

**For information
on 3 April 2003**

**Paper for Subcommittee on the
Public Revenue Protection (Revenue) Order 2003**

Purpose

This paper provides the Administration's response to the questions raised by Members at the meeting of the Subcommittee on the Public Revenue Protection (Revenue) Order 2003 (PRPO 2003) held on 25 March.

Adjustments of tax base and tax rates for private cars and other commercial vehicles

2. As explained, while the Budget proposals will likely bring about an increase in tax liability for the majority of private cars, the increase is merely due to the abolition of exemptions (the value of which as declared by distributors used to constitute 68% of the total value of the vehicle for lower-priced cars) rather than any increase in the tax rate for the bulk of the private cars. The Government has proposed to widen bandwidths, switch to a marginal system and reduce tax rates for lower-priced private cars to mitigate the impact of the abolition.

3. Assuming no change in pricing strategies, the new tax rates would lead to an increase in retail price inclusive of the tax component in a range between 5% and 27% for some representative vehicle models.

4. The impact of the proposals will be higher for more expensive private cars. Nevertheless, these represent only a small portion of the private car market in Hong Kong. In 2002-03 (up to 5 March 2003), only about 6%, or 1,800 of the private cars first registered had a taxable value (after including the tax-exempted items) in excess of \$500,000.

5. Some distributors may choose not to pass the full tax burden on to consumers and may change their pricing strategies. If so, the increase in retail price because of the abolition of exemptions and tax changes would be smaller, although this would impact distributors' profitability. We have found that some distributors have absorbed part of the tax increase and this is more common with higher-priced cars.

6. For commercial vehicles such as buses, light buses, taxis, and goods and special purpose vehicles, we propose to lower their tax rates to mitigate the impact of abolition of exemptions. The proposals are not expected to affect the transport trade's livelihood.

Impact on Persons Engaged in the Trade

7. According to the Census and Statistics Department, the number of persons engaged in the wholesale, retail (including fitting of accessories) and import and export trade of motor vehicles, motorcycles and bicycles was about 12,330 persons in 2002 (630 persons in wholesale, 5,900 persons in retail and 5,800 persons in import and export trade). This number includes employees engaged by authorized dealers, parallel importers as well as shops selling and fitting accessories. Except those dealing only in bicycles, they represent the group whose business might be affected most by the Budget proposals on FRT. There were about 10,000 persons who were engaged in the servicing and repairing of motor vehicles and motorcycles as at March 2002. This group might benefit if people tend to hold on to their existing vehicles for a longer period.

8. According to the Labour Department, as of 29 March 2003, there was no report of labour disputes handled by the Department involving major vehicle distributor or accessories businesses closing down after the Budget proposals took effect on 5 March.

9. We estimate that the Budget proposals on FRT would not have a significant effect on the economy as a whole. The effect of the increases on GDP growth is estimated to be very insignificant, amounting to less than a hundredth of a percentage point. Furthermore, vehicle dealers may absorb part of the tax increase, and in such case, any effect on car sales will be further mitigated.

Sales Before and After Budget Announcement

10. According to Transport Department's statistics, there were 1,636 private car first registrations in the week before the Budget this year, as compared with the weekly average of 571 for 2002-03 (detailed figures are set out in **Annex**). This represents 287% of the weekly average number of registrations in 2002-03. As the market would need some time to digest this surge in volume, the number of private car registrations has dropped to 59 during the week after Budget announcement (i.e. from 6 March to 12 March). However, while the number of first registrations immediately after the Budget announcement slowed down, this has started to pick up again and is gradually rising back to its usual level. During the week from 24 March to 30 March, the number of first registrations for private cars rose to 328.

Estimate on Additional Revenue to be Generated

11. We forecast that \$700 million would be raised by the increases in FRT. This estimate has already taken into account the possibility of distributors changing their pricing strategy and possible drop in car sales due to the proposed increase in tax rates.

12. If consumer demand and vehicle prices were completely inelastic, the estimated FRT receipts in 2003-04 arising from the Budget adjustments would be about 60%, or \$1,400 million higher. Though we expect that FRT proposals would only have a temporary effect on consumer demand, for revenue estimate purposes, we project that there would be a 15% drop in the total number of private cars to be registered in 2003-04, 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. As a result, the estimated FRT receipts in 2003-04 are projected to be about 30%, or \$700 million higher than without the Budget measure. This additional revenue represents about 22% of the 2003-04 estimate of \$3,182 million. The projected decreases in car sales and taxable values are on top of a projected decline in the overall sale of cars in 2003-04 compared with the previous year.

13. The Government last raised FRT in the 1991-92 Budget, when the FRT rates for private cars were raised in a range of 12.5% to 20%. FRT revenue in 1991-92 increased by 67% over the previous year and the number of first registrations for private cars rose by 37%. (The Government did not raise FRT rates in 1994, but revised the system from one that is based on cost-insurance-freight price as the basis of taxation to the current one based on published retail price. That 1994 exercise was conducted on a revenue-neutral basis and the changes did not form part of the 1994-95 Budget. The revised tax system came into effect in August 1994. FRT revenue in 1994-95 eventually rose by 11%, or \$470 million over the previous year.)

