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**Paper for the House Committee meeting
on 7 June 2002**

**Report of the Bills Committee on
Revenue Bill 2002 and Revenue (No. 2) Bill 2002**

Purpose

This paper reports on the deliberations of the Bills Committee on Revenue Bill 2002 and Revenue (No. 2) Bill 2002.

The Bills

2. The Revenue Bill 2002 and Revenue (No. 2) Bill 2002 seek to implement the revenue proposals in the Budget 2002-03.

3. The Revenue Bill 2002 amends the Dutiable Commodities Ordinance (Cap. 109) to increase the ad valorem duty on wine from the existing rate of 60% to 80%. For the purpose of revenue protection, this proposal has come into effect at 2:30 pm on 6 March 2002 under the Public Revenue Protection (Revenue) Order 2002 (the Order). The Order gives temporary legal effect to the proposal for a maximum period of four months up to 6 July 2002.

4. The Revenue (No. 2) Bill 2002 amends the Dutiable Commodities (Exempted Quantities) Notice (Cap. 109 subsidiary legislation) to reduce the quantity of duty-free still wine that a Hong Kong identity card holder may bring back on return to Hong Kong for his own use from 1 litre to 750 millilitres, and that of duty-free tobacco from 100 cigarettes or 25 cigars or 125 grammes of other manufactured tobacco to 60 cigarettes or 15 cigars or 75 grammes of other manufactured tobacco.

The Bills Committee

5. The two bills were introduced into the Legislative Council (the Council) on 17 April 2002. The House Committee agreed at its meeting on

26 April 2002 to form a Bills Committee to study the two bills. The membership list of the Bills Committee is in **Appendix I**.

6. Under the chairmanship of Hon Margaret NG, the Bills Committee has held three meetings with the Administration and met representatives from four trade and business organizations at one of the meetings. It has also received 14 submissions from eight organizations and four individuals. The list of organizations which have given views to the Bills Committee is in **Appendix II**.

Deliberations of the Bills Committee

Revenue Bill 2002

7. The trade and business organizations of the wine, catering, hospitality and entertainment industries namely, the Hong Kong Wine Industry Coalition (HKWIC), Lan Kwai Fong Holdings Ltd., Lan Kwai Fong Association, Soho Association, and Hong Kong Hotels Association strongly oppose to the proposed increase on wine duty from 60% to 80%. The Australian Consulate-General and New Zealand Consulate-General in Hong Kong express concern that the proposed duty increase may affect wine trade between Hong Kong and the two countries. The concerns of the deputations, members' views and the Administration's responses are summarized in the following paragraphs.

The impact of the proposed duty increase on revenue and people's livelihood

8. The Bills Committee notes the deputations' concern that the proposed duty increase will push up retail prices on wine. As consumers are particularly sensitive to price changes in the current economic environment, the deputations are concerned that the rise in retail prices will not only lead to decline in overall consumption, but also encourage consumers to switch to lower-priced beverage products. The HKWIC estimates that the proposed increase will raise average retail prices on wine by over 10%. Moreover, since wine is a popular enjoyment for average people in Hong Kong (bottles of wine priced \$100 and below constitute approximately 90% of wine sold in the retail market), some deputations are also concerned that the proposed duty increase will affect a large cross-section of the population.

9. The Bills Committee notes the Administration's explanation that wine duty is levied on the ex-factory price rather than its far higher retail price. The actual effect of the proposed increase on duty payable on wine and hence retail price will be minimal. According to revenue figures in 2001, the average ex-factory price per bottle of wine consumed in Hong Kong was \$30, and the average duty paid was \$18. About 90% of the 12.25 million bottles of wine consumed have attracted a duty below \$30. The proposed increase in

duty will therefore raise the average duty paid per bottle to \$24, i.e. a marginal increase of \$6 per bottle. The Bills Committee further notes from the results of the Administration's surveys conducted on 21 popular brands of wine sold in supermarkets in February and April 2002 that for those brands with a retail price between \$39 and \$189, the additional duties payable per bottle after the proposed increase ranges only between \$1.3 and \$7.52 and the additional duty as a share of retail price for most of these wines is less than 5%. The Administration stresses that the impact on wine, especially for the low to medium priced wine which accounts for the bulk of the wine consumed, is therefore very small, hence the proposed increase in duty is not expected to affect the overall consumption of wine seriously, nor would it affect people's livelihood in general.

