

## **CHAPTER 7**

**THE GOVERNMENT OF THE  
HONG KONG SPECIAL ADMINISTRATIVE REGION**

**GENERAL REVENUE ACCOUNT**

**GOVERNMENT DEPARTMENT**

**Inland Revenue Department**

**The use of employers' returns and  
notifications for assessing and collecting salaries tax**

**Audit Commission  
Hong Kong  
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# THE USE OF EMPLOYERS' RETURNS AND NOTIFICATIONS FOR ASSESSING AND COLLECTING SALARIES TAX

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# THE USE OF EMPLOYERS' RETURNS AND NOTIFICATIONS FOR ASSESSING AND COLLECTING SALARIES TAX

## Summary and key findings

A. **Introduction.** The Inland Revenue Department (IRD) assesses the salaries tax of an individual based largely on the tax returns submitted annually by him and his employer(s) under the Inland Revenue Ordinance (Cap. 112). An employer is required under the Inland Revenue Ordinance to notify the IRD of the commencement of employment of an employee, the employee's impending cessation of employment or his impending departure from Hong Kong. Audit has recently conducted a review to ascertain whether the IRD has made effective use of employers' returns and notifications for assessing and collecting salaries tax and whether government departments have effectively submitted returns and notifications to the IRD. Audit has found that there is room for improvement in a number of areas (paras. 1.2 and 1.6).

B. **Employers' returns.** Since 1996, the salaries tax unit of the IRD has discontinued to conduct a regular examination of employers' returns for checking the income reported by taxpayers. Audit considers that, if the IRD does not examine the employers' returns, the IRD may not be able to detect the under-reporting or non-reporting of chargeable income by employees in their tax returns. For the purpose of illustrating Audit's view that there is a need for the IRD to examine employers' returns in order to provide adequate assurance that they are free from errors and omissions, Audit examined a small random sample of ten employers' returns for 1998-1999. Audit noted that, for nine of the ten employers selected, the amount of staff remuneration shown in the financial statements was greater than the total amount of emoluments shown in the employer's return. Had the IRD continued to conduct the regular examination of employers' returns, the discrepancies could have been detected. One of these nine employers voluntarily provided to the IRD a list of the staff remuneration shown in the financial statements when he submitted the profits tax return. Audit's analysis of the list indicated that he had omitted at least seven employees in the employer's return (paras. 2.11 to 2.15).

C. **Employers' notifications.** Employers' notifications of the impending departure from Hong Kong of their employees enable the IRD to take urgent action to assess and collect salaries tax from the employees before they leave Hong Kong. However, Audit estimated that the write-off of tax due from employees recruited from outside of Hong Kong, who had left Hong Kong on termination of their employment without first paying their tax, was \$59 million in 1997-1998, \$77 million in 1998-1999 and \$77 million in 1999-2000. Audit examined a random sample of 20 write-off cases in 1999-2000 involving such employees. In these cases, the amount of tax not paid ranged from \$37,080 to \$1,238,077 and averaged \$264,766. Audit noted that none of the employers in the 20 cases had fully complied with the requirements of notification and withholding money under the Inland Revenue Ordinance. Although the non-compliance resulted in the write-off of tax, the IRD had not taken any penalty action against these employers. Furthermore, in ten of the 20 cases, the IRD took a long time to obtain a departure prevention direction from a District Judge, ranging from 348 days to 1,854 days with an average of 821 days. In three of the ten cases, the employees had subsequently returned to Hong Kong and left again without hindrance. Had the departure prevention direction been issued before the date of their last departure from Hong Kong, the outstanding salaries tax might have been recovered (paras. 3.10, 3.12, 3.21 and 3.26).

D. **Returns and notifications submitted by government departments.** An audit test check revealed that certain payments of salary and wages in 1998-1999 by government departments to non-civil service contract officers and to government officers for their part-time jobs had not been included in the computerised returns submitted to the IRD. These payments were made through the Treasury's Payment of Creditors System but were not correctly coded by the government departments concerned as taxable earnings that should also be reported to the IRD. Audit noted that in two salaries tax write-off cases in 1999-2000, the departments concerned had timely submitted to the IRD a notification of impending departure from Hong Kong of a government officer. However, in both cases, the IRD failed to take urgent action to assess and collect the salaries tax of the government officer (paras. 4.4 to 4.9, 4.15 and 4.16).

E. **Audit recommendations.** Audit has made the following major recommendations:

- the Commissioner of Inland Revenue should:
  - (i) implement cost-effective procedures for examining employers' returns (first inset of para. 2.21);
  - (ii) take penalty action against those employers who fail to comply with the requirements of notification or withholding money under section 52 of the Inland Revenue Ordinance (para. 3.28(a));
  - (iii) review the relevant procedures with a view to shortening substantially the time taken to obtain a departure prevention direction from a District Judge (para. 3.28(e));
  - (iv) regularly review the amounts of tax written off due to the departure from Hong Kong of employees, particularly employees in high-risk groups (e.g. employees recruited from outside of Hong Kong), to determine if further measures should be taken to protect the revenue (para. 3.28(f));
  - (v) consider proposing legislative amendments that will empower the IRD to require employees in high-risk groups to purchase interest-bearing tax reserve certificates as income is earned in order to provide security for the payment of tax (para. 3.28(g)); and
  - (vi) in the light of the circumstances leading to the write-off of tax in the cases where the IRD had failed to take urgent action to process timely submissions of impending departure notifications by departments and to assess and collect the salaries tax, improve the assessment and collection procedures to prevent recurrence of similar cases in future (second inset of para. 4.18); and
- the Director of Accounting Services should regularly remind government departments of the requirement that they should properly code all taxable earnings paid through the Treasury's Payment of Creditors System so as to ensure that these payments are all reported to the IRD (first inset of para. 4.19).

F. **Response from the Administration.** The Administration generally agrees with the audit recommendations. The IRD has set up an ad hoc committee chaired by an Assistant Commissioner to examine how best to implement the audit recommendations.

## **PART 1: INTRODUCTION**

### **Assessment and collection of salaries tax**

1.1 Salaries tax is charged on all income arising in or derived from Hong Kong from any office or employment or any pension. Chargeable income includes salary/wages, commission, fees, allowances and similar payments and benefits. The tax charged is the lower of the total income after deductions and allowances charged at progressive rates, or the total income after deductions but before allowances charged at the standard rate. An outline of the computation of salaries tax is at the Appendix.

1.2 The Inland Revenue Department (IRD) assesses the salaries tax of an individual based largely on the tax returns submitted annually by him and his employer(s) under the Inland Revenue Ordinance (Cap. 112). To facilitate the assessment and collection of salaries tax, apart from the annual employer's return of emoluments of employees (hereinafter referred to as employer's return), an employer is also required under the Inland Revenue Ordinance to notify the IRD of the commencement of employment, the impending cessation of employment or the impending departure from Hong Kong of an employee.

1.3 An employee reports his income and claims for deductions and allowances in his tax return. An employer reports the income earned by various employees in an employer's return, which is used by the salaries tax unit of the IRD to cross-check the accuracy and completeness of the income reported in an individual's tax return. After making the salaries tax assessment, the salaries tax unit issues to an individual a notice of assessment and demand for tax stating the amount of salaries tax payable by him and the due dates for payment. Husband and wife are treated as separately chargeable individuals, but they may elect to receive a joint assessment if they will pay less tax under a single assessment based on their combined incomes and allowances than under two separate assessments based on their respective individual incomes and allowances.

1.4 The salaries tax assessments made by the IRD from 1997-1998 to 1999-2000 are shown in Table 1 below.

**Table 1**

#### **Salaries tax assessments made by the IRD from 1997-1998 to 1999-2000**

<b>Year</b>	<b>Number of assessments</b>	<b>Amount of tax</b> <b>(\$ million)</b>
1997-1998	2,277,000	32,700
1998-1999	2,250,000	26,700
1999-2000	2,165,000	26,500

*Source: IRD's records*

1.5 According to the Estimates for the year ending 31 March 2001, 1,174 man-years will be used in 2000-2001 by the IRD for the assessment of salaries tax at an estimated total cost of \$354 million.

### **Audit review**

1.6 Audit has recently conducted a review to ascertain:

- whether the IRD has made effective use of employers' returns and notifications for assessing and collecting salaries tax; and
- whether government departments have effectively submitted returns and notifications to the IRD.

The results indicate that there is room for improvement in the IRD's administrative system regarding the use of employers' returns and notifications relating to salaries tax. Audit has made a number of recommendations to address the issues concerned.

### **General response from the Administration**

1.7 The **Commissioner of Inland Revenue** has said that the IRD is committed to improving its administrative system regarding the use of employers' returns and notifications relating to salaries tax, in order to ensure tax compliance and protect government revenue. To this end, the IRD has set up an ad hoc committee chaired by an Assistant Commissioner to examine how best to implement the audit recommendations. The committee will also assess the cost-effectiveness and practicality of these recommendations, in consultation with concerned parties as appropriate, with a view to determining whether there exist better alternative means of achieving the same objectives.

1.8 The **Secretary for the Treasury** has said that, from the revenue protection perspective, she agrees particularly that there is a need to put in place cost-effective and practicable measures to make use of both the employers' returns and notifications for the purpose of ensuring timely assessment and collection of salaries tax. She notes that the Commissioner of Inland Revenue has set up an ad hoc committee to work out how best to achieve this objective by implementing the audit recommendations and other alternative measures, as appropriate.

## **PART 2: EMPLOYERS' RETURNS**

### **Requirements for submission of employer's return**

2.1 Section 52(2) of the Inland Revenue Ordinance states that every employer shall, when required to do so by notice in writing given by an assessor, furnish within a reasonable time stated in such notice a return containing the names and places of residence and the full amount of the remuneration, whether in cash or otherwise, for the period specified in the notice, of:

- all persons employed by him in receipt of remuneration in excess of a minimum figure to be fixed by the assessor; and
- any other person employed by him named by the assessor.

An employer who without reasonable excuse submits an incorrect return shall be guilty of an offence. The penalty is a fine of up to \$10,000 and a further fine of up to treble the amount of tax undercharged.

2.2 The salaries tax unit of the IRD maintains a computerised employer database which contains a record for every employer who employs in Hong Kong one or more individuals who are or are likely to be chargeable to salaries tax. The records in the employer database are created from information obtained from various sources including the Business Registration Office and the profits tax unit of the IRD. Based on the employer database, the salaries tax unit issues an employer's return to each employer in early April each year, and requires each employer to submit the completed return within one month. The IRD requests the employers to give each employee a copy of the relevant part of the employer's return to assist the employees in submitting their individual's tax returns at a later stage.

