

CHAPTER 7

Customs and Excise Department

**Protection of revenue on dutiable commodities
and motor vehicle first registration tax**

**Audit Commission
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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.

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PROTECTION OF REVENUE ON DUTIABLE COMMODITIES AND MOTOR VEHICLE FIRST REGISTRATION TAX

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PROTECTION OF REVENUE ON DUTIABLE COMMODITIES AND MOTOR VEHICLE FIRST REGISTRATION TAX

Executive Summary

1. According to the Dutiable Commodities Ordinance (Cap. 109), excise duties are levied on four types of commodities for domestic use or consumption, namely liquors, tobacco, hydrocarbon oil and methyl alcohol (collectively referred to as dutiable commodities (DCs)), irrespective of whether they are imported or manufactured locally. Under the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330), first registration tax (FRT) is levied on all motor vehicles for use in Hong Kong. In 2014-15, the Government collected excise duties of \$10,010 million and FRT of \$9,549 million. The Customs and Excise Department (C&ED) is responsible for the protection and collection of excise duties, and the assessment of provisional taxable values of vehicles, while the FRT is collected by the Transport Department. In protection of excise duties, the C&ED discharges its responsibility by providing customs clearance of inbound and outbound cargoes by air, land and sea, clearance of entry passengers and combating smuggling. According to the C&ED, the total expenditure for 2014-15 under the “Revenue protection and collection” programme amounted to \$174.6 million. The Audit Commission (Audit) has recently conducted a review to examine the C&ED’s efforts in protecting government revenue from duties on DCs and FRT.

Licence and permit controls of DCs

2. DCs could be imported by air, land or sea and manufactured locally. Duties on DCs are collected when they are released from an importing carrier or a warehouse for local consumption. The C&ED administers a licence and permit system for the regulation of traders in their import, export, storage, manufacture and movement of DCs. For every instance of movement of DCs, a licensed trader must apply for an appropriate permit in advance. In 2014, 134,871 permits were issued, a 53% increase over the number issued in 2010. 81,774 of the 134,871 permits were Export Permits and 19,210 permits were related to importing DCs, with the remaining related to transfers to/from warehouses/retail outlets and ship’s stores. Depending on the types of DCs involved and the modes of transport/movement, the C&ED may impose different permit conditions, including requiring permit holders to present their DCs for customs clearance at land control

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points. Contravention of a permit condition constitutes an offence and the permit holder concerned may be prosecuted (paras. 1.2, 1.8(b), 1.10, 1.11, 2.2, 2.4 and 2.5(a)).

3. ***Need to take more stringent enforcement actions against detected non-compliance with customs-clearance permit condition.*** Customs clearance of DC consignments entering or exiting Hong Kong is used to ensure compliance of permit conditions and to detect any duty evasion through over-shipment/short-shipment of the quantities specified on the DC permits. Importers and exporters are required to apply for DC permits in advance and customs clearance of the DCs may be imposed by the C&ED. Designated C&ED officers are required to endorse permit conditions under their purview that have been complied with by the permit holders. Of the 6,962 permits issued for the import/export of DCs through land control points in 2014, 232 (3%) permits did not have the necessary endorsement. On investigation, the C&ED discovered that in 10 cases, the permit holders did not present the DCs for customs clearance at the control points. However, the C&ED only instigated prosecution action in one case and verbally reminded the permit holders of their statutory duty for the remaining nine non-compliant cases although they had been duly reminded at the time of permit application. For two permit holders who had multiple cases of non-compliance, there was no record to show why verbal reminders were still considered appropriate. The C&ED needs to take more stringent enforcement actions against all cases of non-compliance detected. In addition to imposing a permit condition that permit holders shall present their DCs for cargo examination, the C&ED has put in place a risk-based system of selecting cargoes for examination at land control points. However, the C&ED's computer system used by Customs officers of the Land Boundary Command needs improvement as it could not match the cargo information provided by carriers and truck drivers to the information on their respective DC permits captured in another computer system. As a result, selection of DC cargoes for examination has to be done by Customs officers manually (paras. 2.2, 2.5, 2.6, 2.11 and 2.13 to 2.19).

4. ***Need to strictly follow cargo examination procedures.*** Audit's sample checking of 127 cases of customs clearance at land control points in 2014 revealed that the scope of cargo examination for 48 (38%) cases fell short of the C&ED's laid-down requirements. There are also disparities in the laid-down requirements for examining import and export of DCs at land control points although the risk of duty evasion is similar in both import and export of DCs (para. 2.21).

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5. *Need to tighten control over endorsement of permit conditions.* The C&ED has authorised designated officers to endorse in its computer system permit conditions which have been complied with by permit holders so that reports on non-compliance cases can be retrieved for follow-up actions. In a sample checking of 1,772 endorsement records for 2015, Audit found that 84 (5%) endorsements were not made by staff responsible for monitoring the endorsed permit conditions. Audit also found that in 2014, there were 127 cases of omission to update the customs-clearance permit condition records after cargo examination. The C&ED needs to tighten control over the endorsement of permit conditions and reduce the risk of unauthorised endorsement not being detected (paras. 2.6, 2.11, 2.25 and 2.27).

6. *Need to tighten permit control over import/export of DCs via public cargo working areas.* Of the 2,461 permits issued for the import/export of DCs by sea via public cargo working areas in 2014, the C&ED imposed permit conditions on 1,761 (72%) permits to enable its staff to arrange checking of DCs imported/exported prior to their loading to/unloading from the carriers. However, similar permit conditions were not imposed on the remaining 700 (28%) permits for control purposes. For the 1,761 permits, the C&ED selected 258 permits for checking the DCs. Audit found that 113 (44%) of the 258 checks of DCs were conducted by the C&ED at locations specified by the permit holders other than public cargo working areas. The C&ED escorted the conveyance of the checked DCs to/from public cargo working areas for 44 (39%) of the 113 cases but had no similar compensatory controls to prevent tampering for the remaining 69 (61%) cases (paras. 2.28 and 2.29).

Enforcement against illicit DCs and management of seized items

7. *Need for stronger enforcement actions against repeated cases of abuse of duty-free cigarette concession.* At present, the law allows a passenger aged 18 or above to bring into Hong Kong 19 sticks of cigarettes for his own use, exempted from duty. Over the past five years, illicit cigarette seizure cases related to abuse of the duty-free cigarette concession increased by 116% from 4,962 in 2010 to 10,703 in 2014. Of the 8,096 repeated offender cases, the C&ED dealt with 6,113 (76%) cases by compound penalty and the others by prosecution. Audit found that 109 repeated offenders had committed six offences or more each for the past

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five years but 27 (25%) of them were not prosecuted because not all of their past offence records had been taken into account when considering compound penalty in lieu of prosecution. From 2010 to 2014, there were 4,618 summons cases relating to non-payment of compound penalty. Since June 2014, the C&ED has required its staff to instigate prosecution actions against repeated offenders with past records of non-payment of compound penalty. However, the requirement had not always been followed (paras. 1.12, 3.5, 3.11 to 3.13 and 3.15).

8. *Need to improve safe custody of seized goods and documentary exhibits.* In 2013, the C&ED's Internal Audit Division found a shortage in the physical quantity of motor spirit stored in its godown since seizure in 2002 as compared to the stock record. Besides, some documentary exhibits also could not be located in the case file. In July 2015, Audit found five similar cases of discrepancies (ranging from 82.6% to 100%) in the physical quantities of the seized motor spirit with the stock records and one case of mislaid documentary exhibits. However, no discrepancies in the quantities of the seized motor spirit were reported in the C&ED's stocktaking exercises conducted during the period of storage. After consulting the Government Laboratory, the C&ED considered that the discrepancies were due to natural evaporation of the volatile motor spirit over the years of storage. There is a need for the C&ED to improve the safe custody of physical and documentary exhibits, and to enhance the stocktaking procedures for ascertaining physical quantities of seized goods (paras. 3.22 and 3.24 to 3.28).

9. *Need to expedite action on disposal of seized items.* As at June 2015, the C&ED had six godowns with a total floor area of 27,810 square metres (m²) and a vehicle detention centre of 45,828 m² for the storage of goods/vehicles seized under various legislation. From 2012-13 to 2014-15, the C&ED disposed of a total of 131,931 items of seized goods and 487 seized vehicles related to all seizure cases, resulting in a decrease of occupancy rates of the godowns/vehicle detention centre. Audit examination of the storage records of DC-related seizure cases as at April 2015 has revealed that goods of 35 seizure cases and 97 seized vehicles were pending disposal more than one year after conclusion of legal proceedings or forfeiture. There is a need to expedite action to clear the long outstanding seizure cases and review the storage space requirement accordingly (paras. 3.33 to 3.38).

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Administration and protection of FRT

10. ***Control over reassessment cases.*** According to the Motor Vehicles (First Registration Tax) Ordinance, a registered distributor is required to publish the retail prices of motor vehicles before offering them for sale for use in Hong Kong. The taxable value of a motor vehicle is calculated based on the published retail price (PRP) as approved by the C&ED. If the assessed PRP is disagreed, the registered distributor may request the C&ED to carry out a reassessment. For such a reassessment case, supervisory endorsement (at Senior Superintendent level) is required for a downward adjustment of the PRP exceeding 10% of the original assessment or equal to \$50,000 and above. In 2014, there were nine cases of downward adjustments of PRPs exceeding the specified limits after multiple reassessments. In five (56%) of the nine cases, the required supervisory endorsement was not obtained. As regards the reassessment of provisional taxable values of vehicles imported for personal use, granting of reduction is not endorsed by a Senior Superintendent irrespective of the amount of reduction. To ensure adequate checks and balances, there is a need to lay down requirement on Senior Superintendent's endorsement similar to the PRP reassessment cases (paras. 4.2, 4.3(b), 4.7 and 4.13 to 4.16).