10. As regards the deputations' concern that consumers may switch to lower-taxed or non-taxed beverages, the Bills Committee observes from the revenue figures of the three types of liquor listed in Schedule 1 to the Dutiable Commodities Ordinance for the period from 1992 to 2001 that there are general signs of "trading-down" activities to cheaper priced liquor when the Administration switched from the old specific-cum-ad valorem duty to the present ad valorem duty back in 1994. However, the Bills Committee also notes that there has not been any apparent "trading-down" activities to lower priced products in the case of the increase in the duty of liquors below 30 degrees in alcohol strengths (i.e. mainly beer) from 30% to 40% in 2001 from the Administration's analysis on different priced beers for the period from 1999-2000 to 2001-02.

11. The Bills Committee notes the Administration's view that as the revenue collected from wine duty has remained stable in the last three years (at about \$220 million per annum) and that the proposed increase in duty is mild, the proposed increase in wine duty will be revenue-productive. The Administration further estimates that the proposal will generate an extra revenue of \$70 million per year. Nonetheless, the Bills Committee notes the views of deputations that with the decline in local wine market since 2000, there is a rise in smuggling activities and under-declaration on duty by unscrupulous importers. This is due to the wide disparity in retail prices for wines in Hong Kong and elsewhere. Coupled with fall in overall consumption, the deputations opine that the duty-paid quantity and dutiable value of wine may decrease, defeating the Government's purpose to raise revenue.

12. The Administration stresses that under the present economic situation and fiscal position, the Government must find ways to improve revenue yields from existing sources. The proposed duty increase which will have minimal effect on economic recovery and people's livelihood is therefore considered appropriate. On concerns about smuggling activities and under-declaration of duty, the Administration points out that duty evasion by wine importers, or individuals who bring wine back on return to Hong Kong, is liable to offences

under the Dutiable Commodities Ordinance (Cap. 109) with heavy penalties. The Customs & Excise Department (C&ED) has been stepping up enforcement against the offences by conducting more verifications of liquor prices declared by duty-payers and more frequent checks on individuals at border check points.

13. As regards the deputations' argument that reduction in wine duty could raise Government revenue as proven by the 21% rise in revenue on wine following the reduction of duty from 90% to 60% in 1997, the Bills Committee notes the Administration's view that other factors, such as the vibrant state of economy in 1997 and celebration of the reunification of Hong Kong with Mainland, may have contributed to the sharp rise in wine consumption and hence duty revenue in that year. A direct correlation between reduction in liquor duty and increase in duty revenue could not be established by making reference to the statistics in a single year.

14. On the HKWIC's suggestion to replace the current ad valorem duty system on alcoholic beverages by the specific duty system, which levies a fixed amount of duty per bottle of wine imported, the Bills Committee notes the Administration's view that the ad valorem duty system was adopted in 1994 because of its advantages as a progressive duty and a stable source of revenue. In contrast, the specific duty system is regressive and, in general, weighted in favour of expensive beverage products. The Bills Committee further notes that as over 70% of the 12.25 million bottle of wine consumed in 2001 have attracted a duty below \$16, this bulk of wine would be subject to a substantial increase in duty by over 80% under the specific duty system.

Effect on the catering, hospitality and entertainment industries

15. The Bills Committee notes that there is general concern among the deputations about the effect of the proposed duty increase on the catering, hospitality and entertainment industries. These industries consume 45% of all wine sold in Hong Kong, employ over 200,000 people, and have business turnover amounting to \$55 billion a year. Under the current market conditions, restaurants, hotels, bars and entertainment outlets are unlikely to pass on to consumers any price increases resulting from the duty increase. The industries' concern is that if their profit margins are further eroded, not only the livelihood of all those employed by the industries will be affected, profits tax contributions from the businesses will also decrease. The Soho Association states that wine sales in bars and restaurants in Soho area have dropped considerably after the increase in duty since early March 2002.

16. The Bills Committee also notes the deputations' comments that high wine prices in hotels and restaurants have been a source of complaint by tourists. The increase in wine duty will further harm Hong Kong's image as an affordable tourist destination and a "shopping paradise". The increase in duty revenue will therefore likely be offset by the loss of income from tourism.

17. According to the Administration, wine duty is charged on the ex-factory price. Given the mild increase in duty rate, it will only be translated into a marginal percentage increase in the retail prices of most wines, hence it is unlikely that the above industries will be affected in any significant way.

