

# **CHAPTER 1**

## **Inland Revenue Department**

<h3><b>Administration of hotel accommodation tax</b></h3>
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**Audit Commission  
Hong Kong  
28 March 2007**

*This audit review was carried out under a set of guidelines tabled in the Provisional Legislative Council by the Chairman of the Public Accounts Committee on 11 February 1998. The guidelines were agreed between the Public Accounts Committee and the Director of Audit and accepted by the Government of the Hong Kong Special Administrative Region.*

Report No. 48 of the Director of Audit contains 8 Chapters which are available on our website at <http://www.aud.gov.hk>.

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# ADMINISTRATION OF HOTEL ACCOMMODATION TAX

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## **PART 1: INTRODUCTION**

1.1 This PART describes the background to the audit of the administration of hotel accommodation tax (HAT) and outlines the audit objectives and scope.

### **Hotel accommodation tax**

1.2 HAT is an indirect tax imposed under the Hotel Accommodation Tax Ordinance (HATO — Cap. 348). It was introduced on 1 July 1966 in the form of a 2% levy on all accommodation charges payable by guests of hotels.

1.3 HAT, currently levied at 3% on all accommodation charges payable by guests of hotels, is recoverable from proprietors of hotels as a debt due to the Government. In 2005-06, the total amount of HAT collected was \$310 million. According to the HATO:

- (a) “hotel” means any establishment, the proprietor of which holds out to the extent of his accommodation that he will provide accommodation to any person presenting himself who is able and willing to pay a reasonable sum for the services and facilities provided and is in a fit state to be received (Amended 39 of 1998 s. 4 — see para. 2.5(a));
- (b) “accommodation” means any furnished room or suite of rooms hired by the proprietor of the hotel to guests, or for the use of guests, for lodging and includes such furnishings, appliances and fittings as are normally provided therein; and
- (c) “accommodation charge” means the sum payable by or on behalf of guests for accommodation received.

### **Role of the Inland Revenue Department**

1.4 The Collector of Stamp Revenue (Note 1) is responsible for administering and collecting HAT. The Inland Revenue Department (IRD) collects HAT on a quarterly basis. Each hotel has to submit a quarterly return and pay to the IRD the amount of HAT payable within 14 days after the end of each quarter. The Inspection Section in Unit 3 of the IRD is under the supervision of an Assistant Commissioner and a Chief Assessor and headed by a Principal Tax Inspector. The inspection team responsible for HAT (i.e. one Senior Tax

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**Note 1:** *The Commissioner of Inland Revenue holds the office of the Collector of Stamp Revenue as appointed by the Chief Executive under the Stamp Duty Ordinance (Cap. 117).*

Inspector, one Tax Inspector I and two Tax Inspector IIs with clerical support) is under the supervision of a Chief Tax Inspector. Tax inspectors periodically carry out inspections at hotels and guesthouses to ensure that the quarterly returns are correct. In 2005-06, 2,004 inspections were conducted.

### **Types of establishments**

1.5 As at 30 September 2006, the IRD charged HAT on 203 out of the following 1,170 establishments:

- (a) 173 chargeable establishments (i.e. 88 hotels and 85 guesthouses) providing short-term accommodation;
- (b) 26 chargeable establishments (i.e. 22 hotels and 4 guesthouses) providing both short-term and long-term accommodation. According to the IRD, long-term accommodation refers to accommodation provided on the basis of a minimum period of 28 continuous days for each letting;
- (c) 4 establishments operating two separate and distinct lines of businesses (i.e. one as hotel business with guest rooms chargeable to HAT, and the other as serviced suites business where concessionary exemption from HAT was granted by the Collector of Stamp Revenue);
- (d) 937 exempt establishments (i.e. 892 guesthouses with less than 10 rooms and 45 charitable establishments); and
- (e) 30 non-chargeable establishments providing only long-term accommodation (i.e. serviced apartments).

### **Audit review**

1.6 The Audit Commission (Audit) has conducted a review to examine the economy, efficiency and effectiveness of the administration of HAT. The review has focused on the following areas:

- (a) charging of HAT (PART 2);
- (b) collection of HAT (PART 3); and
- (c) inspection of hotels and guesthouses (PART 4).

1.7 In carrying out the audit review, Audit examined the records and interviewed the staff of the IRD. Audit has found that there are areas where improvements can be made. Audit has made a number of recommendations to address the issues.

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

1.8 The **Commissioner of Inland Revenue** generally agrees with the audit recommendations.

1.9 The **Secretary for Financial Services and the Treasury** agrees with the response from the Commissioner of Inland Revenue. The Financial Services and the Treasury Bureau will work closely with the IRD and other government departments to take the audit recommendations forward.

### **Acknowledgement**

1.10 Audit would like to acknowledge with gratitude the full cooperation of the staff of the IRD during the course of the audit review.

## **PART 2: CHARGING OF HOTEL ACCOMMODATION TAX**

2.1 This PART examines the charging of HAT and suggests measures for improvement.

### **Legislation**

#### *Definition of “hotel” in the Hotel Accommodation Tax Ordinance enacted in 1966*

2.2 In July 1964, the Financial Secretary stated in a memorandum that the intention of imposing HAT was **not to include** accommodation of boarding house style, but only hotels in the generally accepted sense of the word. For the purpose of excluding boarding houses, upon enactment of the HATO on 1 July 1966, the then section 2 of the HATO stated that:

*“ ‘hotel’ means any establishment, the proprietor of which holds out to the extent of his accommodation that he will provide, **without special contract**, accommodation to any person presenting himself who is able and willing to pay a reasonable sum for the services and facilities provided and is in a fit state to be received.”* (Audit’s emphasis)

When submitting the HAT Bill to the Executive Council (ExCo) for consideration in June 1965, it was said that:

- (a) “special contract” referred to the establishment of a relationship between the parties of other than hotel proprietor and guest (e.g. landlord and tenant); and
- (b) once an establishment had been found to be a hotel, tax would be attracted to the charges made therein notwithstanding the fact that there might be a special contract for the provision of accommodation between the hotel proprietor and the guest. For example, tax would be payable by the Government on hotel rooms occupied by government officers.

#### *Definition of “hotel” in the Hotel and Guesthouse Accommodation Ordinance*

2.3 The Hotel and Guesthouse Accommodation Ordinance (HAGAO — Cap. 349) was enacted in May 1991 to provide for the regulation, control and safety of hotel and guesthouse accommodation through a licensing scheme. In 1994, the then definition of hotel and guesthouse under section 2 of the HAGAO was amended. After the amendment, it was as follows:



“ ‘hotel’ and ‘guesthouse’ mean any premises whose occupier, proprietor or tenant holds out that, to the extent of his available accommodation, he will provide sleeping accommodation for any person presenting himself who appears able and willing to pay a reasonable sum for the services and facilities provided and is in a fit state to be received, but exclude any premises to which the provisions of the Bedspace Apartments Ordinance (Cap. 447) apply.” (Amended 24 of 1994 s. 36)

### *Deficiencies in the Ordinances*

2.4 Following the judgement on a High Court case in 1996, the Administration found that there were deficiencies in the HAGAO and the HATO. The salient points were that:

- (a) the then definitions of “hotel” and “guesthouse” in the HAGAO, and that of “hotel” in the HATO (see para. 2.2) allowed establishments which offered accommodation to limited categories of persons (e.g. persons of a particular nationality or clients of a tourist agency) to operate outside the ambit of both Ordinances. This was because these premises were not offering accommodation to “any person”, notwithstanding the fact that they were in substance hotels and guesthouses; and
- (b) in the judgement on the High Court case of *The Queen v Triview Limited* delivered on 1 March 1996, the interpretation of the term “any person presenting himself” in the definition of “hotel” restricted the scope of application of the HAGAO. The Judge ruled that hotels which accepted guests with prior reservations were not within the purview of the HAGAO.

