

For information

**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 30 May.

Liability of employee or agent authorized by registered distributor

2. As stated at the meeting on 30 May, we have revisited the arrangement in the existing provisions regarding the lack of offences for employees and agents similar to those for a registered distributor for failure to deliver a declaration and for making a false declaration under sections 4(I)(e) and 4(I)(ea), and we have agreed with Members that the authorized employee or agent should also be held liable. A Committee Stage Amendment (CSA) has been prepared (clauses 2, 6, 10(a) and 10(a)(ii) of *Annex A*) to the effect that where a registered distributor has authorized his employees and agents to make a declaration under section 4D(3), the authorized employee or agent, rather than the registered distributor, would be held liable for failure to deliver a declaration and if the employee or agent so authorized makes a false declaration, he will commit an offence under section 4(I). The Transport Department (TD) would inform authorized employees and agents and the registered distributors of their liability in writing subject to passage of the CSA by LegCo.

3. The whole set of draft CSAs which the Administration intends to move is at *Annex A*.

Penalty for failing to keep record

4. We have considered the point raised by a Member that

registered owners should not be subject to any custodial penalty for failing to keep records under the new section 4I(1A). We maintain our view that 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. We have consulted the Department of Justice, which advises that the Court will take into account the circumstances of the case, e.g. the innocence or otherwise of an infringing act, 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. They are of the view that differential penalties for different parties in respect of the same infringing act are inconsistent with legal policy in that the same maximum penalty should be attached to the same offence, leaving it to the Court to decide the appropriate level of penalty. Differential penalties are also inconsistent with other legislation in which the maximum penalties are the same whether the offence is committed by a business or an individual. We therefore consider the proposed penalty level in section 4I(1A) appropriate.

5. TD will inform the registered distributors, associated persons and registered owners of the record-keeping requirement. For example, TD will issue a letter to each registered distributor to remind them of the requirement at first registration. Ignorance of the law is not a justification for differential maximum penalties.

Charging effect of Member's Committee Stage Amendment

6. The Administration is of the view that the draft CSA tabled at the Bills Committee meeting on 30 May which seeks to reduce the proposed marginal tax rates for private cars and van-type light goods vehicles and the tax rate for motorcycles would have the effect of disposing of or charging the revenue of Hong Kong as defined in Rule 57(6) of the Rules of Procedure of the Legislative Council. Rule 57(6) of the Rules of Procedure of the Legislative Council provides that "An amendment, the object or effect of which may, in the opinion of the

President or Chairman, be to dispose of or charge any part of the revenue or other public moneys of Hong Kong shall be proposed only by (a) the Chief Executive; (b) a designated public officer; or (c) a Member, if the Chief Executive consents in writing to the proposal.”

7. The key words in Rule 57(6) are “to dispose of or charge any part of the revenue or other public moneys of Hong Kong”. In this context, “revenue” means the income of Hong Kong from which public expenses are met, and it is not restricted to income that has already been received or accrued due. When one speaks of the amount of income from year to year, one is usually speaking of the amount of income from year to year, not exclusive of what has already been collected from various sources. In other words, the concept of “revenue” has within it a clear meaning of prospective income rather than what has been received or accrued in the past. So, the increased revenue anticipated to be collected from the general public may properly be regarded as “revenue of Hong Kong” even though it may not as yet have accrued due. If the intention had been to limit the powers of Members of the Legislative Council only in relation to revenue already collected, the phrase would have been “revenue collected” or “revenue received or accrued” and not “revenue of”.

8. It is worth noting that in May 1994, when two Members of the then Legislative Council proposed to move amendments to a resolution proposed by the Administration, the then President of the Legislative Council made a ruling that “revenue” meant the annual income of Hong Kong from which public expenses are met, and was not restricted to income that had already been received or accrued due. Therefore, it followed that to “dispose of” revenue must include any action which results in a lawfully established source of revenue no longer being receivable at a future date.