11. ***Enforcement against contravention cases.*** Any prosecution of an offence under the Motor Vehicles (First Registration Tax) Ordinance shall be instituted within six months after the date on which the Commissioner for Transport first has knowledge that the offence has been committed. In 2012, the Transport Department referred to the C&ED for investigation 692 vehicles suspected to have been sold higher than the approved PRPs in contravention with the Ordinance. After screening the cases, the C&ED considered that investigations should be conducted for 681 vehicles. However, given the statutory prosecution time bar, the investigations focused on 529 (78%) vehicles and the suspected offences in respect of 152 (22%) vehicles were not investigated. There is a need to introduce legislative amendments to extend the prosecution time bar so that the C&ED can take enforcement actions effectively (paras. 4.8 and 4.18 to 4.20).

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Audit recommendations

12. Audit recommendations are made in the respective sections of this Audit Report. Only the key ones are highlighted in this Executive Summary. Audit has *recommended* that the Commissioner of Customs and Excise should:

Licence and permit controls of DCs

- (a) take more stringent enforcement actions against all cases of non-compliance with the permit condition of land boundary customs clearance (para. 2.33(c));
- (b) consider integrating the existing computer systems to enable electronic transfer of data for the automatic selection of DC consignments for cargo examination and automatic updating of the permit condition endorsement records after cargo examination (para. 2.33(a));
- (c) remind the land control point staff to strictly follow the guidelines on conducting cargo examination of dutiable goods (para. 2.33(d));
- (d) tighten control over the endorsement of permit conditions by restricting the endorsement right to staff of relevant divisions (para. 2.33(f));
- (e) impose suitable permit conditions on all cases of import/export of DCs by sea via public cargo working areas to guard against duty evasion through over-shipment/short-shipment of DCs (para. 2.33(g));

Enforcement against illicit DCs and management of seized items

- (f) take stronger enforcement actions against recalcitrant offenders, by considering all their past offence records in determining whether they should be prosecuted or allowed to pay compound penalty in lieu (para. 3.17(b));
- (g) tighten monitoring of enforcement actions against repeated offenders with records of non-payment of compound penalty (para. 3.17(c));

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- (h) **improve the safe custody of physical and documentary exhibits, and enhance the stocktaking procedures for ascertaining physical quantities of seized goods (para. 3.39(a));**
- (i) **expedite action to clear long outstanding cases of seized goods and vehicles and review the long-term storage requirements of seized goods and vehicles (para. 3.39(c) to (e));**

Administration and protection of FRT

- (j) **take measures to ensure that the stipulated supervisory endorsement for downward adjustment of PRP is always obtained in cases with multiple reassessment requests (para. 4.21(b));**
- (k) **lay down requirements on Senior Superintendent's endorsement of downward adjustment of provisional taxable values in reassessment cases concerning vehicles imported for personal use similar to the PRP reassessment cases (para. 4.21(c)); and**
- (l) **work on legislative amendments to the Motor Vehicles (First Registration Tax) Ordinance to improve the control regime over FRT, including extension of the time bar for taking prosecution actions (para. 4.21(d)).**

Response from the Government

13. The Commissioner of Customs and Excise agrees with the audit recommendations.

PART 1: INTRODUCTION

1.1 This PART describes the background to the audit and outlines the audit objectives and scope.

Background

1.2 Hong Kong is a free port. It does not levy any Customs tariff on imports or exports. Excise duties are levied only on four types of commodities for domestic consumption, namely liquors, tobacco, hydrocarbon oil and methyl alcohol (collectively referred to as dutiable commodities (DCs)), under the Dutiable Commodities Ordinance (Cap. 109), irrespective of whether they are imported or manufactured locally. For liquor, duty is only payable if its alcoholic strength is more than 30% by volume measured at a temperature of 20°C and the duty rate is 100% of its value (Note 1). For tobacco, hydrocarbon oil (Note 2) and methyl alcohol, duties are charged at specific rates per unit quantity. The duty rates on the four types of DCs as at September 2015 are shown at Appendix A.

1.3 In addition to excise duties on DCs, first registration tax (FRT) is levied on all motor vehicles for use in Hong Kong under the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330). FRT is calculated on the basis of the taxable value of a vehicle and the tax rate for a particular vehicle class as specified in the Ordinance. The taxable value of a vehicle is determined on the basis of the published retail price (PRP) of the vehicle or the provisional taxable value (see para. 1.14) assessed by the Customs and Excise Department (C&ED). The tax rates of different classes of vehicles as at September 2015 are shown at Appendix B.

Note 1: *The value is primarily based on the transaction value which includes price paid or payable, packing costs, commission or brokerage, royalty or licence fee that the buyer is required to pay and any proceeds accrued to the seller, but excludes insurance premium, freight charges and other expenses incidental to the delivery of liquor.*

Note 2: *Duties are levied on three types of hydrocarbon oil, i.e. aircraft spirit, motor spirit and light diesel (except Euro V diesel which has become zero-rated since July 2008). Assessments of duties are based on the sales volume of oil companies declared in their monthly returns.*

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1.4 In 2014-15, the Government collected duties of \$10,010 million and FRT of \$9,549 million. Table 1 shows the revenue collected from these two sources from 2010-11 to 2014-15.

Table 1
Revenue from duties and FRT
(2010-11 to 2014-15)

Revenue	2010-11	2011-12	2012-13	2013-14	2014-15	Percentage increase from 2010-11 to 2014-15
	(\$ million)					
Duties						
Tobacco	4,221	4,207	5,313	5,849	6,069	44%
Hydrocarbon oil	3,027	3,147	3,273	3,451	3,529	17%
Liquor	298	363	383	415	406	36%
Methyl alcohol	5	8	7	5	6	20%
Overall	7,551	7,725	8,976	9,720	10,010	33%
FRT	6,657	7,070	7,466	8,338	9,549	43%

Source: C&ED and Treasury records

1.5 The Financial Services and the Treasury Bureau assumes the policy responsibility for revenue protection and collection of duties and FRT. The C&ED is responsible for:

- (a) the protection and collection of duties by:

- (i) administering a licence and permit system to control the manufacture, import, export, storage and movement of DCs;
 - (ii) assessing and collecting duties when a licensee requests a release of DCs for local consumption; and
 - (iii) combating smuggling and distribution of illicit DCs and taking enforcement actions against illicit activities at all levels; and
- (b) assessment of the provisional taxable value of a motor vehicle for calculating FRT (see para. 1.3) which is collected by the Transport Department (TD) when a vehicle is first registered by its owner. The C&ED also maintains a registration scheme for motor vehicle traders (i.e. importers and distributors) to facilitate control of import and distribution of motor vehicles.

According to the C&ED, the total expenditure for 2014-15 under the “Revenue protection and collection” programme amounted to \$174.6 million.

Licence and permit controls of DCs

1.6 *Licences.* The C&ED administers a licence system to control traders who are involved in the import, export, manufacture and storage of DCs. Through the terms and conditions on the conduct of business imposed in the licences, the C&ED regulates the licensees in their dealings of DCs. Currently, there are three types of DC licences issued by the C&ED which are valid for one year and renewable upon expiry, namely:

- (a) Import and Export Licence;
- (b) Manufacturer’s Licence; and
- (c) Warehouse Licence.

As at March 2015, the C&ED had issued 1,656 licences (comprising 1,558 Import and Export Licences, 13 Manufacturer’s Licences and 85 Warehouse Licences).

Introduction

1.7 **Bonded warehouses.** For the storage of DCs, Warehouse Licences are issued to three types of bonded warehouses, namely General Bonded Warehouses (Note 3), Public Bonded Warehouses (Note 4) and Licensed Warehouses (Note 5). The bonded warehouses, operated under an Open Bond System (OBS — Note 6), are duty-deferral facilities. Owners of DCs may store their goods in a bonded warehouse until they discharge the duty liability. Duty liability is discharged when the duty is paid or the goods are exported. As at March 2015, there were 15 General Bonded Warehouses, 35 Public Bonded Warehouses and 35 Licensed Warehouses run by 55 operators.

1.8 **Permits.** The C&ED also administers a permit system to control the movement of DCs in, out of and within Hong Kong. There are four types of DC permits issued by the C&ED, namely:

- (a) **Removal Permit.** A Removal Permit is required when DCs are removed from an importing carrier to a bonded warehouse, between bonded warehouses, or from a factory to a bonded warehouse;
- (b) **Duty-paid Permit.** A Duty-paid Permit is issued upon payment of duty. Such a permit is required when DCs are removed from an importing carrier, or a bonded warehouse, to a local retail outlet for sale;

Note 3: *General Bonded Warehouses are operated by container/air cargo terminal operators for temporary storage of DCs removed from or to be loaded onto carriers.*