These anomalies presented problems in the application of the licensing scheme under the HAGAO and the charging of HAT on establishments which were in substance hotels. In relation to HAT, there would be revenue implications if other hotels followed the mode of operation of the hotel in the said court case, which accepted only guests of certain categories or guests with prior bookings.

### *Amendments of the Ordinances*

2.5 In December 1998, to overcome the anomalies in these two Ordinances:

- (a) the definitions of “hotel” in both the HATO and the HAGAO were amended so that the meaning covered establishments which offered accommodation only to limited categories of persons and to any person presenting himself in person

or through an agent or a representative, with or without prior booking (Note 2). In the HATO, the definition of “hotel” was amended by repealing the words “without special contract” (see para. 2.2), and a new definition of “any person presenting himself” was added (Note 3). The definition of “hotel” in the HAGAO was also amended to achieve similar results; and

- (b) the Secretary for Home Affairs made an order (i.e. Exclusion Order) under section 3 of the HAGAO to exclude certain types of premises from the application of the HAGAO. Such premises included “premises in which all accommodation is exclusively provided on the basis of a minimum period of 28 continuous days for each letting and no waiver, refund or reduction of fees will be made if the letting is for any reason shortened to less than 28 continuous days” (Note 4). However, no amendment to the HATO was proposed to exempt establishments which offered accommodation on a monthly basis from HAT because the IRD, based on the detailed Drafting Instructions in 1996, believed that the amendments in (a) above would not make serviced apartments and/or furnished flats subject to HAT.

## **Establishments providing long-term accommodation**

### *Legal advice given in 1999 after the amendments of the Ordinances*

2.6 Since the enactment of the HATO in 1966 and notwithstanding the amendments in 1998, the IRD had taken the view that establishments providing long-term accommodation exclusively were not chargeable to HAT because they were not normally providing accommodation to guests. As there was no provision in the amended HATO (see para. 2.5(a)) to exempt those premises let by business operators in which all accommodation was exclusively provided on the basis of a minimum period of 28 continuous days for each letting (e.g. letting of serviced apartments lasting one month or more), in February 1999 the IRD sought legal advice on:

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**Note 2:** *The definition of “hotel” in the Hotel Proprietors Ordinance (Cap. 158) was also amended for consistency.*

**Note 3:** *In the HATO, “any person presenting himself” is defined as: (a) “any person” includes any person of any particular category, class, group or description; and (b) “presenting himself” includes (i) any person presenting himself in person; (ii) any person presenting himself through an agent or a representative; (iii) any person presenting himself, whether in person or through an agent or a representative, by facsimile, letter, telegram, telephone or any other means; (iv) any person presenting himself, whether in person or through an agent or a representative, with prior booking or notice; and (v) any person presenting himself, whether in person or through an agent or a representative, without prior booking or notice. (Added 39 of 1998 s. 4)*

**Note 4:** *The minimum of 28 days was adopted to facilitate enforcement under the HAGAO.*

- (a) whether HAT should be payable on accommodation charges received and receivable by business operators who had provided premises exclusively for letting on the basis of a minimum period of 28 continuous days; and
- (b) if so, what remedies were available to exempt these establishments from HAT.

2.7 In March 1999, the Department of Justice advised the IRD that:

- (a) the amended definition of “hotel” (see para. 2.5(a)) was still qualified by the word “accommodation” (see para. 1.3(b)) which required the existence of a hotel proprietor and guest relationship. At common law, the relationship of a hotel proprietor/innkeeper and guest might be negated if there was a special contract to such effect, and if the lodger was in fact received in a character other than that of a guest pursuant to that contract. The fact that a proprietor was carrying on a hotel business did not *per se* preclude him from also conducting the business of a boarding-house keeper. He might conduct both businesses. In any particular case, it was a question of fact as to whether he had received his guests in the capacity of an innkeeper or a boarding-house keeper. In the latter case, no HAT would be payable. However, it became uncertain as to whether these factors could still effectively negate a hotel proprietor and guest relationship, as a result of the words “without special contract” being repealed from the definition of “hotel”. As a result, the coverage of “hotel” appeared to have been widened to include, possibly, those **with special contracts**; and
- (b) with the amended definition of “hotel”, the scope of coverage of the HATO was much widened. The demarcation between what was and what was not a hotel became unclear. It became extremely difficult, if not impossible, for the business proprietor to argue that the establishment was not a hotel within the new definition. If it was not the policy intention of the Collector of Stamp Revenue to charge establishments providing long-term accommodation or if the Collector wished to exempt, for example, landlords of serviced apartments from payment of the HAT, it might be necessary to amend the HATO.

The IRD considered that it was not necessary to amend the HATO because the amendments in 1998 (see para. 2.5(a)) were clearly not intended to cover establishments providing boarding house style accommodation.

### *IRD decisions in 2000*

2.8 In September 2000, in response to an enquiry from the then Commerce and Industry Bureau, the Commissioner of Inland Revenue advised it that, following the amendments of the HATO in December 1998:

- (a) HAT was not chargeable only on hotels licensed under the HAGAO. Proprietors of all hotels, as defined, would be liable to pay HAT on the accommodation charges received or receivable unless specifically exempt under section 6(1) of the HATO;
- (b) the amended definition of “hotel” was still qualified by the word “accommodation”, which required the existence of a hotel proprietor and guest relationship (see para. 2.7(a)) for HAT to apply, both before and after the law amendment;
- (c) with the repealing of the words “without special contract” from the definition of “hotel”, the coverage of hotel was widened (see para. 2.5(a));
- (d) the presence of a special contract was no longer a factor in deciding whether or not an establishment was a “hotel”. The crucial point to be considered was whether the proprietor of the establishment held out that he would provide “accommodation” to any person presenting himself. As such, whether an establishment was a “hotel” or not had to be decided on the merits of each case;
- (e) basically, HAT was charged on a per establishment basis. However, depending on the facts of each case, it would be possible for an establishment to operate two lines of business, one for “hotel” in the usual sense and one for long-term lease; and
- (f) whether an establishment did provide “serviced apartment” or otherwise was **not** a deciding factor in charging HAT. There had to be a hotel proprietor and guest relationship for the tax to apply, both before and after the law amendment. Therefore, establishments providing short-term accommodation, or both short-term and long-term accommodation (as one single business operation) were and would be subject to HAT.

