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Position Paper

Wine & Spirits Business
Council (WSBC) of the
European Chamber of
Commerce in Hong Kong



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Tax Reform on Spirits can Bring HKD \$1bn in Economic Benefit and around 1,000 Jobs While No Change in Quantitative Consumption Level is Expected

1 Introduction

Reform Spirits Tax to Grow Hong Kong's Economy and Competitiveness

On behalf of the European Chamber of Commerce's Wine & Spirits Business Council (WSBC¹), we are delighted to share with you the findings of a recent academic study² led by Professor Waiman Cheung, Business School, the Chinese University of Hong Kong (CUHK).

Professor Cheung's study suggests that a reform of spirits tax system - replacing current 100% ad valorem tax on liquor above 30% alcohol by volume, with specific tax of around HKD 75 per litre of pure alcohol - could boost the local economy by HKD \$1 billion, create around 1,000 full-time jobs and, most importantly, strengthen Hong Kong's position as a premium tourist destination, providing further impetus for growth.

We believe the proposed reform could be part of the Government's measures to help the businesses, in particular SMEs, in time when the economies of Hong Kong, the Mainland and the world are likely to face headwinds over the next 12 to 18 months.

Therefore, in this submission, we recommend the Government to:

Reform the current outdated spirits tax regime and align it with international practice;

Replace the current 100% ad valorem tax on liquor above 30% alcohol by volume, with a more equitable specific tax; and

Set a reasonable level of specific taxation, at about HK\$75 per litre of pure alcohol, on all alcoholic products above 30% alcohol by volume.

¹ WSBC comprises six leading international wine and spirits companies including Edrington, Moët Hennessy Diageo, Pernod Ricard, Remy Cointreau, Teeling Whiskey, and William Grant and Sons. Together, these companies represent 45% of the "spirits market" in Hong Kong.

² Please refer to Annex 1: Cheung (2019), Study on Spirits Tax Reform and Economic Benefits - A Benchmarking Exercise.

The proposed spirits tax reform will be a supportive move to enhance Hong Kong's competitiveness and vibrancy of the food and beverage (F&B), entertainment, tourism, and spirits auction businesses, and unleash the untapped economic growth potential. More importantly, the changes will benefit the wider public due to the increased employment and the job opportunities, as indicated in the academic study conducted by Professor Waiman Cheung and his team.

2 Tax Reform could generate HKD \$1 billion Economic Benefits

According to Professor Cheung's study, the proposed spirits tax reform could generate as much as HK\$1 billion for Hong Kong's economy. The total economic impact³ of the proposed spirits tax reform is estimated to be between HK\$990 and HK\$1,105 million of value depending on the extent the tax savings are passed onto the consumers.

The economic impact for spirits-related businesses including spirits trade, auction and F&B is estimated to be HK\$702 to HK\$738 million of value-added. The additional impact on tourism is estimated to be HK\$288 to HK\$367 million of value-added. Substantial benefits would be created for the gastronomic, bar and tourism industry.

We have witnessed the enhanced success of Hong Kong wine events after the removal of wine and beer duties in 2008: between 2009 and 2018, the tourist attendance of the annual Wine & Dine Festival has grown significantly from 11k to 19k and meanwhile the number of booths has increased from 151 to 498 (+300%). A vibrant market of premium spirits would reinvigorate the F&B sector to innovate and compete with the growing counterparts in the regional food map, inject new excitement to the annual mega events calendar, and attract new trade participants and visiting tourists to enhance the current success even further. This would secure Hong Kong's competitiveness as a destination of choice in the region, for entertainment, fine dining, art and culture, and other iconic attractions; and promote regional tourism in collaboration with cities in the Greater Bay Area too.

³Total economic impact = total impact in trading sector + tourism sector. It includes direct, indirect and induced economic impact.

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Tax Reform could Bring about Premiumization of Spirits Consumption, More than 80% of Hong Kong Spirits Consumers would Trade Up

A specific tax system with reasonable tax rate will generate multiple benefits to the industry and the wider economy of Hong Kong. The proposed reform could facilitate premiumization and enhance vibrancy of Hong Kong's spirits market. This could unleash the new dynamism in the F&B and tourism space, promote more variety of high quality dining and drinking experiences for local and tourists, convert overseas purchases back to the territory by encouraging visitors to purchase locally, and ultimately attract new players and generate new opportunities for spirits-related businesses (e.g. warehousing, logistics, finance and investment, etc.).