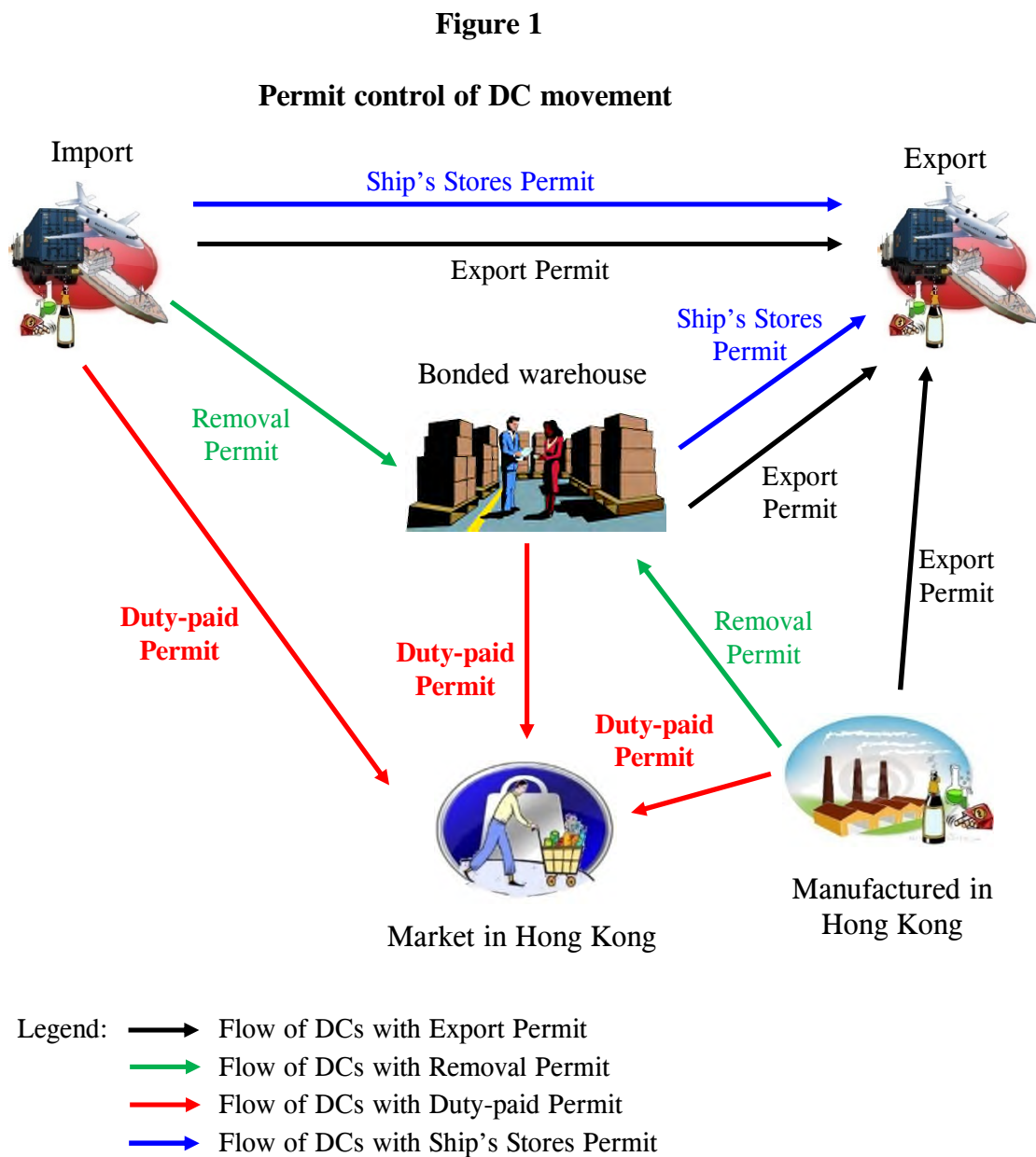
Note 4: *Public Bonded Warehouses are operated by warehouse operators for the storage of DCs owned by licensed importers/exporters.*

Note 5: *Licensed Warehouses are operated by individual licensed importers/exporters for the storage of their own DCs. Factories where DCs are manufactured are also deemed as Licensed Warehouses under the Dutiable Commodities Ordinance.*

Note 6: *Before the introduction of the OBS for warehouses storing tobacco and liquor in April 2003, Customs officers were stationed at these warehouses to provide physical supervision of the warehouse operations. Under the OBS, the related controls are entrusted to bonded warehouse operators, and warehouse operations are subject to surprise customs checks and auditing to detect breaches of the law and non-compliance with licensing conditions. The bonded warehouses for hydrocarbon oil had been operating under an OBS before 2003.*

- (c) **Export Permit.** An Export Permit is required when DCs are removed from a bonded warehouse to an exporting carrier, or from an importing carrier to an exporting carrier for re-export; and
- (d) **Ship's Stores Permit.** A Ship's Stores Permit is required when dutiable goods used as ships'/aircraft stores are removed from a bonded warehouse/an importing carrier to an exporting carrier.

1.9 Figure 1 shows the C&ED's permit control of DC movement.



Source: C&ED records

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Collection of duties

1.10 The C&ED assesses and collects duties when licensees apply for Duty-paid Permits for the release of DCs for local consumption. The application must be made through the Electronic Dutiable Commodities Permits (e-DCP) service. After duty assessment, the C&ED will notify the permit applicant of the duty payable via the e-DCP system. After the payment has been made to the Government, the applicant is required to send a Payment Confirmation Advice message through the system to the C&ED. The system will then approve the issue of a Duty-paid Permit.

Customs cargo and passenger clearance

1.11 **Cargo clearance.** All cargoes imported into/exported from Hong Kong by air, land and sea are subject to customs control, which is done primarily through screening of pre-shipment electronic cargo information and inspection of documents such as manifests, Import and Export Licences, and Removal/Duty-paid/Export Permits. Physical examination of the goods is mainly conducted on a sample basis.

1.12 **Passenger clearance.** Persons entering Hong Kong at control points are required to declare to Customs officers any prohibited/controlled items (Note 7) and the quantities of DCs which are in excess of the duty-free concessions. At present, the law allows a passenger aged 18 or above to bring into Hong Kong the following quantities of DCs for his own use, which are exempted from duty:

- (a) **Liquor:** one litre of liquor with an alcoholic strength above 30% by volume measured at a temperature of 20°C (Note 8); and
- (b) **Tobacco:** 19 sticks of cigarettes, one cigar or 25 grams of cigars, or 25 grams of other manufactured tobacco.

Note 7: *Prohibited/controlled items include dangerous drugs, psychotropic substances, controlled chemicals, antibiotics, arms, ammunition, fireworks, strategic commodities, rough diamonds, animals, plants, endangered species, telecommunication equipment, game, meat, poultry and powdered formula.*

Note 8: *If the passenger holds a Hong Kong Identity Card, he must have spent 24 hours or longer outside Hong Kong to be eligible for the duty exemption for liquor.*

To prevent smuggling of prohibited articles, persons may be selected for baggage examination and personal search.

Enforcement and seizure management of DCs

1.13 To protect revenue, the C&ED combats smuggling and distribution of illicit DCs and takes enforcement actions against illicit activities. In 2014, the C&ED handled 12,009 seizure cases and arrested 12,018 offenders. The C&ED is also responsible for the storage and disposal of seized DCs and vehicles.

Administration and protection of FRT

1.14 Under the Motor Vehicles (First Registration Tax) Ordinance, motor vehicle traders are required to register as vehicle importers and/or distributors and comply with the statutory provisions for the import and distribution of motor vehicles. In particular, a registered distributor is required to publish the retail prices of motor vehicles (i.e. the PRPs) endorsed by the C&ED before offering them for sale for use in Hong Kong. The C&ED will assess the provisional taxable value of a motor vehicle based on the PRP and issue a “Notification of Motor Vehicle Provisional Taxable Value” to the registered distributor. A registered distributor commits an offence if he sells a motor vehicle at a price higher than the approved PRP, without obtaining the C&ED’s prior consent. The TD’s Licensing Office will collect FRT when a vehicle owner produces the Notification and other supporting documents (e.g. the manufacturer’s or dealer’s invoice and payment receipt) for the first registration of his vehicle. In 2014, the C&ED conducted 77,690 assessments and 25,944 reassessments of provisional taxable values on imported vehicles.

1.15 Apart from maintaining the registration scheme for motor vehicle traders and conducting assessments of provisional taxable values, the C&ED also investigates suspected tax evasion and non-compliance cases (detected by its staff, or referred by the TD, other departments and members of the public), and takes necessary enforcement actions. In 2014, the C&ED took prosecution actions on 52 tax evasion and non-compliance cases, involving 181 vehicles with a total court penalty of about \$1 million.

Organisation of the C&ED

1.16 With an establishment of 5,955 posts (as at March 2015), the C&ED is organised into five branches (see Appendix C for an organisation chart). Among the five branches, three branches (namely the Boundary and Ports Branch (BPB), the Excise and Strategic Support Branch, and the Intelligence and Investigation Branch), each headed by an Assistant Commissioner of Customs and Excise, play key operational roles in the protection and collection of duties and administration of DCs and FRT (see details in paras. 1.17 to 1.19).

1.17 *Office of Dutiable Commodities Administration (ODCA).* Under the Excise and Strategic Support Branch, the ODCA, headed by a Senior Superintendent, is mainly responsible for:

- (a) licensing of the import, export, manufacture and storage of DCs;
- (b) assessment and collection of duties and related fees and charges on DCs;
- (c) regulation of the movement of DCs by permits;
- (d) maintenance of a registration scheme for motor vehicle traders; and
- (e) assessment of the provisional taxable values of motor vehicles for the purpose of calculating FRT.

As at March 2015, the ODCA had an establishment of 149 staff, comprising 107 disciplined staff and 42 civilian staff.

1.18 *Boundary and Ports Branch.* The BPB is responsible for the customs clearance of inbound and outbound cargoes by air, land and sea, the customs clearance of entry passengers, and combating smuggling at all the 12 control points in Hong Kong. The BPB comprises four commands, namely the Airport Command, Land Boundary Command, Ports and Maritime Command, and Rail and Ferry Command. As at March 2015, the BPB had an establishment of 3,560 staff, comprising 3,413 disciplined staff and 147 civilian staff.

1.19 *Revenue and General Investigation Bureau (RGIB).* Under the Intelligence and Investigation Branch, the RGIB, headed by a Senior Superintendent, is responsible for combating smuggling and distribution of illicit DCs within Hong Kong and taking enforcement actions against the offenders concerned. As at March 2015, the RGIB had an establishment of 212 staff, comprising 207 disciplined staff and five civilian staff.

Audit review

1.20 *2002 Audit Review.* In 2002, the Audit Commission (Audit) conducted a review of the C&ED's efforts to protect government revenue from DCs (Chapter 2 of the Director of Audit's Report No. 39 of October 2002). The review covered two types of DCs, namely cigarettes and hydrocarbon oil, with focus mainly on abuses of cigarette duty-free concession and enforcement on combating illegal fuelling activities. Since then, the C&ED has implemented various measures to facilitate and monitor the trade and enhance customs clearance, including:

- (a) implementation of the OBS for all bonded warehouses since April 2003;
- (b) implementation of the Red and Green Channel System (see Appendix D) for self-declaration of DCs at all entry points since November 2005; and
- (c) launch of the Road Cargo System (ROCARS) in May 2010 to facilitate advance electronic submission of land cargo information for all types of goods by traders and carriers (which became mandatory in November 2011) and speed up customs clearance at land control points.