9. Another dimension we should consider is whether a particular CSA **may** have the object or effect of disposing or charging any part of the revenue. According to Erskine May, *Parliamentary Practice* (22nd ed) pp 763 and 767, “if there is any doubt on the matter and it appears that the new proposal **may** entail an extension of previously enacted purposes of expenditure or an increase in the

expenditure **potentially** liable to be incurred in pursuit of such a purpose, a money resolution will be required”, and “in practice, this is interpreted to mean a proposal for new or increased expenditure which is not already covered by legislative authorization”. This approach was adopted by the then President of the Legislative Council in his ruling of 28 March 1996 that a Private Member’s Bill, the Employee’ Compensation (Amendment) Bill 1996, has a charging effect. The then President referred to the following opinion of Counsel to the Legislature:

“Counsel of the Legislature also considers that the proposed changes under the Employees Compensation (Amendment) Bill 1996 will result in all employers (including the Government) being legally obliged to ... Even though the likely increased expenditure cannot be forecast with accuracy (because there are many contingencies in the scenario, including the probable number of accidents to government employees, the nature of such accidents etc), SO 23 the equivalent of Rule 57(6) of the LegCo Rules of Procedure is worded in terms of an amendment which “**may**” charge the revenue. Hence it is only nominal (or, in lawyers’ language, “de minimis”) additional expenditure which can properly be ignored under SO23.”

10. The draft Member’s CSA seeks to (i) reduce the marginal tax rates for private cars proposed by the Government in the Revenue Bill 2003 (i.e. 35-75-105-150%) to 35-55-75-95%, (ii) reduce the proposed marginal tax rates for van-type light goods vehicles not exceeding 1.9 tonnes from 35-75-105% to 35-55-95%, and (iii) reduce the tax rate for motorcycles from 40% to 35%.

11. Under the Public Revenue Protection (Revenue) Order 2003 (the Order), the Budget FRT proposals in the Revenue Bill 2003 are given legal effect. The Order, which took effect from 2:30 PM on 5 March 2003, was made under the Public Revenue Protection Ordinance (Cap. 120), and therefore forms an established part of the revenue. Section 2 of Cap. 120 unequivocally authorizes the Chief Executive to make the Order to give “full force and effect of law” to the Revenue Bill 2003. This is the required statutory authority constituting the additional FRT collected since Budget announcement on 5 March 2003 as a lawfully established source of revenue. The additional revenue that we

expect to collect pursuant to our proposals in the Revenue Bill 2003 is revenue of Hong Kong. Clearly, the Member's CSA would have the effect of disposing of the additional FRT already collected pursuant to the Order and anticipated to be collected from the general public at any future date.

12. Not only would the draft Member's CSA lead to reduction in revenue collected pursuant to the Order and to be collected, it **may** even lead to lower overall FRT receipts compared with the pre-Budget position. We propose in the Revenue Bill 2003 to abolish the formerly tax-exempted items. To mitigate the effect of the abolition in increasing 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). The average effective tax rate (ratio of FRT payable to the vehicle's taxable value) under the draft Member's CSA will be lower than under the pre-Budget position for some of the private cars in the third and fourth tax bands and for all motorcycles. The tax payable under the draft Member's CSA will also be lower than under the pre-Budget position for some of the private cars in the second to the fourth tax bands.

13. We have searched through our database on 2002-03 first registrations for private cars, and have identified 1,811 cars which will have a lower **effective tax rate** under the Member's CSA compared with the pre-Budget position (471 with taxable value - including formerly-exempted items - ranging from \$300,000 to \$500,000 and 1,340 with taxable value over \$500,000). The difference in tax rates ranges from 1 to 26 percentage points. For motorcycles, the pre-Budget and the proposed tax rates are both global rates, hence effective tax rates. The rate proposed in the Member's CSA would be 5 percentage points lower than the pre-Budget rate. For van-type light goods vehicles not exceeding 1.9 tonnes, there were 5 registrations in 2002-03. Their new taxable values all fall below \$150,000. Their effective tax rates will be reduced from 40% before the Budget to 35% under the Member's CSA.

