For information
on 23 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 20 May.

Whether draft CSA proposed by LegCo ALA will have charging effect

2. The LegCo Assistant Legal Advisor has pointed out in his paper (LC Paper No. LS 110/02-03) dated 13 May that the draft CSA is intended to exclude the application of the Revenue Ordinance 2003 (the Ordinance) (subject to passage by LegCo and enactment) to any motor vehicle in respect of which a deposit has been paid by a purchaser to a registered distributor before the announcement of the Budget proposals on 5 March, and which is not yet registered by the time the Ordinance is gazetted. If the sale and purchase of such a vehicle has not been finalised till after the gazetting of the Ordinance, the intention is that the vehicle will still be excluded from the application of the Ordinance even if it is subsequently purchased and registered by a different purchaser. On the other hand, vehicles with deposit paid before Budget Day but first registered before the gazetting of the Ordinance would be subject to the Ordinance.

3. The draft CSA proposed by ALA seeks to exempt any motor vehicle from the Revenue Ordinance 2003 in respect of which a deposit has been paid by a purchaser to a registered distributor before the announcement of the Budget proposals on 5 March and which is to be registered after the Ordinance is gazetted, by which time the Order will have lapsed. The draft CSA will therefore not affect any lawfully established source of revenues. The exempted vehicles will be liable to the first registration tax (FRT) as provided in the Motor Vehicles (First

Registration Tax) Ordinance (Cap. 330) before amendment. In other words, the FRT payable pursuant to the CSA will not be less than what was payable under the original law. Therefore, the Administration considers that the draft CSA will not have charging effect.

4. As explained before, the Administration has reservations over the draft CSA proposed by ALA. Exclusion of orders placed before the Budget announcement is not in line with established practice nor the spirit of levying FRT. FRT is a tax on the registration of vehicles for use in Hong Kong. When FRT rates are changed, the new rates always apply to all vehicles which have not been registered at the time when the changes take effect. This has been the practice in the past for the FRT adjustments of 1990-91 and 1991-92 and is also the practice for other tax measures, such as duties on alcohol and tobacco. Any exemption for cars on order is also difficult to enforce. The major difficulty lies in verifying whether sale and purchase has occurred or deposit has been paid on a particular date.

Liability of reinstalled vehicle accessories to FRT

5. 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, given the addition of the four previously tax-exempted items into the base for levying FRT and on the rationale that the six-month requirement is mainly an anti-avoidance measure. As we have pointed out, there will be some operational complexities associated with this proposal. For instance, the requirement for declaration of a replaced accessory may pose compliance cost on the part of the registered owner and/or registered distributor as they will need to ascertain and provide its value for the purpose of the deduction. Also, since the law does not require detailed breakdown of the value of individual accessories in the Published Retail Price list (which is aimed to reduce compliance cost), it will be difficult for the operational department as they have no objective criteria to help them ascertain the value of the accessory replaced. Thus part of the problem which we have found with the system of exempting a number of the accessories and which we are seeking to deal with by the proposed abolition of exemptions will come back, albeit on a smaller scale. There

will be incentive for people to over-declare the value of the replaced accessory / warranty to increase the amount of discount or to declare a replacement which does not actually replace the original one.

6. That said, we think the operational problems are not insurmountable. We therefore intend to propose a CSA to the effect that registered owner and registered distributor (as applicable) should declare the value of the accessory and warranty being replaced, and that the value will be discounted when calculating the additional FRT payable. We agree with Members' proposal that exemption from additional FRT be given if value of the reinstalled vehicle accessories is lower than those being replaced. We intend to propose in the CSA that no additional FRT would be levied in such cases. Nevertheless, in order to prevent tax evasion, we will not propose to exempt the replacement accessory in such cases from the declaration requirement altogether. We will still require the registered owner and the registered distributor (as applicable) to make declaration with the supporting document for verification by the operational departments.

7. Since the registered owner will have made use of the replaced accessory / warranty, we do not propose to refund FRT in case where there may be an argument that FRT should be refunded in a case when a replacement accessory / warranty which is lower in value than the replaced accessory / warranty is fitted to or provided for the vehicle. The aim of the CSA is to avoid "double taxation". By not levying FRT on the replacement accessory in these cases, we will have already avoided "double taxation".