2.9 Based on the merits of each case, the IRD decided whether a particular establishment was a “hotel”. In particular, the IRD identified certain types of accommodation which had clear characteristics of not being accommodation provided to “guests” and did not charge HAT. The following information note (Note 5) was also posted on IRD website in December 2000:

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**Note 5:** *As at 28 February 2007, this information note was still posted on IRD website.*

*“For certain types of accommodation which have clear characteristics of not being accommodation provided to “guests”, e.g. the 28 days accommodation referred to in the Hotel and Guesthouse Accommodation (Exclusion) Order, we generally accept that they are excluded from the charge of HAT. However, each case has to be decided on its own merits.”*

***Legal advice given in May 2002 on hotels  
providing both short-term and long-term accommodation***

2.10 Hotel A, providing both short-term and long-term accommodation to customers and paying HAT since its commencement of business in November 1999, did not pay HAT for its serviced suites from October 2001 onwards. In January 2002, Hotel A applied for exemption from HAT for its serviced suites based on the provisions of the Exclusion Order under the HAGAO and the information note on IRD website. It argued that the licence fees paid by customers under a licence agreement for a minimum period of one month were not accommodation charges received from guests. In May 2002, in view of the significant amount of HAT involved and the possibility that other hotel operators might follow suit, the IRD sought legal advice on:

- (a) whether the hotel proprietor and guest relationship would be negated by signing a licence agreement; and
- (b) whether the Exclusion Order under the HAGAO was also applicable to the HATO.

2.11 In May 2002, the Department of Justice advised the IRD that:

- (a) the hotel proprietor and guest relationship could not be negated by the signing of a licence agreement. The existence of a licence agreement was irrelevant insofar as payment of HAT was concerned;
- (b) the Exclusion Order under the HAGAO referred to “premises in which all accommodation is exclusively provided on the basis of a minimum period of 28 continuous days”. HAT should be chargeable even if the premises had been excluded from the application of the HAGAO; and
- (c) the IRD should remove from its website the information note (see para. 2.9). Otherwise, this information would be regarded as a basis for non-payment of HAT by a hotel proprietor who claimed exemption from HAT.

### *IRD decision in 2002*

2.12 In 2002, the IRD considered that if an establishment operated “two separate and distinct lines of businesses”, the business relating to the long-term leases would be exempt from HAT. The IRD also considered that the information note on its website was correct and should be maintained for the benefit of the hotel industry. In August 2002, the IRD granted concessionary exemption to the serviced suites business of Hotel A because an inspection by a Tax Inspector confirmed that Hotel A operated two separate and distinct lines of businesses.

### **Audit observations**

#### *Exemption for establishments providing only long-term accommodation*

2.13 According to the IRD, establishments providing only long-term accommodation are not chargeable to HAT (see para. 2.6). However, as a result of the amendments of the HATO in 1998, the demarcation between what is and what is not a hotel has become unclear (see para. 2.7(b)). **The IRD’s practice of exempting establishments providing only long-term accommodation from HAT becomes questionable.**

#### *Concessionary exemption for establishments providing both short-term and long-term accommodation*

2.14 According to the IRD, for the charging of HAT, there must exist a hotel proprietor and guest relationship. Establishments providing both short-term and long-term accommodation (as one single business operation) are subject to HAT. The IRD granted concessionary exemption to establishments which were considered as operating two separate and distinct lines of businesses (i.e. hotel guest rooms and serviced suites). The accommodation charges for hotel rooms were subject to HAT, whereas the accommodation charges for serviced suites let on a monthly basis were not. As at 30 September 2006:

- (a) 26 establishments, providing both short-term and long-term accommodation, were chargeable to HAT in respect of **both** their short-term and long-term accommodation businesses; and
- (b) 4 hotels, providing both short-term and long-term accommodation, were granted concessionary exemption by the IRD as they were considered as operating two separate and distinct lines of businesses. Accommodation charges received from the operation of hotel rooms were subject to HAT. Accommodation charges received, through signed licence agreements, from the operation of serviced suites (i.e. long-term accommodation) were exempt from HAT.

According to the legal advice (see para. 2.11), the hotel proprietor and guest relationship could not be negated by the signing of a licence agreement. Hotels were liable to HAT even if they had been excluded from the application of the HAGAO. **Audit notes that the HATO is silent on whether hotels letting serviced suites in the form of long-term accommodation (by licence agreements) through a separate line of business are exempt from HAT. In Audit's view, the IRD needs to consider charging HAT for long-term accommodation on hotels providing both short-term and long-term accommodation.**

### *Granting and withdrawal of concessionary exemption*

2.15 Before granting concessionary exemption to six hotels (i.e. Hotels A to F) providing both short-term and long-term accommodation from August 2002 to March 2004, the IRD examined each case to determine whether they operated “two separate and distinct lines of businesses”. The concessionary exemption was granted to these hotels on the conditions that there should not be frequent changes in their room inventories (i.e. mix of hotel rooms and serviced suites), and that prior notification of such changes should be given so as to satisfy the IRD that the hotels were operating two separate and distinct lines of businesses. The concessionary exemption granted to Hotels B and D was eventually withdrawn because of non-compliance with the conditions imposed by the IRD. The IRD considered that these two hotels were not operating under two separate and distinct lines of businesses due to frequent changes in their room inventories.

2.16 Hotels A to E were all providing short-term and long-term accommodation (i.e. serviced suites business). Hotel F, which commenced its serviced suites business in November 2001, also operated hotel business from May 2003. Details are shown in Table 1.

**Table 1**  
**Hotels with concessionary exemption**  
**granted to their serviced suites business**

<b>Hotel</b>	<b>Date of commencement of business</b>	<b>Effective date of concessionary exemption</b>	<b>Date of granting of concessionary exemption</b>	<b>Date of withdrawal of concessionary exemption</b>
A	Nov 1999	Oct 2001	Aug 2002	–
B	Mar 2000	Feb 2002	Feb 2003	Apr 2005
C	Jul 1995	Apr 2002	Nov 2002	–
D	Jun 2002	Jun 2002	Apr 2003	Dec 2004
E	Oct 2002	Oct 2002	May 2003	–
F	Nov 2001	May 2003	Mar 2004	–

*Source: IRD records*

2.17 Hotel B and Hotel D informed the IRD in their applications that they would change their room inventories to meet market demand. As these two hotels had changed the room inventories frequently, the concessionary exemption granted was withdrawn. No HAT was charged during the exemption periods (i.e. Hotel B for 38 months from February 2002 to March 2005, and Hotel D for 29 months from June 2002 to November 2004). Audit noted that, in the administration of concessionary exemption:

- (a) no specific criteria had been set for verifying that a hotel was operating under “two separate and distinct lines of businesses”;
- (b) the IRD did not define what was meant by “frequent changes in room inventories”;
- (c) the IRD decided to withdraw the concessionary exemption granted to Hotels B and D after several instances of breaches of the conditions were found and warning letters were issued. As withdrawal of the exemption had no retrospective effect, any delay would result in loss of revenue; and
- (d) all the four hotels with concessionary exemption had changed their room inventories after the granting of exemption. They were subject to routine inspections by the IRD.

