

**For information
on 20 May 2003**

**Paper for Bills Committee on the
Revenue Bill 2003**

Purpose

This paper provides the Administration's response to the questions raised by Members at the meeting of the Bills Committee on the Revenue Bill 2003 (the Bill) held on 16 May.

Declaration of accessories fitted to vehicles after first registration

2. As explained at the Bills Committee meeting, the declaration requirement after first registration is not new. Before the proposed Bill took effect, registered owners and registered distributors had a legal responsibility to declare to the Transport Department (TD) any accessories which had been fitted by registered distributors or associated persons within three months of first registration. The penalty level for non-compliance was a maximum fine of \$500,000 and imprisonment for 12 months.

3. Under the Bill, in addition to the above requirement, it is provided that registered owners have to declare any accessories as well as warranties which are fitted or provided by any person (i.e. in addition to accessories fitted by registered distributors or associated persons) and registered distributors have to declare any accessories and warranties fitted or provided by them or associated persons within six months (i.e. instead of three months) after first registration. The penalty level for non-compliance remains a maximum fine of \$500,000 and imprisonment for 12 months.

4. The proposals in the Bill aim to strengthen the existing provisions that prevent avoidance of FRT through the purchase of accessories and warranties after first registrations. We believe that as the air-conditioners, anti-theft devices, audio equipment and distributor's warranties become taxable, there will be greater incentive for tax evasion

and such strengthened anti-avoidance measure is necessary. They will also level the playing field for all providers of accessories and warranties, because under the previous arrangements, only accessories fitted by registered distributors and associated persons but not those fitted by independent repair shops, for example, are subject to the declaration requirement.

5. We believe that the proposals will not increase the motor trade's compliance cost nor will they be administratively complicated. As set out above, registered distributors and registered owners already had legal obligations before the Revenue Bill 2003 takes effect to make declarations to and pay TD additional FRT for accessories fitted within a certain period after first registration. There is an established declaration mechanism with which these parties are familiar.

6. We consulted the motor trade, including the vehicle distributors and associations as well as association representing consumer interests, in 2001. The Motor Traders Association of Hong Kong supported the proposals and suggested the lengthening of the anti-avoidance period for accessories and warranties to six months, which we have adopted. Other representatives also did not state any in-principle objection to the proposed requirement. The declaration requirement is widely publicized by TD through issuing letters to registered owners and a practice guide to the trade and notices placed in TD's licensing centres.

7. On receipt of declaration of accessories and warranties after first registration, TD and the Customs and Excise Department (C&ED) will closely examine a case if it is suspicious. C&ED will investigate cases referred from TD, complaints from public and cases developing from intelligence.

Liability of reinstalled vehicle accessories to FRT

8. Proposed section 4E(2A) in the Revenue Bill 2003 provides that: -

“After receiving a declaration made under section 4D(2) or (2A), the

Commissioner shall revise the taxable value of the motor vehicle to which the declaration relates **by adding the value of the accessory or taxable warranty as declared in the declaration or, if applicable, the market value of the accessory or taxable warranty as assessed under subsection (2B) to the existing taxable value of the vehicle calculated under this section and calculate the additional first registration tax payable for the vehicle.**”

9. There has been no change in the spirit of the declaration and taxing requirement on accessories fitted after first registration as originally provided in section 4D(2) of the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330). If a person fits a new accessory, including air-conditioner, anti-theft device and audio equipment within six months after first registration, no matter if it is replacement or not, sections 4D(2) and 4E(2A) apply. TD would add the value of a declared accessory to the existing taxable value of the vehicle and calculate the additional taxable value. FRT is levied on vehicles for use in Hong Kong. Even if an accessory that comes with a vehicle when first registered is subsequently replaced within the tax avoidance period, the registered owner has actually made use of the accessory. Therefore, FRT is levied on the value of the newly fitted accessory without the value of the old accessory deducted.

