods and services. This tax is a/an

- A. proportional tax as everyone will pay 5% of their expenditure on goods and services as tax.
- B. progressive tax as the tax payment increases with the price of the goods and services.
- C. regressive tax as the proportion of tax payment to income decreases when income increases.
- D. indirect tax as consumers indirectly bear all the tax burden.

2009/CE/II/43

Refer to the following relationship between the tax rate and the taxable income of a certain tax.



Which of the following statements is correct?

- A. The taxation principle of equity put forth by Adam Smith applies to this tax.
- B. The tax rate remains constant when the taxable income increases.
- C. The imposition of this tax would lead to an increase in the ratio of indirect tax revenue to direct tax revenue.
- D. When the taxable income increases, the percentage increase of the tax payment is greater than the percentage increase of the taxable income.



2010/CE/II/41

Taxable income (\$)	Tax Payment (\$)	
	Tax System A	Tax System B
100 000	4 000	5 000
200 000	4 000	10 000
300 000	4 000	15 000

Refer to the above data. Tax system A is \_\_\_\_\_ while tax system B is \_\_\_\_\_.

- A. proportional ..... progressive
- B. progressive ..... proportional
- C. regressive ..... proportional
- D. regressive ..... progressive

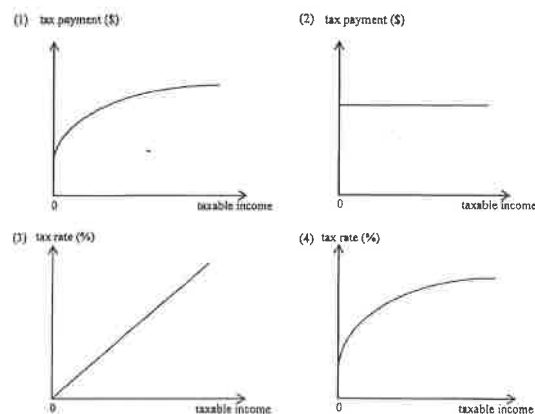
2014/DSE/II/36

The government plans to impose a new tax under which the tax payment drops when taxable income drops. Which of the following statements about the new tax is correct?

- A. The tax is regressive as the tax rate increases when the taxable income drops.
- B. The tax is proportional as the taxable income and the tax payment are positively related.
- C. The tax cannot be progressive as the tax rate increases when the tax payment drops.
- D. The tax can be progressive, proportional or regressive.

2017/DSE/II/35

Which of the following diagrams describe a regressive tax?



- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (4) only
- D. (3) and (4) only

1990/CE/II/59

Which of the following is **INCORRECT** if a general sales tax is imposed in Hong Kong?

- A. The fluctuations of government tax revenue will be reduced
- B. The proportion of direct tax in the government tax revenue will increase
- C. There will be a redistribution of income
- D. The general price level will increase

1991/CE/II/37

A sales tax on food is regarded as \_\_\_\_\_ tax.

- A. a direct and regressive
- B. an indirect and regressive
- C. a direct and proportional
- D. an indirect and progressive

1991/CE/II/39

Income (\$)	Tax Amount (\$)	
	Policy A	Policy B
10 000	1 000	1 000
50 000	5 000	4 000
100 000	10 000	7 000
500 000	50 000	30 000

Which of the following is likely to take place if the government changes from Policy A to Policy B?

- A. less incentive to work
- B. more uneven income distribution
- C. a lower rate of economic growth
- D. a fall in the consumption expenditure

1991/CE/II/43

In the financial year 1990-91, the government increased the tax allowance by about 5%. The inflation rate at the same period was about 10%. Which one of the following was a consequence of the above situation?

- A. The government had to introduce a sales tax.
- B. More people fell into the tax net.
- C. The real income of Hong Kong people increased.
- D. The government collected more indirect tax revenue.

1993/CE/II/46

Taxpayers with the same net chargeable income paid different amounts of tax in the two fiscal years 1990/91 and 1991/92. Several examples are shown below to illustrate this:

Total net chargeable income (\$)	Total tax payment (\$) for the fiscal year of	
	1990/91	1991/92
10 000	200	200
20 000	600	400
30 000	1 500	1 300
40 000	2 700	2 200
50 000	4 200	3 900
60 000	6 000	5 600
70 000	8 100	8 100
80 000	10 600	10 600

How does the change in the total tax payment affect the income distribution in Hong Kong?

- A. It gives a more even income distribution.
- B. It gives a more uneven income distribution.
- C. It has no effect on income distribution.
- D. The effect on income distribution is uncertain.



1993/CE/II/47

If the government increases the personal allowance on the salaries tax, then

- A. the taxpayers paying at the standard tax rate will have a higher work incentive.
- B. we are not certain how the total tax revenue will change.
- C. the government will have to cut its expenditure.
- D. the tax base will be widened.

1993/CE/II/48

Which of the following government measures will increase the inequality of wealth distribution in Hong Kong?

- A. removing the tax on soft drinks
- B. selling more flats under the Home Ownership Scheme at lower prices
- C. increasing fees for medical service in government hospitals
- D. increasing the personal allowance on the salaries tax

1994/CE/II/48

The aim of the Hong Kong government in increasing the proportion of indirect taxes to total taxation is to

- A. increase the total tax revenue.
- B. stabilize the tax revenue in different phases of a business cycle.
- C. narrow the gap between the rich and the poor.
- D. narrow the tax base.

1996/CE/II/43

Which of the following will lead to a more uneven income distribution?

- A. decreasing the sales tax rate
- B. imposing more indirect taxes on luxuries
- C. increasing the housing allowance of senior civil servants
- D. increasing the standard tax rate of the salaries tax

1996/CE/II/45

Which of the following statements is true about progressive tax in Hong Kong?

- A. It will lead to a more uneven distribution of income.
- B. It is a tax levied on good and services.
- C. The tax burden can be shifted.
- D. It may discourage working incentive.

1997/CE/II/45

Suppose the Hong Kong government increases the salaries tax allowance by 5% while both the wage rates and the inflation rate of the economy in the year increase by 10%. It follows that

- A. more people would fall into the tax net.
- B. the ratio of tax payment to income would decrease.
- C. the tax revenue would increase and the income distribution would be more even.
- D. the real income of the people after tax would remain unchanged.

1998/CE/II/37

A progressive tax is more effective than a proportional tax in achieving the following aim:

- A. to increase government revenue
- B. to lower the administrative costs of the government
- C. to achieve a more equitable income distribution
- D. to reallocate the resources of the economy

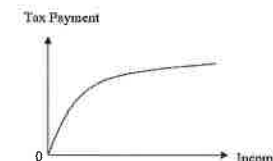
1998/CE/II/42

If the government of Hong Kong raises the tax allowance on the salaries tax,

- A. the income distribution will be more uneven.
- B. less people will fall into the tax net.
- C. the working incentive of those paying at the standard tax rate will increase.
- D. the tax bands will be widened.

1999/CE/II/40

The following diagram shows a tax system:



Which of the following statements concerning the above tax is correct?

- A. It is a progressive tax as the tax payment increases when income increases.
- B. It would lead to an uneven distribution of income.
- C. It would encourage the working incentive of workers.
- D. The progressivity of the tax rate will increase when income rises.

