DUTY ON ALCOHOLIC BEVERAGES

CONSULTATION DOCUMENT

FOREWARD

The Government is conducting a review on the duty on alcoholic beverages to see if the existing duty system and rates are appropriate and whether any changes should be introduced.

This consultation document highlights salient features of our existing system and invites your opinion on the review.

Treasury Branch
Financial Services and the Treasury Bureau
Government Secretariat

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Duty on Alcoholic Beverages

Under the Dutiable Commodities Ordinance, Cap. 109 (DCO), four commodities are subject to excise duty. They are alcoholic beverages, tobacco, hydrocarbon oils and other alcohol products. The duty on alcoholic beverages was introduced in 1909 to generate revenue. It is a common form of taxation which is levied by all major tax jurisdictions in the world.

2. The duty is levied on alcoholic beverage products that are for local consumption in Hong Kong. It is not levied on exports or re-exports.

Existing and Previous Duty Systems

3. Duty on alcoholic beverages is currently charged in accordance with the following *ad valorem* (AV) structure-

Alcoholic strength	**Duty** (on basis of ex-factory price, which is the manufacturer's selling price)
More than 30% (strong liquors e.g. brandy and whisky)	100%
Not more than 30% (mild liquors e.g. mainly beer)	40%
Wine	80%

4. The AV system was first adopted in 1994-95. Before then, a more complicated specific cum AV duty system was used, which charged $49 per litre plus 35% of the Cost, Insurance and Freight (CIF) price on sparkling wine, $34 per litre plus 20% of the CIF price on still wine, $80 per litre plus 35% of the CIF price on whisky and brandy, and $3.36 per litre (specific only) on beer.

The duty as a stable revenue source

5. The duty on alcoholic beverages is a stable source of revenue and has contributed on average 0.4% - 0.5% of total Government operating revenue annually over the past five years. The duty receipts for 2003-04 were about $767 million, or around 0.4% of total Government operating revenue for the year. The duty receipts in dollar amounts and as a percentage of the total operating revenue for the past five years are set out in the following table:

	1999-2000 ($ million)	2000-01 ($ million)	2001-02 ($ million)	2002-03 ($ million)	2003-04 ($ million)
Duty on alcoholic beverages	774	715	792	819	767
Total Government operating revenue	175,196	171,320	151,405	153,336	174,611
Duty as a percentage of total Government operating revenue	0.4%	0.4%	0.5%	0.5%	0.4%

6. Out of the main categories of alcoholic beverage products, wine, beer, brandy and whisky contributed 39%, 35%, 11% and 4% respectively of the total receipts in 2003-04. The remaining 11% of the receipts are contributed by other alcoholic beverage products such as gin, vodka, rum, mow toi, sheung ching and sake.

Overseas practices

7. All major tax jurisdictions impose taxes on alcoholic beverages. One major difference between our system and others is that we have only a single tax, namely excise duty, on these products, while many other places levy more than one tax (customs tax, sales tax, alcohol tax, state tax, etc.).

8. As regards the duty system itself, taking wine as an example, some places including Australia, the Philippines, Korea, the Mainland of China and Macau, like us, adopt an AV system. New Zealand, Malaysia, Singapore, US, Belgium and the UK adopt a specific duty system. Those in this latter group all have a sales tax in place, which injects a progressive element into the overall tax system for alcoholic beverages.

9. Hong Kong charges its duty on the ex-factory price, while many others which also adopt an AV system use CIF, which is a higher basis, for the charging. We have done a rough comparison of the total amounts of duties on similar products for a number of selected

jurisdictions. We have found that for lower-end products, Hong Kong's duty is generally lower compared with the total duties and taxes on such products in many places, except Macau and the Mainland, but for high-end products, our duty is generally higher than major jurisdictions in the region and even some of the more mature European economies.

10. A survey conducted in August 2004 reveals that in Hong Kong, duty only accounts for 9% to 25% of the retail price of the popular brands of wine, and the percentages for hotels and restaurants are even lower: between 3% and 15%.