18. The Administration has also drawn the attention of the Bills Committee to the results of Government's surveys on wine prices at hotels, and restaurants in Soho and Lan Kwai Fong areas in March and May 2002, which indicate that the additional duties as a share of retail price for most wines is below 5% after the duty increase. The figures point to the conclusion that the proposed increase in duty is very mild, and will have minimal effect on the retail prices and profits of these industries. The Administration's finding, however, is disputed by depositions from the catering and hotel industries as the price figures quoted at hotels and restaurants in May 2002 may not have been adjusted to take into account of the duty increase. The real effect of duty increase on retail prices may be more accurately seen towards the latter half of 2002. The Bills Committee also notes the comment made by the Administration that the extent to which the increase will be passed on to the consumers through wholesalers and retailers is entirely a commercial decision. In this regard, the industry's view is that restaurants and hotels charge higher prices on wine than retail outlets. The higher mark-up is necessary to cover costs paid to wholesalers and retailers, and other operating costs. Income from wine contributes an essential part of the profits of the catering sector. Hence, the "ripple effect" of the duty increase on this sector will be much greater than expected by the Government.

The negative effects on wine trade

19. The Bills Committee notes the concern expressed by the Australian Consulate-General and New Zealand Consulate-General in Hong Kong that as Australia and New Zealand are the major wine exporters of Hong Kong, the proposed duty increase will adversely affect trade with the two countries. The New Zealand Consulate-General opines that increase in wine duty will run counter to Hong Kong's long pursued policy of trade liberalization. The Bills Committee also notes the HKWIC's comment that the proposed duty increase will reverse the Government's policy of developing the wine industry in Hong Kong and discourage related business investment in Hong Kong.

20. On these concerns, the Administration explains that as the mild increase in duty would only translate into a marginal percentage increase in the retail price for most wines, it is unlikely that it would affect wine consumption, trade in wine nor the wine-related industries in any significant way. Furthermore, since wine imported for re-export is not subject to duty, the duty rate on wine is not relevant to Hong Kong's position and development as a wine distribution centre. As such, the Bills Committee notes that the

proposed duty increase will not undermine Hong Kong's role as a regional wine hub.

21. As to Hong Kong Hotels Association's concern that increasing wine duty might be inconsistent with China's obligation to reduce tariffs after its accession to the World Trade Organization (WTO), the Bills Committee notes the Administration's view that since Hong Kong's wine duty is levied on both locally-produced and imported alcohol, the duty is not regarded as an import tariff and therefore does not fall under the WTO's jurisdiction. The Administration further explains that as Mainland and Hong Kong are separate members to the WTO, Hong Kong, China will continue to formulate its own trade policies.

Undermining Hong Kong's competitiveness

22. The Bills Committee recognizes that the existing wine duty of 60% is among the highest in the world and is higher than those of 34.4% in China (to be reduced to 14% in 2004), 15% in Macau, 5% in Philippines, 55.8% in Thailand, below 7% in New Zealand, as well as those charged by the United Kingdom, United States and Australia. The Bills Committee notes the deputations' concern that increasing the duty will seriously affect Hong Kong's competitiveness.

23. The Administration, however, stresses that as different economies adopt tax regimes that vary to great extents, it is difficult to compare on a like-for-like basis the local wine duty with those of other economies. It is worth noting that while Hong Kong has only a single duty on wine, other economies raise a number of other taxes on wine in addition to duties. For instance, in Mainland China, there are consumption tax (10%) and value-added tax (VAT) (17% of sum of CIF price, import tax and consumption tax). In Philippines, there are excise tax (HK\$2.1 to HK\$4.2 per litre), VAT (10%), sales tax (10% of retail price). In Thailand, there are excise tax (60%), municipal tax (10% of excise tax), health tax (2% of excise tax), and VAT (7%). In New Zealand, there are excise duty (NZ\$2.05 to NZ\$0.37 per litre), Alcoholic and Liquor Advisory Council Levy (NZ\$0.03 to NZ\$0.05 per litre), and goods and services tax (12.5%). The Administration considers that in board terms, the average duty payable on wine in Hong Kong does not compare unfavourably to the rates in most economies in the region. It further emphasizes that Hong Kong maintains a simple tax regime and imposes low taxation rates which have attracted many investors. It does not envisage that the mild increase in wine duty will affect Hong Kong's overall competitiveness vis-à-vis other economies.