14. We have also identified from our database on 2002-03 private car first registrations 606 cases or 150 models ('tax-saving models') where the **FRT payable** under the Member's CSA would be

lower than under the pre-Budget 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, \$150,000-\$300,000 and \$300,001-\$500,000 respectively. There were also 142 cases or 83 models of motorcycles where the FRT payable under the draft Member's CSA will be lower than under the pre-Budget system.

15. If there are any changes in the pricing strategy of vehicle distributors after the abolition of exempted items, for example reduction in the value of the exempted items, and if these go beyond our assumptions (i.e. 10% drop in average FRT payable) the total taxable value of private cars, hence the FRT payable, will reduce further. This in return will reduce the estimated additional revenue of \$181 million under the Member's CSA, leading to revenue loss compared to the pre-Budget system. If we assume that the average FRT payable would drop by 20% (instead of the 10% drop in average FRT which is the assumption adopted for deriving the \$181 million additional revenue), pursuant to the Member's CSA, the additional revenue would be reduced by about \$370 million or \$189 million less than pre-Budget position. We cannot rule out this possibility entirely, as the value of the formerly tax-exempted items (i.e. air-conditioner, audio equipment, anti-theft device and distributor's warranty) as declared by the vehicle distributors amounted to a significant percentage of the taxable values, namely 66%, 46%, 22% and 16% of the old taxable value of private cars falling into the first to fourth proposed marginal tax bands respectively.

16. Under a scenario whereby private car first registration numbers drop more than the Government has assumed, e.g. by 25% (instead of a drop of 15% which is the assumption used for deriving the \$181 million additional revenue, and on top of the projected natural decline of 4%), revenue will be \$300 million less than the 15% drop assumption or \$119 million less than pre-Budget position. We cannot rule out this possibility entirely because the trade considers that the prospect for the trade is not good under the current economic situation and the Government original assumption is too optimistic.

17. There will be a drain on revenue if both factors, namely first registration and average FRT value perform worse than the Government's estimates, which are considered too optimistic by Members.

18. While it is not possible for the Administration to forecast precisely how the pattern of registrations and the pricing strategy of vehicle distributors would change in response to the draft Member's CSA, or whether or to what extent the overall FRT receipts would drop, in accordance with the principle mentioned in para 9 above, so long as the CSA **may** have a **potential** liability to loss of revenue, the CSA should be regarded as having a charging effect. It is not necessary to satisfy the test that the Member's CSA would have the necessary consequence of reducing revenue for it to have a charging effect.

19. There is a third dimension to the charging effect of the Member's CSA. The CSA, if passed, would lead to a refund of excessive FRT collected under the Order. It is estimated by TD that they would incur \$900,000 in terms of staff and computer programming costs to arrange refund for some 5,000 vehicles. This amount is not insignificant and with this factor alone, the CSAs tabled at the last Bills Committee would have the effect of disposing of or charging Government's expenditure in accordance with Rule 57(6) of the Rules of Procedure of the Legislative Council.

Consequences if both the Administration's revised tax rate proposals and Members' counterproposal are not passed by LegCo

20. In the event that the Administration's CSA on the revised tax rates and the Member's CSA on tax rates were not passed at the Committee Stage, the pre-Budget Schedule to Cap. 330, i.e. the "present tax bands and rates" column in *Annex B*, would be in force again upon gazetting of the Revenue Ordinance 2003 as amended and passed by LegCo. In other words, the system would revert to the original non-marginal rates and tax bands for private cars and the originally higher tax rates for goods vehicles, taxis, light buses, buses and special purpose vehicles.