**Audit considers that the IRD needs to set objective criteria for assessing applications for the granting of concessionary exemption. The IRD also needs to introduce internal control procedures to review the granting of concessionary exemption, and procedures for monitoring compliance by the hotels after the granting of concessionary exemption.**

### **Audit recommendations**

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

#### ***Exemption for establishments providing only long-term accommodation***

- (a) **in consultation with the Secretary for Financial Services and the Treasury and the Department of Justice, consider amending the HATO to the effect that the Collector of Stamp Revenue would be empowered to grant exemption to establishments providing only long-term accommodation, if it is intended that exemption from HAT should be granted;**



*Concessionary exemption for establishments providing both short-term and long-term accommodation*

- (b) **in consultation with the Department of Justice, consider charging HAT for long-term accommodation on hotels providing both short-term and long-term accommodation, having regard to the legal advice mentioned in paragraphs 2.7 and 2.11; and**

*Granting and withdrawal of concessionary exemption*

- (c) **if she is satisfied that the Collector of Stamp Revenue is already empowered by existing legislation to grant concessionary exemption for long-term accommodation to hotels providing both short-term and long-term accommodation:**
- (i) **set objective criteria for determining long-term accommodation to be exempt from HAT;**
  - (ii) **introduce internal control procedures to review the granting of concessionary exemption, and procedures for monitoring compliance by the hotels after the granting of concessionary exemption; and**
  - (iii) **critically monitor the mode of operation of Hotels A, C, E and F which have been granted concessionary exemption.**

## **Response from the Administration**

2.19 The **Commissioner of Inland Revenue** has said that the IRD will review the legislation to see whether there is any doubt for granting exemption from HAT to establishments providing only long-term accommodation, and establishments providing both short-term and long-term accommodation and, if so, the IRD will consider whether it should be removed by way of legislative amendment to the HATO or by administrative exposition to the public. The IRD will determine by objective criteria whether a hotel is providing both short-term and long-term accommodation. The IRD agrees to fine-tune the internal control procedures for granting concessionary exemption and closely monitor the mode of the operation of Hotels A, C, E and F. She has also said that:

*Exemption for establishments providing only long-term accommodation*

- (a) HAT was introduced in 1966 to raise from the tourist industry a fair proportion of the tourist promotional funds. The intention was not to impose HAT on boarding house style accommodation, but only on hotels in the generally accepted sense of the word (see para. 2.2). Notwithstanding the amendments to the definition of “hotel” in 1998, the intention remains unchanged;

- (b) the design of HAT was to cover the type of hotels patronised by tourists (see para. 2.32). Generally, tourists would book in hotels for short-term accommodation only. In IRD’s views, the existing policy of generally excluding establishments providing only long-term accommodation fully accords with the existing legislation, the policy intention and the legal advice mentioned in paragraph 2.7;

***Concessionary exemption for establishments providing both short-term and long-term accommodation***

- (c) the legal advice mentioned in paragraph 2.7(a) confirms “the fact that a proprietor was carrying on a hotel business did not *per se* preclude him from also conducting the business of a boarding-house keeper and he might conduct both businesses”. Further, the legal advice mentioned in paragraph 2.11 did not address the question whether a hotel could run two businesses, which had not been posed to the Department of Justice. This two-businesses proposition is in fact founded in case law, e.g. *Daniel v Hotel Pacific Pty. Ltd.*, (1953) where the Supreme Court of Victoria in Australia said that “the fact that an innkeeper conducts an inn does not disable him from also conducting the business of a boarding-house keeper. He may conduct both. In any particular case it is a question of fact whether, vis-à-vis the plaintiff, he has received him in his capacity of innkeeper or of boarding-house keeper”; and

***Granting and withdrawal of concessionary exemption***

- (d) the IRD is satisfied that the existing policy is supported by case law. Whether a hotel is providing both short-term and long-term accommodation is a question of facts. The IRD will determine this question by objective criteria. Once exemption is granted in respect of the long-term accommodation, the IRD will closely monitor the compliance of the conditions by the hotel concerned.

**Accommodation charges**

2.20 Under section 2 of the HATO, the definition of payment in respect of accommodation charges is as follows:

“payment” means any payment in money or money’s worth made by any person to the proprietor of a hotel for accommodation received whether by that person or by some other person and includes any credit, book entry, set off or any other act by which a debt due to the proprietor of a hotel for accommodation charges may be discharged.

In the quarterly tax returns, hotels report the accommodation charges in different ways. The provisions of the HATO are applicable to accommodation charges under barter agreements and cash coupons.

## **Audit observations**

### *Accommodation charges under barter agreements*

2.21 Barter is the direct exchange of goods or services without reference to money or money value. From time to time, hotels enter into barter agreements with providers of goods and services using the hire of hotel rooms as the medium of exchange. Since “payment” is defined as any payment in money or money’s worth, the commercial value of room-nights offered by hotels under barter agreements is liable to HAT.

2.22 Audit review of three cases (i.e. Hotel G, Hotel H and Hotel I) involving 14 barter agreements for various periods between 2003-04 and 2006-07 found that:

#### *Hotel G*

- (a) Hotel G included in its quarterly tax returns the accommodation charges under three barter agreements. For calculating HAT, this hotel used the average room rates, ranging from 39% to 51% of the barter room rates, instead of the rates stated in the barter agreements. The barter room rates were very close to the tariff rates published by the hotel;
- (b) it did not report the accommodation charges arising from the forfeiture of room-nights in the tax returns. During routine inspections, the IRD tax inspector calculated the underpayment of HAT based on the barter values stated in the barter agreements and assessed HAT for the room-nights forfeited. The hotel settled the underpayment;

#### *Hotel H*

- (c) Hotel H offered room-nights to its service providers in exchange for promotion services at the barter values stated in five barter agreements. The barter room rates, ranging from 22% to 39% of the tariff rates published by the hotel for the corresponding periods, were reported in the quarterly tax returns;

- (d) it did not report the accommodation charges arising from the forfeiture of room-nights in the quarterly tax returns. During routine inspections, the IRD tax inspector adjusted HAT based on the barter room rates for the room-nights forfeited. The hotel settled the underpayment;

### ***Hotel I***

- (e) Hotel I did not report hotel room transactions offered in exchange for services under six barter agreements in the quarterly tax returns submitted before December 2005. This was because barter values were not stated in the barter agreements; and
- (f) upon request by the IRD tax inspector during an inspection in February 2006, Hotel I calculated HAT on the accommodation charges arising from the six barter agreements based on a flat rate per night, ranging from 42% to 45% of the tariff rates published by the hotel. The tax inspector accepted the flat rate for calculating HAT. The hotel settled the underpayment.

2.23 Audit noted that the barter values stated in the barter agreements of Hotel G and Hotel H were accepted by the IRD as the basis for calculating HAT, notwithstanding that the barter room rates (i.e. 22% to 39% of the tariff rates) of Hotel H were substantially below the tariff rates. In the case of Hotel I, a flat rate was accepted for calculating HAT. All the three hotels did not report HAT on the accommodation charges arising from the forfeiture of room-nights in the quarterly tax returns. Such irregularities were detected by IRD tax inspectors.

2.24 **The barter values used for calculating HAT may not reflect a fair valuation of the accommodation charges of the hotel rooms. The IRD needs to advise the hotel industry an acceptable basis for determining accommodation charges under barter agreements for the charging of HAT, and publicise (e.g. through issuing advisory letters to hotels) the procedures for reporting HAT on the redemption and forfeiture of hotel room-nights provided under barter agreements.**

### ***Cash coupons and service charges***

2.25 It is not uncommon for a hotel to issue cash coupons to guests for the settlement of accommodation charges and collect service charges on the accommodation charges. Audit observations on cash coupons and service charges are as follows:

- (a) *Cash coupons.* According to the legal advice given in October 2000, cash coupons have cash value and can be used by customers to settle part of their accommodation charges. Since 1 January 2001, the value of cash coupons has been chargeable to HAT. However, the tax treatment has not been publicised. Some hotels were not aware that the value of cash coupons should be chargeable to HAT. In 2002 to 2004, the use of cash coupons in three cases was not reported by the hotels in their quarterly returns. The irregularities were subsequently detected through inspections and rectified by the IRD; and
- (b) *Service charges.* In June 1965, ExCo was informed that service charges should be exempt from HAT. In practice, the usual service charge (i.e. 10% of the accommodation charges) is not chargeable to HAT. In 2001, it was found that Hotel J had lowered its room rate and increased its service charge to a level as high as 157% of the room rate. In July 2001, the Department of Justice advised the IRD that as there was no tax avoidance provision in the HATO, it would be necessary to amend the legislation (e.g. by specifying the formula for calculating HAT and the maximum amount of compulsory service charges that could be exempt from HAT) to prevent hotels from taking similar tax avoidance measures. The IRD fully recovered the HAT on the excessive service charge imposed by Hotel J in June 2002.