1.21 In April 2015, Audit commenced a review to examine the C&ED's efforts in protecting government revenue from duties on DCs and FRT. The review has focused on the following areas:

- (a) licence and permit controls of DCs (PART 2);
- (b) enforcement against illicit DCs and management of seized items (PART 3); and

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- (c) administration and protection of FRT (PART 4).

Audit has found room for improvement in the above areas and has made a number of recommendations to address the issues.

Acknowledgement

1.22 Audit would like to acknowledge with gratitude the assistance and full cooperation of the staff of the C&ED during the course of the audit review.

PART 2: LICENCE AND PERMIT CONTROLS OF DUTIABLE COMMODITIES

2.1 This PART examines the C&ED's licence and permit controls of DCs.

Controls of licence and permit conditions

2.2 The Dutiable Commodities Ordinance empowers the C&ED to administer a licence and permit system for the regulation of the import, export, storage, manufacture and movement of DCs. For every instance of movement of DCs, a DC licensee (see para. 1.6) must apply for an appropriate permit in advance. Each permit has a specified validity period. From 2010 to 2014, the number of permits issued for DCs increased by 46,982 (53%) from 87,889 to 134,871 (see Table 2). An analysis of the number of permits issued by permit types is shown in Figure 2.

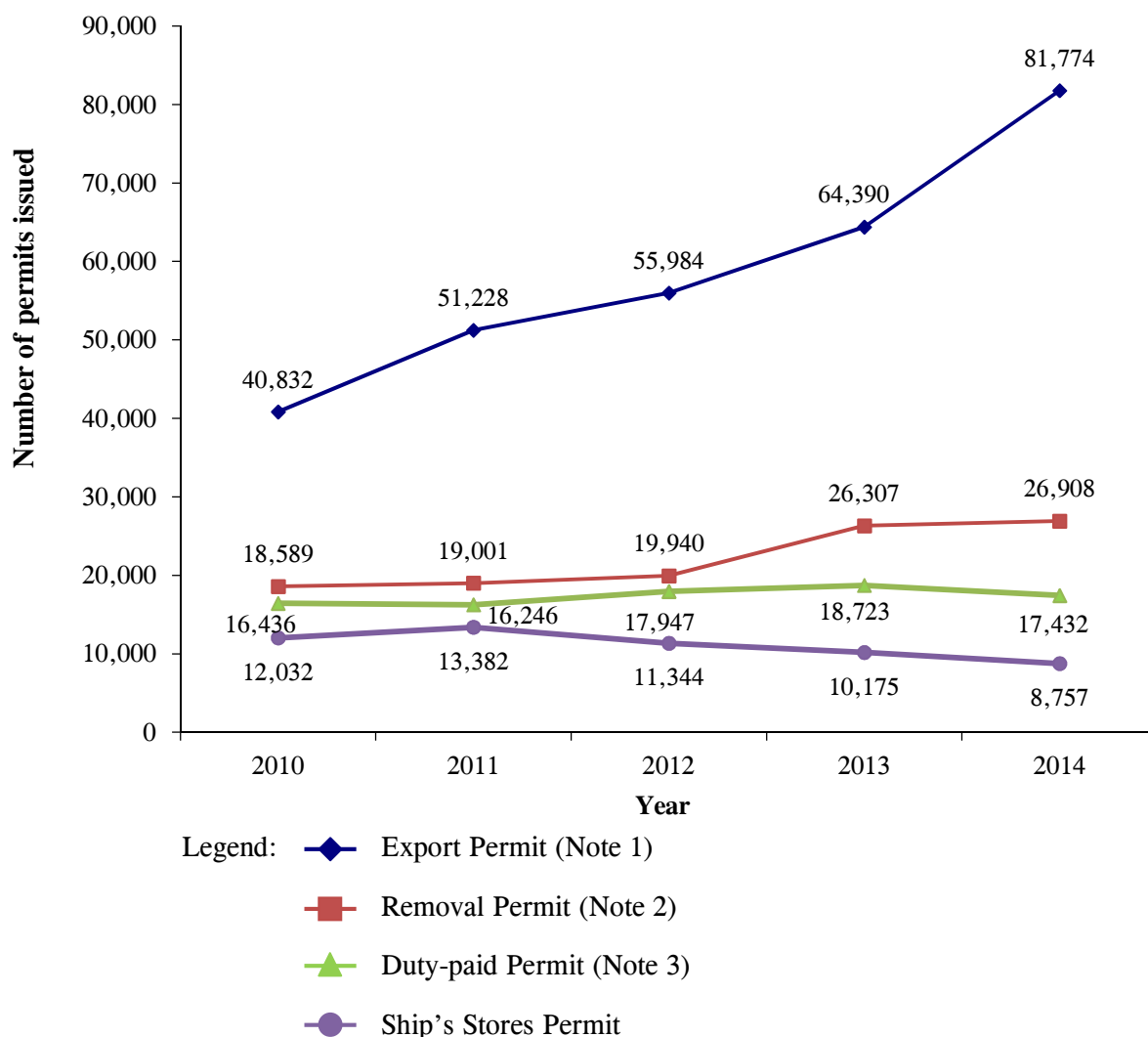
Table 2
Analysis of permits issued by DC types
(2010 to 2014)

DC	Number of permits issued					Percentage increase/(decrease) from 2010 to 2014
	2010	2011	2012	2013	2014	
Tobacco	60,553	69,731	76,615	88,547	105,268	74%
Liquor	24,864	28,082	26,265	28,750	27,128	9%
Methyl alcohol	1,530	1,274	1,555	1,574	1,718	12%
Hydrocarbon oil	942	770	780	724	757	(20%)
Overall	87,889	99,857	105,215	119,595	134,871	53%

Source: C&ED records

Figure 2

Number of permits issued by types
(2010 to 2014)



Source: C&ED records

Note 1: Of the 81,774 Export Permits in 2014, 9,937 (12%) were for trans-shipment. The increase in number of Export Permits from 2010 to 2014 was mainly related to tobacco (see Table 2).

Note 2: Of the 26,908 Removal Permits in 2014, 7,784 (29%) were for importing DCs and the remaining 19,124 (71%) were for transfers between bonded warehouses or between factories and bonded warehouses.

Note 3: Of the 17,432 Duty-paid Permits in 2014, 11,426 (66%) were for importing DCs and the remaining 6,006 (34%) were for removal from bonded warehouses to retail outlets.

Licence and permit controls of dutiable commodities

2.3 Since 1998, the C&ED has been using the computerised Customs Control System (CCS) to assist in carrying out DC-related customs control functions. The ODCA sub-system of the CCS (Note 9) processes all DC-related licences and permits, maintains a database on the licences/permits issued, and keeps the stock/transaction records of DCs held in individual bonded warehouses.

Monitoring compliance with permit conditions

2.4 In accordance with the Dutiable Commodities Ordinance, the C&ED may impose conditions on individual permits for control purposes. A permit holder shall strictly comply with all the permit conditions. Contravention of a permit condition constitutes an offence and the permit holder concerned may be prosecuted (Note 10). Depending on the types of DCs involved, the modes of transport/movement and the latest trend of smuggling, different permit conditions are applied to different types of permits. At present, there are only two general conditions which are applicable to all permits:

- (a) ***Executed Permit Advice.*** A permit holder shall send an Executed Permit Advice via e-DCP (see para. 1.10) to the C&ED within 14 working days after the removal of DCs; and
- (b) ***Permit cancellation.*** If a permit has not been used, the permit holder shall report it to the C&ED within 14 working days from the approved removal date by sending a cancellation request via e-DCP.

2.5 Currently, there are 34 specific conditions for which the C&ED can impose on the four types of permits (see para. 1.8) to cater for different situations. Such conditions can be broadly classified as customs actions required (16 conditions), submission of documents for post-clearance check (six conditions),

Note 9: *The CCS consists of three sub-systems. Besides the ODCA sub-system, the other two sub-systems are for maintaining a trader database to facilitate risk assessment for cargo clearance, and administration of sea cargo and vessel clearance.*

Note 10: *A convicted person may be fined \$1 million and imprisoned for two years. Where an offence is committed with intent to avoid duty payment, an additional fine not exceeding ten times the amount of duty payable may be imposed.*

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restrictions on use of duty-exempted goods (five conditions), restrictions on DC labelling (four conditions) and time limit for removal of DCs (three conditions). Examples of conditions on specific types of permits are as follows:

- (a) ***Customs clearance for import or export of DCs by land.*** Permit holders shall present DCs to Customs officers at one of the designated land control points (i.e. Lok Ma Chau/Man Kam To/Shau Tau Kok/Shenzhen Bay Control Point) for import/export clearance. DCs conveyed under the Intermodal Trans-shipment Facilitation Scheme (ITFS — Note 11) are exempted from this permit condition;
- (b) ***Notification of import/export of DCs requiring vanning/devanning of containerised cargoes via sea.*** Permit holders shall send a notification to the C&ED 24 hours before the vanning/devanning operation (Note 12). Separate notification shall be sent for subsequent change in the particulars of that operation four hours before the change takes effect; and
- (c) ***Appointment for customs attendance.*** For excise operations, such as sample drawing, destruction of DCs and selective check on duty-paid goods imported in containers, permit holders shall make appointment for customs supervision.