1999/CE/II/42

During a recession, the refund of rates by the government to the people would

- A. lead to a more efficient allocation of resources.
- B. decrease the foreign exchange and gold reserves of Hong Kong.
- C. increase the incentive to invest.
- D. increase the consumption expenditure of the lower income group.

1999/CE/II/43

Which of the following government policies would lead to more even distribution of income?

- A. lowering the tax rates of regressive taxes
- B. imposing more indirect taxes on necessities
- C. increasing the depreciation allowance of the profits tax.
- D. reducing the standard tax rate of the salaries tax

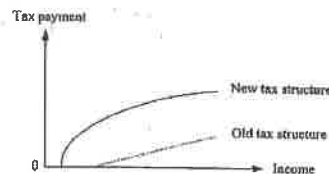
1999/CE/II/44

If the income of Hong Kong people falls by 5% in a fiscal year,

- more people will fall into the tax net.
- the tax bands of the salaries tax will be narrowed.
- the government revenue from the salaries tax will fall by more than 5%.
- the wealth distribution of people in Hong Kong will remain unchanged.

2001/CE/II/35

The following graph shows the relationship between tax payment and income before and after a change in the structure of a tax.



Compared to the old tax structure, the new tax structure

- results in a less even income distribution.
- has a lower tax rate for the same level of income.
- has a larger tax allowance.
- has no effect on working incentive.

2001/CE/II/36

Taxable Income (\$)	Tax Payment Under Tax A (\$)	Tax Payment Under Tax B (\$)
10 000	1 500	2 000
20 000	3 800	3 800
30 000	6 600	5 400

From the above data, we can conclude that

- Tax A is a direct tax and Tax B is an indirect tax.
- there would be a more even income distribution under Tax A.
- the tax rate of Tax A is lower than that of Tax B for all levels of income.
- the fluctuations of government tax revenue would be smaller under Tax A than under Tax B when income fluctuates.

2001/CE/II/39

Which of the following will widen the tax base of Hong Kong?

- an increase in the tax allowance
- a decrease in the standard tax rate
- an increase in the profits tax rate
- the introduction of a sales tax

2002/CE/II/40

If a general sales tax is introduced in Hong Kong,

- the tax base would be widened.
- the wealth gap would be reduced.
- less Hong Kong people would shop in Shenzhen.
- the proportion of direct tax in the government tax revenue would increase.

2002/CE/II/42

Suppose the government of an economy cuts the salaries tax allowance by 10% while both the wage rates and the general price level in the year fall by 5%. It follows that

- the tax revenue would increase.
- more people would fall into the tax net.
- the real income of people before tax would generally increase.
- the ratio of people's tax payment to their nominal income would generally decrease.

2003/CE/II/39

Suppose the salaries tax allowance in Hong Kong decreases and the salaries of taxpayers remain constant. It results that

- some taxpayers paying at the standard tax rate may pay at a lower tax rate.
- the middle-income group would have to pay a larger proportion of their income as tax.
- less people would fall into the tax net.
- the after-tax income of all taxpayers would decrease.

2003/CE/II/40

If the government raises the profits tax rate,

- the government revenue will increase.
- the unemployment rate will fall.
- the incentive for investment will decrease.
- the general price level will rise.

2003/CE/II/41

The following table describes a tax:

Taxable Income (\$)	Tax Payment (\$)
10 000	2 000
20 000	3 800
30 000	5 400
40 000	6 800
50 000	8 000

The above tax would

- lead to a less even distribution of income.
- reduce the working incentive of workers.
- improve the resource allocation of the economy.
- increase the consumption expenditure of the lower income group.

2004/CE/II/41

Taxable income (\$)	Tax payment (\$)		
	Tax A	Tax B	Tax C
10 000	500	800	1 000
20 000	1 000	1 700	1 000
30 000	1 500	2 700	1 000

According to the above table, which of the following statements is correct ?

- None of the above taxes is a regressive tax.
- The taxation principle of equity put forth by Adam Smith applies to all the above taxes.
- Tax A is the most effective in achieving a more even income distribution.
- Tax B is a progressive tax.

2004/CE/II/43

Suppose there is a change in an income tax as follows:

Marginal Tax Band	Marginal Tax Rate (%)	
	Old System	New System
First \$30 000 taxable income	2.0	2.0
Next \$30 000	7.5	8.0
Next \$30 000	13.0	14.0
Remainder	18.5	20.0

Under the new system,

- A. the ratio of direct tax revenue to indirect tax revenue will decrease.
- B. the government will have a budget surplus.
- C. more people will fall into the tax net.
- D. the income gap will be reduced.

2005/CE/II/41

Which of the following government policies would lead to a less even income distribution of Hong Kong citizens?

- A. raising the standard tax rate of the salaries tax
- B. reducing the personal allowance of the salaries tax
- C. raising the profits tax rate
- D. lowering the excise tax rate of tobacco and wine

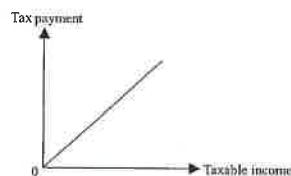
2005/CE/II/42

The introduction of a general sales tax would lead to

- A. inflation.
- B. lower output.
- C. higher consumption expenditure.
- D. higher GDP.

2005/CE/II/43

Refer to the following relationship between the tax payment and the taxable income of a certain tax.



Which of the following is correct?

- A. The above tax would lower the working incentives of workers.
- B. The above tax is in accordance with the equality principle put forth by Adam Smith.
- C. The tax allowance for the above tax is zero.
- D. Every employee has to pay the above tax.

2006/CE/II/39

Suppose the salaries tax of an economy changes from tax system A to tax system B.

Taxable income	System A	System B
	Marginal tax rate	Marginal tax rate
First \$20 000	3%	2%
Next \$20 000	6%	5%
Next \$20 000	10%	8%
Remainder	15%	12%

As a result,

- A. less people would fall into the tax net.
- B. the working incentive of workers would increase.
- C. the income gap would be reduced.
- D. the ratio of direct tax revenue to indirect tax revenue would increase.

2006/CE/II/42

Which of the following would widen the tax base of Hong Kong?

- A. a reduction in the tax allowance
- B. abolition of the first registration tax on motor vehicles
- C. an increase in the progressivity of salaries tax
- D. an increase in the profits tax rate

2007/CE/II/42

Taxable income (\$)	Tax Payment (\$)	
	Tax System A	Tax System B
100 000	6 000	5 000
200 000	12 000	12 000
300 000	18 000	21 000

Refer to the above data. When the tax system changes from A to B,

- A. the income gap between the rich and the poor will be reduced.
- B. the work incentive of workers will increase.
- C. the tax base of the economy will be widened.
- D. the government budget position will be improved.

2007/CE/II/43

In order to increase the competitiveness of Hong Kong, some businessmen propose to reduce the profits tax rate. When the profits tax rate decreases,

- A. the foreign exchange and good reserve of Hong Kong would increase.
- B. the investment incentive would increase.
- C. the government tax revenue would decrease.
- D. the size of the public sector would decrease.

2008/CE/II/41

When the government reduces the profits tax rate,

- A. the unemployment rate will increase.
- B. the investment incentive will increase.
- C. the government tax revenue will decrease.
- D. the income inequality will be reduced.