8. We do not intend to provide exemption for used accessories for which FRT had already been paid and which are used for reinstallation. The existing legislation also does not provide for exemption of such used and FRT-paid used accessory. The subject of first registration taxation is a vehicle for use in Hong Kong, not the individual accessory attached to it. As a vehicle has not been taxed for an accessory that it bears, the spirit is that additional FRT will be payable when the accessory is fitted to it, irrespective of whether the accessory is used or previously tax-paid. Furthermore, it appears that administratively it is not practicable to exempt a used accessory as such.

It will be very difficult, if not impossible, for the operational departments to ascertain whether an accessory claimed to be dismantled from a previously registered vehicle is actually so, particularly if the previous vehicle has been scrapped. A registered owner may get hold of any scrapping certificate and claim that a used accessory is dismantled therefrom.

9. To tackle the operational complexities, we intend to propose in the CSA to the effect that documents should be provided to support the claim that the replaced accessory / warranty was with the vehicle. Certification of the value of the replaced accessory / warranty and that the accessory has been removed or the warranty has ceased to be in force will have to be provided. Supporting documents should also be provided stating the use of the replacement accessory in relation to the replaced accessory. The proposed sections 4D(2) and 4D(2A) have already prescribed the declaration and supporting documents required for the replacement accessory.

10. The proposed section 4E(2B) provides that the Commissioner may assess the market value of the accessory or taxable warranty having regard to the declared value or the range of market values of any similar accessory or taxable warranty, in case he is of the opinion that the value declared to him does not reflect the market value for the purpose of taxation. In line with this proposed section and as reserve power against tax evasion, we intend to propose that the same power should be given to the Commissioner in respect of the declared value of the replaced accessory / warranty.

11. Because of the operational complexities we have explained, we will review this proposed arrangement, if implemented, in one year's time.

Revised proposal on the tax rates

12. As explained, both the number of registrations of private cars and registrations and the FRT revenue have picked up after the initial slow down upon announcement of FRT increases on Budget Day. 401 private cars were registered in the week commencing 12 May,

representing 70% of the 2002-03 weekly average. By the second month after Budget announcement, overall FRT receipts from private cars had almost reached the level of FRT receipts in an average month in 2002-03. For motorcycles, 109 were registered in the week commencing 12 May, representing 121% of the 2002-03 weekly average.

13. Nevertheless, noting the effect of the outbreak of the Severe Acute Respiratory Syndrome on the economy in general and the motor trade in particular, but bearing in mind the need for additional revenue to help resolve the Budget deficits, we propose to revise the marginal tax rates for the same four tax bands as follows: -

Marginal tax band	**Marginal tax rate**
for first $150,000 of taxable value	35%
for next $150,000	70%
for next $200,000	85%
for the balance (i.e. for the part of the taxable value over $500,000)	105%

14. As shown in ***Annex A***, the average effective tax rates of this revised proposal will be 35%, 44%, 59% and 76% respectively for vehicles falling into the four marginal tax bands. In the two upper bands, they are significantly lower than the effective rates of 35%, 46%, 65% and 95% of the original Budget proposals. This will address the motor trade's concerns that the Budget proposals will significantly affect the tax liability of more expensive private cars. Based on the representative model analysis, the projected percentage increase in retail price (including tax) under the revised proposal will be reduced for all models falling into the second, third and fourth marginal tax bands. The percentage increase in retail price for the most expensive private cars (i.e. above $500,000 in taxable value), for example, is projected to drop from the 19% - 27% range under the original Budget proposal to only 11% - 16% under the revised proposal. The effect of the percentage increase on retail price under this revised proposal is more evenly spread across the four different bands.

15. Under the counterproposal (i.e. 35%-55%-75%-95%) suggested by Members, the percentage increase in retail price for cars in the lowest band will exceed those in the higher bands. This is illustrated

in the representative model analysis in ***Annex B***. The increase in retail price under the counterproposal will actually be regressive in the sense that the percentage increase in retail price would be lower for all models with a taxable value in excess of $150,000 than for those below this figure. Apart from the revenue aspects therefore, we do not favour this counterproposal.