Note 11: *The ITFS, launched in November 2010, facilitates the movement of trans-shipment cargoes across the boundary with the Mainland. Trans-shipment cargoes, if selected for examination, will be subject to customs inspection once either at the entry or exit point. Under the ITFS, electronic locks are applied to secure cargo compartments of goods vehicles to prevent the cargoes from being tampered with during the journeys. Besides, Global Positioning System devices are used for monitoring the status of the electronic locks and tracking the movement of the vehicles to ensure the security of the cargoes while being conveyed within Hong Kong.*

Note 12: *Vanning and devanning refer to the processes of loading DCs for export into containers and affixing seals to the containers, and unloading imported DCs from sealed containers respectively. Before April 2003, all vanning and devanning operations were supervised by the C&ED and relevant DC importers/exporters had to pay a charge for the customs attendance. Since April 2003, customs attendance has been replaced by selective checks on a surprise basis without charges. In 2014, the ODCA received 11,417 vanning/devanning notifications and checked 1,867 (16%) such operations.*

Licence and permit controls of dutiable commodities

2.6 The C&ED has authorised designated officers to endorse permit conditions in the CCS under their purview that have been complied with by the permit holders. For example, Customs officers at land control points responsible for examining DCs presented for import/export clearance (see para. 2.5(a)) will retrieve the relevant permit record from the CCS and endorse it in the system. The CCS facilitates the C&ED in monitoring the compliance with permit conditions by:

- (a) providing lists of permit holders who are subject to specific conditions for checking against the physical documents they have submitted (e.g. vanning/devanning notifications (see para. 2.5(b)) and Executed Permit Advice (see para. 2.4(a))); and
- (b) identifying defaulters who have not complied with individual conditions (e.g. permits for import/export of DCs without customs-clearance endorsement by the land control points).

Licence control of bonded warehouses

2.7 With the full implementation of the OBS in April 2003, Customs officers guarding the bonded warehouses have been withdrawn. The related controls on movement/processing of DCs have been entrusted to the bonded warehouse operators who are now subject to more stringent licensing requirements. They have to comply with a set of licensing conditions covering DC record keeping, inventory control and maintenance of books/accounts for C&ED's excise audits and compliance checks. The C&ED may revoke their licences if there is proof of an offence committed by the warehouse operators. Penalties are also prescribed for breaching the provisions of the Dutiable Commodities Ordinance.

2.8 Bonded warehouse operators are required to return to the C&ED an electronic Executed Permit Advice immediately after each receipt/release of DCs into/from the warehouse. The C&ED will regularly check the CCS records for any discrepancies in the reported DC quantities from the returned Advice against that submitted by relevant permit holders (see para. 2.4(a)). The warehouse operators are also required as a licensing condition to submit monthly returns to the C&ED on the stock balances and DC movements during the period. The returns are verified by the C&ED against corresponding permit records held in the CCS.

Licence and permit controls of dutiable commodities

2.9 To ensure compliance with the licensing conditions, the C&ED conducts surprise compliance checks on the bonded warehouses at least once a month and other surprise checks including those outside the warehouses' operating hours to detect unauthorised activities. The C&ED also conducts excise audits on the systems, processes, practices and records of the warehouses on an annual basis. In 2014, the ODCA conducted 929 monthly compliance checks and 412 other surprise checks on bonded warehouses and carried out 55 excise audits of warehouse operators (Note 13).

Enforcement statistics

2.10 Table 3 shows the number of cases of non-compliance with permit and licence conditions with prosecution actions taken by the C&ED in 2014.

Table 3
30 non-compliance cases with prosecution
(2014)

Non-compliance	Number of cases
Removal of DCs not meeting permit requirements	14
No notification of vanning/devanning operation	6
Import and removal of DCs without permit	4
DCs not removed within the permit condition of 24 hours	2
DCs not presented for customs clearance at land control points	2 (Note)
No customs attendance for checking DC removal/sample drawing	1
Incorrect monthly return	1
Total	30

Source: C&ED records

Note: The two cases were detected in 2013 with prosecution actions taken in 2014.

Note 13: *For operators with more than one bonded warehouse, the excise audit would usually cover all its bonded warehouses in one go. The excise audit team comprises Customs officers and staff with accountancy background.*

Post-clearance document check

2.11 As mentioned in paragraph 2.6, the C&ED has authorised designated officers to endorse permit conditions in the CCS under their purview. The ODCA regularly retrieves from the CCS reports on permit conditions without relevant C&ED staff's endorsements for follow-up actions. According to these reports, in 2014, there were 232 permits (i.e. 3% of 6,962 permits for import/export of DCs via the land control points) without the land control point's endorsement of the customs-clearance permit condition (see para. 2.5(a)). After clarifications with the land control points and relevant permit holders, the ODCA noted that:

- (a) ***Cases without customs clearance.*** In 10 (4%) cases, the permit holders had failed to comply with the permit condition of presenting their DCs for customs clearance;
- (b) ***Cases with customs clearance but the CCS records not updated.*** In 127 (55%) cases, the land control point staff had not retrieved the permit records from the CCS for endorsement after conducting customs clearance of the DCs concerned;
- (c) ***Exempt cases.*** In 74 (32%) cases, the DCs concerned were conveyed under the ITFS (see para. 2.5(a)) and hence exempted from the customs-clearance permit condition; and
- (d) ***Cancelled cases.*** The remaining 21 (9%) cases were related to cancelled permits.

Audit examination

2.12 According to the C&ED, there are no similar permit conditions for customs clearance of import/export of DCs by air or sea because they are mainly handled by cargo terminals (Note 14) which are bonded warehouses subject to the C&ED's compliance checks and excise audits (see para. 2.9). The C&ED relies on

Note 14: *All air cargoes for import/export are handled by the air cargo terminals. As for the import/export of DCs by sea, the dutiable goods covered by 92% of 30,593 permits in 2014 were handled by cargo terminals. For the remaining 8% (or 2,461 permits), the loading/unloading of the related DCs to/from carriers was carried out in public cargo working areas.*

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the independent submission of Executed Permit Advice by both the permit holders and the bonded warehouse operators (see paras. 2.4(a) and 2.8) to ascertain that the DCs have been duly imported or exported. The C&ED cannot rely on the same control for import/export of DCs via public cargo working areas and those transported by land and hence strict control of the customs-clearance permit condition is important. Having regard to the higher control risk of DCs imported/exported by land, and those handled in public cargo working areas, Audit has focused on the following areas in this review:

- (a) selection of DCs for customs examination at land control points (see paras. 2.13 to 2.16);
- (b) enforcement actions against detected non-compliance with customs-clearance permit condition (see paras. 2.17 to 2.19);
- (c) cargo examination procedures at land control points (see paras. 2.20 to 2.22);
- (d) control over endorsement of permit conditions (see paras. 2.23 to 2.27); and
- (e) permit control over import/export of DCs via public cargo working areas (see paras. 2.28 and 2.29).

In addition, Audit has reviewed the actions taken on idle DC stocks in bonded warehouses (see paras. 2.30 to 2.32).

Need to better integrate information in computer systems to facilitate selection of DCs for customs examination at land control points

2.13 According to the Land Boundary Command's laid-down procedures for cargo processing, all inbound and outbound vehicles carrying DCs should be subject to cargo examination. In addition to imposing a permit condition which requires permit holders to present their DCs (through their carriers or truck drivers) for cargo examination, the Land Boundary Command has put in place a risk-based system of selecting cargoes for examination.

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2.14 With the implementation of ROCARS in 2011 (see para. 1.20(c)), all registered agents, carriers and cross-boundary truck drivers are required to submit a set of pre-defined cargo information electronically to the C&ED before the cargoes enter or exit Hong Kong. The submission should be done at least 30 minutes before but not more than 14 days in advance of the import/export. Based on the submitted information and with the assistance of ROCARS, the cargo selectors of the Land Boundary Command perform risk profiling and select consignments for customs examination. An action code would be assigned to the selected consignment so that when the truck carrying the consignment arrives at the control point, it would be directed to the cargo examination compound for customs clearance.

2.15 Cargo information in the ROCARS submission which can help identify DC-related consignments includes goods descriptions, DC permit types and numbers (Note 15). At present, there is no linkage between ROCARS and the CCS to assist the cargo selectors in verifying the submitted permit numbers for identifying DC consignments. As such, the cargo selectors have to rely on goods descriptions and permit types for making the selections. In response to the ODCA's enquiries on why an action code was not assigned to the ten cases without customs clearance (see para. 2.11(a)), the Land Boundary Command said that the submitted information was inconsistent and misleading. For example, in five of the ten cases, the goods descriptions (such as red wine and wine cabinet) were non-DC types. For the remaining five cases, while the goods descriptions were DC types, the permit types were marked as "others".

2.16 To enhance the efficiency of selecting DC consignments for customs clearance, Audit considers that there is merit to consider integrating the existing computer systems to enable electronic transfer of DC permit numbers for matching with the CCS records. With automatic selection of DC consignments based on permit numbers, human errors in manual selection can be minimised. The cargo

Note 15: *According to the Import and Export (Electronic Cargo Information) Regulation (Cap. 60L), goods descriptions must be provided in ROCARS submissions. It is an offence to provide incorrect goods descriptions in the ROCARS submission. As for the provision of DC permit types and numbers, it is an administrative requirement only. In 2011, the CCS was enhanced to automatically remind permit applicants for import/export of DCs by land to provide permit numbers when lodging ROCARS submissions. The compliance rate of submissions of permit numbers was high. For example, for the 127 cases with customs clearance (see para. 2.11(b)), 114 (90%) had correct DC permit numbers submitted.*

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selectors' workload would also be reduced to handling the unmatched permit number cases only so that they can pay more attention to other risk profiling work. In the long term, there is a need to consider adopting enhancement measures to ensure that DC permit numbers are input in ROCARS submissions.

Need to take more stringent enforcement actions against detected non-compliance with customs-clearance permit condition

2.17 Customs clearance of DC consignments entering or exiting Hong Kong is used to detect duty evasion through over-shipment/short-shipment of DCs than the quantities specified on the permits.

2.18 For the ten cases of non-compliance with the customs-clearance permit condition in paragraph 2.11(a), the C&ED had only instigated prosecution action against one permit holder (see Table 4). For the remaining nine cases, the C&ED had verbally reminded the permit holders concerned to comply with the customs-clearance permit condition. In response to Audit's enquiries, in September 2015, the C&ED said that it had considered sufficiency of evidence for taking prosecution action for the ten cases, and only one case was found warranting prosecution.