2008/CE/11/44

Suppose the salaries tax system of Hong Kong changes as follows:

Old System		New System	
Marginal Tax Band	Tax Rate (%)	Marginal Tax Band	Tax Rate (%)
First \$30 000 taxable income	2.0	First \$40 000 taxable income	2.0
Next \$30 000	7.0	Next \$40 000	7.0
Next \$30 000	13.0	Next \$40 000	13.0
Remainder	19.0	Remainder	19.0
Standard Rate	16.0	Standard Rate	16.0

Under the new system, with the salaries of all taxpayers unchanged

- A. fewer people will fall into the tax net.
- B. fewer people will have to pay at the standard rate.
- C. the income gap will not be affected.
- D. the government will run into a budget deficit.

2009/CE/11/42

An economy levies a 5% general sales tax on all goods and services. This tax is a/an

- A. proportional tax as everyone will pay 5% of their expenditure on goods and services as tax.
- B. progressive tax as the tax payment increases with the price of the goods and services.
- C. regressive tax as the proportion of tax payment to income decreases when income increases.
- D. indirect tax as consumers indirectly bear all the tax burden.

2009/CE/11/44

In the financial year of 2008-09, the standard rate of salaries tax was reduced from 16% to 15%. Other things being equal, the above measure would

- A. reduce the number of people falling into the tax net.
- B. increase the progressivity of the salaries tax system of Hong Kong.
- C. increase the consumption expenditure of people in Hong Kong.
- D. increase the after tax income of low-income people in Hong Kong.

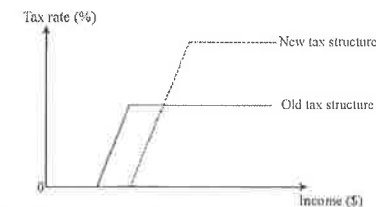
2010/CE/11/42

There was a one-off tax reduction up to a maximum of \$6 000 on the salaries tax and the tax under personal assessment for 2008-09. This would

- A. reduce the income gap between the rich and the poor.
- B. narrow the tax base of Hong Kong.
- C. increase the working incentive of those paying at the standard tax rate.
- D. increase the consumption expenditure of those entitled to the tax reduction.

2013/DSE/1/36

The following diagram shows the change in the salaries tax structure of an economy.

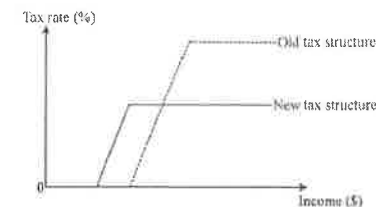


Compared to the old salaries tax structure, the new tax structure

- A. has a smaller personal allowance.
- B. has a lower standard tax rate.
- C. will narrow the income gap between the rich and the poor.
- D. will widen the tax base.

2016/DSE/1/36

The following diagram shows the changes in the salaries tax structure of an economy.



Compared to the old tax structure, the new tax structure will

- A. result in a more even income distribution
- B. reduce the work incentive of all workers
- C. broaden the tax base
- D. lead to an increase in total tax revenue

2018/DSE/1/35

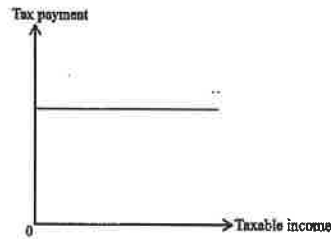
Suppose the salaries tax system in Hong Kong has the following changes:

Old System		New System	
Net chargeable income	Tax rate	Net chargeable income	Tax rate
First \$50 000	2%	First \$60 000	2%
Next \$50 000	7%	Next \$60 000	7%
Next \$50 000	12%	Next \$60 000	12%
Remainder	17%	Remainder	17%
Standard Rate	15%	Standard Rate	15%

If the basic tax allowance remains unchanged, which of the following is most likely to be a result of the above changes in the tax system?

- A. Fewer people will fall into the tax net.
- B. Fewer people will have to pay at the standard tax rate.
- C. People's work incentive will decrease.
- D. Consumption expenditure will decrease.

The following diagram shows the relationship between taxable income and tax payment in a tax system.



Which of the following statements about the above tax system is correct?

- A. The lower income group pays a smaller percentage of their taxable income as tax payment.
- B. It violates the tax principle of equity put forward by Adam Smith.
- C. It is a proportional tax.
- D. It leads to a more even income distribution.

2020/DSE/I/58

In 2019, the Japanese government increases the general sales tax rate on most of the goods and services from 8% to 10%. As a result,

- (1) income inequality will be higher.
- (2) the fiscal deficit will be eliminated.
- (3) the invisible trade deficit will decrease.

- A. (1) only
- B. (2) only
- C. (3) only
- D. (1), (2) and (3)

2020/DSE/I/41

In the case **WITHOUT** tax exemption, John needs to pay \$15 000 and Mary needs to pay \$35 000 as income tax.

Suppose the government proposes the following income tax exemption measures:

	Amount of tax exemption
Measure I	75% of income tax, maximum \$30 000
Measure II	100% of income tax, maximum \$20 000

John will prefer \_\_\_\_\_ while Mary will prefer \_\_\_\_\_.

- A. measure I ..... measure I
- B. measure I ..... measure II
- C. measure II ..... measure I
- D. measure II ..... measure II

## Short &amp; Structured Questions

1990/CE/I/5(b)(i)

Suppose the Hong Kong government adopts the following tax policies :

- Policy A: introducing a 3% sales tax on all commodities
- Policy B: cutting down the standard tax rate by 3%

Explain how **EACH** of the above policies affects the distribution of income between the rich and the poor.

(Assuming in Hong Kong, the poor spend a higher ratio of their income on consumption than the rich.)

(8 marks)

1992/CE/I/5(c)(i)

It has now been decided that a new airport will be built at Chek Lap Kok

Suggest **THREE** possible government measures, other than printing money, to obtain enough capital to construct the new airport. State **ONE** disadvantage to Hong Kong's economy of each of the methods you have mentioned.

(9 marks)

1993/CE/I/5

(b) If Mr. Chan rents the flat to a tenant, he will have to pay property tax to the Hong Kong government for the rental income.

(i) Explain whether property tax is progressive, regressive or proportional.

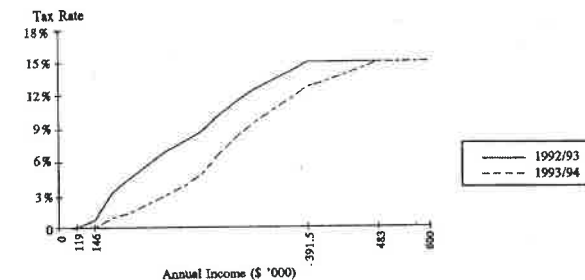
(3 marks)

(d) Some people suggest that a capital gains tax (資產增值稅) should be imposed on those flat-owners who gain money from the resale of housing units in Hong Kong. From the view point of the government, give **ONE** reason for and **ONE** reason against this suggestion.

(4 marks)

1994/CE/I/10(b)

The Hong Kong government revised the salaries tax structure for the fiscal year 1993/94. The following graph helps to illustrate some of these changes.



\*The above graph shows the effective tax rate for a typical single income family of four.

Refer to the above graph.

- (i) Explain whether the salaries tax is progressive, regressive or proportional over the income range. (4 marks)
- (ii) (I) Point out **TWO** major changes to the tax structure shown on the graph. (4 marks)
- (II) Which tax structure shown on the graph would give a more even distribution of income in Hong Kong, other things being equal? Explain. (6 marks)
- (iii) Give **ONE** reason to explain why it is possible that the salaries tax revenue collected from these families might increase after the changes in the tax structure. (3 marks)

1995/CE/1/5

Define progressive tax and proportional tax. Name a local example of each.

