For information
on 30 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 23 May.

Estimated additional revenue under revised Government proposal and Members' counterproposal

2. Assuming there will be no adjustments to the tax rates and no abolition of exemptions (i.e. the pre-Budget position), the estimated tax revenue for 2003-04 will be around $2.5 billion. This estimate has reflected a projected natural decline of 4% in the overall sale of cars in 2003-04 compared with the previous year.

3. We estimate that compared with the pre-Budget position, the counterproposal by some Members to adjust the tax rates for private cars to 35-55-75-95% would yield $181 million of additional revenue, and that the Government's revised proposal of 35-70-85-105% would yield $421 million of additional revenue under like circumstances. As with the original Budget proposal, on top of the projected natural decline of 4%, we have factored in a 15% drop in total number of private cars to be registered, and a 10% drop in the average tax payable for private cars (due to possible changes in the pricing strategy of vehicle dealers pursuant to the inclusion of the formerly-exempted items in the calculation of taxable value).

4. The difference of some $240 million in additional revenue to be generated under the Government's revised proposal and the proposal made by some Members can be explained by the fact that Members' proposal imposes a relatively moderate increase on more expensive cars (with a taxable value of $300,000 or above). As such cars contribute more than half (55%) of the total FRT from private cars (although only

accounting for 18% of the market share), a lesser increase will depress additional revenue rather substantially and hence the difference of $240 million in revenue yield arises.

5. Under Government's revised proposal, the tax rate for the first band will be adjusted downwards from 40% to 35% to mitigate the impact of abolishing the exemptions on less expensive cars. The tax rate for the second band will be adjusted from a global rate of 45% to a marginal rate of 70%. The bandwidths of the first two bands will also be widened from $100,000 to $150,000. The combined effect of these changes will lower the tax liability for some cars in the first and second tax bands, while increasing the tax liability for others in the same bands. The actual impact depends on the value of exempted items and retail price of individual car models. Average effective rate will be 35% and 44% respectively as against 40% and 45% formerly. Under Members' counterproposal, the rates would be 35% and 40% respectively.

Liability of employee or agent authorized by registered distributor

6. Under the existing section 4D(3), a registered distributor may authorize his employees or agents to make declarations. The existing section 4I(1)(e) imposes a criminal liability on registered distributors in relation to the making of a declaration, without at the same time providing for a like offence in respect of their employees or agents. We have followed this approach in the proposed section 4I(1)(ea).

7. We have revisited this arrangement in the light of Members' views. We agree that the authorized employee or agent should also be held liable for failure to deliver a declaration and for making a false declaration under sections 4(I)(e) and 4(I)(ea). A CSA will be proposed to achieve this.

Penalty for failing to keep record

8. It is proposed in the Bill that a registered distributor, associated person or registered owner who fails to keep records of sale and purchase of motor vehicles, accessories and taxable warranties under the new section 4FA will be liable on conviction to a fine of $10,000 and

to imprisonment for 6 months. The records required to be kept under the new section 4FA will help in the effective enforcement of the tax and prevent tax evasion. The provision is applicable not only to individuals but also to registered distributors and associated persons. The stated penalty is the maximum that the Court may impose. The Court will take into account the circumstances of the case, e.g. severity of the non-compliance, whether the convicted party is a business undertaking or an individual, etc, when determining the appropriate level of penalty to be imposed. We consider the penalty level appropriate.

9. This penalty level is consistent with the existing penalty under section 4I(2) of Cap. 330 for cases where a person fails to comply with a requirement by an authorized person in performing a duty under the Ordinance.

10. It is not uncommon to have custodial penalty attached to a record-keeping requirement. In the Dutiable Commodities Ordinance, for example, bonded warehouse-keepers are required to keep all the documents relating to the movement of goods into and out of the warehouse and payments made and received in the course of business. Failure to do so attracts a maximum fine of $500,000 and imprisonment of 1 year.

Tax Rates

11. We have informed the Bills Committee at the last meeting that the Government is prepared to move a CSA to adjust downwards the marginal tax rates for private cars from the Budget proposal of 35-75-105-150% to 35%-70%-85%-105%. Effective tax rates will be revised down from 35-46-65-95% to 35-44-59-76%. Compared with Members' counterproposal (marginal rates at 35-55-75-95% and effective rates at 35-40-51-67%), the impact on retail prices for private cars in different bands will be more progressive and equitable under the Government's revised proposal. The impact on retail prices for cars in the four bands under Government's revised proposal will be increases of 9-10-7-16% while under the counterproposal made by some Members, the impact will be 9-7-1-10%. The tables setting out the impact of the two proposals are at ***Annexes A*** and ***B***.

12. We therefore urge Members to support the Government's revised proposal. The relevant CSA is at ***Annex C*** for the Committee's consideration. As can be seen from the CSA, we also propose to make similar adjustments to the marginal tax rates for van-type light goods vehicles not exceeding 1.9 tonnes such that their rates tie in with those for private cars.