The same premiumization trend was observed following the removal of wine duties in 2008. We commissioned IPSOS to conduct a street intercept survey in 2018, to understand how the proposed tax reform would impact spirits customers' purchasing behavior on-trade and off-trade. The survey shows that, after tax reform, majority of Hong Kong spirits consumers will trade up at both on- and off-trade; meanwhile, majority of travellers from Mainland China will consider consuming or purchasing spirits in Hong Kong during their visit⁴.

The reform will be a catalyst for premiumization and the entire value chain stands to benefit from a more diverse and vibrant portfolio of products. This is particularly crucial in the borderless e-commerce marketplace.

⁴ For Hong Kong citizens who consumed spirits in the last 12 months, 80% of the respondents would up trade their choice of spirits at on-trade by considering better grade of spirits or increasing their spending on high grade spirits. 36% of respondents claim to increase on-trade spirits consumption frequency after tax reform. While 84% of the respondents would choose to upgrade their purchase at off-trade; premium / super premium grade spirits are expected to be the most popular after the proposed reform. For Chinese travelers, 73% of the respondents would consider on-trade spirits consumption in Hong Kong after the proposed reform; on-trade spending in Hong Kong is also expected to increase. There is also greater consideration (81%) of purchasing tax paid spirits in Hong Kong.

4 Tax Reform will boost the Spirits Auction Market

The proposed spirits tax reform will reinvigorate what are currently fragmented auction activities, facilitating the growth of Hong Kong into Asia's spirits auction hub, much similar to the emergence of Hong Kong as a global wine auction centre following the removal of wine duties in 2008.

According to HKTDC's report 'Hong Kong Means Business'⁵, Hong Kong is already the world's third largest art market after New York and London, and the largest international art market in Asia. With leading auction houses' Asia headquartered in Hong Kong, there is tremendous potential to grow the auction activities as well as related brokerage and valuation businesses for investor grade spirits. Premium and rare spirits are very much sought after by connoisseurs, collectors and investors from all parts of the globe, including the burgeoning middle class in Mainland China, Taiwan, India and South East Asia. Hong Kong is well-equipped and well-positioned to capitalize on the booming trend of alternative investment in premium and rare spirits once the proposed spirits tax reform happened. The growth of the auction market would also attract higher spending visitors, helping to levitate Hong Kong's average tourism spending.

⁵Full report at: <https://hkmb.hktdc.com/en/1X0AG6SQ/first-person/Auction-House-Records-Stellar-Year>

5 Tax Reform could create around 1,000 Jobs and Enrich Career Opportunities

The proposed spirits tax reform will create nearly 1,000 additional jobs for Hong Kong in related industries e.g. spirits trade, tourism, gastronomic, bar, auction and related sectors, thus providing a wider spectrum of opportunities at different levels, especially to young people. Based on the observed impact following the abolition of duties on wine and beer tax in 2008, Professor Cheung estimates that the proposed tax reform will generate as many as 469 to 931 full-time jobs. In the tourism sector alone, the additional employment generated is estimated at 364 to 463 full-time jobs.

6 Hong Kong Competitiveness Being Eroded by Current Ad Valorem Taxation

Hong Kong currently bears one of the heaviest burdens on spirits taxes (standards and above category) in Asia. The territory is lagging behind other spirits market in the region, losing its competitiveness at a time when global and regional economic uncertainty demand that it raises its competitiveness, supports industries/trades and creates new paths for tackling the challenges that lie ahead.

For nearly a quarter of a century, liquor above 30% of alcohol by volume is taxed at 100% based on the import value since 1994. It is the only dutiable commodity that is taxed based on its value. The Government recognized, in a public consultation exercise on alcoholic beverages tax in 2004 that “for high end products, [Hong Kong’s] duty is generally higher than major jurisdictions in the region and even some of the more mature European economies”. However, there has been no reform on the tax of spirits in the past 25 years.

A review and reform are long overdue. In the region, Hong Kong operators face one of the heaviest tax burdens on spirits, at 100% of import value, versus 33% in Mainland China, 40% in Macau, 39% in Taiwan, and 43% in Japan⁶. In addition, ad valorem tax system imposes a heavy administrative burden on the Government as it is necessary to verify the import price (transfer price) of a product declared by the importers. This is contrary to Hong Kong Government’s stated tax policy which is “low, simple and competitive”.