(6 marks)

1996/CE/1/10(b)

Suppose Country A plans to impose tariffs on its imports. Explain whether this tax is progressive, proportional or regressive. (4 marks)

1996/CE/1/12(d)

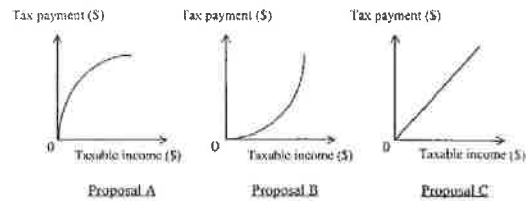
Suppose the government increases the progressivity of the salaries tax in order to provide unemployment benefits to the unemployed. Explain how this would affect Hong Kong's income distribution. (4 marks)

1997/CE/1/9(d)(ii)

Suppose a general sales tax is introduced to finance the construction of the new railway. Explain the effect of this tax on Hong Kong's income distribution. (3 marks)

1998/CE/1/5

The following shows three different proposals for an income tax of an economy.



Explain the differences among the three proposals in terms of the relationship between the tax payments and the taxable incomes. Then point out which proposal would be the most effective in achieving a more even distribution of income. (7 marks)

1998/CE/1/7(b)

Suppose the salaries tax allowance in Hong Kong remains unchanged. Explain why the total tax revenue from this tax would increase at times of inflation. (3 marks)

1999/CE/1/8

Taxable income	\$10 000	\$20 000	\$30 000
Tax amount	\$1 000	\$1 900	\$2 700

Explain whether the tax described above is progressive. Show your working. (5 marks)

2000/CE/1/8

In 1999, the government refunded 10% of the salaries tax and profits tax to taxpayers. Explain how this would affect the wealth gap between the low-income group and the high-income group. (4 marks)

2000/CE/1/9(a)

Study the following information.

Gasoline Bill		
Quantity sold:	50L (liter)	
Price per liter:	3.780 \$/L	\$189
Government tax:	6.060 \$/L	\$303
<b>Sales total:</b>		<b>\$492</b>

(i) Define regressive tax and explain whether the above gasoline tax is progressive, proportional or regressive. (5 marks)

(ii) Give **TWO** economic reasons for the government to levy tax on gasoline. (4 marks)

2001/CE/1/7

Suppose the Hong Kong government introduces a general sales tax.

(a) Explain whether a sales tax is a direct tax or an indirect tax. (2 marks)

(b) Explain what would be the effect of the introduction of a general sales tax on Hong Kong's income distribution. (3 marks)

2001/CE/1/11(b)

Suppose the government significantly reduces the stamp duty on the sale of property. Explain how this would affect

- (i) investment
- (ii) employment opportunities

in the construction industry. (4 marks)

2002/CE/1/12(c)

Mr Wong's bookstore has to pay profits tax and rates.

(i) Explain which of the above two taxes is an indirect tax.

(ii) Explain whether profits tax is progressive, proportional or regressive. (5 marks)

2003/CE/1/10(d)

The first registration tax on a newly imported car is a fixed percentage of the car's value. Explain whether the tax is proportional. (3 marks)

2004/CE/1/10(e)

In Hong Kong, the air passenger departure tax is \$120 per adult passenger. Explain whether the tax is a progressive tax, a proportional tax or a regressive tax. (3 marks)

2006/CE/1/11(b)(i)(II)

Explain whether general sales tax is a direct tax or an indirect tax. (2 marks)

2008/CE/1/8

In Hong Kong, red wine is subject to an excise tax of 40% of its value.

(a) Explain whether this tax is progressive, regressive or proportional. (4 marks)

(b) Explain whether this tax is a direct tax or an indirect tax. (2 marks)



2009/CE/1/11

In the fiscal year 2008-09, the government took some measures to reduce the tax burden on the public.

- (a) The corporate profits tax rate was reduced from 17.5% to 16.5%. Explain whether the government revenue from profits tax would necessarily decrease as a result of a reduction in the profits tax rate. (4 marks)
- (b) Rates (差餉) were waived for most properties. Explain whether this tax is a direct tax or an indirect tax. (2 marks)

2012/DSE/II/4

According to a report of the United Nations in 2008, the Gini coefficients of Hong Kong and Beijing were 0.53 and 0.22 respectively.

- (a) Was the income gap between the rich and the poor in Hong Kong wider or narrower than that in Beijing? (1 mark)
- (b) Explain how an increase in the standard tax rate of salaries tax will affect the post-tax Gini coefficient of Hong Kong. (3 marks)

2013/DSE/II/8

Suppose a government is facing a budget deficit. Some politicians have proposed that the government should raise the income tax rate to reduce the budget deficit. Evaluate their proposal. (4 marks)

2014/DSE/II/6(b)

Karen, a Hong Kong resident, works as a photographer in a media group in Shanghai.

Is salaries tax a direct or an indirect tax? Explain your answer. (2 marks)

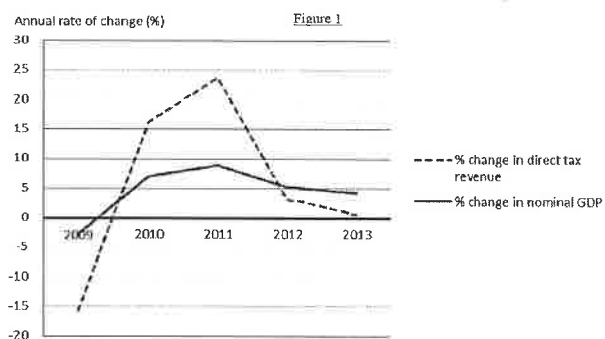
2014/DSE/II/7(a)

In an attempt to reduce its growing fiscal deficits, the US government has tried to increase tax on the one hand and decrease fiscal spending on the other. But many worry that such a policy would give rise to undesirable side effects.

Explain **TWO** possible undesirable effects of the above fiscal policy on the US economy as a whole. (4 marks)

2015/DSE/II/11(a)

Figure 1 shows the percentage changes in direct tax revenue and nominal GDP in Hong Kong for the years 2009-2013.



- (i) With reference to Figure 1, describe the relationship between the percentage change in direct tax revenue and the percentage change in nominal GDP for the years 2009-2013 and compare their trends. (2 marks)
- (ii) Briefly explain the relationship you described in (a)(i). (2 marks)

2017/DSE/II/13(b)

To finance the scheme, there are different proposals which include:

- Proposal A: increase the standard tax rate and the progressivity of salaries tax
- Proposal B: use the fiscal reserves in the government

Discuss the effects of these two proposals on economic variables which include

- (i) income distribution
- (ii) **ONE** other economic variable.

(7 marks)

2018/DSE/II/6(a)

The government proposes the following changes in the profits tax system.