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Table 4

Enforcement actions taken against ten non-compliant cases

Permit holder	Date of import/export	Permit type	Quantity of DC stated in permit	Enforcement action taken
A	30.7.2014	Removal	648 bottles of liquor (Note 2)	Prosecution (in July 2015)
B	19.8.2014	Duty-paid	398 bottles of liquor (Note 2)	} Verbal reminder
	19.8.2014	Removal	216 bottles of liquor (Note 2)	
	11.12.2014	Export	222 bottles of liquor	
C	3.9.2014 (Note 1)	Export	11.3 million sticks of cigarettes	
	3.9.2014 (Note 1)	Export	11.3 million sticks of cigarettes	
	3.9.2014 (Note 1)	Export	11.35 million sticks of cigarettes	
D	18.3.2014	Export	900 litres of ethyl alcohol (under permit for liquor) (Note 2)	
E	28.4.2014	Export	1,022 litres of methyl alcohol (Note 2)	
F	25.8.2014	Export	681 bottles of liquor	

Source: C&ED records

Note 1: The DCs covered by the three Export Permits were separately conveyed by three different vehicles.

Note 2: The goods descriptions in the ROCARS submissions differed from those in the DC permits (see para. 2.15).

2.19 Audit considers that enforcement action taken should be proportionate to the seriousness of an offence. Non-compliance with the customs-clearance permit condition carries the risk of duty evasion as there is no customs checking to ensure

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that the permit specified quantities of DCs have been duly imported/exported. Such non-compliance cases should be taken seriously. In this connection, Audit noted that:

- (a) since 2011, the CCS has been enhanced to automatically remind DC permit applicants to direct their carriers/drivers to present the DCs for customs clearance. In other words, all permit holders of the nine cases of non-compliance had been duly reminded of their statutory duty beforehand; and
- (b) for permit holders B and C who had multiple cases of non-compliance, there was no record to show why verbal reminders were still considered appropriate. There was also no record to show that the C&ED had sought legal advice before coming to such decisions.

The C&ED needs to take more stringent enforcement actions against all cases of non-compliance with the customs-clearance permit condition, seeking legal advice where appropriate.

Need to strictly follow cargo examination procedures at land control points

2.20 The Land Boundary Command has laid down the following guidelines for examining the import and export of DCs:

- (a) for import of DCs covered by a Removal Permit, the land control point staff should check the particulars via the CCS workstation and examine the DCs if necessary;
- (b) for import of DCs covered by a Duty-paid Permit, the type and quantities of the DCs declared must be ascertained, particularly liquors and cigarettes;
- (c) for export of DCs covered by an Export Permit, the land control point staff should check the particulars via the CCS workstation and conduct physical examination randomly on the declared DCs to check if the permit conditions are complied with. Attention should be paid to ensuring that

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the dutiable goods and quantities correspond with the description on the relevant permit; and

- (d) after completion of cargo examination, the land control point staff should input the results (including the description of goods and quantities examined) into ROCARS and generate a cargo examination report for signature by the driver to certify that no damage has been caused to the goods examined.

2.21 *Non-compliance with guidelines on cargo examination.* Of the 127 cases with customs clearance conducted (see para. 2.11(b)), the C&ED could only produce 77 (61%) cargo examination reports for Audit's examination. For the remaining 50 (39%) cases, the ROCARS records showed that:

- (a) the cargo examination for 48 (38%) cases (11 covered by Duty-paid Permits and 37 by Export Permits) only involved external checking and counting of the packages and gross weight. In other words, the scope of check fell short of the cargo examination requirements for Duty-paid and Export Permits, i.e. ascertaining the type and quantities of the DCs and ensuring that they corresponded with the descriptions in the permits respectively (see para. 2.20(b) and (c)); and
- (b) the remaining two (1%) cases (one covered by a Removal Permit and the other by an Export Permit) only had documents checked. Audit notes that under the present guidelines, the absence of cargo examination is regarded as non-compliance with internal guidelines for the Export Permit case but not for the Removal Permit case as the land control point staff are only required to examine DCs if necessary (see para. 2.20(a) and (c)). This is an anomaly which the C&ED needs to address as the risk of duty evasion is similar in both import and export of DCs.

2.22 *Failure to update CCS records after cargo examination.* As can be seen from the 127 cases of omission to update the permit condition records in the CCS after cargo examination, a lot of administrative work was required. ODCA staff had to carry out post-clearance document checks to identify the omission cases while the land control point staff had to answer queries from the ODCA. Given that the land control point staff have to update ROCARS records after cargo examination, it would help reduce the manual input efforts and human errors if there is electronic

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transfer of such data to automatically update the permit condition endorsement records of the CCS. The C&ED needs to explore the feasibility of integrating the existing computer systems to enhance the efficiency and effectiveness in maintaining the ROCARS and CCS records.

Need to tighten control over endorsement of permit conditions

2.23 In an assignment study of the C&ED's control and release of DCs in 2003, the Independent Commission Against Corruption (ICAC) found that C&ED officers designated to endorse the compliance with permit conditions under their purview were given global endorsement right. There was a risk that the non-control point staff could endorse the customs-clearance permit condition even though the DCs covered by an Export Permit had never passed through the designated land control point. In January 2004, the C&ED informed the ICAC that it would restrict the endorsement right to relevant divisions with effect from March 2004.

2.24 In the course of reviewing the 232 import/export permits without relevant C&ED staff's endorsements on the land customs-clearance permit condition (see para. 2.11), Audit found that 34 (15%) permits also had wrong endorsement of another permit condition. The permit condition of notification of vanning/devanning operations under the purview of the ODCA (see para. 2.5(b)) was wrongly endorsed by some BPB staff, indicating that the problem of global endorsement right still existed in 2014. Upon enquiry, the C&ED informed Audit that:

- (a) the ICAC's recommendation put emphasis on limiting right on endorsement of the permit condition for dutiable goods leaving Hong Kong to officers of control points only. This had been implemented by restricting ODCA staff from endorsing such permit condition;
- (b) the customs-clearance permit condition served an important function of ascertaining that the relevant DCs had been duly imported/exported by land (see para. 2.12) and hence strict control over its endorsement was necessary; and
- (c) the same strict control over the endorsement right might not be necessarily applied to other permit conditions, but the C&ED agreed to review if necessary.

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2.25 For an extended checking of the endorsement of permit conditions, Audit obtained from the C&ED an extract of the CCS records from 29 May to 30 June 2015. The extract contained 365 endorsement records for the land customs-clearance permit condition and 1,407 records for the permit condition of notification of vanning/devanning operations. Audit found that of the 1,772 (365 plus 1,407) endorsement records:

- (a) two Export Permits with the customs-clearance permit condition at land control points were wrongly endorsed by the Airport Command staff; and
- (b) 82 permits with the permit condition of notification of vanning/devanning operations were wrongly endorsed by BPB staff (similar to the 34 cases of 2014 (see para. 2.24)).

2.26 In response to Audit's enquiries, in July 2015, the C&ED said that the observed wrong endorsement cases were in fact unnecessary endorsements because:

- (a) the two Export Permits were endorsed by the Airport Command staff after cargo examination although they were related to the trans-shipment of DCs under the ITFS (Note 16); and
- (b) for the 82 Export Permits with the permit condition of notification of vanning/devanning operations endorsed by BPB staff, the DCs were not exported using containers (see Note 12 to para. 2.5(b)). As no vanning and devanning operations were involved in these cases, the permit condition of notification was not applicable.

2.27 Audit noted the C&ED's explanation that there was no adverse consequence for the observed wrong endorsement cases. However, the fact remains that if the issue of unrestricted endorsement right is not properly addressed, there is always a risk of unauthorised endorsement. In this connection, Audit notes that among the divisions with responsibilities for endorsing permit conditions, only the ODCA has internal guidelines requiring its supervisory staff to conduct checks on the endorsement records. For divisions without instituting supervisory check, there is a risk of unauthorised endorsement not being detected. Given the large number

Note 16: *As mentioned in paragraph 2.5(a), trans-shipment of DCs under the ITFS is exempted from the land customs-clearance permit condition.*

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of endorsement records each year (e.g. in 2014, 134,871 permits were issued and each with one to seven specific permit conditions — see paras. 2.2 and 2.5), it is more cost effective to tighten control over the endorsement of permit conditions by restricting the endorsement right to staff of relevant divisions.

Need to tighten permit control over import/export of DCs via public cargo working areas

2.28 Of the 2,461 permits for the import/export of DCs by sea via public cargo working areas in 2014 (see Note 14 to para. 2.12), the C&ED imposed permit conditions on 1,761 (72%) permits to enable its staff to arrange checking of DCs imported/exported prior to their loading to/unloading from the carriers. Audit is concerned that similar permit conditions were not imposed on the remaining 700 (28%) permits for control purposes. The C&ED needs to impose suitable permit conditions on all cases of import/export of DCs via public cargo working areas to guard against duty evasion through over-shipment/short-shipment of DCs.

2.29 For the 1,761 permits with permit conditions imposed, Audit noted that:

- (a) holders of 31 permits (27 Duty-paid Permits and four Removal Permits for import) were required to submit applications to the C&ED prior to their removal from the importing carriers for Customs officers' attendance for checking the dutiable goods (see para. 2.5(c)). In the event, the Customs' checking of DCs for 6 (19%) permits was conducted at public cargo working areas and that for 25 (81%) permits at other locations specified by the permit holders; and
- (b) holders of 1,730 permits (1,592 Export Permits and 138 Removal Permits for import) were required to send notifications to the C&ED 24 hours before the vanning/devanning operation of their containerised cargoes so that the C&ED could arrange selective checks (see para. 2.5(b)). Based on the notifications, the ODCA selected 227 (13%) of 1,730 vanning/devanning operations for checking. For 88 (39%) of these 227 selected cases, the checks were conducted at locations specified by permit holders other than public cargo working areas.