10. We have carefully considered the trade’s views and Members’ request. With the addition of the four previously tax-exempted items into the base for levying FRT, and with the rationale that the six-month requirement is mainly an anti-avoidance measure in mind, we agree with Members that it is arguable that the calculation of FRT should be on the difference between the old and newly fitted accessory / warranty instead of the value of the newly fitted accessory / warranty. Hence, we are examining the possibility of amending the proposed section 4E(2A) so that the value of the accessory being replaced, as declared by the registered owner and registered distributor (as applicable) and agreed by the Commissioner, will be discounted when calculating the additional FRT payable. However, this must be subject to operational departments’ advice that it is administratively practicable. The breakdown of the values of the accessories that come with a vehicle first registered would in most cases not be available from the Published Retail

Price list. It would pose compliance cost on the part of the registered owner and/or registered distributor declaring a replacement accessory as they will need to ascertain and provide its value for the purpose of the deduction. This is one of the envisaged problems that we would have to consider further.

FRT Revenue before and after Budget announcement

11. As shown in the TD statistics at *Annex*, the FRT revenue from private cars in an average month in 2002-03 was \$186 million. The revenue in the first month after Budget announcement was \$100 million. As expected, the revenue receipts picked up further in the second month after Budget announcement, amounting to \$178 million, after the initial psychological impact of the tax increase on consumers had faded. The overall number of private cars has also continued to pick up. Latest information shows that in the week commencing 12 May, there were 401 private car registrations, representing 70% of the 2002-03 weekly average.

12. There is no trading down in the private cars registered. According to TD's record, in the first month after Budget announcement, the number of registrations of private cars with a taxable value (including formerly tax-exempted items) over \$500,000 was 76, representing 49% of the 2002-03 monthly average. In the second month after Budget announcement, the number has increased to 97, representing 63% of the 2002-03 monthly average. During these periods, the total number of registrations has been 36% and 55% respectively of the 2002-03 monthly average. Therefore, registrations of private cars over \$500,000 actually outperformed the overall average for the cars in all tax bands.

13. The FRT revenue from motorcycles in an average month in 2002-03 was \$3 million. The revenue in the first month after Budget announcement was \$2.9 million. By the second month after Budget announcement, the revenue was \$3.7 million, exceeding the 2002-03 monthly average. The overall number of registration has also continued to pick up. Latest information shows that in the week commencing 12 May, there were 109 motorcycle registrations, representing 121% of the 2002-03 weekly average.

14. There was a relatively significant drop in the number of registrations of motorcycles in the middle price ranges vis-a-vis the lower price range for first month after Budget announcement. The numbers for the \$50,001 - \$100,000 and \$100,001 - \$150,000 price ranges were 42% and 53% of the 2002-03 monthly average, while the overall number of motorcycle registrations was 81% of the 2002-03 monthly average. However, by the second month after Budget announcement, the number of registered motorcycles in the middle and upper price ranges (131%, 105% and 143% of the 2002-03 monthly average for the price ranges of \$50,001 - \$100,000, \$100,001 - \$150,000 and above \$150,000) was even higher than the corresponding numbers in 2002-03. There is no apparent trading down in motorcycles registered.

Revenue comparison between Government's and trade's proposals

15. As explained, we forecast that \$700 million would be raised by the increases in FRT proposed by the Government. The proposal of the motor trade referred to in Appendix I to the LegCo Secretariat's letter dated 16 May is estimated to yield only \$181 million of additional revenue, significantly less than the Government's proposal. Both estimates have taken into account the possibility of distributors changing their pricing strategy and possible drop in car sales due to increase in tax rates.

16. Though the marginal rates in the counterproposal (for first \$150,000 at 35%; for next \$150,000 at 55%; for next \$200,000 at 75%; and for the balance, i.e. the part of taxable value over \$500,000 at 95%) are not lower than the original tax rates in Cap. 330 before amendment (taxable value below \$100,000 at 40%; between \$100,001 and \$200,000 at 45%; between \$200,001 and \$300,000 at 50%; and above \$300,000 at 60%), the rates are NOT directly comparable. This is because what the counterproposal (and the Revenue Bill 2003 as well) contains are marginal tax rates. Under the counterproposal, the effective tax rates for the private cars with taxable value below \$150,000, between \$150,001 and \$300,000, between \$300,001 and \$500,000 and above \$500,000 would be 35%, 42%, 53% and 68% respectively on average. This is much less progressive than the average effective tax rates under the

Government proposals, viz. 35%, 46%, 65% and 95% respectively for the same tax bands.