Profit	Existing system	New two-tier system
On the first \$2 000 000	16.5%	8.25%
Remainder		16.5%

Would the above changes in tax system *necessarily* result in a drop in profits tax revenue? Explain. (4 marks)



MARKING SCHEME

1990/CE/II/47 D	2000/CE/II/43 B	1990/CE/II/59 B	1999/CE/II/42 D	2005/CE/II/42 B (28%)
1990/CE/II/55 B	2002/CE/II/43 D (56%)	1991/CE/II/37 B	1999/CE/II/43 A	2005/CE/II/43 B (44%)
1991/CE/II/37 B	2003/CE/II/38 A (31%)	1991/CE/II/39 B	1999/CE/II/44 C	2006/CE/II/39 B (64%)
1992/CE/II/36 A	2004/CE/II/41 D (69%)	1992/CE/II/43 B	2001/CE/II/35 A	2006/CE/II/42 A (56%)
1993/CE/II/45 C	2004/CE/II/42 D (33%)	1993/CE/II/46 A	2001/CE/II/36 B	2007/CE/II/42 A (78%)
1994/CE/II/47 D	2005/CE/II/39 C (66%)	1993/CE/II/47 B	2001/CE/II/39 D	2007/CE/II/43 B (83%)
1995/CE/II/45 C	2005/CE/II/40 A (35%)	1993/CE/II/48 C	2002/CE/II/40 A (73%)	2008/CE/II/41 B (80%)
1995/CE/II/46 D	2007/CE/II/40 D (70%)	1994/CE/II/48 B	2002/CE/II/42 B (46%)	2008/CE/II/44 B (30%)
1995/CE/II/48 B	2008/CE/II/43 D (61%)	1996/CE/II/43 C	2003/CE/II/39 B (38%)	2009/CE/II/42 C (59%)
1996/CE/II/41 A	2009/CE/II/42 C (59%)	1996/CE/II/45 D	2003/CE/II/40 C (72%)	2009/CE/II/44 C (59%)
1996/CE/II/44 B	2009/CE/II/43 D (34%)	1997/CE/II/45 A	2003/CE/II/41 A (59%)	2010/CE/II/42 D (51%)
1997/CE/II/40 C	2010/CE/II/41 C (74%)	1998/CE/II/37 C	2004/CE/II/41 D (69%)	2013/DSE/I/36 C (80%)
1998/CE/II/39 D	2014/DSE/I/36 D (52%)	1998/CE/II/42 B	2004/CE/II/43 D (63%)	2016/DSE/I/36 C (61%)
2000/CE/II/41 A	2017/DSE/I/35 A (57%)	1999/CE/II/40 B	2005/CE/II/41 B (53%)	2018/DSE/I/35 B (49%)

*Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.*

2020/DSE/I/36 B	2020/DSE/I/38 A	2020/DSE/I/41 C
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1990/CE/II/5(b)(i) Policy A widens the wealth gap since the poor pay more in proportion to their income on consumption than the rich compared with the rich, the poor pay a larger portion of their income as tax	(1) (2) (2) (max: 4)
Policy B widens the wealth gap benefits the rich as their tax burden is lowered and income after tax ↑ no effect on the poor because they are outside the tax net or not paying at the standard rate	(1) (2) (2) (max: 4)

- 1992/CE/II/5(c)(i)  
- raise direct taxes  
(disadv: work disincentive / investment disincentive)  
- raise indirect taxes  
(disadv: inflationary pressure / more uneven distribution of real income)  
- use past fiscal reserves  
(disadv: reduce the reserves for contingent purposes / interest return from the investment of the reserves is forsaken / inflationary pressure)  
- borrowing / issue government bonds  
(disadv: the economy has to bear interest cost / burden will be borne by the future generations when the principal is repaid)  
- invite private sector participation  
(disadv: reduce government say in the related services)  
- cut other government expenditures  
(disadv: less public services in other aspects)  
- raise other sources of government revenue, e.g. privatization / sale of the public assets, increase fees  
(disadv: more burden on the users of the public services)  
(Mark the **FIRST THREE** points only.) (3@, max: 9)

- 1993/CE/II/5  
(b) (i) It is a proportional tax, because a fixed portion of the rental income is taxed (1)  
(2)

- (d) For:  
- increase government revenue  
- discourage speculation in the property market  
- widens the tax base / sources of tax revenue  
- a tax on earning / ability-to-pay  
(Mark the **FIRST** point only.) (2@, max: 2)

- Against:  
- high administration cost  
- against laissez-faire policy / freedom to buy and sell  
- against simple taxation principle  
- distort resource allocation  
- not fair if only apply to the property market  
(Mark the **FIRST** point only.) (2@, max: 2)

- 1994/CE/II/10(b)  
(i) First progressive (because the tax rate first rises as income rises), but then proportional (because the tax rate later becomes a flat rate as income rises). (2)  
(2)

- (ii) (I) - a greater amount of tax allowances (raised from \$119 000 to \$146 000) / more low-income families fall out of the tax net  
- families have to earn more than \$483 000 (\$391 500 in 1992/93) before paying tax at the standard rate  
- families with an annual income of more than \$119 000 and up to \$483 000 pay less tax / average tax rate ↓  
- less progressivity before reaching the standard rate  
(2@, max: 4)  
(Mark the **FIRST TWO** points only.)

- (ii) (II) The new tax structure, because (to compare with the old tax structure,) the low-income and sandwich class families earning less than and up to \$483 000 a year pay a lower tax rate, but those earning more than \$483 000 a year pay the same tax rate. (Exact figures are **NOT** required in candidates' answers.) (2)  
(2)

- (iii) Workers would have a higher incentive to work, and thus earn higher income (i.e. a larger tax base). (2)  
(1)

1995/CE/1/5

Progressive tax: the tax rate ↑ as income ↑  
e.g., salaries tax / profits tax (fiscal year 2018/19 onwards)  
(Mark the **FIRST** example only.)

(2)

(1)

Proportional tax: the tax rate is constant as income ↑  
e.g., salaries tax for those who pay at the standard rate / property tax  
(Mark the **FIRST** example only.)

(2)

(1)

1996/CE/1/10(b)

Regressive tax, because  
the low-income group spends a greater proportion of income on clothing than the high-income group, and therefore  
the low-income group pays a larger proportion of income as tax than the high-income group.

(1)

(2)

(2)

(max: 3)

**OR**

the same amount of tax on clothing represents a greater proportion of income for the low-income group.

(3)

1996/CE/1/12(d)

Increased progressivity means the tax burden of taxpayers with higher salary income increased at a faster rate than the low-income group / unemployed.

(2)

The provision of unemployment benefits will benefit the low-income group / unemployed but not the high-income group.

(1)

∴ More even income distribution.

(1)

1997/CE/1/9(d)(ii)

The low-income group spend most of their income on purchasing goods and services for their living,  
but the high-income group spend only a small amount of their income for their living.

(1)

(1)

**OR**

The low-income group pay a larger portion of their income than the high-income group on the general sales tax.

(2)

(max: 2)

⇒ More uneven income distribution

(1)

1998/CE/1/5

Proposal A: the tax payment takes a decreasing proportion of taxable income as taxable income rises.

(2)

Proposal B: the tax payment takes a increasing proportion of taxable income as taxable income rises.

(2)

Proposal C: the tax payment takes the same proportion of taxable income as taxable income rises.

(2)

∴ Proposal B is the most effective.

(1)

1998/CE/1/7(b)

During inflation, the nominal income of people increases.

(1)

With no change in tax allowance, more people are put into the tax net or into higher tax brackets.