21. The value of the formerly tax-exempted items amounted to as much as 68%, 46%, 22% and 17% of the old taxable value of the private cars falling into the four former non-marginal tax bands. With the taxable value inflated by the exemption abolition as proposed in the Revenue Bill 2003, but without the tax bands widened or the tax rates for the lowest band adjusted as proposed, the tax liability of all vehicles would increase. The additional FRT receipts from private cars as a result of only removing the exempted items (but sticking to the old non-marginal tax rates and bands) are estimated to be about \$400 million. The underlying assumptions used here are the same as those used for the original and revised Government proposals.

22. It should be noted that since the values of formerly-exempted items constitute a relatively larger portion of the taxable value of the less expensive private cars, the impact on the tax payable for these private cars would be more significant. Based on the vehicles registered in 2002-03, the impact on retail prices for cars in the four former non-marginal tax bands will be increases of 17-15-14-6%. The impact is apparently regressive, i.e. the less expensive the private car, the higher the percentage increase in retail price (inclusive of tax). The impact on retail prices for cars in the four proposed marginal tax bands under the revised Government proposal will be 9-10-7-16%.

23. It was the suggestion of the Motor Traders Association of Hong Kong that a marginal tax system be adopted for private cars. The Government has taken on board the suggestion, which has received the general support of the motor trade. If neither clause 11 of the Revenue Bill 2003 nor the CSAs thereto were passed by LegCo, the marginal tax system would not be implemented.

24. For commercial vehicles such as buses, light buses, taxis and special purpose vehicles (which were subject to the pre-Budget FRT rate of 4%) and goods vehicles (pre-Budget FRT rates at 18-20%), we have proposed in the Revenue Bill 2003 to adjust downwards the tax rates to mitigate the impact of abolition of exemptions. If neither clause 11 nor the CSAs were passed, the increase in taxable value, hence FRT for these vehicles would not be mitigated.

25. Noting the regressiveness of the resultant impact on the retail prices of private cars, in particular the less expensive private cars, the increase in tax liability of the commercial vehicles and the non-adoption of a marginal system as suggested by the motor trade, we again urge Members to support the revised Government proposal and the related CSA to be moved by the Administration.

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Financial Services and the Treasury Bureau
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First Registration Tax on Motor Vehicles

Vehicle type	Present tax bands and rates	Proposed tax bands and rates #
Private cars	(a) taxable value does not exceed \$100,000 40% (b) taxable value exceeds \$100,000 but does not exceed \$200,000 45% (c) taxable value exceeds \$200,000 but does not exceed \$300,000 50% (d) taxable value exceeds \$300,000 60%	(a) for first \$150,000 of taxable value 35% @ (b) for next \$150,000 75% @ (c) for next \$200,000 105% @ (d) for the balance (i.e. for taxable value over \$500,000) 150% @
Motor cycles	40%	40%
Motor tricycles	40%	40%
Goods vehicles		
Van-type light goods vehicles not exceeding 1.9 tonnes permitted gross vehicle weight	(a) taxable value does not exceed \$100,000 40% (b) taxable value exceeds \$100,000 but does not exceed \$200,000 45% (c) taxable value exceeds \$200,000 50%	(a) for first \$150,000 of taxable value 35% @ (b) for next \$150,000 of taxable value 75% @ (c) for the balance (i.e. for taxable value over \$300,000) 105% @
Van-type light goods vehicles exceeding 1.9 tonnes permitted gross vehicle weight	20%	17%
Goods vehicles, other than van-type light goods vehicles	18%	15%
Taxis	4%	3.7%
Public and private light buses		
Public and private buses (except those exempted from the Motor Vehicle First Registration Tax as specified in the relevant Ordinance)		
Special purpose vehicles		

Under the proposed tax system, no exemption will be given to air-conditioners, audio equipment, anti-theft devices or distributors' warranties. Also, the marginal tax system will be adopted for private cars and van-type light goods vehicles not exceeding 1.9 tonnes.

@ These are marginal tax rates.