2.3 For 1998-1999, the IRD required an employer to report in the employer's return the personal particulars and the remuneration of the following employees:

- single employees whose total emoluments amounted to:
  - (i) \$108,000 (Note 1) or more or, if employed for less than a year, a lesser sum in proportion; or
  - (ii) less than \$108,000 but who were likely to have had other income chargeable to salaries tax (e.g. part-time employees); and

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**Note 1:** *For 1998-1999, the basic allowance was \$108,000. A single employee with income less than \$108,000 was not liable to pay salaries tax. For a married person who and whose spouse have elected to receive a joint assessment, the incomes and allowances of the person and his spouse have to be combined to determine their salaries tax liability.*



- married employees, irrespective of the amount of emoluments paid.

### **Submission of employer's return**

2.4 To reduce the manual efforts of employers in the preparation of employers' returns and the IRD's efforts of entering manually details of individual employees into its computer systems, the IRD encourages employers to submit their returns in the computerised format. The IRD has since 1989-1990 developed computer software to capture employees' data directly from magnetic tapes or computer disks supplied by employers. Employers may use self-developed computer software for the preparation of their returns. Alternatively, they may use the software developed by the IRD and supplied to them free of charge in a CD ROM. Internet users may also download the IRD's software through the IRD's Internet Home Page.

2.5 As at 31 March 2000, excluding government departments, the IRD received employers' returns for 1998-1999 from 248,100 employers. These employers' returns contained details of the emoluments of 2,552,900 employees. 25,200 of these employers furnished their employers' returns in respect of 1,419,100 employees in the computerised format.

### **Processing of employers' returns**

2.6 The salaries tax unit of the IRD maintains a computerised salaries income database for capturing the income earned by an individual during a year of assessment. This database is regularly updated by data in the employers' returns as follows:

- *Employers' returns in computerised format.* Data are uploaded directly from the magnetic tapes, computer disks or CD ROMs submitted by the employers; and
- *Employers' returns in paper form.* Data are manually input to the salaries income database.

2.7 In early May each year, based on the salaries tax assessment records and the salaries income database, the IRD issues individual's tax returns to individuals who are or are likely to be chargeable to salaries tax. Periodically, based on the newly updated data in the salaries income database, the IRD issues individual's tax returns to individuals who are or are likely to be chargeable to salaries tax but have not been issued with individual's tax returns. Upon the receipt of an individual's tax return, the IRD compares the income stated by the individual with that recorded in the salaries income database to see if there are omissions/understatements of income, and then issues an assessment.

### **Examination of employers' returns**

2.8 Prior to 1996, to ensure the accuracy of employers' returns, the salaries tax unit of the IRD carried out an examination of the employers' returns on an annual or cyclical basis. In the examination, the assessing officer was required to take into consideration the location, size and nature of the business in order to determine whether the information in the employer's return was reliable, reasonably adequate and acceptable for salaries tax purposes. If the assessing officer had

doubts about the accuracy of an employer's return, he was required to make enquiries of the employer. Standard forms were used for making the following enquiries:

- ***Apparent discrepancy between the amount of staff remuneration shown in the financial statements of the employer's business and the total amount of emoluments shown in the employer's return.*** The employer was required to explain or reconcile the apparent discrepancy, and to submit supplementary returns in respect of any omissions of income in the employer's return; and
- ***Omissions of part-time employees, married employees, employees whose earnings exceeded the entitled personal allowance, and daily-paid employees in the employer's return.*** The employer was required to explain the omissions and submit an analysis of salaries/wages paid to these employees.

If the replies of the employer were unsatisfactory, the assessing officer was required to arrange tax inspectors to conduct a wages audit at the employer's business premises. A wages audit included an inspection of the employer's wages and salaries sheets/books, payrolls and other records, and the counting of the number of employees who should be included in the employer's return.

2.9 Prior to 1989, the examination of employers' returns was performed annually for employers with an unsatisfactory history, and once every three years for other employers. In 1989, the requirement was revised so that the examination of employers' returns was performed once every five years for employers who did not have an unsatisfactory history. However, since 1996, the salaries tax unit of the IRD has discontinued the regular examination of employers' returns. In response to Audit's enquiry about the reasons for discontinuing the regular examination of employers' returns, in August 2000 the IRD said that:

- many businesses did not close their annual accounts on 31 March and hence reconciliation between employer's return and financial statements could not be readily made;
- substantial resources were required in the regular examination of employers' returns;
- the regular examination of employers' returns was not cost-effective; and
- audit on wages account with reconciliation with employers' returns had been included in field audit work since the establishment of the Field Audit Group in 1991.

2.10 The IRD's Field Audit Group, established in June 1991, conducts field audits on corporations and unincorporated businesses to ensure that correct returns of profits have been made. From 1992 to 1995, the Field Audit Group conducted some wages audits with the assistance of tax inspectors. The primary purpose of these wages audits was to determine whether salary and wages paid by an employer had been correctly reported for profits tax purposes, although the tax inspectors also examined whether the employer had properly filed the employer's

return for salaries tax purposes. Since 1996, the Field Audit Group has not arranged tax inspectors to conduct wages audits (Note 2).

## **Audit observations on employers' returns**

### **Discontinuation of the examination of employers' returns**

2.11 The salaries tax unit of the IRD uses the employers' returns to identify individuals chargeable to salaries tax and to cross-check the accuracy and completeness of the income reported in the individual's tax returns. Audit noted that since 1996, the regular examination of employers' returns has been discontinued. **Audit considers that it is useful to examine the employers' returns to ensure their accuracy.**

2.12 The Inland Revenue Ordinance imposes an obligation on individual taxpayers to file true and correct returns. There are penalty provisions to ensure compliance. However, if an employee knows the IRD's practice of cross-checking his individual's tax return with his employer's return, he may state in his individual's tax return the same amount of income as that reported in the employer's return. Accordingly:

- if an employer understates by mistake an employee's income in the employer's return, the employee may state the same erroneous income in his tax return;
- if an employer has omitted to report an employee's income in the employer's return, the employee may not report to the IRD that he has income chargeable to salaries tax; and
- for a family business, the employer may intentionally understate or omit the salaries paid to family members in the employer's return.

**In all such cases, if the IRD does not conduct a proper examination of the employers' returns, the IRD may not be able to detect the under-reporting or non-reporting of chargeable income by the employees in their tax returns.**

### **Audit's examination of ten employers' returns**

2.13 Audit examined a small random sample of ten employers' returns (Note 3) for 1998-1999. These ten employers filed their financial statements for 1998-1999 with the profits tax

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**Note 2:** *According to the IRD, since 1996, tax inspectors have played a lesser role in wages audits. The audit of wages account of individual employers, including checking whether the wage roll/payroll is in line with the employer's return, has been carried out by the Field Audit Group in the course of field audits. In 1999-2000, the Field Audit Group completed the audit of 948 cases.*

**Note 3:** *The small random sample is appropriate for the purpose of illustrating Audit's view that there is a need for the IRD to examine employers' returns in order to provide adequate assurance that they are free from errors and omissions. The sample is not intended to be statistically representative of all employers' returns, and should not be used to project the total errors and omissions of the whole population. To facilitate audit analysis, only employers who used 31 March as the financial year ending date were selected.*

unit of the IRD when they submitted their profits tax returns for 1998-1999. For each employer, Audit compared the amount of staff remuneration shown in the financial statements with the total amount of emoluments shown in the employer's return. **Audit noted that, for nine of the ten employers selected, the amount of staff remuneration shown in the financial statements was greater than the total amount of emoluments shown in the employer's return.** Details are given in Table 2 below.

**Table 2**

**Discrepancies between the amount of staff remuneration shown in the financial statements for 1998-1999 and the total amount of emoluments shown in the employer's return for 1998-1999**

Case	Staff remuneration shown in the financial statements	Total emoluments shown in the employer's return	Discrepancies	Percentage of discrepancy
	(a)	(b)	(c) = (a) - (b)	(d) = $\frac{(c)}{(a)} \times 100\%$
	(\$'000)	(\$'000)	(\$'000)	(%)
1	3,648	853	2,795	77%
2	3,751	2,408	1,343	36%
3	9,344	6,599	2,745	29%
4	450	372	78	17%
5	4,674	4,151	523	11%
6	11,648	10,525	1,123	10%
7	3,946	3,682	264	7%
8	16,474	16,083	391	2%
9	10,452	10,287	165	2%
10	5,005	5,005	—	—

*Source: IRD's records*

2.14 A discrepancy between the amount of staff remuneration shown in the financial statements and the total amount of emoluments shown in the employer's return may possibly be due to the non-reporting of the remuneration of those single employees whose total emoluments

were less than \$108,000 (see the first inset of paragraph 2.3 above). However, the discrepancy may also be due to errors or omissions in the employer's return or overstatements of the staff remuneration in the financial statements for reducing the net profit assessable to profits tax. Prior to 1996, there was a regular examination of employers' returns and an employer was required to explain or reconcile any apparent discrepancy (see the first inset of paragraph 2.8 above). **If the IRD had continued with the regular examination, the discrepancies shown in Table 2 in paragraph 2.13 above could have been detected.**

2.15 For profits tax purposes, the profits tax unit of the IRD in general does not require corporations and unincorporated businesses to submit details of the staff remuneration. Of the nine employers referred to in paragraph 2.13 above, eight (i.e. Cases 2 to 9 in Table 2 in paragraph 2.13 above) did not submit details of the staff remuneration shown in the financial statements when they submitted the profits tax returns. Audit therefore could not ascertain whether there were errors or omissions in their employers' returns. However, the employer in Case 1 (hereinafter referred to as Employer A) voluntarily provided to the IRD a list of the staff remuneration shown in the financial statements when he submitted the profits tax return. Employer A's list provided the names, the identity card numbers and the remuneration of all of his 64 employees. Audit noted that only five employees (out of the 64) were included in the employer's return of Employer A. Audit's analysis of Employer A's list of staff remuneration indicated that he had omitted at least seven employees (i.e. those in categories (b) and (c) in Table 3) in the employer's return, as shown in Table 3 below.

**Table 3**

**Audit's analysis of the list of  
staff remuneration voluntarily provided by Employer A**

	<b>Number of employees</b>	<b>Total remuneration</b>	
		(\$'000)	
<i>Included in the employer's return of Employer A</i>			
(a) Employees with income of \$108,000 or more	5	853	
<i>Omitted from the employer's return of Employer A</i>			
(b) Employees with income of \$108,000 or more	7	1,004	} 2,795
(c) Employees with income less than \$108,000	52	1,791	
<b>Total</b>	<b><u>64</u></b>	<b><u>3,648</u></b>	

Source: IRD's records

Note: The IRD's requirements on employers' returns for 1998-1999 are mentioned in paragraph 2.3 above.

2.16 As indicated in Table 3 above, in his employer's return, Employer A had omitted seven employees with income of \$108,000 or more. Audit traced to other relevant records of the IRD and found that:

- (a) Employer A had provided to the IRD an incorrect identity card number for one of these seven employees. Audit therefore could not ascertain whether the IRD had raised any salaries tax assessment on this employee;
- (b) the IRD had issued individual's tax returns to only three of these seven employees in the annual mailing exercise in May 1999. Of these three employees:
  - (i) one employee submitted an individual's tax return in which he reported an income of more than \$108,000 from Employer A;
  - (ii) one employee submitted an individual's tax return in which he reported his total income but did not give the names of his employer(s); and
  - (iii) one employee did not even submit an individual's tax return.