Taken together, of the 258 (31 plus 227) Customs' checks, 113 (25 plus 88) were conducted at locations other than public cargo working areas. The C&ED had

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escorted the conveyance of the checked DCs to/from public cargo working areas for 44 (39%) of the 113 cases but had no similar compensatory controls for the remaining 69 (61%) cases. Audit considers that for all cases of Customs' checking of DCs conducted at places other than public cargo working areas, the C&ED needs to put in place control to prevent the checked cargoes from being tampered with prior to their loading to/unloading from the carriers.

Need to take action on idle DC stocks in bonded warehouses

2.30 As a licensing condition, a bonded warehouse operator is required to file monthly returns to the C&ED to report any DCs which have been left for a period of more than three years in a warehouse. According to the Dutiable Commodities Regulations (Cap. 109A), the C&ED is empowered to sell such DCs by auction after serving the necessary notice on the owner and the DCs are not removed or re-entered in the warehouse records by the specified date. Proceeds of sale shall be used to pay any necessary expenses for the sale, duty or fee payable to the Government and the warehouse operators. Should the DCs be un-saleable or their saleable value would not cover the necessary expenses of sale, the C&ED may arrange for the destruction of the DCs.

2.31 The C&ED has laid down the following guidelines for staff in handling monthly returns of idle DC stocks from bonded warehouse operators, including:

- (a) conducting selective checks on the returns against the records in the CCS;
- (b) serving a notice on the DC owner requesting him to remove the DCs or apply for a Removal Permit to re-enter the DCs in the warehouse records. A copy of the notice will also be served to the warehouse operator for information;
- (c) for those owners who fail to respond to the notice, publishing a notice in the Gazette which shall contain the description of the DCs, quantities, name of the owner (if known) and the date on which the DCs were deposited in the related warehouse; and
- (d) arranging for the disposal by auction or destruction after the specified period in the notice.

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2.32 Audit noted that as at April 2015, 34 owners had DCs left idle for more than three years in 11 warehouses. Of the 34 owners, 16 held valid DC licences and 18 did not. An ageing analysis of these DCs shows that 43.2% of 42,224 bottles of liquor and 80.8% of 313,178 packs of tobacco had been kept in the warehouses for over ten years (see Table 5). C&ED staff had spent time on record checking and surprise inspections of the idle DC stocks over these years. According to the C&ED, it had urged the warehouse operators to contact the DC owners for arranging the DCs to be removed or their records in the warehouse updated. However, C&ED staff had not followed the guidelines to serve notices on the owners concerned. In Audit's view, the C&ED needs to exercise its statutory power to dispose of the idle DC stocks with a view to minimising the C&ED's administrative work caused by the prolonged storage.

Table 5

**Ageing analysis of idle DC stocks in 11 warehouses
(April 2015)**

Period of storage (Year)	16 owners with valid DC licences		18 owners without valid DC licences		Total	
	Liquor (Bottle)	Tobacco (Pack)	Liquor (Bottle)	Tobacco (Pack)	Liquor (Bottle)	Tobacco (Pack)
> 3 to 10	20,444	20,354	3,525	39,962	23,969 (56.8%)	60,316 (19.2%)
> 10 to 15	—	—	10,545	102	10,545 (25.0%)	102 (0.1%)
> 15 to 20	2,070	—	3,326	252,760	5,396 (12.8%)	252,760 (80.7%)
> 20 to 25	2,077	—	108	—	2,185 (5.1%)	—
> 25 to 30	—	—	129	—	129 (0.3%)	—
Total	24,591	20,354	17,633	292,824	42,224 (100.0%)	313,178 (100.0%)

Source: Audit analysis of C&ED records

Remarks: In September 2015, the C&ED informed Audit that action had been taken from May to August 2015 to properly deal with 26,988 (64%) of 42,224 bottles of liquor and 20,354 (6%) of 313,178 packs of tobacco (i.e. they were either removed under Duty-paid/Export Permits or destroyed, or their records in the warehouses were updated).

Audit recommendations

2.33 **Audit has recommended that the Commissioner of Customs and Excise should:**

- (a) **consider integrating the existing computer systems (ROCARS and the CCS) to enable electronic transfer of data for:**
 - (i) **the automatic selection of DC consignments for cargo examination using DC permit numbers; and**
 - (ii) **the automatic updating of the permit condition endorsement records after cargo examination;**
- (b) **consider the need for enhancement measures to ensure that DC permit numbers are input in ROCARS submissions;**
- (c) **take more stringent enforcement actions against all cases of non-compliance with the permit condition of land boundary customs clearance, seeking legal advice where appropriate;**
- (d) **remind the land control point staff to strictly follow the guidelines on conducting cargo examination of dutiable goods;**
- (e) **amend the cargo examination guidelines to bring the scope of check on DCs covered by Removal Permits on a par with that for Export and Duty-paid Permits;**
- (f) **tighten control over the endorsement of permit conditions by restricting the endorsement right to staff of relevant divisions;**
- (g) **impose suitable permit conditions on all cases of import/export of DCs by sea via public cargo working areas to guard against duty evasion through over-shipment/short-shipment of DCs;**

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- (h) **for all cases of import/export of DCs via public cargo working areas but with Customs' checking conducted at other places, put in place control to prevent the checked cargoes from being tampered with prior to their loading to/unloading from the carriers; and**
- (i) **serve notices of removal on owners of idle stocks of DCs and take appropriate actions to dispose of any unclaimed DCs.**

Response from the Government

2.34 The Commissioner of Customs and Excise agrees with the audit recommendations. He has said that the C&ED:

- (a) has kicked off enhancement work to enable electronic transfer of data between ROCARS and the CCS for the automatic selection of DC consignments for cargo examination. The C&ED will conduct a technical feasibility study on the automatic updating of permit condition endorsement records after cargo examination;
- (b) will consider suitable measures to ensure that DC permit numbers are input in ROCARS submissions. In the interim, the C&ED will remind licensees through mails and meetings of the Customer Liaison Groups on the correct input of DC permit numbers when lodging cargo information onto ROCARS;
- (c) has reminded all relevant personnel to strictly comply with the guidelines on conducting cargo examination of dutiable goods; and
- (d) will review all permit conditions and restrict the endorsement right on each permit condition to relevant divisions.

PART 3: ENFORCEMENT AGAINST ILLICIT DUTIABLE COMMODITIES AND MANAGEMENT OF SEIZED ITEMS

3.1 This PART examines the C&ED's enforcement actions against illicit DCs and management of seized items. Audit has found room for improvement in the following areas:

- (a) enforcement against abuse of duty-free cigarette concession (paras. 3.6 to 3.18); and
- (b) management of seized goods and vehicles (paras. 3.19 to 3.40).

Legislation

3.2 According to the Dutiable Commodities Ordinance, it is an offence to import, export, store and deliver DCs without a valid licence or permit granted by the C&ED. The offence attracts a maximum penalty of two years imprisonment and a fine of \$1 million. Smuggling of DCs is also an offence under the Import and Export Ordinance (Cap. 60) and attracts a maximum penalty of seven years imprisonment and a fine of \$2 million.

3.3 The Dutiable Commodities Ordinance also provides for a compounding scheme which allows the offender to pay a penalty in lieu of being prosecuted for the offence. The compounding scheme was introduced in 1996 with a view to saving the time and cost of legal proceedings in handling minor offences. An example of the compoundable offences is failing to declare or making a false declaration of the quantity of DCs carried by a person which is in excess of the duty-free concessions (such as a passenger is allowed to bring 19 sticks of cigarettes — see para. 1.12). The compound penalty for abusing the duty-free concessions is equivalent to five times the duty payable plus a fine of \$2,000.

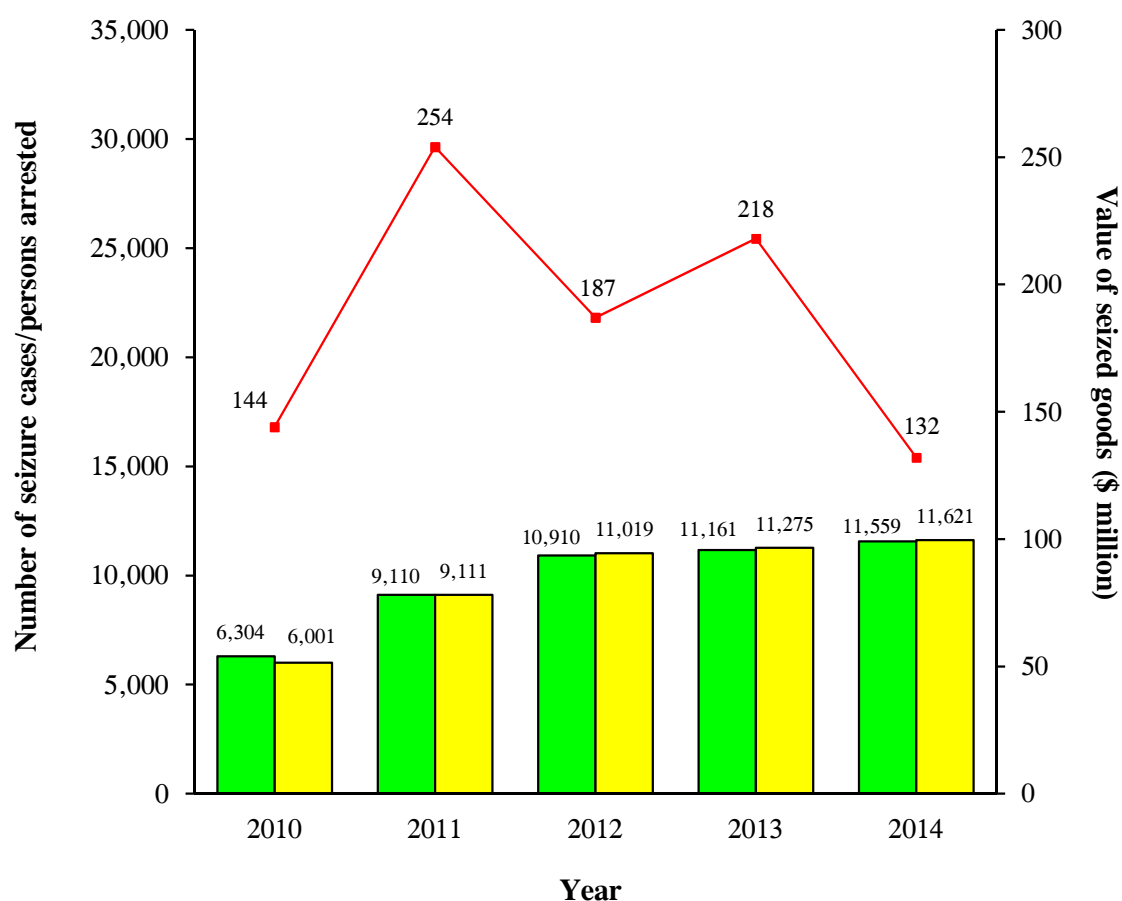
Enforcement against illicit dutiable commodities and management of seized items