**Audit considers that the IRD needs to publicise the tax treatment on the multifarious ways by which accommodation charges are determined in order to facilitate accurate reporting and payment of HAT.**

#### *Non-chargeable establishment*

2.26 Hotel K, which started operation in August 1999 with a hotel licence issued under the HAGAO, is exempt from HAT. The Inspection Section decided in April 2000 and January 2002 that Hotel K did not constitute a “hotel” under section 2 of the HATO based on the following grounds:

- (a) the hotel would not receive any person who was not a staff member of a group of companies;
- (b) the accommodation was provided to the staff member who was directed by the group to be received by the hotel not as a guest; and
- (c) the hotel proprietor and guest relationship could not be possibly established as the hotel only received the staff member of the same business group.

2.27 Audit noted that:

- (a) according to the land lease agreement, Hotel K could not be open to the public unless with the consent of the landlord;
- (b) according to the IRD inspection report of November 1999:
  - (i) staff members of the group, who were not on duty, would be required to pay accommodation charges; and
  - (ii) Hotel K would charge associated companies of the same business group for accommodating their staff members; and
- (c) up to November 2006, tax inspectors had not conducted inspections to ascertain whether Hotel K complied with the conditions for exemption from HAT.

**Hotel K may collect accommodation charges when it receives members of the public, off-duty staff members and staff members of its associated companies. According to the IRD, regular inspections are required to re-confirm the non-chargeable status of this hotel.**

#### **Audit recommendations**

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

- (a) **devise an acceptable basis for determining accommodation charges, and ensure that hotels apply a fair valuation of the accommodation charges of the hotel rooms for the charging of HAT under barter agreements;**
- (b) **publicise the tax treatment of multifarious ways of determining accommodation charges (such as redemption and forfeiture of hotel room-nights under barter agreements, and by cash coupons) and service charges to facilitate accurate reporting of accommodation charges and payment of HAT; and**
- (c) **conduct regular inspections to ascertain whether Hotel K complies with the conditions for HAT exemption.**

## Response from the Administration

2.29 The **Commissioner of Inland Revenue** agrees with the audit recommendations. She has said that the IRD agrees to:

- (a) ensure that hotels apply a fair basis for determining the fair valuation of money's worth in barter agreement cases. By definition, HAT may be charged on money's worth. The valuation of money's worth depends on the objective facts of each case. In general, reference may be made to the value agreed by the parties in the barter agreement but the IRD is not bound by it. On the other hand, the tariff rates are another reference point only because the actual amounts paid by hotel guests are normally not the same as the advertised tariff rates. In most cases, the actual room rates are less than the tariff rates, depending on market condition and bargaining power. In determining the money's worth in barter agreement cases, the existing general practice is to use the actual average room rate of the same class of rooms at the relevant time as a base to be adjusted by factors peculiar to each particular case;
- (b) publicise the tax treatment of various charges. The term "accommodation charge" is defined in the HATO (see para. 1.3 (c)). As service charges are not meant to be charges for accommodation, it is not subject to HAT. When the sum payable to the hotel is a mixture of accommodation charges and other charges (e.g. service charges and Internet connection charges), section 4 of the HATO empowers the IRD to make an appropriate apportionment of the accommodation charges involved and assess HAT on the proper portion accordingly; and
- (c) conduct regular inspections on Hotel K. An inspection made on this hotel in February 2007 confirmed that the conditions for compliance had been fully met.

## Tax implications of exemption provisions

2.30 Section 6(1) of the HATO states that the provisions of the HATO shall **not** apply to accommodation charges where the Collector of Stamp Revenue is satisfied that:

- (a) the accommodation charge is less than \$15 a day;
- (b) the accommodation is provided by a society not established or conducted for profit; or
- (c) the hotel contains less than 10 rooms normally available for lodging guests.

## Audit observations

2.31 The exemption provisions have remained unchanged since 1966. In June 1965, when considering the HAT Bill, ExCo was informed that:

- (a) representations had been received to the effect that all hotels should bear the tax, including those with less than 10 rooms and regardless of the level of accommodation charge;
- (b) the proposals might seem generous, but they had been designed to cover that type of hotel which enjoyed by far the greatest proportion of tourist bookings; and
- (c) the levels were capable of variation by resolution of the Legislative Council, and the Administration considered that they should be reviewed only after some experience had been gained.

2.32 With reference to hotels which charged less than \$15 a day or had less than 10 rooms, in moving the HAT Bill before the Legislative Council in 1965 the Financial Secretary stated that:

*“It has been represented that in equity all hotels, irrespective of size or room charge, should bear the tax. But I think the present proposals cover adequately the type of hotel patronised by tourists and therefore likely to benefit from expenditure on tourist promotion. Furthermore, to widen the scope of the tax would probably increase the cost of collection out of proportion to the gain in revenue.”*

2.33 Audit noted that, in December 2003:

- (a) the IRD was aware that for many years, no hotel and guesthouse had charged fees below \$15. The IRD considered that, if the \$15 was raised to the prevailing price level, it might induce hotel proprietors to adjust the accommodation charges to an appropriate level for tax avoidance purposes and additional efforts would be required to counteract any tax avoidance measures; and
- (b) the IRD estimated that an additional revenue of \$12.9 million a year would be generated if no exemption was granted to establishments operating with less than 10 rooms. However, the IRD considered that any attempt to widen the scope of charge would face strong criticism from the tourism and hotel industry.



There was however a significant increase in the number of guesthouses over the past forty years. The number of exempt establishments **with less than 10 rooms** increased significantly by 40 times, from 22 in 1966 to 892 in September 2006. Notably, following the introduction of the Individual Visit Scheme in July 2003 which allowed travellers from the Mainland to visit Hong Kong on an individual basis, the number of guesthouses with less than 10 rooms increased by 12% from 796 in July 2003 to 892 in September 2006. **The IRD needs to review the tax implications of the exemption provision of establishments with less than 10 rooms.**

### **Audit recommendations**

2.34 **Audit has recommended that the Commissioner of Inland Revenue should, in consultation with the Secretary for Financial Services and the Treasury, consider reviewing the exemption provisions of the HATO on:**

- (a) **the accommodation charge of less than \$15 per day; and**
- (b) **establishments with less than 10 rooms, taking into account the significant increase in the number of such guesthouses, the borderline exempt cases (i.e. guesthouses with 9 rooms or more but with 9 rooms for hire) and the cost-effectiveness of the collection of HAT.**

### **Response from the Administration**

2.35 **The Commissioner of Inland Revenue accepts the audit recommendations of reviewing the exemption provisions of the HATO mentioned in paragraph 2.34 in view of the increase in the number of guesthouses with less than 10 rooms since 2003.**

## **PART 3: COLLECTION OF HOTEL ACCOMMODATION TAX**

3.1 This PART examines the collection of HAT and suggests measures for improvement.

### **Payment of hotel accommodation tax**

3.2 Section 5 of the HATO states that:

- (a) the proprietor of every hotel shall pay to the Collector of Stamp Revenue, within 14 days after 30 September, 31 December, 31 March and 30 June in each year, the amount of the tax payable in respect of the 3 monthly periods ending on those dates and at the same time, the manager of that hotel shall sign and send to the Collector a return setting out the total amount of accommodation charges made by the proprietor of the hotel during the period in respect of which the tax paid relates; and
- (b) any proprietor of a hotel who fails to pay tax to the Collector in accordance with (a) above commits an offence and shall be liable on summary conviction to a fine at level 4 (Note 6).