Reasons for the Review

11. There are constant calls from the liquor industry and the catering sector for a reduction in the duty on alcoholic beverages. They are of the view that there is a "stigma" that Hong Kong imposes a heavy duty on such products and that there is a need to enhance the price competitiveness of alcoholic beverages in Hong Kong in order to achieve the objectives of enhancing Hong Kong's popularity and status in particular as a wine enjoyment centre and distribution hub. They are of the view that such a move would help boost tourism. They argue that if reduction in duty leads to a corresponding reduction in the retail price of alcoholic beverages, it may boost consumption by residents and tourists. In the case of a significant reduction in duties, this might create a distinct

signalling effect and foster a more liberal psychology among consumers which would boost consumption further.

The Administration's Position: the Duty Should be Retained

12. We consider that there is a general consensus amongst the community at large that the imposition of a certain duty on alcoholic beverage products is appropriate on a number of grounds including revenue generation, affordability and health. As mentioned, all major jurisdictions in the world impose a duty on alcoholic beverages (over and above a general GST/sales tax). Our average duties on wine ($23 per 750 ml bottle for 2003-04) for example are on the low side in comparison with other major jurisdictions. The abolition of duty would not directly foster trading, because liquor for export and re-export is not subject to duty.

13. We are therefore of the view that the duty on alcoholic beverages should not be abolished but be retained as a form of tax.

Options to Change the Duty

14. We consider that the following options on changing the duty may be further explored-

(A) to introduce a cap to the present AV duty on wine and strong liquors;

(B) to replace the present AV duty with a specific duty; and

(C) to lower the present AV duty rate on alcoholic beverages.

(A) Introduce a cap to AV duty on wine and strong liquors

15. One option is to adopt a mixed system using the following formula: retain the current AV structure while setting a cap on the duty for wine and strong liquors (no need for a cap on mild liquors because the price range for these is not so wide). Under this option, consumers would be readier to consume high-end products and less likely to shift their consumption elsewhere, while allowing the present system, which is generally popular and equitable, to remain intact. There might also be less trading down by consumers, a trend which will be discussed in greater detail in para 18 below. The revenue loss under this option would be limited because high-end wine and strong liquor products account for only a very small portion of total consumption, for instance, wine and strong liquors that attract a duty above $300 and $500 account for only 0.3% and 0.1% of the market respectively and contribute to 7.8% and 4.0% of the tax receipts.

16. Such a system would be more complicated than the existing one. It would be similar to the system now adopted in Japan. If this system were adopted, the cap should be sufficiently high, perhaps at the level of some hundred dollars, in order to be relatively equitable. Under this option, retailers, hotels and restaurants would need to pass on the duty reduction to consumers in order for it to be effective in boosting consumption and tourism. This option would cause revenue loss in the order of $15 million and $7 million per annum, assuming a cap of $300 and $500 respectively, and no increase in consumption.

(B) Switch to a Specific Duty

17. Certain quarters of the liquor industry have urged the Government to replace the existing AV system by a specific duty system with wine duty, for example, being set at a uniform rate of $15 or $20 per bottle (750 ml). Arguments advanced for this option include the one that the AV system prompts trading down.

18. In recent years, while consumption has remained stable - at around 190 million litres per annum, duty revenue has, however, seen a moderate declining trend, due to a shift towards cheaper products. The average duty in 2003-04 was $23 per bottle (750 ml) for wine products, $61 per bottle (700 ml) for brandy, $29 per bottle (750 ml) for whisky and $0.6 per can (330 ml) for beer products. The corresponding figures for 1994-95 (i.e. the first year under the current AV system) were $29,

$110, $41 and $0.6 for wine, brandy, whisky and beer respectively. Taking account of changes in the levels of duty during the period, it can be seen that there has been a general trading down in alcoholic beverage consumption over the past decade, particularly in brandy, whisky and wine. Some of the reasons for the trading down may be the availability of cheaper products that are of an acceptable quality, and the economic downturn. Another reason may be the AV duty, as under such a system consumers have a tendency to move down-market.