Based on the available information, the IRD raised assessments/estimated assessments of the salaries tax liabilities of these three employees; and

- (c) the IRD had not assessed the tax liabilities of the remaining three of the seven employees.

For the 52 employees with income less than \$108,000, it is likely that some of them are married employees and as such Employer A should have included them in the employer's return (see the second inset of paragraph 2.3 above).

2.17 Employer A's list of the staff remuneration, filed voluntarily for profits tax purposes, provided useful information for checking the accuracy of his employer's return filed for salaries tax purposes. The profits tax unit, however, did not pass Employer A's list of the staff remuneration to the salaries tax unit. **Audit considers that such useful information should have been referred to the salaries tax unit for necessary action.** As mentioned in paragraph 2.16(b)(i) above, one employee who had been omitted from the employer's return of Employer A later submitted an individual's tax return in which he reported that his income from Employer A was more than \$108,000. Audit noted that the IRD did not follow up with Employer A as to why he had failed to report the total emoluments of this employee in the employer's return. **In Audit's view, the IRD should have implemented procedures to identify those employers who had filed incorrect employers' returns for taking appropriate follow-up action, and possibly penalty action against them in warranted cases.**

**Need to implement cost-effective procedures for examining employers' returns**

2.18 **Audit considers that there is a need for the IRD to implement cost-effective procedures for examining employers' returns in order to provide an adequate assurance that the total emoluments of employees, who are chargeable to salaries tax, are accurately and fully reported to the IRD. One way of doing this is to implement the following additional procedures:**

- **requiring an employer to state in the profits tax return the amount of staff remuneration and to submit a statement of reconciliation of this amount with the related item(s) in the financial statements;**
- **comparing the amount of staff remuneration stated in the profits tax return with the total amount of emoluments shown in the employer's return. If there is a significant discrepancy between the two amounts, after taking into account the possible effect of the use of a financial year ending date other than 31 March, the IRD should require the employer to provide a statement of reconciliation; and**
- **examining the reconciliation statements to ensure that they are correct.**

2.19 **A reconciliation of the total amount of emoluments shown in the employer's return with the amount of staff remuneration shown in the financial statements will help ensure that the total emoluments of employees are accurately and fully reported in the employer's return. In addition, a reconciliation will help ensure that the staff remuneration claimed by the employer as a deductible expense for profits tax purposes is supported by a detailed list of the emoluments of employees as contained in the employer's return.**

2.20 The IRD currently requires an employer to report in the employer's return the remuneration of all married employees. For single employees, however, the IRD does not require an employer to report their remuneration if their total emoluments are less than the basic allowance and they are unlikely to have had other income chargeable to salaries tax. Nevertheless, Audit noted that many employers, especially those submitting the employers' returns in the computerised format, had already been reporting voluntarily the remuneration of all employees in their employers' returns (see paragraph 2.5 above). **Audit considers that the IRD should require all employers to report in their employers' returns the remuneration of all employees** because:

- it is difficult for the IRD to compare the staff remuneration shown in the financial statements with the total emoluments shown in the employer's return if an employer does not report the remuneration of all employees in the employer's return; and
- an employer does not know whether a single employee really has total emoluments less than the basic allowance because the employee may have income from another employer and the aggregate income of the employee from all sources may render him liable to salaries tax. His other employer(s) may also not report the employee's income.

Requiring all employers to report the remuneration of all employees will enable the IRD to aggregate the incomes of an individual from different sources for salaries tax assessment. It will also help the IRD keep a more comprehensive salaries income database mentioned in paragraph 2.6 above.

## **Audit recommendations on employers' returns**

2.21 **Audit has recommended that the Commissioner of Inland Revenue should:**

- **implement cost-effective procedures for examining employers' returns. In particular, the Commissioner should consider requiring all employers:**
  - (i) **to state in the employer's return the total remuneration of all employees;**
  - (ii) **to state in the profits tax return the amount of staff remuneration and submit a statement of reconciliation of this amount with the related item(s) in the financial statements; and**
  - (iii) **to reconcile and explain any significant discrepancies between the amount of staff remuneration shown in the profits tax return and the total amount of emoluments shown in the employer's return;**
- **in the light of the audit findings in paragraph 2.16 above and the provisions of the Inland Revenue Ordinance which allow the issue of additional back-year assessments up to the past six years:**
  - (i) **follow up the case of incorrect employer's return submitted by Employer A; and**
  - (ii) **consider the need to examine other employers' returns for other similar cases of omission and to raise assessments for 1994-1995 and after;**
- **require the profits tax unit to pass information filed by employers, which is useful for salaries tax assessment purposes, to the salaries tax unit for necessary action; and**
- **carry out checks on individual's tax returns to ensure that there are no errors and omissions in the employers' returns and take necessary follow-up action, including penalty action, in warranted cases.**



## **Response from the Administration**

2.22 The **Commissioner of Inland Revenue** has said that he accepts the audit recommendation to implement cost-effective procedures for examining employers' returns, and to consider imposing the additional requirements on all employers. The IRD has set up an ad hoc committee to examine how best to implement the audit recommendations (see paragraph 1.7 above). He has also said that:

### *Implementation of the audit recommendations*

- (a) he sees the merits of requiring employers to submit employers' returns in respect of all employees regardless of their remuneration amount and marital status. This will help employers to avoid inadvertent omissions and/or minor errors in respect of salary payments to part-time and married employees as well as those employees who are marginally liable to tax. He believes that this will also provide the IRD with a comprehensive information base to conduct field audit and investigation work on salaries tax, through either targeted checks or random inspections. However, he needs time to consider this requirement, as well as the requirements to submit reconciliation statements, further before deciding whether, and if so, when and how best to implement them;
- (b) apart from cost-effectiveness, one major consideration is that, if employers are to be required to submit employer's return in respect of all employees and the proposed reconciliation statements, employer's return and profits tax return have to be amended. It will be necessary to consult the Board of Inland Revenue (Note 4) before this can be put into effect. Moreover, since the additional requirements may increase the tax compliance costs to employers, especially for those who are preparing their accounts with a closing date other than 31 March, he will also need to consult employer associations, chambers of commerce and tax practitioners;

### *Discontinuation of the examination of employers' returns*

- (c) the annual/cyclical examination of employers' returns was a very labour-intensive exercise. Despite the great efforts spent, the number of unsatisfactory cases found to warrant the conduct of a wages audit was very small. For the three years ended 31 March 1989, only five wages audits needed to be conducted, involving total tax undercharged of \$130,000 and total penalties imposed amounting to \$64,600. Due to resource constraints and in view of its cost-ineffectiveness, the examination of employers' returns by the salaries tax unit was curtailed to a minimal scale in 1990-1991;

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**Note 4:** *The Board of Inland Revenue is constituted under section 3 of the Inland Revenue Ordinance. It is chaired by the Financial Secretary and comprises four other appointed members, of whom only one can be a government official. This Board operates independently of the IRD. One of its functions is to prescribe the form of the returns for property tax, salaries tax, profits tax and personal assessment.*

- (d) the phasing out of the examination of employers' returns also followed the world trend of adopting an "Honour System" under which tax returns are usually accepted in good faith in the first instance, but subject to audit or check subsequently as circumstances warrant. The decision to scale down the examination of employers' returns substantially was therefore taken in 1990-1991 upon the establishment of the Field Audit Group. The field audit teams, when performing audit of wages account, would also check whether the wage roll/payroll is in line with the employer's return. Invariably, reconciliation of the wages and salaries accounts is a routine process when the field audit team screens a tax file to determine whether a wages audit should be conducted. In 1999-2000, the field audit teams screened 4,876 tax files and completed audit in 948 cases. The officers of the Investigation Unit also take care of the wages and salaries accounts in the course of review and investigation. In 1999-2000, the Investigation Unit completed review and investigation in 1,805 and 926 cases respectively. Out of the completed field audit and investigation cases for 1999-2000, a total of 388 cases, involving tax and penalties of \$93 million, were salaries tax cases;
- (e) since 1990-1991, the IRD has been adopting a strategic approach to identify under-reporting of salaries income cases with particular emphasis on high-risk areas. In 1991-1992, the IRD started the Property Tax Compliance Check to detect potential abuses through various forms of provision of quarters by employers. The back tax and penalties recovered from such targeted exercises amounted to \$10.9 million, \$10 million and \$13.6 million for 1991-1992, 1992-1993 and 1993-1994 respectively. In late 1994, the IRD expanded the scope of checking to cover share options exercised by employees. Apart from recovery of tax of about \$16 million, the exercise brought to the IRD, in its first year of implementation, total penalties of approximately \$1.6 million imposed on employees as well as employers. Since August 1999, the IRD has also commenced review of share option benefits granted by multi-national corporations and recovered tax of approximately \$22 million. From 1995 to date, the IRD had assessed tax of approximately \$230 million in respect of disguised employment cases. The detection of all the aforesaid types of under-assessment cases required more in-depth examination on specific items of income than routine matching of information provided in the employers' returns. They also proved to be more productive in terms of revenue and have generated a greater deterrent effect on all parties concerned; and

*Audit's examination of ten employers' returns*

- (f) in view of the audit findings in the examination of ten employers' returns, the IRD has raised enquiries on all the employers concerned. A quick response from three employers has already been received indicating that the discrepancy was because the employees were earning below the tax threshold. Appropriate follow-up action will be taken in the remaining cases.

2.23 The **Secretary for the Treasury** agrees to the comments made by the Commissioner of Inland Revenue (see also paragraph 1.8 above).

## **PART 3: EMPLOYERS' NOTIFICATIONS**

### **Notification of commencement of employment of an employee**

3.1 *Requirements of the Inland Revenue Ordinance.* Under section 52(4) of the Inland Revenue Ordinance, an employer who commences to employ an individual who is likely to be chargeable to salaries tax is required to give notice to the Commissioner of Inland Revenue not later than three months after the date of commencement of such employment. The IRD provides a specified form to facilitate compliance with the requirements. An employer who without reasonable excuse fails to comply with the requirements of section 52(4) shall be guilty of an offence. The penalty is a fine of up to \$10,000.

3.2 *IRD's procedures.* Notifications of commencement of employment of an employee received from different employers are input to the salaries income database in batches. The computer processing will ensure that, if the predetermined criteria are met, individual's tax returns will be issued to the employees concerned in the annual exercise or the next periodic issue of individual's tax returns (see paragraph 2.7 above). In addition, the computer will check whether there are any outstanding tax liabilities of the employees for initiating recovery actions, including the automatic issue of a notice under section 76(1) of the Inland Revenue Ordinance to the employees' present employers to recover the outstanding tax.