At the beginning of each quarter, the Inspection Section sends a tax return to each hotel for completion. According to the HATO, every hotel is required to submit a tax return and pay the tax on or before the statutory due date (i.e. within 14 days after the end of each quarter). In case of late filing of the tax return and late payment of HAT, a reminder will be issued normally ten days after the statutory due date.

### **Audit observations**

#### ***Overdue HAT***

3.3 HAT is collected on a quarterly basis. Audit noted that most of the chargeable hotels and guesthouses paid the tax before the statutory due date (i.e. within 14 days after the end of each quarter). However, for the quarter ended 30 September 2006, 78 (38%) out of the 204 chargeable hotels and guesthouses (Note 7) paid the tax after the statutory due date. Audit analysed overdue HAT from 1 April 2004 to 30 September 2006. The results are shown in Table 2.

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**Note 6:** *Under the Criminal Procedure Ordinance (Cap. 221), a fine at level 4 is \$25,000.*

**Note 7:** *The IRD's records as at 30 September 2006 did not include a newly operated guesthouse which commenced its business on 19 September 2006.*

**Table 2**  
**Overdue HAT**  
**(1 April 2004 — 30 September 2006)**

Quarter ended	Number of overdue cases	Amount (\$ million)
<b>2004-05</b>		
30.6.2004	59	7.0
30.9.2004	52	8.4
31.12.2004	60	11.5
31.3.2005	63	12.1
	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
	<b>234</b>	<b>39.0</b>
<b>2005-06</b>		
30.6.2005	65	13.1
30.9.2005	86	19.0
31.12.2005	83	22.1
31.3.2006	68	14.5
	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
	<b>302</b>	<b>68.7</b>
<b>2006-07</b>		
30.6.2006	74	18.3
30.9.2006	78	17.5
	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
	<b>152</b>	<b>35.8</b>
<b>Total</b>	<b>688</b>	<b>143.5</b>
	<hr style="width: 50px; margin: 0 auto;"/>	<hr style="width: 50px; margin: 0 auto;"/>
<b>Average per quarter</b>	<b>69</b>	<b>14.4</b>

*Source: IRD records*

3.4 Audit conducted an ageing analysis of overdue HAT for the period from 1 April 2004 to 30 September 2006. Audit analysis, as shown in Appendix A, indicated that, out of the 688 overdue cases involving \$143.5 million:

- (a) 382 (55%) cases involving \$103.9 million were overdue for 1 to 7 days;
- (b) 150 (22%) cases involving \$31.4 million were overdue for 8 to 14 days;
- (c) 56 (8%) cases involving \$6.2 million were overdue for 15 to 21 days;
- (d) 54 (8%) cases involving \$1.3 million were overdue for 22 to 28 days; and
- (e) 46 (7%) cases involving \$0.7 million were overdue for 29 days to three months.

On average, 69 cases involving \$14.4 million were overdue in each quarter. Audit noted that HAT paid by 21 hotels and guesthouses after the statutory due dates in all the ten quarters was \$33.8 million.

3.5 Audit notes that no surcharge is imposed on overdue HAT because there is no such provision in the HATO. Audit research indicates that many overseas tax authorities (e.g. Australia, New Zealand, Singapore, the UK and the USA) impose penalties (such as surcharge and interest) on late payment of hotel tax (or Value Added Tax/Goods and Services Tax for hotels) after the due date. In Hong Kong, it is stated in section 71 of the Inland Revenue Ordinance (Cap. 112) that tax unpaid on or before a specified due date shall be deemed to be in default. The Commissioner of Inland Revenue may in her discretion add a surcharge not exceeding 5% in all of the amount in default and after the expiry of 6 months from the due date, add an additional surcharge not exceeding 10% in all of the unpaid amount (i.e. including the surcharge not exceeding 5%). **Audit considers that the IRD needs to consider introducing a surcharge on HAT in default similar to that imposed on tax in default provided under the Inland Revenue Ordinance.**

*Feasibility of electronic filing of tax returns and electronic payment of tax*

3.6 The filing of HAT returns and the payment of HAT are manually processed by a clerical officer in the Inspection Section. Audit notes that electronic means of filing of salaries tax returns and payment of tax are available to taxpayers. **The IRD needs to consider introducing filing of HAT returns and payment of HAT by electronic means.**

**Audit recommendations**

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

- (a) **consider introducing a surcharge on HAT in default similar to that imposed on tax in default under the Inland Revenue Ordinance; and**

- (b) **in consultation with the hotel industry, explore the feasibility of introducing electronic means for filing of HAT returns and payment of HAT.**

### **Response from the Administration**

3.8 The **Commissioner of Inland Revenue** accepts the audit recommendations. She has said that:

- (a) the IRD agrees that surcharge for late payment of HAT should be considered to keep in line with other types of tax. The IRD notes that more than 75% of HAT was paid within 14 days after the due date; and
- (b) on submission of HAT returns, the IRD will explore the feasibility of implementing an electronic submission system. In view of the small number of returns involved, it may not be cost-effective to implement such a system.

### **Powers of the Collector of Stamp Revenue**

3.9 Under section 8 of the HATO, the Collector of Stamp Revenue may prescribe the form of the return to be furnished under section 5(1), enter into such agreement as she thinks fit for the payment of HAT or to defer the time of payment of HAT, and make an offer to compound an offence. In January 1998, the IRD prepared and submitted Draft Drafting Instructions to the then Secretary for the Treasury to amend the HATO to empower the Collector to delegate such powers and duties to other public officers.

### **Audit observations**

3.10 Audit noted that:

- (a) in 2003, the Assistant Commissioner of Unit 3, on behalf of the Collector of Stamp Revenue, gave approval to some hotels for extension of payment of HAT on various occasions notwithstanding the fact that she had not been delegated such powers; and
- (b) up to January 2007, the HATO had not been amended to empower the Collector of Stamp Revenue to delegate her powers and duties to other public officers.

### **Audit recommendations**

- 3.11 **Audit has *recommended* that the Commissioner of Inland Revenue should:**
- (a) **personally exercise the powers of the Collector of Stamp Revenue under section 8 of the HATO; and**
  - (b) **follow up with the Financial Services and the Treasury Bureau on the proposal to amend the HATO to delegate her powers and duties to other public officers.**

### **Response from the Administration**

3.12 The **Commissioner of Inland Revenue** accepts the audit recommendations. Before the amendment of the HATO, the Collector of Stamp Revenue will exercise the powers under section 8 of the HATO herself.