16. Nevertheless, it should be noted that our revised proposal is estimated to yield substantially lower additional revenue vis-a-vis the original Budget proposal, viz. about $400 million, or $300 million less than the original proposal. These estimates have again taken into account the possibility of distributors changing their pricing strategy and possible drop in car sales due to increase in tax rates.

17. The Administration will move a CSA to introduce the revisions to the proposed tax rates. As explained previously, any excessive FRT collected under the Order will be refunded subject to the passage of the CSA and the Revenue Bill 2003 by LegCo.

18. As regards the counterproposals on reducing motorcycle tax rates from the existing 40% to 32% or 35%, the Administration disagrees with these proposals. As explained, motorcycles are usually provided with one or two of the items exempted under the old taxation regime. Compared with private cars which are usually fitted with three to four such items, the impact of abolishing exemptions is significantly higher on private cars than on motorcycles. Based on the published retail prices of the motorcycles registered in 2002-03, their price inclusive of the tax component should rise by 8% on average after the abolition of the exempted items, assuming no change in pricing strategy. This is smaller than the projected increase in retail price of 11% for the representative models of lower-priced private cars with taxable value below $150,000. The number of registrations and revenue receipts from motorcycles has been recovering well for motorcycles after the initial psychological impact of the Budget announcement has faded.

Effect of the 35%-55%-75%-95% counterproposal on revenue

19. There were about 606 cases in 2002-03 where the FRT

payable under the counterproposal would be lower than under the original tax system. These cases spread across the first three marginal tax bands. For example in the 2002-03 database, 110, 295 and 201 cases are from the marginal tax bands of below \$150,000, \$150,001 - \$300,000 and \$300,001 - \$500,000 respectively.

20. As pointed out at the last meeting, if registrations of the above mentioned ‘tax-saving’ models are exceptionally high, this might reduce the overall FRT revenue to below the amount that 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 registration would change in response to the counterproposal.

Treasury Branch
Financial Services and the Treasury Bureau
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Annex A

Impact analysis of revised Government proposal on individual private car models

Vehicle Model	Old tax system # (I) Taxable value under old FRT regime	(II) Value of exempted items	(III) Tax under old FRT regime (<=$100,000@40% $100,001-$200,000@45% $200,001-$300,000@50% >$300,000@60%)	(IV) Old tax as % of old taxable value	(V) Retail price (including the old taxable value) under old FRT regime	(VI) Old tax as % of old retail price (including the old taxable value)	Revised Government Proposal * (VII) New taxable value after including exempted items	(VIII) Tax payable under the revised tax regime (First $150,000@35% Next $150,000@70% Next $200,000@85% Value>$500,000@105%)	(IX) New retail price (including the new taxable value)	(X) New tax as % of new taxable value	(XI) New tax as % of new retail price (including the new taxable value)	(XII) % difference in tax payable	(XIII) % difference in retail price (including the taxable value) after tax increase
Toyota Picnic	88,700	63,820	35,480	40%	188,000	19%	152,520	54,264	206,784	36%	26%	53%	10%
Toyota Corolla	61,300	54,080	24,520	40%	139,900	18%	115,380	40,383	155,763	35%	26%	65%	11%
Toyota Echo	34,700	30,420	13,880	40%	79,000	18%	65,120	22,792	87,912	35%	26%	64%	11%
Toyota Camry	106,500	63,500	47,925	45%	217,925	22%	170,000	66,500	236,500	39%	28%	39%	9%
Mercedes C200k - Classic	157,000	35,700	70,650	45%	263,350	27%	192,700	82,390	275,090	43%	30%	17%	4%
Mercedes E240V6 - Avantgarde	250,000	61,000	125,000	50%	436,000	29%	311,000	166,850	477,850	54%	35%	33%	10%
Mercedes ML320	217,000	61,000	108,500	50%	386,500	28%	278,000	142,100	420,100	51%	34%	31%	9%
Lexus - LS430	415,300	125,520	249,180	60%	790,000	32%	540,820	370,361	911,181	68%	41%	49%	15%
Mercedes S320L	366,000	53,000	219,600	60%	638,600	34%	419,000	258,650	677,650	62%	38%	18%	6%
Mercedes S350L	480,000	70,700	288,000	60%	838,700	34%	550,700	380,735	931,435	69%	41%	32%	11%
BMW - 735I	530,000	106,400	318,000	60%	954,400	33%	636,400	470,720	1,107,120	74%	43%	48%	16%
Porsche - 911 Carrera 4 Coupe	654,625	52,600	392,775	60%	1,100,000	36%	707,225	545,086	1,252,311	77%	44%	39%	14%