### **Notification of impending cessation of employment of an employee**

3.3 *Requirements of the Inland Revenue Ordinance.* Under section 52(5) of the Inland Revenue Ordinance, an employer who ceases or is about to cease to employ an individual who is likely to be chargeable to salaries tax is required to give notice to the Commissioner of Inland Revenue not later than one month before such individual ceases to be employed, provided that the Commissioner may accept such shorter notice as he may deem reasonable. The IRD provides a specified form to facilitate compliance with the requirements. An employer who without reasonable excuse fails to comply with the requirements of section 52(5) shall be guilty of an offence. The penalty is a fine of up to \$10,000.

3.4 *IRD's procedures.* A notification of impending cessation of employment of an employee contains basically the same information as that contained in an employer's return. Notifications received from different employers are input to the salaries income database in batches. Similar to the employer's return, the notification is used for identifying individuals chargeable to salaries tax and cross-checking the accuracy and completeness of the income reported in the individual's tax returns. However, if the employee is about to leave Hong Kong, the employer is required to submit, instead of a notification of his impending cessation of employment, a notification of his impending departure from Hong Kong (see paragraphs 3.5 and 3.6 below).

## Notification of impending departure from Hong Kong of an employee

3.5 **Requirements of the Inland Revenue Ordinance.** The Inland Revenue Ordinance imposes the following requirements on the employer of an individual who is about to leave Hong Kong:

- **Notification of impending departure from Hong Kong of an employee.** Under section 52(6), the employer of an individual who is chargeable to salaries tax and is about to leave Hong Kong for any period exceeding one month is required to give notice to the Commissioner of Inland Revenue of the expected date of departure of such individual not later than one month before the expected date of departure, provided that the Commissioner may accept such shorter notice as he may deem reasonable. This does not apply to an individual who is required in the course of his employment to leave Hong Kong at frequent intervals. The IRD provides a specified form to facilitate compliance with the requirements; and
- **Withholding of money.** Section 52(7) provides that an employer who is required by section 52(6) to give notice to the Commissioner shall not, in the case of an individual whom he has ceased, or is about to cease, to employ in Hong Kong, make any payment of money to the individual for a period of one month from the date of that notice, except with the consent in writing of the Commissioner.

An employer who without reasonable excuse fails to comply with the requirements of section 52(6) or 52(7) shall be guilty of an offence. The penalty is a fine of up to \$10,000.

3.6 **IRD's procedures.** The IRD requires its officers to give very high priority to a notification of impending departure from Hong Kong of an employee. The duplicate copy of the notification is required to be passed to the responsible assessing officer by hand while the original is used for input to the salaries income database. An individual's tax return will be issued urgently to the employee. Salaries tax assessment will be made expeditiously upon the receipt of the individual's tax return. If the employee does not submit an individual's tax return, the IRD will raise an estimated salaries tax assessment.

## Audit observations on employers' notifications

### Failure of employers to submit notifications

3.7 In 1999-2000, the IRD received 67,615 notifications of commencement of employment of an employee and 376,386 notifications of impending cessation of employment/departure from Hong Kong of an employee (Note 5). **According to an information sheet issued by the IRD**

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**Note 5:** *A further breakdown of these 376,386 notifications into notifications of impending cessation of employment and notifications of impending departure from Hong Kong is not readily available.*

together with the employer's return to each employer in April 2000, many employers failed to submit these notifications. As there was no readily available information, Audit could not ascertain the extent of non-compliance with the notification requirements.

3.8 An employer is required to report in the employer's return the period of employment of an employee. Audit's examination of ten employers' returns for 1998-1999 (see paragraph 2.13 above) and the notifications submitted by these ten employers revealed that:

- nine of the ten employers disclosed in their employers' returns that they had commenced to employ a total of 58 employees in 1998-1999. However, none of these nine employers had submitted any notification of commencement of employment of an employee; and
- eight of the ten employers had ceased to employ a total of 64 employees in 1998-1999. However, only three of these eight employers had submitted notifications of impending cessation of employment of an employee in respect of 16 employees. The emoluments of the remaining 48 employees were reported in the employers' returns.

3.9 Audit noted that the IRD did not check an employer's return to identify cases in which the employer had failed to submit a notification of commencement/impending cessation of employment of an employee. In general, the IRD processed all notifications of commencement/impending cessation of employment of an employee submitted by employers. However, the IRD did not take any follow-up or penalty action if it was later found that an employer had failed to submit these notifications. In Audit's view, notifications of commencement/impending cessation of employment of an employee are useful for the assessment and collection of salaries tax. In particular, for employees recruited from outside of Hong Kong, the timely submission of notifications of impending cessation of employment of such employees by their employers enables urgent action to be taken to assess and collect taxes due from them before their departure from Hong Kong (see paragraph 3.24 below).

#### **Write-off of salaries tax due to departure of taxpayers from Hong Kong**

3.10 A notification of impending departure from Hong Kong of an employee includes all the information about an individual as contained in an employer's return. In addition, the employer is required to indicate in the notification the expected date of departure, the reason for departure and whether the employee will return to Hong Kong. This enables the IRD to take urgent action to assess and collect salaries tax before the employee's departure from Hong Kong. **Nevertheless, Audit noted that there were substantial amounts of write-off of tax revenue as a result of departure from Hong Kong of taxpayers who had not paid the salaries tax due.** An analysis of salaries tax written off in 1999-2000 is shown in Table 4 below.

**Table 4**

**Analysis of salaries tax written off in 1999-2000**

Reason for write-off	Case		Amount		Average amount per case
	(a)		(b)		(c) = $\frac{(b)}{(a)}$
	(Number)	(Percentage)	(\$ million)	(Percentage)	(\$)
Taxpayers departed from Hong Kong	739	6%	58.5	37%	79,200
Taxpayers with no known source of income	10,078	80%	47.5	30%	4,700
Untraceable taxpayers	1,456	12%	45.4	29%	31,200
Others	315	2%	6.4	4%	20,300
<b>Total</b>	<b><u>12,588</u></b>	<b><u>100%</u></b>	<b><u>157.8</u></b>	<b><u>100%</u></b>	<b>12,500</b>

Source: IRD's records

Note 1: In 1999-2000, write-off cases with amount up to \$250,000 were approved by the Commissioner of Inland Revenue or authorised IRD directorate officers. Write-off cases with amount in excess of \$250,000 were approved by the Secretary for the Treasury. In all cases, the Commissioner certified that no fraud, suspected fraud or negligence was involved, that all possible recovery actions had been tried and that the Commissioner was satisfied that the whole amount was irrecoverable.

Note 2: The IRD maintains the collection files and records of all write-off cases. If recovery of any items already written off appears possible at a later date (e.g. receipt of an employer's notification of commencement of employment of a taxpayer who had previously departed from Hong Kong or had previously been untraceable), the IRD will commence recovery action. For write-off cases re-opened in 1999-2000, the tax recovered amounted to \$36.9 million.

Note 3: The analysis excluded write-off cases with amounts less than \$100.

3.11 As shown in Table 4 above, \$58.5 million or 37% of the salaries tax written off in 1999-2000 was due to departure from Hong Kong of 739 individuals who had not paid the tax. The IRD found out that these 739 individuals had departed from Hong Kong after making enquiries of the arrival/departure information of the Immigration Department.

**Audit's examination of 20 tax write-off cases involving employees recruited from outside of Hong Kong**

3.12 Although there are no readily available statistics, it is believed that a large portion of tax write-off cases was related to employees who were recruited from outside of Hong Kong and who left Hong Kong on termination of their employment without first paying their tax. **Audit estimated that the write-off of tax due from such employees was \$59 million in 1997-1998, \$77 million in 1998-1999 and \$77 million in 1999-2000.** In view of the substantial amounts of write-off in these cases, Audit examined a random sample of 20 write-off cases in 1999-2000 involving the departure from Hong Kong of such employees. In these cases, the amount of tax not paid ranged from \$37,080 to \$1,238,077 and averaged \$264,766. The audit findings are given in paragraphs 3.13 to 3.20 below.

*Notification requirements not complied with by employers*

3.13 Audit found that the employers in all the 20 write-off cases did not comply with the requirements of section 52(6) of the Inland Revenue Ordinance. 17 employers did not submit a notification of impending departure from Hong Kong of an employee. The remaining three employers failed to submit such a notification not later than one month before the expected date of departure as shown in Table 5 below.

**Table 5**

**Analysis of three employers' notifications of impending departure from Hong Kong of an employee**

<b>Employer</b>	<b>Date of notification</b>	<b>Expected date of departure of employee</b>
B	8 April 1997	12 December 1996
C	9 July 1997	31 July 1997
D	1 December 1997	15 November 1997

*Source: IRD's records*

3.14 Of the 17 employers who did not submit a notification of impending departure from Hong Kong of an employee:

- three employers reported the emoluments and the cessation of employment of the employee in the annual employer’s return; and
- 14 employers submitted a notification of impending cessation of employment of an employee. However, all the 14 notifications were not submitted within the required period under section 52(5) of the Inland Revenue Ordinance as shown in Table 6 below.

**Table 6**

**Analysis of 14 employers’ notifications of impending cessation of employment of an employee**

<b>Timing of submission</b>	<b>Number of employer</b>
Not later than one month before the date of cessation of employment as required by the Inland Revenue Ordinance	None
Within one month after the date of cessation of employment	4
More than one month after the date of cessation of employment	10
<b>Total</b>	<b><u>14</u></b>

*Source: IRD’s records*

*Note: According to the IRD, in two of the 14 cases the employees had stayed in Hong Kong for several months after cessation of employment before they left Hong Kong, and in another case the employee left abruptly without giving any notice to the employer.*



The 14 employers who submitted the notifications did so either after the employees had left Hong Kong, or a few days before the departure of the employee. As a result, the IRD was unable to raise assessments of tax and issue tax demand notes before the departure of the employees of these 14 employers.

3.15 Upon the IRD's follow-up enquiries, it was found that only one of the 20 employers had withheld money payable to the employee. The other 19 employers did not comply with the requirements of section 52(7) of the Inland Revenue Ordinance (see the second inset of paragraph 3.5 above).

#### *Assessments of tax not timely made*

3.16 As mentioned in paragraph 3.13 above, three employers (i.e. Employer B, Employer C and Employer D) submitted a notification of impending departure from Hong Kong of an employee. **Employer C's notification was received by the IRD's Central Mail Office on 11 July 1997 (Friday) and passed to the salaries tax unit on 14 July 1997 (Monday).** The notification reported the employee's emoluments in 1997-1998. The employee's emoluments in 1996-1997 were also reported in the employer's return submitted to the IRD on 23 April 1997. As the expected date of departure of the employee was 31 July 1997, the IRD should have raised assessments of tax for both 1996-1997 and 1997-1998, and should have issued tax demand notes as early as possible (i.e. before 31 July 1997). Without an individual's tax return from the employee, the salaries tax unit made an estimated assessment of tax of \$43,557 for 1997-1998 based on the emoluments reported in Employer C's notification. **The tax demand note for 1997-1998, with the due date of 31 July 1997, was sent on 29 July 1997 to the employee at Employer C's business address. However, according to the information obtained in January 1999 by the IRD from the Immigration Department, the employee had already departed from Hong Kong on 19 July 1997. The IRD also failed to make an assessment of tax and issue the tax demand note for 1996-1997 before the expected date of departure of the employee (i.e. 31 July 1997).** Based on the emoluments reported in the employer's return submitted on 23 April 1997, the assessment of tax of \$149,322 for 1996-1997 was only made (and the demand note issued) in November 1997.