(2)

1999/CE/1/8

Tax to income ratio

Average tax rates are:

\$1 000 / \$10 000 = 10%; \$1 900 / \$20 000 = 9.5%; \$2 700 / \$30 000 = 9%

(2)

**OR**

Marginal tax rates are:

\$(1 900 - 1 000) / \$(20 000 - 10 000) = 9%; \$(2 700 - 1 900) / \$(30 000 - 20 000) = 8%

(2)

The conclusion is: not a progressive tax, because

the marginal tax rate decreases / the average tax rate decreases / the tax amount increase less proportionately than the taxable income.

(3)

2000/CE/1/8

Correct comparison of the amount of money rebated to the high-income group and the low-income group:  
e.g. 1 High-income group taxpayers are rebated a larger amount of money than low-income taxpayers.  
e.g. 2 The government rebated money to the taxpayers but no money to the poor who were non-taxpayers.  
It results in a wider wealth gap.

(3)

(1)

2000/CE/1/9(a)

(i) A regressive tax is a tax which tax rate decreases as income increases.

(2)

Consumers pay the same amount of gasoline tax for purchasing the same amount of gasoline.

⇒ In proportion to individual's income, the richer pay at a lower tax rate while the poorer pay at a higher tax rate.

(3)

∴ Gasoline tax is a regressive tax.

(ii) - to reallocate resources: use more public transport but less private transport

(2)

- a source of tax revenue

(2)

2001/CE/1/7

(a) Indirect tax because the tax burden can be shifted onto others (the buyers).

(2)

(b) The poor consumes a larger proportion of their income.

(1)

**OR**

Same amount of tax for the same good paid by people with different incomes

(1)

∴ A higher proportion of income of the low-income group is taxed.

(1)

∴ The general sales tax increases the income inequality.

(1)

(Remark: Mere mentioning of the conclusion without elaboration: zero marks)

2001/CE/1/11(b)

Demand side:

Cost of transaction ↓ ⇒ incentive to buy property ↑ and number of transaction ↑

(1)

Supply side:

Volume / value of business of the construction industry ↑ ⇒ expansion in the production of the construction industry and the derived demand for construction workers ↑

(1)

(i) investment ↑

(1)

(ii) employment opportunities ↑

(1)

(Remark: Mere mentioning of the conclusion without elaboration: zero marks)

2002/CE/1/12(c)

(i) Rates is an indirect tax because

(1)

the tax burden can be shifted by the landlord onto the tenants.

(1)

(ii) The profits tax is a proportional tax because

(1)

its effective tax rate is constant / the tax amount is proportional to the taxable income.

(2)

2003/CE/1/10(d)

No, because

(1)

as his income increases, the tax rate is not fixed / the tax rate decreases.

(2)

2004/CE/1/10(e)

Regressive tax, because

(1)

same tax payment relative to different incomes

(1)

⇒ decreasing tax rate as income rises

(1)

2006/CE/I/11(b)(i)(II)

- The tax is an indirect tax because (1)  
the tax burden can be shifted from the producers to the consumers. (1)

2008/CE/I/8

- (a) Regressive tax, because (1)  
all red wine buyers pay the same amount of tax for purchasing the same bottle of red wine (1)  
higher-income earners pay a less than proportionate amount of tax / the tax rate decreases as the income increases. (2)
- (b) Indirect tax, because (1)  
the tax burden can be shifted by the red wine sellers onto the consumers. (1)

2009/CE/I/11

- (a) A reduction in the profits tax rate may boost more business investment and increase profits. (2)  
No, because (1)  
the increase in government tax revenue resulting from the increase in profit earnings could be big enough to offset the decrease in government tax revenue resulting from the reduction in the tax rate. (1)
- (b) Indirect tax, because (1)  
the tax burden can be shifted from the landlords onto the tenants. (1)

2012/DSE/II/4

- (a) Wider (1)
- (b) Lower, because (1)  
higher income group has a lower post-tax income while the income of lower income group remains unchanged. (2)

2013/DSE/II/8

Government should increase the income tax rate to reduce the budget deficit

- if the increase in tax revenue due to the rise in tax rate outweighs the reduction in tax payment due to the reduction in the tax base/taxable income (e.g., a fall in the number of tax payers as a result of disincentive effects to labour). (4)
- because increase in tax rate is fairer as income tax is often proportional (or even progressive) and this helps equalize income. (2)
- if there is an inflationary (output) gap as an increase in income tax reduces output and relieves the inflationary pressure. (2)

Government should NOT increase the income tax rate to reduce the budget deficit

- if the increase in tax revenue due to the rise in tax rate falls short of the reduction in tax payment due to the reduction in the tax base/taxable income (e.g., a fall taxable income as a result of reduction in aggregate output). (4)
- because an increase in income tax rate will result in a greater disincentive to work and more people may quit the job and rely on welfare programmes and this further worsen the budget deficits. (2)
- as an increase in income tax rate reduces the aggregate output, which may result in unemployment / deflationary (income) gap. (2)

(max: 4)

2014/DSE/II/6(b)

- Direct tax, because (1)  
the tax burden cannot be shifted by these tax-payers to someone else. (1)

2014/DSE/II/7(a)

- negative output effect (fall in GDP) due to a reduction in government expenditure and thus aggregate demand
- negative output effect (fall in GDP) due to a rise in sales/income tax, which would lower consumption/investment demand and thus aggregate demand
- negative (disincentive) effect on labour supply and thus on employment (and output) as a result of higher income taxes

(2@, max: 4)

[Mark the FIRST TWO points only.]

2015/DSE/II/11(a)

- (i) The percentage change in direct tax revenue and percentage change in nominal GDP tend to move in the same direction. (1)  
Fluctuation of the former is greater than that of the latter. (1)

- (ii) Growth in the economy (increases in GDP) would be accompanied by growth in salary and profit incomes, which would in turn generate higher revenue from taxes on such incomes. (1)  
Progressive taxation may be one explanation for why direct tax revenue fluctuated more than GDP. (1)

2017/DSE/II/13(b)

- (ii) Proposal A's effect on income distribution:  
Salaries tax payers (higher-income group) would pay more taxes while non-tax-payers (lower-income group) would not be affected. (2)

**OR**

- High-income tax payers pay more, low-income tax payers pay less. (2)  
The after-tax income inequality would thus be reduced. (1)  
(max: 3)

Proposal B's effect on income distribution:

- There will be no extra effect on current tax payers, so the income inequality is unaffected. (2)  
Reduction of fiscal reserves may result in a tax increase in the future, so future tax payers (mainly the younger portion of the population) may have to pay more taxes, thus *increasing income inequality between generations*. (2)  
(max: 2)

- (iii) Proposal A's effect on other variables:

- Price level would drop as AD drops (while there is no such an effect generated by proposal B). (2)  
Unemployment may increase as AD drops (while there is no such an effect generated by proposal B). (2)  
(max: 2)

Proposal B's effect on other variables:

- A worsening of the government's budgetary position (due to a drain on fiscal reserves) may imply tax increase in the future. (No such effect arises under proposal A.) (2)  
Business confidence may be weakened. Expecting tax increases in the future (due to the problem of fiscal sustainability), which would reduce their after-tax profits, business firms may choose to cut down their investment. (No such effect arises under proposal A.) (2)  
(max: 2)

2018/DSE/II/6(a)

- No, because (1)  
the reduction in the profits-tax rate may induce firms to increase their investment expenditure, so they may end up earning higher profits (tax base). The increase in profits tax revenue due to the increase in profits (tax base) may be greater than the decrease in profit tax revenue due to the reduction in tax rate. (3)

### 3.4 PUBLIC SECTOR AND FISCAL POLICY

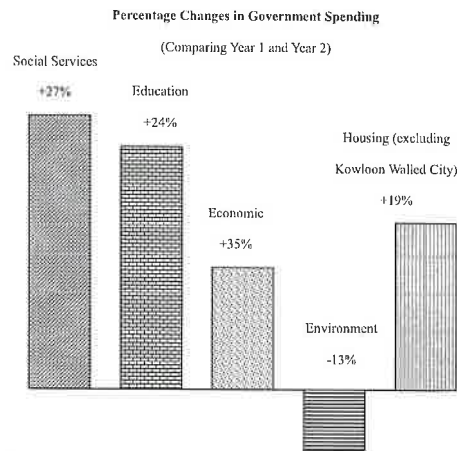
#### Multiple Choice Questions

1990/CE/II/44

Which of the following is a fiscal policy used to reduce inflation?