17. We propose in the Bill to abolish the formerly tax-exempted items. To mitigate the effect of the abolition in inflating the taxable value, we propose to widen the tax bands (viz. widening the tax bandwidths for private cars from \$100,000 for the first three steps to \$150,000 for the first two steps and \$200,000 for the third step). We have identified some cases for which the tax payable for a private car under the counterproposal would be even less than under the original tax system, as a result of the lower tax rates vis-a-vis the rates proposed in the Bill and the widened tax bands.

18. We illustrate below the argument in paragraph 17 with a specific example. It is a real-life vehicle chosen from the TD database.

- Original taxable value: \$305,141
- Value of air conditioner: \$6,998
- Value of audio equipment: \$3,827
- Value of anti-theft device: \$3,832
- Taxable value based on Revenue Bill 2003: \$319,798
- ***Original tax under Cap. 330 before amendment: \$183,085***
- Proposed tax based on Revenue Bill: \$185,788
- ***Tax based on the counterproposal: \$149,849***

19. Notwithstanding the projection of overall revenue gain under the counterproposal (see paragraph 15), as the public learn that some vehicle models would enjoy tax reduction pursuant to the counterproposal, consumption pattern may change in favour of such 'tax-saving' models. This might reduce the overall FRT revenue to below what the Government would have collected even under the original tax system in Cap. 330 before amendment. In that case, the counterproposal will have charging effect. Nevertheless, it is not possible for the Administration to forecast precisely how the pattern of consumption would change in response to the counterproposal.

Treasury Branch
 Financial Services and the Treasury Bureau
 May 2003

Annex

FRT Revenue before and after Budget Announcement

Taxable value (including value of formerly exempted accessories and warranties)	Average month in 2002/03 (up to 31/3/03)		First month after Budget (6/3/03-5/4/03)		Second month after Budget (6/4/03-5/5/03)	
	No. of private cars	FRT (million)	No. of private cars ()#	FRT (million) ()^	No. of private cars ()#	FRT (million) ()^
\$150,000 or below	1148	\$ 29	413 (36%)	\$15 (52%)	469 (41%)	\$17 (59%)
\$150,001 to \$300,000	895	\$ 56	350 (39%)	\$35 (63%)	560 (63%)	\$59 (105%)
\$300,001 to \$500,000	284	\$ 46	59 (21%)	\$15 (33%)	227 (80%)	\$53 (115%)
Above \$500,000	155	\$ 55	76 (49%)	\$35 (64%)	97 (63%)	\$49 (89%)
Total	2482	\$ 186	898 (36%)	\$100 (54%)	1353 (55%)	\$178 (96%)

@ No. of private cars liable to FRT from 1 April 2002 to 31 March 2003

()# shows the number of private cars as a percentage of the monthly average in 2002/03.

()^ shows the FRT revenue as a percentage of the monthly average in 2002/03.

Taxable value (including value of formerly exempted accessories and warranties)	Average month in 2002/03 (up to 31/3/03)		First month after Budget (6/3/03-5/4/03)		Second month after Budget (6/4/03-5/5/03)	
	No. of motorcycles	FRT (thousand)	No. of motorcycles ()#	FRT (thousand) ()^	No. of motorcycles ()#	FRT (thousand) ()^
\$50,000 or below	365.8	\$ 2,409	303 (83%)	\$2,476 (103%)	287 (78%)	\$2,778 (115%)
\$50,001 to \$100,000	23.6	\$ 453	10 (42%)	\$263 (58%)	31 (131%)	\$771 (170%)
\$100,001 to \$150,000	1.9	\$ 80	1 (53%)	\$52 (65%)	2 (105%)	\$96 (120%)
Above \$150,000	0.7	\$ 44	2 (285%)	\$125 (284%)	1 (143%)	\$65 (148%)
Total	392	\$ 2,986	316 (81%)	\$2,916 (98%)	321 (82%)	\$3,710 (124%)

@ No. of motorcycles liable to FRT from 1 April 2002 to 31 March 2003

()# shows the number of motorcycles as a percentage of the monthly average in 2002/03.

()^ shows the FRT revenue as a percentage of the monthly average in 2002/03.