3.17 Employer B and Employer D, unlike Employer C, submitted the notification of impending departure from Hong Kong of an employee after the departure of their employees. Therefore, the IRD was unable to make assessments of tax and issue tax demand notes before the departure of the employees of these two employers.

#### *Recovery actions not effective*

3.18 For all of the 20 write-off cases, the IRD initiated recovery action after the assessed tax

had become due and unpaid. These included requiring, under section 76(1) of the Inland Revenue Ordinance, the employers and the employees' bankers to pay to the IRD any money they owed or held for the employees. However, the amount of tax recovered, if any, was minimal as 19 employers had not withheld any money payable to the employees, and all the employees had not left behind any significant bank deposits in Hong Kong.

*Long time taken to obtain a departure prevention direction from a District Judge*

3.19 Under section 77 of the Inland Revenue Ordinance, if the Commissioner of Inland Revenue applies to a District Judge and satisfies him that there are reasonable grounds for believing that an individual intends to depart, or has departed, from Hong Kong to reside elsewhere without paying all the tax due from him, the District Judge shall issue a departure prevention direction to stop the individual from leaving Hong Kong. As at 30 June 2000, the IRD had obtained a departure prevention direction in ten of the 20 write-off cases. In the remaining ten write-off cases, either the IRD was in the process of gathering information for making an application to a District Judge for a departure prevention direction, or no such application was made as certain conditions for the issue of a departure prevention direction (e.g. the taxpayer being aware of the outstanding tax liabilities) were not met.

3.20 Counting from the date of the employer's notification of impending cessation of employment/departure from Hong Kong of an employee, the time taken by the IRD to obtain a departure prevention direction in the ten cases ranged from 348 days to 1,854 days with an average of 821 days. The departure prevention direction was issued in all of the ten cases after the employee had left Hong Kong. **According to the information obtained by the IRD from the Immigration Department, in three of the ten cases the employees had subsequently returned to Hong Kong and left again without paying the tax due. They were able to leave because the departure prevention direction was issued after the date of their last departure.** Details are given in Table 7 below.

Table 7

Time taken by the IRD to obtain a departure prevention direction in three tax write-off cases

	Case 1	Case 2	Case 3
(a) <b>Date of employee's departure from Hong Kong</b>	23 February 1996	8 November 1994	21 November 1996
(b) <b>Date of employer's notification of impending cessation of employment of the employee</b>	11 March 1996	22 November 1994	27 November 1996
(c) <b>Dates employee re-entered Hong Kong (after the date in (a))</b>	9 March 1996 28 May 1996 1 December 1996	1 January 1995 4 December 1995	38 times between 22 November 1996 and 5 April 1999
(d) <b>Dates employee again left Hong Kong (before the date in (f))</b>	16 March 1996 19 June 1996	15 January 1995	37 times between 23 November 1996 and 3 April 1999
(e) <b>Date of employee's last departure from Hong Kong</b>	12 December 1996	7 December 1995	6 April 1999
(f) <b>Date of issue of departure prevention direction</b>	15 April 1999	20 December 1999	9 March 2000
(g) <b>Number of days counting from the date of employer's notification to the date of employee's last departure from Hong Kong (between (b) and (e))</b>	276 days	380 days	860 days
(h) <b>Number of days counting from the date of employer's notification to the date of issue of departure prevention direction (between (b) and (f))</b>	1,130 days	1,854 days	1,197 days

Source: IRD's records

### Need for enhancing compliance with the notification requirements

3.21 Audit noted that once an employee had left Hong Kong, the IRD would have great difficulties in recovering from him any unpaid tax. It is therefore essential for the IRD to ensure that employers comply with the requirements of notification and withholding money so as to enable the IRD to take urgent action to assess and collect the salaries tax from the employees before they leave Hong Kong. The IRD has prepared an information sheet to draw the attention of employers to these requirements and the penalties for their non-compliance. The IRD has, for many years, issued the information sheet together with the employer's return to each employer annually. **However, as indicated in paragraphs 3.13 to 3.15 above, none of the 20 employers had fully complied with these requirements. In particular, three employers did not submit either a notification of impending departure from Hong Kong of an employee or a notification of impending cessation of employment of an employee. Although the non-compliance resulted in the write-off of tax, up to 30 June 2000, the IRD had not taken any penalty action against these employers. Audit considers that, in order to ensure compliance with these requirements and to have a deterrent effect, penalty action should be taken against these employers.**

3.22 In the 20 write-off cases selected by Audit, the amount of tax written off ranged from \$37,080 to \$1,238,077 and averaged \$264,766. However, the penalty for failure to comply with the requirements of notification or withholding money is a fine of only up to \$10,000. **Audit considers that the IRD should consider the feasibility of imposing heavier penalties.** In this connection, reference may be made to the fine of up to \$10,000 and a further fine of up to treble the amount of tax undercharged for the offence of submitting an incorrect employer's return.

### Need for taking urgent action for departure cases

3.23 In the case of Employer C, Audit noted that within 19 days (i.e. from 11 July to 29 July 1997) the IRD had made an assessment of tax and issued the tax demand note before the expected date of departure of the employee for the current year of assessment (i.e. 1997-1998). However, the IRD did not immediately do so for the previous year of assessment (i.e. 1996-1997 — see paragraph 3.16 above). **Audit considers that when a notification of impending departure from Hong Kong of an employee is received, the IRD should take urgent action to assess and collect salaries tax, for all years of assessment for which tax has not been assessed and collected, from the employee before his departure from Hong Kong.**

3.24 Employees recruited from outside of Hong Kong are usually required to obtain an entry visa from the Immigration Department for employment in Hong Kong. The employer's sponsorship is usually required in the visa application process. On cessation of employment of the employee, an employer may not know whether the employee is really about to leave Hong Kong as the employee may have successfully sought another employment in Hong Kong and therefore may be allowed to stay longer. Under such circumstances, the employer may choose to submit a notification of impending cessation of employment of an employee (instead of a notification of his impending departure from Hong Kong), despite the fact that the employee may actually intend to leave Hong Kong permanently. In the 20 write-off cases selected by Audit, 14 employers had chosen to submit (not within the required time limit) a notification of impending cessation of employment of an employee notwithstanding the fact that all the employees intended to leave Hong Kong permanently. **Audit therefore considers that, for cases involving employees recruited from outside of Hong Kong, the IRD should take urgent action to assess and collect salaries tax from the employee upon the receipt from an employer of a notification of impending cessation of his employment or a notification of his impending departure from Hong Kong.**

Audit notes that the staff handbook of the IRD's salaries tax unit requires IRD officers to deal with a notification of impending cessation of employment of an employee on an "urgent case" basis if the employee concerned was recruited from outside of Hong Kong.

3.25 Section 52(7) of the Inland Revenue Ordinance requires an employer to withhold, for one month from the date of notification of impending departure from Hong Kong of an employee, payment of money to the employee. The purpose is to facilitate the recovery of any unpaid tax from the employer. Audit notes that this provision is not entirely satisfactory because:

- an employer may choose to submit only a notification of impending cessation of employment of an employee. In such cases, the employer will not withhold any money payable to the employee (see paragraph 3.24 above);
- some employees, including those who intend to evade tax, may resign without giving prior notice to the employer. An employer may not be able to withhold any money in such cases; and
- the amount of money withheld by the employer may not be sufficient to settle the amount of unpaid tax.

3.26 In cases where insufficient money has been withheld by or is recoverable from the employer, a departure prevention direction issued before the departure from Hong Kong of an employee should be an effective measure for recovering the outstanding tax from the employee. If the employee has already departed from Hong Kong, the issue of a departure prevention direction afterwards is also an effective measure for recovering the outstanding tax from the employee if he subsequently returns to Hong Kong. To achieve the objective of recovering outstanding tax, departure prevention directions should be issued promptly. **Audit noted that the time taken by the IRD to obtain a departure prevention direction in ten write-off cases ranged from 348 days to 1,854 days with an average of 821 days (see paragraph 3.20 above). The long time taken by the IRD to obtain a departure prevention direction is a matter of concern. As indicated in paragraph 3.20 above, in three of the ten cases, the employees had subsequently returned to Hong Kong and left again without hindrance. The outstanding salaries tax might have been recovered had the departure prevention direction been issued before the date of their last departure from Hong Kong. Audit considers that the IRD should review the procedure with a view to shortening substantially the time taken to obtain a departure prevention direction.**

3.27 **In view of the substantial amounts of write-off attributed to employees recruited from outside of Hong Kong, Audit considers that the IRD should review regularly the position to determine if further measures should be taken to protect the revenue. If the amounts of tax written off attributable to employees in high-risk groups (e.g. employees recruited from outside of Hong Kong) continue to be substantial, the IRD should consider the feasibility of requiring them to purchase interest-bearing tax reserve certificates as income is earned in order to provide security for the payment of tax.**

## **Audit recommendations on employers' notifications**

3.28 **Audit has recommended that the Commissioner of Inland Revenue should:**

- (a) **take penalty action against those employers who fail to comply with the requirements of notification or withholding money under section 52 of the Inland Revenue Ordinance;**
- (b) **consider proposing legislative amendments that will empower the IRD to impose heavier penalties on those employers who fail to comply with the requirements of notification or withholding money under section 52 of the Inland Revenue Ordinance;**
- (c) **upon the receipt of a notification of impending departure from Hong Kong of an employee, take urgent action to assess and collect salaries tax, for all years of assessment for which tax has not been assessed and collected, from the employee before his departure from Hong Kong;**
- (d) **for employees in high-risk groups (e.g. employees recruited from outside of Hong Kong), take urgent action to assess and collect salaries tax from the employee upon the receipt of either a notification of impending cessation of employment of an employee or a notification of impending departure from Hong Kong of an employee;**
- (e) **review the relevant procedures with a view to shortening substantially the time taken to obtain a departure prevention direction from a District Judge;**
- (f) **regularly review the amounts of tax written off due to the departure from Hong Kong of employees, particularly employees in high-risk groups, to determine if further measures should be taken to protect the revenue; and**
- (g) **consider proposing legislative amendments that will empower the IRD to require employees in high-risk groups to purchase interest-bearing tax reserve certificates as income is earned in order to provide security for the payment of tax.**

## **Response from the Administration**

3.29 The **Commissioner of Inland Revenue** has said that the IRD has set up an ad hoc committee to examine how best to implement the audit recommendations (see paragraph 1.7 above). He has also said that:

***Notifications of commencement/impending cessation of employment of an employee***

- (a) he agrees that employers' notifications of commencement/impending cessation of employment of an employee are useful means of ensuring due collection of salaries tax in default. There are departmental instructions for staff to identify warranted cases for follow-up with penalty action;