19. We agree that a specific duty set at a reasonable level might encourage more consumption of high-end products. Enforcement work may also be somewhat simplified as a result. However, such a duty system is regressive. While some overseas jurisdictions do adopt a specific duty on alcoholic beverages, they all have a GST/sales tax on top, which is ultimately levied on the basis of a percentage of the retail price, and hence there is a progressive element in the tax to a certain extent. We do not have a GST at the moment to add a progressive element to the overall tax.

20. If we were to switch to a specific duty at revenue-neutral levels of $23 per bottle of wine, $22 per bottle of strong liquor, and $0.6 per can of mild liquor, the low-end liquor products would see their effective tax rates rising rather substantially for the most part (and more than double in certain cases). This situation would be particularly prominent in strong liquors because of the disparity in the prices of different products in this category: the average duty for brandy/whisky is $48 but that for the rest,

e.g. Chinese-type strong liquors, is only $9. The impact on beer and other mild liquors will not be as significant because the price range is not as wide.

(C) Lower AV duty on alcoholic beverages

21. Another less fundamental change would be to reduce the duty rates on wine and strong liquors. One option would be to align their duty rates with the duty on mild liquors, i.e. 40% across the board. Under this option, consumption on wine and strong liquor may be boosted. The "stigma" perception problem may be eased. This option will also simplify the duty system in the sense that all alcoholic beverages will be subject to a single duty rate. However, this may have the effect of changing the tax structure to the disadvantage of the currently lower-duty products such as beer.

22. There will be a drain in revenue of the order of about $240 million a year. Under this option, consumption of wine and strong liquors will need to increase by 100 –150% for the proposal to be revenue neutral.

23. Another sub-option is to lower the duty on wine and strong liquors from 80% and 100% respectively to 60% to match the duty levels of neighbouring places. Currently, three types of taxes are levied on alcoholic beverages in the Mainland, namely import tariff duty,

value-added tax and consumption tax. Tariff duty is levied on imported goods only. The Mainland has been reducing its import tariff duty on alcoholic beverages in phases vis-à-vis World Trade Organization members. Its import tariff rate was reduced in 2003 to 24.2% of the CIF value for sparkling wine, 24.2% - 29% for non-sparkling wine, and 28.3% for whisky and brandy. The specific import tariff rate for beer was also reduced in 2003 to RMB 1.5 per litre. In 2004, the rates have been further reduced to 14% for sparkling wine, 14% - 20% for non-sparkling wine and 19.2% for whisky and brandy. The Mainland will levy tariff rates of not higher than 14% and 14% - 20% for sparkling and non-sparkling wine respectively from 2004 onwards and not higher than 10% for whisky and brandy from 2005 onwards. As regards import tariff rate for beer, the Mainland's WTO commitment is to zero-rate it from 2004 onwards. The Mainland also imposes a value-added tax and a consumption tax (the rate varies according to different products) on alcoholic beverages.

24. If we are to match the lower ranges of the Mainland's duties and enhance the price competitiveness of our alcoholic beverages, we may lower our duties on wine and strong liquors to around 60%. The duty on mild liquor may be lowered to around 30%. If consumption remains unchanged, revenue loss would be $214 million a year.

Consultation/Views Sought

25. We are reviewing whether the present system/rates for the duty on alcoholic beverages should be changed. To help us consider the matter further, we welcome your views and suggestions on the following issues:

(a) Do you agree that the duty on alcoholic beverage products should be retained in some form?

(b) Do you consider the existing AV system for the duty on alcoholic beverages appropriate?

(c) Do you consider the existing duty rates for the duty on alcoholic beverages appropriate?

(d) If you consider that changes should be made to the current system/rates, what changes do you consider the most appropriate? Do you prefer any of the options set out in paras 15 to 24 above?

26. Please send your views on these issues to the following address by letter, by fax (Fax number: 2530 5921), or by electronic mail (email address: liquor@fstb.gov.hk) on or before 2 February 2005.

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