## **PART 4: INSPECTION OF HOTELS AND GUESTHOUSES**

4.1 This PART examines the inspection of hotels and guesthouses by the IRD and suggests measures for improvement.

### **Regular inspections**

4.2 The Inspection Section, headed by a Principal Tax Inspector, is responsible for ensuring that the provisions of the HATO are complied with and HAT is properly collected. These duties are discharged mainly through conducting inspections. The inspection team, under the supervision of a Chief Tax Inspector, comprises one Senior Tax Inspector, one Tax Inspector I and two Tax Inspector IIs. The inspectors conduct regular inspections of hotels and guesthouses (including serviced apartments and boarding houses) to ensure the proper submission of quarterly tax returns and payment of HAT (Note 8).

4.3 According to the IRD, apart from charitable establishments exempt from HAT, all taxable and exempt cases are subject to inspections. For taxable cases, accounting records are inspected and checked. Overpayments and underpayments of HAT are adjusted in the next quarterly returns. For exempt cases, guest registers, and daily room occupancy and sales reports are checked. For guesthouses with less than 10 rooms available for hire, a physical check of the number of rooms available for hire is carried out. The licence issued under the HAGAO by the Office of the Licensing Authority (OLA) of the Home Affairs Department (HAD) is also checked to ensure that the name, address and area of the establishment are identical to those stated in the Business Registration Certificate.

### **Frequency of inspections**

4.4 The frequency of regular inspections of hotels and guesthouses varies from once in three months to once a year according to the types and the number of rooms available for hire. Inspections for new cases and special cases (e.g. informer cases) are conducted on a need basis.

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**Note 8:** *The records inspected by tax inspectors include guest register, occupied rooms report, guest ledger, daily room sales report, daily summary report, night auditor's machine balance, bills, receipts, general ledger containing accommodation charges account and tax payable account, and price list of room charges.*

4.5 During the period from 1 April 2002 to 31 March 2006, the number of hotels and guesthouses increased by 13% from 981 to 1,107. As a result, the number of inspections increased by 36% from 1,471 in 2002-03 to 2,004 in 2005-06. To cope with the increase in workload, additional resources were flexibly deployed from other inspection teams to help conduct inspections with effect from November 2005. The number of inspections for the years from 2002-03 to 2005-06 is shown in Table 3.

**Table 3**  
**Number of inspections**  
**(2002-03 to 2005-06)**

Year	Inspections (Number)	Increase over 2002-03 (Percentage)
2002-03	1,471	-
2003-04	1,547	5%
2004-05	1,745	19%
2005-06	2,004	36%

*Source: IRD records*

### **Audit observations**

4.6 According to the IRD, the extent of checking is as follows:

- (a) **Hotels.** Each inspection includes a thorough checking of the accounting records for at least one month in each quarter;
- (b) **Guesthouses.** Each inspection includes the physical counting of rooms available for hire and a thorough checking of the accounting records for at least one month in each quarter; and
- (c) **Exempt establishments.** Each inspection includes the physical counting of rooms available for hire and a random checking of records since the last inspection.



Audit noted that the IRD adopted a minimum degree of record check of one month in each quarter for all regular inspections of hotels. The tax inspector checked the accounting records of four months in an annual inspection of a large hotel, and the accounting records of one to three months in each of the four inspections of a small guesthouse in a year. As the minimum record check for each type of hotels and guesthouses was the same, more frequent inspections helped detect irregularities at an early stage.

4.7 After each inspection, the tax inspector prepares an inspection report stating the inspection results and discrepancies found. Audit analysed the discrepancies found from 2003-04 to 2005-06. The results shown in Appendix B indicated that there was:

- (a) an underpayment of \$90,054 involving 314 cases with an average of \$287 per case; and
- (b) an overpayment of \$17,513 involving 83 cases with an average of \$211 per case.

These 397 cases, with discrepancies up to \$24,492, involved 159 hotels and guesthouses.

4.8 The number of discrepancies found in the 159 hotels and guesthouses is shown in Table 4.

**Table 4**

**Number of discrepancies found  
in the 159 hotels and guesthouses  
(2003-04 to 2005-06)**

Number of discrepancies	Number of hotels and guesthouses
1	46
2	52
3	33
4 to 11	28
	—
	<b>Total</b> <u><u>159</u></u>

*Source: IRD records*

Apart from clerical errors, the identified discrepancies were mainly resulted from the use of barter agreements and cash coupons, and the imposition of high service charges (see paras. 2.21 to 2.25). Notwithstanding the discrepancies found during inspections of hotels and guesthouses, the IRD did not extend the degree of record check in most of these inspections.

4.9 For taxable cases, underpayment and overpayment of HAT could only be detected through inspections. **As there were variations in the amounts of underpayments and overpayments of HAT from 2003-04 to 2005-06, Audit considers that the IRD needs to review the frequency of regular inspections, and the extent of checking the records of various types of hotels and guesthouses, taking into account the level of risk and materiality.**

### **Audit recommendations**

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

- (a) **reviewing the frequency of regular inspections, and the extent of checking the records of different types of hotels and guesthouses, taking into account the level of risk and materiality; and**
- (b) **increasing the extent of checking the records of hotels and guesthouses when discrepancies are found during regular inspections.**

### **Response from the Administration**

4.11 The **Commissioner of Inland Revenue** accepts the audit recommendations. The IRD agrees to explore ways to further improve the existing system of regular inspections. The existing regular inspections are considered an effective system of surveillance to enforce the law, as shown by the very low level of underpayment.

### **Periodic check of establishments**

4.12 For the updating of records of licensed hotels and guesthouses kept by the IRD and the effective administration of HAT, the Inspection Section periodically requests the OLA of the HAD to provide an updated list of hotels and guesthouses with licences issued under the HAGAO. The HAD provides, on a quarterly basis, a full list of licensed hotels, tourist guesthouses, local guesthouses, holiday flats and holiday camps with their names, licence numbers and business addresses to the IRD. A clerical officer of the Inspection Section checks IRD records against the list provided by the OLA to ensure that they are complete for the purpose of issuing quarterly tax returns. Inspections, under section 8(3) of the HATO, are conducted on these establishments.

## Audit observations

### *Checking of unlicensed establishments*

4.13 The IRD identifies unlicensed establishments that may be liable to HAT through referrals from its Business Registration Office, search of advertisements in newspapers and the Internet, and information provided by the Hong Kong Tourism Board. However, the IRD does not check OLA records of unlicensed establishments. The Enforcement Unit of the OLA is responsible for taking enforcement actions against unlicensed establishments (Note 9). If there is prima facie evidence that an unlicensed establishment is in operation, the OLA issues a warning letter to the operator requiring him to cease operation and apply for a licence if he still wants to carry on business. If an unlicensed establishment is still in operation after the issue of the warning letter, the OLA conducts in-depth inspections to collect evidence for prosecution. Upon receipt of advice from the Department of Justice, the OLA instigates prosecution action under the HAGAO. Audit noted that during the period from January 2004 to June 2006, 45 cases resulted in convictions. Details are shown in Table 5.