14. Apart from the 1991-92 Budget increase, we also raised FRT rates in the 1990-91 Budget. The increases in 1990-91, which were in the range of 11% to 14% for private cars, were also revenue productive, with the number of first registrations in respect of private cars dropping slightly by 1.4% but revenue increasing by 18% over the previous year. (There was another increase in 1982-83, at 100% for private cars, which did not result in any increase in revenue. According to the information we have to hand, this increase was not announced in the 1982-83 Budget and not intended to be a revenue-raising measure.) Detailed figures for the 1990-91 and 1991-92 FRT increases are set out in **Annex**.

Exemption for orders placed before PRPO 2003 took effect

15. 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. When prospective car buyers place their orders, they should be aware that there is the possibility of a tax adjustment and that if their cars have not been registered by Budget Day they will be subject to such new rates as may be announced in the Budget.

16. In practice, an exemption for cars on order is difficult to enforce. The major difficulty lies in verifying whether a sale has taken place on a particular date. There will be incentive for people to submit back-dated or fabricated orders to achieve tax savings. Even if a case appeared suspicious, investigations may be very difficult as they would have to rely on the voluntary co-operation of the vehicle sellers and buyers. Documentary proof may not be available in all cases for verification of the date of order e.g. for deposits paid in cash. Substantial revenue loss may result if this suggestion is adopted.

17. As regards the suggestion to exempt cars imported before Budget Day, again FRT is a tax on first registration and as such, we consider that there is no justification to exempt cars in the stock of distributors, which might not be subsequently sold and registered in Hong Kong. According to our records, many of the cars imported into Hong Kong are never registered for use in Hong Kong but are eventually re-exported.

Views of Motor Traders Association Hong Kong

18. According to its latest submission, the Motor Traders Association of Hong Kong, the major Association representing car distributors, is supportive of the timing of the Government's measures, which uses the entry into force of the PRPO as the effective date for the new rates.

Conclusion

19. We believe that the slow-down in car sales would be only a temporary phenomenon, that car sales should pick up after the initial psychological impact of the tax increase on consumers has faded, and that this should have a limited impact on the trade.

Treasury Branch
Financial Services and the Treasury Bureau
April 2003

Annex

	Total FRT revenue for all vehicles types (\$million) (y-o-y % change)	Date of Budget/Change in tax system or rates	No. of private cars first registration						
			One week before Budget Day or date of change of tax system/rates	One week after Budget Day or date of change of tax system/rates	One month before Budget Day or date of change of tax system/rates	One month after Budget Day or date of change of tax system/rates	Total number of first registration	Monthly Average	Weekly Average
1989-90	1,735	1.3.1989 (Budget Day)	1,505	82	3,314	1,072	27,318	2,277	525
1990-91	2,054 (18%)	7.3.1990 * (Budget Day)	1,484	71	4,247	1,131	26,934	2,245	518
1991-92	3,437 (67%)	6.3.1991 * (Budget Day)	1,131	119	2,214	1,401	36,842	3,070	709
1992-93	4,940 (44%)	4.3.1992 (Budget Day)	3,071	193	5,471	1,749	41,421	3,452	797
1993-94	4,192 (-15%)	3.3.1993 (Budget Day)	3,287	57	6,583	1,393	41,482	3,457	798
1994-95	4,662 (11%)	2.3.1994 (Budget Day)	2,955	208	4,986	1,859	34,158	2,847	657
		1.8.1994 #	2,015	54	4,732	1,920			
1995-96	2,880 (-38%)	1.3.1995 (Budget Day)	3,716	55	5,214	1,126	20,174	1,681	388
1996-97	3,249 (13%)	6.3.1996 (Budget Day)	496	374	1,605	1,877	26,820	2,235	516
1997-98	4,246 (31%)	12.3.1997 (Budget Day)	651	772	2,551	3,301	44,056	3,671	847
1998-99	2,237 (-47%)	18.2.1998 (Budget Day)	522	507	3,167	3,021	29,641	2,470	570
1999-2000	2,613 (17%)	3.3.1999 (Budget Day)	324	483	1,306	2,157	32,231	2,686	620
2000-01	3,025 (16%)	8.3.2000 (Budget Day)	2,030	200	3,780	1,877	34,346	2,862	661
2001-02	2,676 (-12%)	7.3.2001 (Budget Day)	1,701	343	3,789	2,217	33,274	2,773	640
2002-03	2,605 α (-3%)	6.3.2002 (Budget Day)	673	415	1,760	2,042	29,687	2,474	571
2003-04		5.3.2003 @ (Budget Day)	1,636	59	3,026	581 ^			

* Change of tax rates

Change of tax system w.e.f. 1.8.1994

@ Change of tax system and rates w.e.f. 5.3.2003

^ Statistics up to 28 March 2003

α 2002-03 Revised Estimate