***Penalty action against employers***

- (b) he agrees to Audit's view that penalty action should be taken against employers proven to have failed to comply with the notification requirements. The IRD will take more vigorous penalty action against employers in warranted cases to enhance the deterrent effect. In addition, the IRD considers that publicity and education are equally important. As stated in paragraph 3.21 above, the IRD has distributed an information sheet to draw employers' attention to the notification requirements and the penalties applicable in the event of non-compliance. The IRD will also continue to conduct seminars for employers to remind them of their filing obligations every year;

***Imposition of heavier penalties***

- (c) as regards the audit recommendation to consider proposing legislative amendments that will empower the IRD to impose heavier penalties, he will consider it alongside all the other audit recommendations in the context of the deliberations of the IRD's ad hoc committee;

***Urgent action to assess and collect tax***

- (d) there are already procedural requirements laid down in the staff handbooks and circulars regarding the assessment and collection procedures on receiving notifications of impending departure and notifications of impending cessation of employment of employees recruited from outside of Hong Kong. He will take the necessary steps to ensure that all the responsible officers do adhere strictly to such procedural requirements and take prompt and timely action in assessing and collecting salaries tax from employees in high-risk groups;

### ***Time taken to obtain a departure prevention direction***

- (e) the IRD will review the relevant procedures and endeavour to shorten the time to apply for a departure prevention direction as far as practicable. Given that the application for a departure prevention direction is one of the most vigorous recovery actions, it is important to exercise due care before deciding whether this power should be invoked, especially having regard to the regulations on the liberty of movement under Article 8 of the Hong Kong Bill of Rights Ordinance (Cap. 383). In fact, the relevant provisions under the Inland Revenue Ordinance were amended in 1993 to stipulate much more stringent conditions for the application of a departure prevention direction;

### ***Gathering of arrival and departure data***

- (f) the IRD has no direct access to the arrival and departure data of individual taxpayers as the ownership of such sensitive data belongs to another department. Since the enactment of the Personal Data (Privacy) Ordinance (Cap. 486), the IRD has to comply with more stringent procedures to obtain such data for tax recovery purposes;

### ***Gathering of requisite facts and information***

- (g) although the IRD will take immediate action once the taxpayer's impending permanent departure is known, it is sometimes inevitable that the IRD has to spend considerable time in gathering all the requisite facts and information in support of an application for a departure prevention direction if there is a need to do so. The Special Due Date Section of the Collection Enforcement Section is responsible for the close monitoring of all impending departure cases. As illustrated by some cases with concrete information of the taxpayer's permanent departure, timely actions have been taken to recover the outstanding tax from the taxpayers concerned;

### ***Long time taken to obtain a departure prevention direction in three write-off cases***

- (h) the IRD has reviewed the three cases referred to in Table 7 in paragraph 3.20 above. For all these cases, the employers only filed a notification of cessation of employment. As the IRD had no knowledge about the impending departure of the taxpayers or the dates of their subsequent returns, much efforts had been expended in tracing the whereabouts of the taxpayers. Information on their permanent departure only came to light at a later date. Moreover, given the fact that the demand notes to the taxpayer in



Case 3 had not been successfully served in the first instance, and both the taxpayers in Case 2 and Case 3 raised objections to the assessments when they became aware of their tax liabilities, departure prevention directions for these two cases could not be applied until all the necessary legal formalities were met;

***Tax treatments for employees recruited from outside of Hong Kong***

- (i) it is the IRD's policy to maintain a simple and non-discriminatory tax system in Hong Kong. Unlike many other countries, there are no differential tax treatments for residents and non-residents, except in the case of visiting entertainers and sportsmen, where their sponsors are required under section 20B of the Inland Revenue Ordinance to withhold sufficient funds for the payment of their profits tax liabilities relating to their performance in Hong Kong. However, in view of the growing number of cases involving employees recruited from outside of Hong Kong who had left Hong Kong without fully settling their tax liabilities, he agrees that there is a need to put in place practicable arrangements to ensure the due and timely collection of salaries tax revenue from this category of high-risk employees; and

***Proposal to require employers of employees recruited from outside of Hong Kong to withhold money***

- (j) as a viable alternative, the IRD proposes to make legislative changes, along the lines of section 20B of the Inland Revenue Ordinance, to require employers of all employees recruited from outside of Hong Kong to withhold sufficient amount of money for the payment of their salaries tax liabilities arising from their employment in Hong Kong. The IRD will need to seek the views of employer associations, chambers of commerce and tax practitioners on this proposal before deciding whether to introduce this into the Legislative Council.

3.30 The **Secretary for the Treasury** agrees to the comments made by the Commissioner of Inland Revenue (see also paragraph 1.8 above).

## **PART 4: RETURNS AND NOTIFICATIONS SUBMITTED BY GOVERNMENT DEPARTMENTS**

### **Requirements of the IRD**

4.1 In early April each year, the IRD sends a circular memorandum to all government departments setting out the returns and notifications required to be submitted to the IRD. The main requirements, as exemplified in the April 1999 circular memorandum, are as follows:

- *Computerised returns.* The Treasury is required to submit in early April two computerised returns (in the form of magnetic tapes) for the preceding financial year for all officers. One return is to report mainly the taxable earnings paid through the Treasury's Payroll System and the other return is to report the taxable earnings paid through the Treasury's Payment of Creditors System (POCS);
- *Manual return.* Government departments are required to submit promptly a manual return for the preceding financial year to report an officer's other taxable earnings (e.g. payments made through departmental imprests) which have not been included in the Treasury's computerised returns. The IRD provides a specified form for this purpose;
- *Notification of impending cessation of employment of an officer.* Government departments are required to notify the IRD of the taxable earnings of an officer upon his leaving the Government on retirement, completion of contract, resignation or other occasions. Only those payments made other than through the Treasury's Payroll System and which have not been included in the Treasury's computerised returns are required to be reported, using a specified form. When an officer is leaving Hong Kong permanently, a notification of impending departure from Hong Kong of an officer is required to be submitted instead; and
- *Notification of impending departure from Hong Kong of an officer.* Government departments are required to notify the IRD of the taxable earnings of an officer upon his permanent departure from Hong Kong by completing a specified form. The IRD states in the circular memorandum that section 52(6) of the Inland Revenue Ordinance (see the first inset of paragraph 3.5 above) covers the case of an officer leaving Hong Kong permanently and requests government departments to submit the specified form in sufficient time to allow assessment and collection of tax prior to the officer's departure from Hong Kong. As indicated in the specified form, only those payments made other than through the Treasury's Payroll System and which have not been included in the Treasury's computerised returns are required to be reported.

### **Returns and notifications submitted by government departments**

4.2 Salaries and allowances of officers paid through the Treasury's Payroll System are taxable earnings and therefore are fully included in the Treasury's computerised returns. Payments

made to creditors (Note 6) by government departments through the POCS are included in the Treasury's computerised returns to the IRD as taxable earnings only when:

- the payments (e.g. salaries and wages) are made to non-civil service contract officers (Note 7) and the government departments have entered the code "9" in the third digit of the Creditor Reference Numbers of these officers. This code denotes that all payments to them are taxable earnings; or
- the payments (e.g. salaries for part-time jobs) are made to government officers and the government departments have coded the payments as taxable earnings by inserting a taxable payment indicator "T" in the payment vouchers.

Other taxable earnings paid through the POCS but not coded as such by government departments will not be included in the Treasury's computerised returns. Government departments are required to report such taxable earnings in their manual returns to the IRD. In addition to the notifications mentioned in the IRD's circular memorandum, every month the Treasury notifies the IRD of the particulars of newly appointed officers.

### **Processing of returns and notifications submitted by government departments**

4.3 In the IRD, returns and notifications submitted by government departments are processed in essentially the same way as the corresponding employers' returns and notifications submitted by employers in the private sector. Data in the Treasury's computerised returns are uploaded directly from the magnetic tapes to the salaries income database. Data in the manual returns and notifications submitted by government departments are manually input to the salaries income database. These data are used for identifying individuals chargeable to salaries tax and cross-checking the accuracy and completeness of the income reported in the individual's tax returns.

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**Note 6:** *A Creditor Reference Number is assigned to each regular creditor. This number has to be input for making a payment through the POCS.*

**Note 7:** *Government departments may, subject to the availability of funding, employ non-civil service contract officers remunerated at non-directorate equivalent level to meet service needs where the service need:*

- *is short-term or does not require keeping staff on a long-term or permanent basis;*
- *requires staff only on a part-time basis; or*
- *requires flexible engagement and deployment of staff.*

*Non-civil service contract officers are not civil servants. They do not occupy posts on the establishment of the government departments and are not counted towards the establishment.*

**Audit observations on returns and notifications submitted by government departments**

**Audit’s examination of taxable earnings paid through the POCS to non-civil service contract officers**

4.4 To test check whether taxable earnings paid through the POCS to non-civil service contract officers had been properly reported to the IRD, Audit selected a random sample of ten government departments. Audit used a computer program to identify from the POCS the payments of salary and wages by these ten government departments in 1998-1999 to non-civil service contract officers but which had not been properly coded as taxable earnings. The results are shown in Table 8 below.

**Table 8**

**Payments of salary and wages in 1998-1999 to non-civil service contract officers through the POCS but not coded as taxable earnings**

Department	Total payments	Total number of officers	Average payment per officer
	(a)	(b)	(c) = $\frac{(a)}{(b)}$
	(\$)		(\$)
Environmental Protection Department	10,807,395	421	25,671
Fire Services Department	364,478	13	28,037
Official Receiver’s Office	61,125	1	61,125
<b>Total</b>	<b><u>11,232,998</u></b>	<b><u>435</u></b>	<b>25,823</b>

Source: POCS

Note 1: Audit’s test checking was not intended to identify all taxable earnings paid to non-civil service contract officers which had not been properly coded as such by the ten selected government departments. The taxable earnings included in this analysis represent only those payments which met the following selection criteria:

- the word “salary”, “salaries”, “wage” or “wages” was at the beginning of the payment description;
- the payment was not made to a government officer; and
- the third digit of the Creditor Reference Number was not “9”.

Note 2: Seven of the ten government departments selected did not have any payments which met the selection criteria in Note 1 above. These seven government departments were the Financial Services Bureau, the Education Department, the Department of Health, the Radio Television Hong Kong, the Social Welfare Department, the Territory Development Department and the Treasury.