**Table 5**  
**Prosecution by the OLA**  
**(2004 — 2006)**

Year	Suspected unlicensed establishments  (Number)	Issue of warning letters  (Number)	Prosecution cases  (Number)	Successful prosecution cases  (Number)
2004	324	85	24	15
2005	383	100	14	20
2006 (up to 30 June)	207	60	16	10
<b>Total</b>	<b><u>914</u></b>	<b><u>245</u></b>	<b><u>54</u></b>	<b><u>45</u></b>

*Source: OLA records*

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**Note 9:** *The OLA obtains information about suspected unlicensed establishments through public complaints, referrals from other government departments (e.g. the Buildings Department and the Fire Services Department) and from the Building Safety Unit of the OLA for matters concerning licence application and issue, and cases identified by the Enforcement Unit from field surveillance and search of newspaper advertisements.*

**Audit considers that the IRD needs to obtain information on convicted cases of unlicensed establishments from the OLA and assess whether these establishments are required to pay HAT under the HATO.**

*Updating of records of establishments*

4.14 A clerical officer of the Inspection Section conducts a full check of HAD records with IRD records concerning licensed establishments on a quarterly basis. As there are more than 1,100 records of licensed establishments, a full check of such records is time-consuming and inefficient. **Audit considers that the quarterly checking procedures should be streamlined. The IRD needs to liaise with the OLA for the provision of information relating to those establishments which have obtained a licence, ceased to apply for a licence or changed business particulars (such as name and address) on a quarterly basis.**

*Inspection of suspected unlicensed establishments*

4.15 According to section 8(3) of the HATO, the Collector of Stamp Revenue or any officer authorised in writing by her may enter any hotel at any reasonable time and inspect the records of the hotel relating to accommodation charges or the occupancy of the accommodation of the hotel or the payment of HAT. However, the HATO does not empower the Collector to enter any suspected unlicensed establishment or obtain any information and records for the purpose of determining whether any establishment is a hotel. For such establishments, the tax inspectors can only make inspections and enquiries for business registration purpose and obtain information from the establishments under section 13(2) of the Business Registration Ordinance (Cap. 310 — Note 10). **In Audit's view, the IRD needs to consider empowering, under the HATO, IRD officers to conduct inspections on suspected unlicensed establishments.**

**Audit recommendations**

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

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**Note 10:** *Section 13(2) of the Business Registration Ordinance states that any business registration inspector and any inspector appointed shall, for the purpose of ascertaining whether the provisions of this Ordinance are being complied with, have power at all reasonable times to enter any premises at which he had reason to believe any business is being carried on and there to make such examination and inquiry as may be necessary for such purpose.*

*Checking of unlicensed establishments*

- (a) **in consultation with the Director of Home Affairs, obtain information on convicted cases of unlicensed establishments from the OLA and assess whether these establishments are required to pay HAT under the HATO;**

*Updating of records of licensed establishments*

- (b) **in consultation with the Director of Home Affairs, streamline the quarterly checking procedures with HAD records by requesting the OLA to provide, on a quarterly basis, information relating to those establishments which have obtained a licence, ceased to apply for a licence or changed business particulars; and**

*Inspection of suspected unlicensed establishments*

- (c) **consider amending the HATO to empower IRD officers to conduct inspections on suspected unlicensed establishments.**

**Response from the Administration**

4.17 The **Commissioner of Inland Revenue** accepts the audit recommendations. She has said that:

*Checking of unlicensed establishments*

- (a) the IRD will obtain the information about the convicted cases from the OLA;

*Updating of records of licensed establishments*

- (b) in consultation with the Director of Home Affairs, the IRD will streamline the quarterly checking procedures; and

*Inspection of suspected unlicensed establishments*

- (c) the IRD will consider whether amendments to the HATO are appropriate.

4.18 The **Director of Home Affairs** welcomes the audit recommendations mentioned in paragraph 4.16(a) and (b). The OLA will liaise with the IRD for implementation of the audit recommendations.

**Appendix A**  
(para. 3.4 refers)

**Ageing analysis of overdue hotel accommodation tax  
(1 April 2004 — 30 September 2006)**

Quarter ended	1 to 7 days	8 to 14 days	15 to 21 days	22 to 28 days	29 days to 3 months	Total
	(Number of cases)					
<b>2004-05</b>						
30.6.2004	25	17	5	8	4	59
30.9.2004	28	11	5	3	5	52
31.12.2004	31	18	2	4	5	60
31.3.2005	39	8	8	2	6	63
<b>2005-06</b>						
30.6.2005	40	17	3	4	1	65
30.9.2005	60	15	6	2	3	86
31.12.2005	42	24	1	9	7	83
31.3.2006	34	11	11	8	4	68
<b>2006-07</b>						
30.6.2006	39	15	9	6	5	74
30.9.2006	44	14	6	8	6	78
<b>Total</b>	<u><u>382</u></u>	<u><u>150</u></u>	<u><u>56</u></u>	<u><u>54</u></u>	<u><u>46</u></u>	<u><u>688</u></u>
<b>Percentage of total number of cases</b>	<b>55%</b>	<b>22%</b>	<b>8%</b>	<b>8%</b>	<b>7%</b>	<b>100%</b>
<b>Average number of overdue cases per quarter</b>	<b>38</b>	<b>15</b>	<b>6</b>	<b>5</b>	<b>5</b>	<b>69</b>
<b>Total overdue payments (\$ million)</b>	<b>103.9</b>	<b>31.4</b>	<b>6.2</b>	<b>1.3</b>	<b>0.7</b>	<b>143.5</b>
<b>Average overdue payments per quarter (\$ million)</b>	<b>10.4</b>	<b>3.2</b>	<b>0.6</b>	<b>0.1</b>	<b>0.1</b>	<b>14.4</b>

Source: Audit analysis of IRD records

Remarks: Special cases with different due dates were excluded from the analysis.

**Discrepancies found during inspections  
(2003-04 to 2005-06)**

Type of establishment	Underpayment		Overpayment	
	Number of cases	Amount (\$)	Number of cases	Amount (\$)
<b>2003-04</b>				
Hotel	35	8,681	4	214
Guesthouse	19	328	13	68
Hotel/guesthouse providing both short-term and long-term accommodation	13	2,610	1	7
Hotel with concessionary exemption	4	59	—	—
	<u>71</u>	<u>11,678</u>	<u>18</u>	<u>289</u>
<b>2004-05</b>				
Hotel	56	16,846	1	314
Guesthouse	29	2,163	18	2,510
Hotel/guesthouse providing both short-term and long-term accommodation	25	12,404	1	53
Hotel with concessionary exemption	5	65	—	—
	<u>115</u>	<u>31,478</u>	<u>20</u>	<u>2,877</u>
<b>2005-06</b>				
Hotel	56	36,667	6	1,105
Guesthouse	46	4,604	37	2,992
Hotel/guesthouse providing both short-term and long-term accommodation	20	4,092	2	10,250
Hotel with concessionary exemption	6	1,535	—	—
	<u>128</u>	<u>46,898</u>	<u>45</u>	<u>14,347</u>
<b>Total</b>	<u>314</u>	<u>90,054</u>	<u>83</u>	<u>17,513</u>
<b>Average per case</b>		<b>287</b>		<b>211</b>

Source: IRD records

**Acronyms and abbreviations**

Audit	Audit Commission
ExCo	Executive Council
HAD	Home Affairs Department
HAGAO	Hotel and Guesthouse Accommodation Ordinance
HAT	Hotel accommodation tax
HATO	Hotel Accommodation Tax Ordinance
IRD	Inland Revenue Department
OLA	Office of the Licensing Authority