Old tax system refers to the system which was in place before 2:30 p.m. on 5 March 2003 when the Public Revenue Protection Order took effect.

* Proposed tax regime	Rate	Effective rate
First $150,000	35%	35%
Next $150,000	70%	44%
Next $200,000	85%	59%
Value>$500,000	105%	76%

Annex B

Impact analysis of the 35%-55%-75%-95% counter-proposal on individual private car models

	Old tax system #						35%-55%-75%-95% counter-proposal *						
Vehicle Model	(I) Taxable value under old FRT regime	(II) Value of exempted items	(III) Tax under old FRT regime (<=$100,000@40% $100,001-$200,000@45% $200,001-$300,000@50% >$300,000@60%)	(IV) Old tax as % of old taxable value	(V) Retail price (including the old taxable value) under old FRT regime	(VI) Old tax as % of old retail price (including the old taxable value)	(VII) New taxable value after including exempted items	(VIII) Tax payable under the proposed tax regime (First $150,000@35% Next $150,000@55% Next $200,000@75% Value>$500,000@95%)	(IX) New retail price (including the new taxable value)	(X) New tax as % of new taxable value	(XI) New tax as % of new retail price (including the new taxable value)	(XII) % difference in tax payable	(XIII) % difference in retail price (including the taxable value) after tax increase
Toyota Picnic	88,700	63,820	35,480	40%	188,000	19%	152,520	53,886	206,406	35%	26%	52%	10%
Toyota Corolla	61,300	54,080	24,520	40%	139,900	18%	115,380	40,383	155,763	35%	26%	65%	11%
Toyota Echo	34,700	30,420	13,880	40%	79,000	18%	65,120	22,792	87,912	35%	26%	64%	11%
Toyota Camry	106,500	63,500	47,925	45%	217,925	22%	170,000	63,500	233,500	37%	27%	32%	7%
Mercedes C200k - Classic	157,000	35,700	70,650	45%	263,350	27%	192,700	75,985	268,685	39%	28%	8%	2%
Mercedes E240V6 - Avantgarde	250,000	61,000	125,000	50%	436,000	29%	311,000	143,250	454,250	46%	32%	15%	4%
Mercedes ML320	217,000	61,000	108,500	50%	386,500	28%	278,000	122,900	400,900	44%	31%	13%	4%
Lexus - LS430	415,300	125,520	249,180	60%	790,000	32%	540,820	323,779	864,599	60%	37%	30%	9%
Mercedes S320L	366,000	53,000	219,600	60%	638,600	34%	419,000	224,250	643,250	54%	35%	2%	1%
Mercedes S350L	480,000	70,700	288,000	60%	838,700	34%	550,700	333,165	883,865	60%	38%	16%	5%
BMW - 735I	530,000	106,400	318,000	60%	954,400	33%	636,400	414,580	1,050,980	65%	39%	30%	10%
Porsche - 911 Carrera 4 Coupe	654,625	52,600	392,775	60%	1,100,000	36%	707,225	481,864	1,189,089	68%	41%	23%	8%

Old tax system refers to the system which was in place before 2:30 p.m. on 5 March 2003 when the Public Revenue Protection Order took effect.

* Proposed tax regime	Rate	Effective rate
First $150,000	35%	35%
Next $150,000	55%	40%
Next $200,000	75%	51%
Value>$500,000	95%	67%