4.5 Table 8 above indicated that taxable earnings of \$10.8 million were paid in 1998-1999 to non-civil service contract officers through the POCS but not coded as such by the Environmental Protection Department (EPD). In response to Audit's enquiry, the EPD said that:

- the \$10.8 million were salary payments to non-civil service contract officers. The EPD by mistake did not enter the code "9" in the third digit of the Creditor Reference Numbers of these officers. As a result, these payments were not included in the Treasury's computerised returns submitted to the IRD in early April 1999;
- the EPD had detected the errors in June 1999 and filed a manual return in July 1999 to report these taxable earnings to the IRD; and
- **there were similar POCS coding errors in 1997-1998 and before, but only for temporary employees as the EPD did not employ other non-civil service contract officers before 1998-1999. In view of the absence of certain personal data such as address and marital status required for the completion of a manual return, the EPD had not filed manual returns for 1997-1998 and before to report to the IRD the taxable earnings of all the temporary employees.** The EPD could not ascertain the number of temporary employees involved, as the original payment vouchers were kept by the Treasury and the copies kept by the EPD were destroyed in accordance with the Treasury's Standing Accounting Instructions. The salaries paid to all the temporary employees in 1997-1998 amounted to \$9.1 million.

4.6 Table 8 in paragraph 4.4 above also indicated that taxable earnings totalling \$0.4 million were paid in 1998-1999 to non-civil service contract officers through the POCS but not coded as such by the Fire Services Department and the Official Receiver's Office. The Fire Services Department did not file a manual return for 1998-1999 to report the taxable earnings to the IRD. The Official Receiver's Office filed a manual return for 1998-1999 to report the taxable earnings to the IRD.

4.7 According to Accounting Circular No. 3/2000 dated 16 June 2000 issued by the Treasury, non-civil service contract officers will continue to be excluded from the Treasury's Payroll System. With the increasing number of such officers engaged by government departments, the amount of salary and wages paid to them through the POCS may increase. **Audit considers that there is a need for government departments to ensure that all the taxable earnings paid to non-civil service contract officers through the POCS are coded correctly for reporting to the IRD. Audit also considers that the POCS should be modified so that the system will automatically display a reminder to government departments of the coding requirement for a non-civil service contract officer, when they perform on-line input of a new Creditor Reference Number.**

**Audit’s examination of taxable earnings  
paid through the POCS to government officers**

4.8 To test check whether taxable earnings paid through the POCS to government officers had been properly reported to the IRD, Audit selected another random sample of ten government departments. Audit used a computer program to identify from the POCS the payments of salary by these ten government departments in 1998-1999 to government officers for their part-time jobs (e.g. part-time teachers). The results are shown in Table 9 below.

**Table 9**

**Payments of salary in 1998-1999 to government  
officers for their part-time jobs through the POCS**

<b>Department</b>	<b>Total payments</b>	<b>Total number of payments</b>	<b>Total number of officers</b>	<b>Average payment per officer</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>	<b>(d) = <math>\frac{(a)}{(c)}</math></b>
	<b>(\$)</b>			<b>(\$)</b>
Education Department	831,165	233	84	9,895
Correctional Services Department	399,767	97	10	39,977
<b>Total</b>	<b><u>1,230,932</u></b>	<b><u>330</u></b>	<b><u>94</u></b>	<b>13,095</b>

Source: POCS

Note 1: Audit’s test checking was not intended to identify all taxable earnings paid to government officers through the POCS by the ten selected government departments. The taxable earnings included in this analysis represent only those payments which met the following selection criteria:

- the word “part-time” or “part time” was at the beginning of the payment description; and
- the payment was made to a government officer.

Note 2: Eight of the ten government departments selected did not have any payments which met the selection criteria. These eight government departments were the Civil Engineering Department, the Customs and Excise Department, the Fire Services Department, the Highways Department, the Hong Kong Police Force, the Immigration Department, the Social Welfare Department and the Water Supplies Department.

4.9 Table 9 above indicated that the Education Department and the Correctional Services Department had paid salary of \$0.8 million and \$0.4 million respectively in 1998-1999 to government officers for their part-time jobs. For each of the two departments, Audit randomly selected five payments to test check whether a taxable payment indicator “T” had been inserted in the payment voucher. Audit noted that:

- *Education Department.* For four of the five selected payments, the Education Department did not insert a taxable payment indicator “T” in the payment voucher; and
- *Correctional Services Department.* For all the five selected payments, the Correctional Services Department did not insert a taxable payment indicator “T” in the payment voucher.

For the nine payments not coded as taxable earnings in the POCS, both the Education Department and the Correctional Services Department did not file a manual return for 1998-1999 to report the taxable earnings to the IRD. Based on other information of the nine government officers concerned, Audit traced to the IRD’s records and noted that only six of them had included their earnings from part-time jobs in their individual’s tax returns. **Therefore, the IRD had not assessed the tax liabilities of the remaining three government officers in respect of their earnings from part-time jobs. Audit considers that there is a need for government departments to ensure that all the taxable earnings paid to government officers through the POCS are coded correctly and duly reported to the IRD.**

#### **Write-off of salaries tax involving government officers**

4.10 Similar to the IRD’s corresponding requirements for employers in the private sector, a notification of impending departure from Hong Kong of an officer, or a notification of impending cessation of employment of an officer for cases involving expatriate officers, from a government department enables the IRD to take urgent action to assess and collect salaries tax from the officer before his departure from Hong Kong. In 1999-2000 write-off of salaries tax due from government officers and employees of public bodies was \$3 million. (This \$3 million is part of the \$157.8 million shown in Table 4 in paragraph 3.10 above.) However, there were no readily available statistics to indicate the reasons for the write-offs. Table 10 below shows an analysis of salaries tax written off in 1999-2000 involving government officers and employees of public bodies.

Table 10

**Analysis of salaries tax written off in 1999-2000  
involving government officers and employees of public bodies**

Status	Case		Amount		Average amount per case
	(a)		(b)		(c) = $\frac{(b)}{(a)}$
	(Number)	(Percentage)	(\$ million)	(Percentage)	(\$)
Expatriate officers	46	23%	1.0	33%	21,739
Local officers	154	77%	2.0	67%	12,987
<b>Total</b>	<b><u>200</u></b>	<b><u>100%</u></b>	<b><u>3.0</u></b>	<b><u>100%</u></b>	<b>15,000</b>

Source: IRD's records

Note 1: The 200 write-off cases shown in this analysis are part of the 12,588 write-off cases in Table 4 in paragraph 3.10 above.

Note 2: There were no readily available statistics that indicate separately the number of write-off cases relating to government officers.

4.11 Audit examined five randomly selected major write-off cases in 1999-2000 involving three expatriate officers and two local officers. The amount of salaries tax written off in these five cases ranged from \$24,471 to \$97,919 with an average of \$65,603. In all these five cases, the officer left the Government on completion of contract or resignation, and departed from Hong Kong shortly after. In the examination, Audit focused on the IRD's specific notification requirements, assessment procedures and collection procedures applicable to government officers.

***Notification requirements not clearly stated***

4.12 In April 1999, the IRD stated in its circular memorandum issued to all government departments that it did not always receive notifications of impending departure from Hong Kong of an officer from certain government departments in respect of their staff members who would leave Hong Kong permanently. Audit noted that the circular memorandum required government departments to notify the IRD of the taxable earnings of an officer upon his leaving the Government or permanent departure from Hong Kong. **However, the IRD's notification requirements were not clearly stated. Audit noted that:**



- the circular memorandum did not mention the time limit within which a government department should report to the IRD the impending cessation of employment of an officer. It also did not specify clearly the time limit for the submission of a notification of impending departure from Hong Kong of an officer, but only mentioned that section 52(6) of the Inland Revenue Ordinance covered the case of an officer leaving Hong Kong permanently and requested government departments to submit a notification of impending departure from Hong Kong of an officer in sufficient time to allow assessment and collection of tax prior to the officer's departure from Hong Kong (see the last inset of paragraph 4.1 above); and
- the circular memorandum and the relevant specified forms stated that only those payments made to an officer other than through the Treasury's Payroll System were required to be reported. The intention was that the specified forms, which were essential documents for tax assessment purposes, should be submitted in all cases. However, the reference to "other than through the Treasury's Payroll System" may be misleading. A government department which has not made any payments to an officer other than through the Treasury's Payroll System may think that there is no need to submit to the IRD the specified form upon his leaving the Government or permanent departure from Hong Kong.

4.13 In respect of the five write-off cases examined by Audit, the audit findings are as follows:

- *Case A.* In December 1997, the Hong Kong Police Force submitted a notification of impending departure from Hong Kong of an officer. In the notification, the Hong Kong Police Force reported an allowance paid to the officer other than through the Treasury's Payroll System;
- *Case B.* In April 1996, the Treasury sent a memo notifying the IRD that an expatriate officer of the Civil Aviation Department would leave the Government on completion of contract and an end-of-contract gratuity of about \$116,000 would shortly be payable to him. **The memo from the Treasury indicated that if the IRD wished to recover any tax from the officer's end-of-contract gratuity, the IRD should timely send a recovery notice to the Treasury.** No payments had been made to the officer other than through the Treasury's Payroll System and the Civil Aviation Department did not submit a notification of impending cessation of employment/departure from Hong Kong of this officer to the IRD; and
- *Cases C, D and E.* The departments (i.e. the Education Department, the Hong Kong Police Force and the Transport Department) did not submit any notifications. The tax assessments made by the IRD after the departure from Hong Kong of the three officers concerned revealed that the three departments had not made any payments to them other than through the Treasury's Payroll System.

4.14 **Audit considers that all taxable earnings of an officer, including those paid through the Treasury's Payroll System, should be promptly reported to the IRD for taking urgent action to assess and collect tax from the officer before his departure from Hong Kong. There**

is a need for both the IRD and the Treasury to clearly state the notification requirements to be followed by government departments in reporting the impending cessation of employment and the impending departure from Hong Kong of an officer.

*Failure to timely respond to notifications*

4.15 Government departments are requested by the IRD's circular memorandum to submit a notification of impending departure from Hong Kong of an officer in sufficient time to allow assessment and collection of tax prior to the officer's departure from Hong Kong. Audit noted that the Hong Kong Police Force in Case A and the Treasury in Case B had followed the IRD's request by submitting a notification well in advance of the officer's departure from Hong Kong. However, the IRD failed to timely respond to the notifications. In both cases, the IRD made assessments of tax and issued tax demand notes about **two months** after receiving the notifications, and did not impose due dates for the immediate payment of tax. Details are shown in Table 11 below.

**Table 11**

**IRD's delay in the processing of notifications  
of impending departure from Hong Kong of government officers**

Case	Date of notification by the department	Expected date of departure	Issue date of tax demand note	Due date of tax demand note
A	3 December 1997	23 January 1998	6 February 1998	17 March 1998
B	16 April 1996	31 May 1996	14 June 1996	24 June 1996

Source: IRD's records

Note: In Case B, the Treasury notified the IRD of the impending cessation of employment of the expatriate officer by a memo instead of using the specified form (see the second inset of paragraph 4.13 above). In accordance with the requirement as specified in the staff handbook of the salaries tax unit, such a notification should be regarded as a notification of impending departure from Hong Kong of the expatriate officer (see paragraph 3.24 above).