- A. a direct control on the rise in wages of workers.
- B. an increase in unemployment benefits.
- C. an increase in the required reserve ratio of banks.
- D. a decrease in the spending on an environmental protection scheme.

1991/CE/II/38



The above chart indicates that

- A. economic services was the largest item of government spending.
- B. the price level was higher in Year 2 than that Year 1.
- C. the government spent less on environment protection in Year 2 than in Year 1.
- D. the spending on the Kowloon Walled City was financed by China.

1991/CE/II/40

Which of the following are tools of fiscal policy in Hong Kong?

- (1) the linked exchange rate
- (2) government expenditure on infrastructure
- (3) the standard tax rate
- (4) the minimum cash reserve ratio

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

1992/CE/II/40

Which of the following is an expansionary fiscal policy?

- A. the introduction of a new tax
- B. the construction of a new airport
- C. the cutting of expenditure in some government departments
- D. the increased purchase of water from China

1992/CE/II/41

A surplus budget will lead to

- A. a decrease in government expenditure.
- B. a fiscal surplus.
- C. a balance of payments surplus.
- D. a contraction of the economy.

1993/CE/II/49

In an economy with unemployment, a deficit budget will lead to

- A. a lower rate of unemployment.
- B. a lower level of national income.
- C. a lower rate of household consumption.
- D. a decrease in government debt.

1994/CE/II/49

Year	1987-88	1988-89	1989-90	1990-91
Public Expenditure	536	648	819	950
GDP	3 690	4 336	4 990	6 588

According to the above table, the size of the public sector as measured by the **RATIO** of public expenditure to GDP over the period 1987-1991 was

- A. getting bigger.
- B. getting smaller.
- C. bigger at the beginning but smaller at the end.
- D. stagnant.

1994/CE/II/50

A \_\_\_\_\_ budget is one in which the \_\_\_\_\_ government revenue is greater than the \_\_\_\_\_ government expenditure.

- A. surplus ..... actual ..... actual
- B. surplus ..... estimated ..... estimated
- C. deficit ..... estimated ..... actual
- D. deficit ..... actual ..... estimated

1995/CE/II/49

In general, a deficit budget will

- A. reduce a country's foreign exchange and gold reserves.
- B. have an expansionary effect on economic activity.
- C. lead to a more uneven distribution of income.
- D. increase the government's debt.

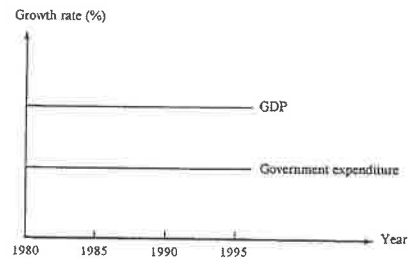
1996/CE/II/39

If the government greatly increases the salaries tax rate to finance the provision of more public assistance to the unemployed,

- The government budget will be balanced because the increase in government expenditure will be financed by the increase in tax revenue.
- The total consumption of the economy will not change as the decrease in consumption of the rich will be compensated by an increase in the consumption of the poor.
- The working incentive will decrease because a higher proportion of salary income will be taxed.
- The size of the public sector will remain unchanged because the increased expenditure is matched by the increased tax revenue.

1996/CE/II/42

Refer to the following diagram of an economy:



During the period 1980 to 1995, which of the following can be concluded from the above diagram?

- Both the GDP and the government expenditure have not changed in this period.
- The GDP increases at the same rate as the government expenditure.
- The ratio of government expenditure to GDP decreases over this period.
- The growth rate of GDP remains constant because the government expenditure increases at a constant rate.

1997/CE/II/43

Hong Kong's public expenditure as a percentage of GDP has risen steadily in recent years. Which of the following is/are reason(s) for this?

- the progress of the construction projects of the government and the new airport
  - a fall in the GDP in this period
  - a large increase in government welfare payments to the unemployed
- (1) only
  - (2) only
  - (1) and (2) only
  - (1), (2) and (3)

1999/CE/II/41

A surplus budget could turn out to be a budgetary deficit if the actual government revenue is \_\_\_\_\_ than the actual government expenditure and the estimated government revenue is \_\_\_\_\_ than the estimated government expenditure.

- greater ..... greater
- smaller ..... greater
- greater ..... smaller
- smaller ..... smaller

2000/CE/II/44

Suppose the government uses a great amount of its fiscal reserve to develop information technology in education. Which of the following is correct?

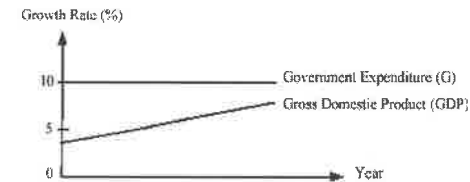
- Government expenditure in other sectors will decrease.
- The government will have a budget deficit.
- The average labour productivity will be higher.
- The banking system will be less able to create deposits.

2000/CE/II/45

The government will participate in the project for establishing Disneyland in Hong Kong. During the period of construction, it must

- increase the tax burden on taxpayers.
- increase the size of the public sector.
- increase the ratio of public expenditure to GDP.
- discourage the incentive of private investment.

2002/CE/II/41



According to the above graph, the ratio of G to GDP is

- increasing.
- decreasing.
- first increasing and then decreasing.
- first decreasing and then increasing.

2008/CE/II/42

According to the 2007-08 Policy Address of the Chief Executive, the Government will launch 10 major infrastructure projects in the coming years. This will result in

- an increase in the GDP of Hong Kong.
- an increase in the size of the public sector.
- government budget deficits in the years of construction.

- (1) and (2) only
- (1) and (3) only
- (2) and (3) only
- (1), (2) and (3)

2009/CE/II/45

An increase in the Hong Kong government's expenditure on infrastructure must lead to an increase in

- the ratio of public expenditure to GDP in Hong Kong.
- the government budget deficits.
- the wage rate of workers in Hong Kong.
- the potential GDP of Hong Kong in the future.

2010/CE/11/43

During a recession, a government plans to promote economic growth through infrastructural development. As a result,

- (1) the size of the public sector would increase.
- (2) the employment opportunity would increase.
- (3) the government budget would run into a deficit.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2010/CE/11/44

Which of the following will increase in times of economic recovery?