The Public Revenue Protection (Revenue) Order 2002

24. The Bills Committee notes that the Order shall expire and cease to be in force upon the notification in the Gazette of the rejection by the Council of Revenue Bill 2002. Under section 6 of the Public Revenue Protection Ordinance (Cap. 120) (PRPO), any excess of duty paid under the Order over that payable immediately after the expiry of the Order shall be repaid to the person who paid the same. The Bills Committee hence seeks information from the Administration on repayment arrangements and possible course of action to be taken under such circumstances.

25. According to the Administration, in case Revenue Bill 2002 were not passed by the Council, the Administration will publish a notification in the Gazette (Part B of Legal Supplement No. 2) of the rejection of the bill by the Council in accordance with section 5(2) of PRPO on the day immediately following the Council meeting. The Order will cease to be in force pursuant to the notification and the duty rate on wine will revert to 60%. The C&ED will arrange to refund to duty-payers any excess that they have paid based on the rate of 80% during the period in which the Order was effective. The C&ED will identify the licensees who have paid excess duty based on the dutiable commodities permits for the wine in question and invite them in writing to contact the Department for refund. The Department will also issue a press release to invite those incoming passengers who have paid excess duty at boundary control points to contact the Department for refund. The Department will check an individual's eligibility for refund against its duty payment records. The Department estimates that on average, each eligible refund request will be completed within two weeks of the day on which the request has been lodged.

26. The Bills Committee notes the Administration's proposed arrangement above and has not raised objection to it.

The Bills Committee's views on Revenue Bill 2002

27. The Bills Committee has carefully examined the details of the bill. Some members have expressed concern about the limited contribution of the extra revenue of \$70 million per year vis-à-vis the total estimated revenue of over \$200 billion for 2002-03, and, having regard to the possible impact on the related industries, consider the proposal not worth pursuing. The Bills Committee also notes these members' concern about the knock-on effect of the increase in wine duty on the economy and hindrance to economic recovery.

28. The Bills Committee considers that it would be for individual Member to consider whether or not to support the Bill on basis of its merits. The Bills Committee will not move any Committee Stage amendment (CSA) to the bill, nor would the Administration.

Revenue (No. 2) Bill 2002

29. The Bills Committee notes the suggestion from a Sai Kung District Council member of reducing the quantity of duty-free cigarettes from 60 to 50 sticks. The Administration explains that as cigarettes commonly come in packs of 20 sticks, the proposed reduction to 50 sticks will not tie in with the standard size of a cigarette pack.

30. Members note from the Administration that the proposed reduction in the quantities of duty-free tobacco and alcoholic liquor will bring about additional revenue of \$330 million in a full year.

Bills Committee's views on Revenue (No. 2) Bill 2002

31. The Bills Committee notes that the revenue proposal enshrined in Revenue (No. 2) Bill 2002 has little bearing on the livelihood and will not hinder economic recovery. The Bills Committee expresses support for the bill. Neither the Bills Committee nor the Administration will move CSA to this bill.

Recommendation

32. The Bills Committee supports the resumption of the Second Reading debate on the two bills on 26 June 2002.

Advice sought

33. Members are invited to support the recommendation of the Bills Committee in paragraph 32 above.

**Bills Committee on
Revenue Bill 2002 and Revenue (No. 2) Bill 2002**

Membership list

Chairman Hon Margaret NG

Members Hon Mrs Selina CHOW LIANG Shuk-ye, JP
Hon HUI Cheung-ching, JP
Hon CHAN Kam-lam
Hon SIN Chung-kai
Hon Andrew WONG Wang-fat, JP
Hon Howard YOUNG, JP
Hon CHOY So-yuk
Hon Tommy CHEUNG Yu-yan, JP

(Total : 9 Members)

Clerk Ms Connie SZETO

Legal Adviser Ms Bernice WONG

Date 7 May 2002

**Bills Committee on
Revenue Bill 2002 and Revenue (No. 2) Bill 2002**

**List of organizations/individuals
which have given views on the two bills**

Organizations:

Australian Consulate-General
Hong Kong Hotels Association
Hong Kong Wine Industry Coalition
Lan Kwai Fong Association
Lan Kwai Fong Holdings Ltd.
New Zealand Consulate-General
Soho Association Limited
Topsy Trading Company Limited

Individuals:

A Central & Western District Council member
The owner of a wine company called "Tiffany"
Two Sai Kung District Council members