Therefore, we call for a simple and equitable tax system - specific tax based on alcohol content - on liquor with an alcoholic strength of more than 30% of pure alcohol. The proposal is aligned with the Government’s new fiscal philosophy in alleviating companies’ tax burden to stimulate economic vibrancy. Specific taxation on alcohol is also consistent with international practice, with many developed economies having adopted a pure specific tax system on spirits including the EU, the US, Australia, New Zealand, Japan, Singapore and Taiwan.

⁶ Comparing total import & excise tax burdens on ad-valorem equivalence basis, using spirits at 40% abv with retail value at HK\$200/75cl bottle.

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Specific taxation is better suited to address concerns related to alcohol harm

Taxing alcohol on the basis of its value does not address the negative externalities associated with excessive alcohol consumption, whereas a specific tax system taxing on the basis of its alcoholic content does. The proposed specific tax system on spirits would effectively put a floor price on spirits, and the tax/price of a product would rise in line with its alcoholic content. Such a system is also endorsed by the WHO's Global Strategy to Reduce Harmful Use of Alcohol to "take into account, as appropriate, the alcoholic content of the beverage".⁷

A telephone survey⁸ has shown that the proposed reform will not have any quantitative impact on Hong Kong citizens drinking patterns, 98.9% of non-drinkers will not start consuming spirits because of the tax changes. While the quantitative consumption level is not expected to change significantly, the WSBC fully supports the prohibition of sale and supply of alcohol to people under 18 years old. We are ready to work with the Government and other stakeholders on complementary programs to raise awareness against underage drinking, binge drinking and other harmful drinking behaviours among adults. The WSBC's members stand ready to further discuss with the Health authorities to examine ways to ensure that Hong Kong remains a safe destination, recognized for its responsible drinking and low per capita consumption of alcohol.

⁷ WHO, Global Strategy to Reduce Harmful Use of Alcohol, 2010a, p. 16

⁸ According to the telephone survey, to examine Hong Kong's citizens' current drinking behavior and the effects of the proposed spirits tax reform on drinking pattern, conducted by the Chinese University's Centre for Communication and Public Opinion Survey in August 2018, the proposed spirits tax reform, which would replace the current ad valorem system with a spirits tax based on alcohol content set at around \$75/LPA (litre of pure alcohol), would not have any quantitative impact on the respondents' drinking pattern/habit one way or the other. Specifically, 81.5% of current spirits drinkers stated that they will not consume more spirits, whereas 97% of non-spirits drinkers indicated that they will not shift to spirits after the proposed tax reform. In addition, almost all non-drinkers (98.9%) will not start consuming spirits because of the tax changes.

8 Conclusion

The Wine & Spirits Business Council urges the Government to review and then replace the current ad valorem tax system on liquor with an alcoholic strength of more than 30% of pure alcohol with a specific system set at around HK\$75 per litre of pure alcohol. Such a reform will deliver substantial economic benefits to Hong Kong even in the first year of implementation, with sustainable and spillover positive economic impact in the medium and long term.

The WSBC and its members have been in dialogue with a range of stakeholders on this proposal for more than a year. We are pleased to acknowledge that there is strong support from a broad range of economic actors across different sectors for our proposal (see attached list)⁹. Many believe that we have to move fast to capitalize on regional developments including, but not limited to, developments in the Greater Bay Area. We look forward to engaging the Government to discuss the best way forward and a roadmap for this urgent and important matter for Hong Kong.

⁹Please refer to annex 4 for the list

List of Appendices

1. [Presentation of Key Findings] Study on Spirits Tax Reform and Economic Benefits - A Benchmarking Exercise, by Professor Waiman Cheung, CUHK and Doctor Simon Su, ASA Projects Limited (Jan 2019)
2. 有關酒精飲品 電話調查, 中文大學傳播與民意調查中心 (Aug 2018)
3. Evaluating impacts on spirits tax restructure in Hong Kong, Among Hong Kong citizens and Chinese Travellers in Hong Kong, by IPSOS Hong Kong (Jan 2019)
4. A list of supporting industries/organizations