- A. trade surplus
- B. budget deficit
- C. government expenditure
- D. direct tax revenue

2014/DSE/1/25

Year	Year-on-year percentage change in nominal GDP	Year-on-year percentage change in nominal government spending
2011	9.0	12.0
2012	5.5	6.0

Based on the above information, which of the following statements are correct?

- (1) The size of the public sector in the economy increased in 2012.
- (2) Both the nominal GDP and the nominal government spending dropped in 2012.
- (3) A drop in both the real GDP and the real government spending was possible in 2012.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

#### Short & Structured Questions

1993/CE/1/5(e)

State **THREE** general aims of a fiscal policy.

(6 marks)

2019/DSE/1/34

Both the wage rate and general price level increase by 8% in a certain year. If the government increases the salaries tax allowance by 5%,

- A. more people will fall into the tax net.
- B. income distribution will become more even.
- C. government's tax revenue will decrease.
- D. people's real income after tax will increase.



### MARKING SCHEME

1990/CE/II/44 D	1993/CE/II/49 A	1996/CE/II/42 C	2002/CE/II/41 A (23%)	2014/DSE/I/25 B (54%)
1991/CE/II/38 C	1994/CE/II/49 C	1997/CE/II/43 A	2008/CE/II/42 A (68%)	2019/DSE/I/34 A
1991/CE/II/40 C	1994/CE/II/50 B	1999/CE/II/41 B	2009/CE/II/45 D (53%)	
1992/CE/II/40 B	1995/CE/II/49 B	2000/CE/II/44 C	2010/CE/II/43 A (59%)	
1992/CE/II/41 D	1996/CE/II/39 C	2000/CE/II/45 B	2010/CE/II/44 D (65%)	

*Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.*

1993/CE/II/5(e)

- full or high level of employment
- economic growth / rising living standard / per capita GNP ↑
- even or more even distribution of income
- control of inflation / deflation

(Mark the **FIRST THREE** points only.)

(2@, max: 6)

### 3.5 EFFECT OF A BALANCED BUDGET

#### Multiple Choice Questions

1997/AL/II/04 (modified)

Suppose a government reduces its expenditure on goods and services and at the same time increases its transfer payments to the public by the same amount, then

- A. (out of syllabus)
- B. aggregate demand would remain unchanged.
- C. aggregate demand would decrease.
- D. aggregate demand would increase by the same amount as the change in government expenditure.

2016/DSE/I/38

If the government simultaneously increases its expenditure and income tax by the same amount, the effect on the aggregate output is \_\_\_\_\_.

- A. contractionary
- B. neutral
- C. expansionary
- D. indeterminate

2021/DSE/II/40

Suppose a government finances its expenditure by collecting tax from the households and the amount of expenditure equals the amount of tax collected. The effect on aggregate demand will be \_\_\_\_\_.

- A. expansionary
- B. contractionary
- C. neutral
- D. indeterminate



Short & Structured Questions

1993/AL/II/7

If the new airport project costs HK\$170 billion over the next four years, and the government decides to finance this expenditure entirely by taxation without borrowing, will such a fiscal policy be expansionary, contractionary, or neutral? Explain.

(10 marks)

2009/AL/II/6(a) (modified)

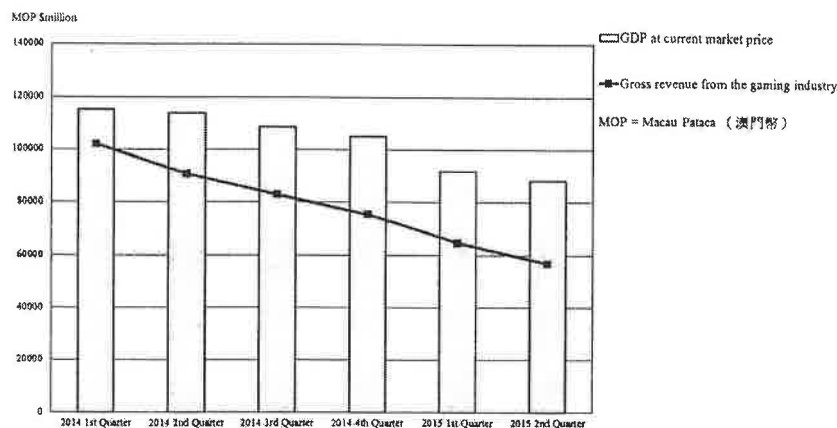
In the face of recent economic hardship, it has been proposed that the Hong Kong government introduces some stimulative measures. One sure measure is to inject cash directly into people's pockets by providing transfer payment.

- Explain how the above cash transfers would affect consumption and aggregate demand.
- Does it make any difference to the effect of aggregate demand if, instead of providing the cash transfers, the government simply uses the cash to increase its own expenditure? Explain your answer.

(5 marks)

2016/DSE/II/12

Gaming industry (博彩業) is a major sector in Macau's export of services. The following diagram shows the revenue from the gaming industry and the aggregate output of Macau.



- With reference to the above diagram, describe and explain the trend of the importance of the gaming industry relative to the aggregate output of Macau. (2 marks)

The Macau government implements a cash-sharing scheme, under which every resident receives cash from the government.

The recent decline in the gaming industry results in a drop in tax revenue. Hence, the government considers reducing its spending on investment but still keeping the cash-sharing scheme. However, an economist suggests that the government should suspend the cash-sharing scheme and allocate the sum of money to investment instead.

- Discuss the suggestion of the economist by giving arguments **FOR** and **AGAINST** it. (5 marks)

MARKING SCHEME

1997/AL/II/04

C

2021/DSE/II/40

A

2016/DSE/II/38

D (deleted)

1993/AL/II/7

If the spending on the airport project is exactly financed by increased taxation of the same amount, the fiscal policy effect (on aggregate demand) is expansionary.

The reason is that if income is not taxed, the private sector will save part of it. If it is taxed, the government will spend all the tax revenue. Therefore the expansionary effect of increased spending is greater than the contractionary effect of increased tax.

(Note: However, taxation, be it a direct tax or an indirect tax, would also have supply-side effects, but these are not considered in the HKAL syllabus.)

2009/AL/II/6(a)

- By increasing disposable income, the cash transfers ( $T_r$ ) would increase consumption. The aggregate demand would then increase, and thus increase output.
- If the government simply uses the cash to increase its own expenditure, the aggregate demand would increase by  $\Delta G (= \Delta T_r)$  and thus increase output by a bigger amount. This is because while people will only spend part of the cash transfers on consumption (and save the rest), the government will spend all of it directly.

2016/DSE/II/12

- The relative importance of the gaming industry has been declining because its gross revenue has been falling faster than GDP at current market price. (1)

- Arguments for:

  - Investment would increase potential output over time, but cash sharing would not have similar long-run effects on the economy. (2)
  - Investment would raise aggregate demand (AD) directly. But the cash-sharing scheme could only raise AD indirectly via an increase in consumption. In case the residents choose not to spend the cash received on consumption, the AD effect would vanish. (2)

(max: 3)

Arguments against:

  - During economic downturn, a reduction in social welfare due to suspension of the cash-sharing scheme may result in discontent of the citizens and political instability. (2)
  - While people can benefit from the cash-sharing scheme instantly, it may take a longer time for investment to boost their income. (2)
  - Public investment may be inefficient due to high administrative costs or low sensitivity to market / price signals (lack of profit incentives). (2)

(max: 3)

[Remark: Maximum mark of part (c) is 5 marks]