*Failure to withhold end-of-contract gratuity*

4.16 While employers in the private sector are required under the Inland Revenue Ordinance, in permanent departure from Hong Kong cases, to withhold money payable to an employee for a period of one month (see the second inset of paragraph 3.5 above), the IRD's circular memorandum does not specify that government departments are required to do the same. However, similar to employers in the private sector, under section 76(1) of the Inland Revenue Ordinance, the IRD can issue recovery notices to government departments requiring them to withhold money payable to an officer for recovering the outstanding tax. In Cases A and B, the

officers were expatriate officers employed on contract terms with an entitlement to an end-of-contract gratuity. However, the IRD failed to timely require the Treasury to withhold the payment of end-of-contract gratuity in both cases. Had the IRD required the Treasury to withhold the end-of-contract gratuity before the date of payment, the full amount of the outstanding tax would have been recovered in both cases. Details are shown in Table 12 below.

**Table 12**

**IRD's delay in making arrangements for withholding the payment of end-of-contract gratuity**

Case	Date of payment of end-of-contract gratuity by the Treasury	Date of the IRD's contact with the Treasury	Amount of end-of-contract gratuity paid by the Treasury	Amount of salaries tax written off
			(\$'000)	(\$'000)
A	12 March 1998	1 April 1998	290	68
B	28 May 1996	18 June 1996	116	54

*Source: IRD's records*

4.17 Based upon the facts in Cases A and B, Audit considers that the IRD should investigate the circumstances leading to the write-off of taxes in these two cases to identify deficiencies in the assessment and collection procedures for making necessary improvements. In particular, there is a need for the IRD to consider whether all government departments, like employers in the private sector, should also be required to withhold for a specified period monies due to a government officer who is about to depart from Hong Kong permanently (except for officers leaving Hong Kong on retirement but with entitlements to future payments of monthly pension).

**Audit recommendations on returns and notifications submitted by government departments**

4.18 Audit has *recommended* that the Commissioner of Inland Revenue should:

- in consultation with the Director of Accounting Services:
  - (i) spell out the roles of the Treasury and government departments and the notification requirements for reporting to the IRD the impending cessation of employment and the impending departure from Hong Kong of a government officer; and

(ii) ensure that all taxable earnings of an officer (i.e. in addition to those items of payment made through the Treasury's Payroll System) are promptly reported to the IRD for the assessment and collection of tax before the officer departs from Hong Kong;

— in the light of the circumstances leading to the write-off of tax in the cases where the IRD had failed to take urgent action to process timely submissions of impending departure notifications by departments and to assess and collect the salaries tax, improve the assessment and collection procedures to prevent recurrence of similar cases in future; and

— examine the feasibility of requiring all government departments, like employers in the private sector, to withhold for a specified period monies due to a government officer who is about to depart from Hong Kong permanently (except for officers leaving Hong Kong on retirement who are entitled to future payments of monthly pension).

4.19 Audit has *recommended* that the Director of Accounting Services should:

— regularly remind government departments of the requirement that they should properly code all taxable earnings paid through the POCS so as to ensure that these payments are all reported to the IRD;

— in the light of the audit findings and as additional back-year assessments can be made up to the past six years, consider the need to ask all government departments to review their records to ascertain if there had been taxable earnings paid in or after 1994-1995 through the POCS but not properly coded so as to report all these payments to the IRD for follow-up action; and

— consider enhancing the POCS so that, at the on-line input stage, the system will automatically display a reminder message to government departments that they should properly code the Creditor Reference Number of a non-civil service contract officer.

4.20 Audit has *recommended* that the Commissioner of Correctional Services, the Director of Education, the Director of Environmental Protection and the Director of Fire Services should file manual returns to the IRD to report the taxable earnings identified by Audit as having been omitted from the Treasury's computerised returns and ascertain if there are other similar cases of omission which have not been reported to the IRD.

## **Response from the Administration**

4.21 The **Commissioner of Inland Revenue** has said that he will revise the circular memorandum to government departments to remove any ambiguities so as to avoid misunderstanding. He will also review the assessment and collection procedures from time to time with a view to achieving greater operational efficiency. In addition, he will, in consultation with all the relevant departments where appropriate, assess the feasibility of requiring all government departments to withhold for a specified period monies due to a government officer who is about to depart from Hong Kong permanently. The Commissioner has also said that:

### *IRD's notification requirements*

- in the circular memorandum issued by the IRD to government departments annually, it is stated that section 52(6) of the Inland Revenue Ordinance imposes a legal obligation on all employers to give one-month notice of the expected date of departure of any employee leaving Hong Kong for any period exceeding one month. In the memorandum, reference is also made to Civil Service Regulation 613 in which the requirement is spelt out. Government departments should therefore be aware of the one-month notice requirement. Nevertheless, the IRD agrees that further improvement can be made to the circular memorandum and the return forms to avoid misunderstanding; and

### *Write-off cases*

- the IRD has investigated into the two cases mentioned in paragraphs 4.15 to 4.16 above. The IRD found that the officers concerned had not properly followed the procedures specified in the staff handbook in respect of impending departure cases. The IRD would strengthen internal controls to make sure that all officers adhere strictly to the laid down procedures.

4.22 The **Secretary for the Treasury** agrees to the comments made by the Commissioner of Inland Revenue (see also paragraph 1.8 above).

4.23 The **Director of Accounting Services** has said that:

### *Taxable earnings paid through the POCS*

- he reminds government departments in writing annually of the requirement to report the taxable earnings of their staff to the IRD. In the light of the audit findings, he is taking the following additional measures:

- (i) helping the departments concerned (i.e. the Correctional Services Department, the Education Department, the Environmental Protection Department and the Fire Services Department) as far as possible in tracing cases which have been omitted from their returns to the IRD;
- (ii) asking other departments by circular to review their records to identify missing cases; and
- (iii) displaying a message in the POCS at the on-line input stage to reiterate the need for proper coding of taxable payments; and

***IRD's notification requirements***

- government departments are responsible for reporting directly to the IRD the taxable earnings of their respective staff. It would certainly be helpful if the IRD would draw the attention of all government departments again to their obligations as employers under the Inland Revenue Ordinance, including the need for prompt notifications to the IRD in the event of cessation of employment or departure from Hong Kong of their staff.

4.24 The **Commissioner of Correctional Services** has said that he has conducted a review on the preparation of payment vouchers in respect of taxable earnings paid to government officers through the POCS. His findings are as follows:

***Payments in 1994-1995 to 1997-1998***

- as copies of the payment vouchers for the years 1994-1995 to 1997-1998 were destroyed, he has requested the Treasury's assistance in retrieving the relevant data from the POCS so as to enable him to prepare the manual returns for these years, where applicable;

***Payments in 1998-1999***

- due to oversight by the staff concerned at the operational level, a taxable payment indicator "T" had not been inserted in all of the payment vouchers in respect of taxable earnings paid in 1998-1999 to government officers. In response to the audit recommendations, a manual return was filed to the IRD in September 2000; and

### *Payments in 1999-2000 and after*

- a taxable payment indicator “T” had not been inserted in all of the payment vouchers in respect of taxable earnings paid in 1999-2000 to government officers. However, the omissions were noted and a manual return was filed to the IRD in April 2000. Since April 2000, a taxable payment indicator “T” has been inserted in the payment vouchers in respect of taxable earnings paid to government officers.

4.25 The **Director of Education** has said that he regrets the omission of a taxable payment indicator “T” in four of the five payment vouchers selected by Audit for test check. The omissions were mainly due to oversight by the staff concerned at the operational level. He has also said that:

- he has already given clear instructions to his staff to ensure that the correct coding is used in future for all taxable earnings paid to government officers through the POCS. He understands that the Treasury is considering whether enhancement to the POCS can be made to strengthen input control; and
- he has already filed a manual return to the IRD to report the taxable earnings identified by Audit as having been omitted from the Treasury’s computerised returns. He is liaising with the Treasury with a view to tracing other similar cases of omission and rectifying the position as appropriate.

4.26 The **Director of Environmental Protection** has said that, due to clerical mistakes, he has omitted reporting to the IRD the payments of taxable earnings in 1997-1998 and before to non-civil service contract officers through the POCS. He has also said that:

### *Payments in 1994-1995 to 1997-1998*

- in response to the audit recommendations, he has requested the Treasury’s assistance in extracting from the POCS the details of payments in 1994-1995 to 1997-1998 to non-civil service contract officers. He will as far as possible compile and file the required manual returns to the IRD on the basis of the information to be provided by the Treasury and the personal particulars of the payees concerned that are available from his records;

### *Payments in 1998-1999*

- he has already filed the required manual return for 1998-1999 to the IRD (see the second inset of paragraph 4.5 above); and

*Payments in 1999-2000 and after*

- for 1999-2000 and onwards, all payments of taxable earnings to non-civil service contract officers are effected through an autopay system arranged by his department with a bank instead of through the POCS. The said bank autopay system produces the required employer's return at year end for his filing to the IRD. As such, no similar cases of omission will occur in future.

4.27 The **Director of Fire Services** has said that he had inadvertently not entered the code "9" in the third digit of the Creditor Reference Numbers of the non-civil service contract officers when making salary payments in 1998-1999 to them through the POCS. Hence, he did not file a manual return for 1998-1999 to report the taxable earnings of these officers to the IRD. The administrative oversight is much regretted. He has also said that:

*Payments in 1994-1995 to 1997-1998*

- in response to the audit recommendations, a manual return was submitted to the IRD in September 2000 covering cases in 1995-1996 to 1997-1998. No payments of this nature were made to non-civil service contract officers in 1994-1995 and before;

*Payments in 1998-1999*

- in regard to the taxable earnings paid in 1998-1999 to non-civil service contract officers and identified by Audit as having been omitted from the Treasury's computerised returns, he had immediately forwarded a manual return to the IRD in August 2000; and

*Payments in 1999-2000 and after*

- he had detected the POCS coding errors in March 2000 and had forwarded a manual return for 1999-2000 to the IRD. Since April 2000, all payments of taxable earnings to non-civil service contract officers have been coded in the proper manner.



**Computation of salaries tax**

	(\$)
<b>(A) Calculation of net chargeable income</b>	
Total income from offices, employments and pensions	XX
Add: Value of places of residence provided	XX
	<hr/>
Assessable income	XX
Less: <u>Deductions</u>	
Outgoings and expenses	(XX)
Depreciation	(XX)
Expenses of self-education	(XX)
	<hr/>
Net assessable income	XX
Less: <u>Concessionary deductions</u>	
Approved charitable donations	(XX)
Elderly residential care expenses	(XX)
Home loan interest	(XX)
	<hr/>
Net income	XX
Less: Allowances	(XX)
	<hr/>
Net chargeable income	<u>XX</u>

**(B) Calculation of tax payable**

Tax payable is the lower of the:

- (i) Net chargeable income × Progressive rates (Note 1); or
- (ii) Net income × Standard rate (Note 2).

*Source: IRD's records*

*Note 1: The progressive rates for 2000-2001 are 2% for the first \$35,000, 7% for the next \$35,000, 12% for the next \$35,000 and 17% for the remainder.*

*Note 2: The standard rate for 2000-2001 is 15%.*