Calculation of FRT on Replaced Accessories

13. As mentioned at the last Bills Committee meeting, we consider that it should be arguable that the calculation of FRT should be on the difference between the old and newly fitted accessory instead of the value of the newly fitted accessory, given that the six-month requirement is mainly an anti-avoidance measure.

14. We have prepared a CSA along the above lines. We further propose that if the value of the new accessory is lower than that being replaced, we do not levy additional FRT but there will be no refund, since, after all, the replaced accessory has been used. We also propose not to apply the deduction approach to warranties because, unlike accessories which there may be a genuine need to replace within a short time period, there should not be such a need for warranties within six months of first registration. Providing deduction for warranties is also difficult to administer and prone to abuse.

15. There will be operational complexities associated with implementing the deduction approach, particularly as there is no breakdown of the values of individual accessories coming with a vehicle at first registration. The operational departments will have no objective criteria to help them ascertain the declared value of replaced accessories and hence it will be difficult for them to judge whether the value of the replaced accessories has been over-declared (which was the major operational difficulty leading to the proposal to abolish all exemptions). We will, therefore, as a safeguard, require documents to be provided to TD. These documents include those supporting a claim that the replaced accessory was with the vehicle, certification of the value of the replaced accessory, as well as those supporting that the accessory has been

removed. TD may also assess the market value of both the replaced and new accessory in case it is of the opinion that the declared values do not reflect the market value. These would help to minimize abuse.

16. The relevant CSA is at ***Annex D***.

17. We will review the arrangements in one year's time and re-consider whether they are satisfactory or whether there is revenue leakage.

Treasury Branch
Financial Services and the Treasury Bureau
May 2003

Impact analysis of revised Government proposal on FRT for private cars

			Old tax system #						Revised Government proposal *					
			Tax rate (Non-marginal / Effective rate) <=$100,000 @40% $100,001 - $200,000 @45% $200,001 - $300,000 @50% > $300,001 @60%						Marginal tax rate First $150,000 @ 35% Next $150,000 @ 70% Next $200,000 @ 85% Value > $500,000 @ 105%			Effective rate 35% 44% 59% 76%		
Value of cars	No. of cars registered in 2002-03	% of FRT receipts	(I) Taxable value under old FRT regime	(II) Value of exempted items	(III) Tax under old FRT regime	(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 revised tax regime	(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 retail price (including the taxable value) after tax increase**
$150,000 and below	13,776 (46%)	15%	64,259	42,607	25,704	40%	132,570	19%	106,866	37,403	144,269	35%	26%	**9%**
$150,001 - $300,000	10,740 (36%)	30%	140,600	64,946	63,270	45%	268,816	24%	205,546	91,382	296,928	44%	31%	**10%**
$300,001 - $500,000	3,408 (12%)	25%	306,478	68,656	183,887	60%	559,021	33%	375,134	221,364	596,498	59%	37%	**7%**
$500,001 or above	1,860 (6%)	30%	589,486	93,631	353,692	60%	1,036,809	34%	683,117	519,773	1,202,890	76%	43%	**16%**
Total	29,784	100%												

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

* Revised Government proposal represents the latest proposal of the Government as revised from the original 2003-04 Budget proposal (which is marginal system with rates at 35-75-105-150%). Proposed rate for motorcycles under Government's revised proposal is to be maintained at 40%.

Estimated additional revenue : $421 million

(assuming 15% drop in sales and 10% drop in average FRT)

Annex B

Impact analysis of 35%-55%-75%-95% counter-proposal on FRT for private cars

			Old tax system #						35%-55%-75%-95% counter-proposal *					
			Tax rate (Non-marginal / Effective rate) <=$100,000 @40% $100,001 - $200,000 @45% $200,001 - $300,000 @50% > $300,001 @60%						Marginal tax rate First $150,000 @ 35% Next $150,000 @55% Next $200,000 @ 75% Value > $500,000 @ 95%			Effective rate 35% 40% 51% 67%		
Value of cars	No. of cars registered in 2002-03	% of FRT receipts	(I) Taxable value under old FRT regime	(II) Value of exempted items	(III) Tax under old FRT regime	(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 revised tax regime	(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 retail price (including the taxable value) after tax increase**
$150,000 and below	13,776 (46%)	15%	64,259	42,607	25,704	40%	132,570	19%	106,866	37,403	144,269	35%	26%	**9%**
$150,001 - $300,000	10,740 (36%)	30%	140,600	64,946	63,270	45%	268,816	24%	205,546	83,050	288,596	40%	29%	**7%**
$300,001 - $500,000	3,408 (12%)	25%	306,478	68,656	183,887	60%	559,021	33%	375,134	191,351	566,485	51%	34%	**1%**
$500,001 or above	1,860 (6%)	30%	589,486	93,631	353,692	60%	1,036,809	34%	683,117	458,961	1,142,078	67%	40%	**10%**
Total	29,784	100%												

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

* Proposed rate for motorcycles : reduced to 35%

Estimated additional revenue : $181 million

(assuming 15% drop in sales and 10% drop in average FRT)