Enforcement actions

3.4 To curb the inflow of illicit DCs at source, the BPB is responsible for inspecting cargoes imported or exported by air, land and sea, and processing travellers and their baggage at control points to detect any abuse of the duty-free concessions. Operations targeted at syndicated smuggling, distribution and street-level peddling of illicit DCs are launched regularly by the RGIB. The enforcement statistics from 2010 to 2014 are shown in Figures 3 to 5.

Figure 3

Seizure of illicit cigarettes (2010 to 2014)

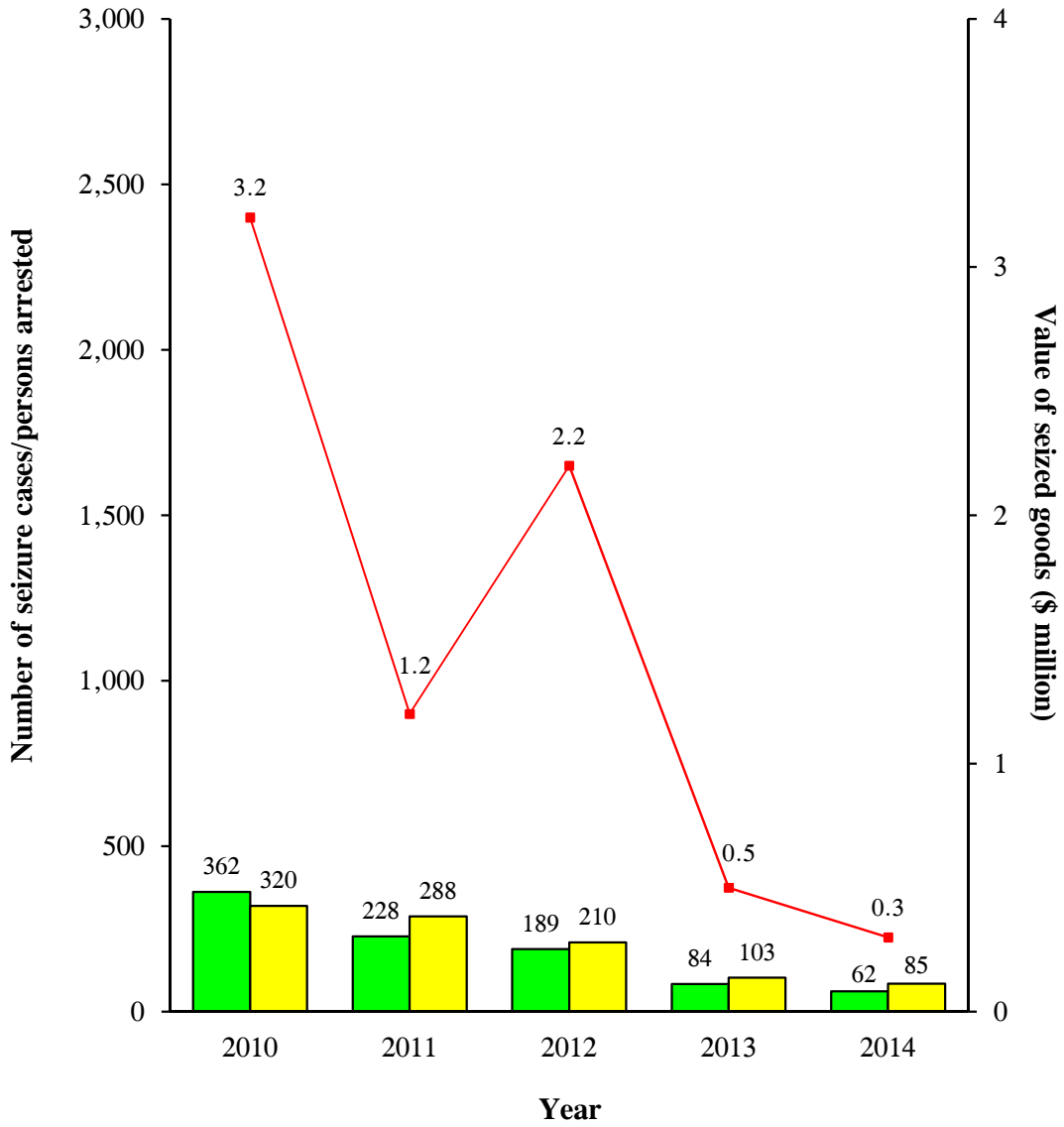


Legend: ■ Number of seizure cases
■ Number of persons arrested
■ Value of seized goods

Source: C&ED records

Figure 4

Seizure of illicit hydrocarbon oil
(2010 to 2014)

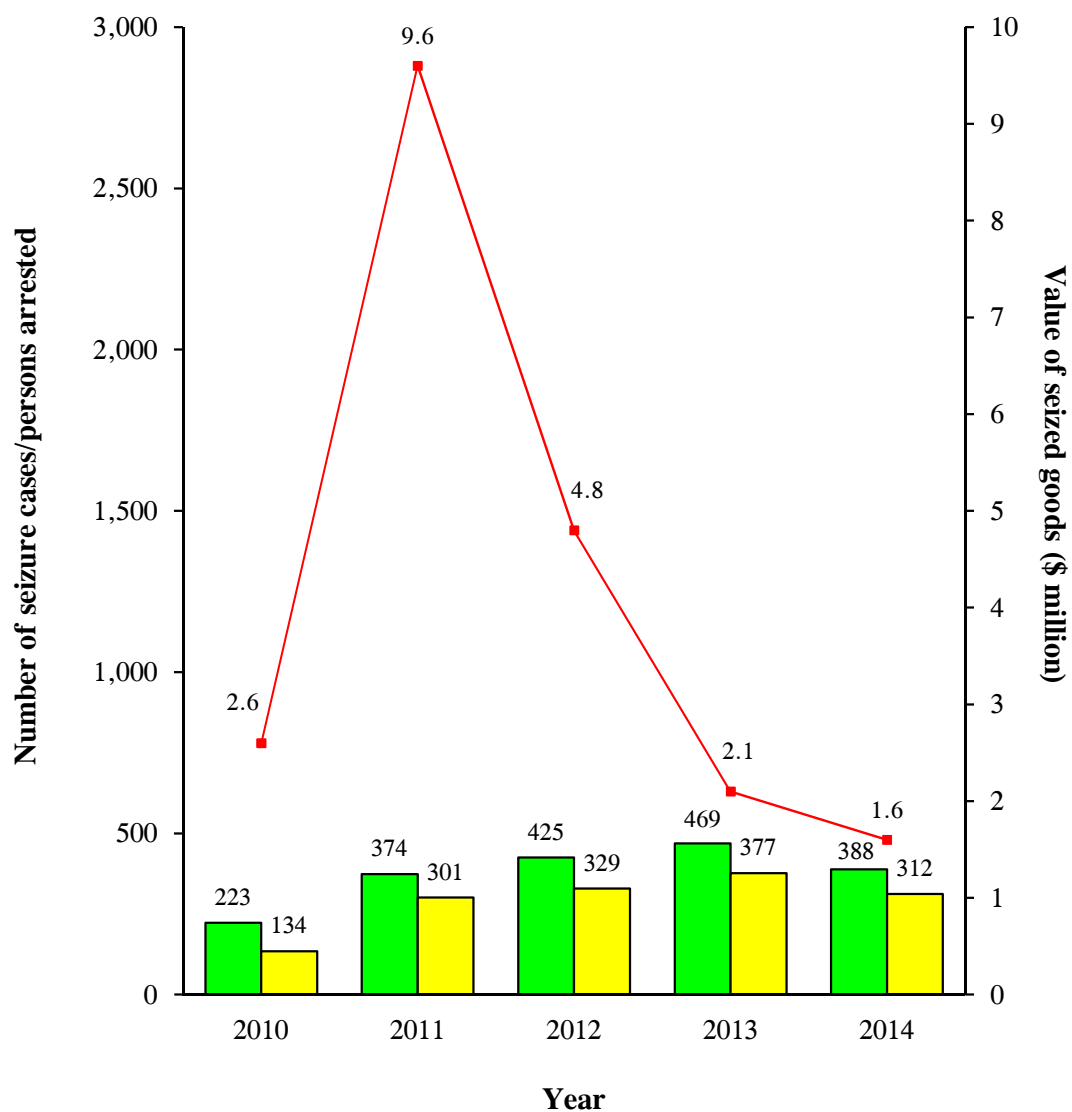


Legend: ■ Number of seizure cases
■ Number of persons arrested
—■— Value of seized goods

Source: C&ED records

Figure 5

**Seizure of illicit liquors
(2010 to 2014)**



Legend: ■ Number of seizure cases
■ Number of persons arrested
—■— Value of seized goods

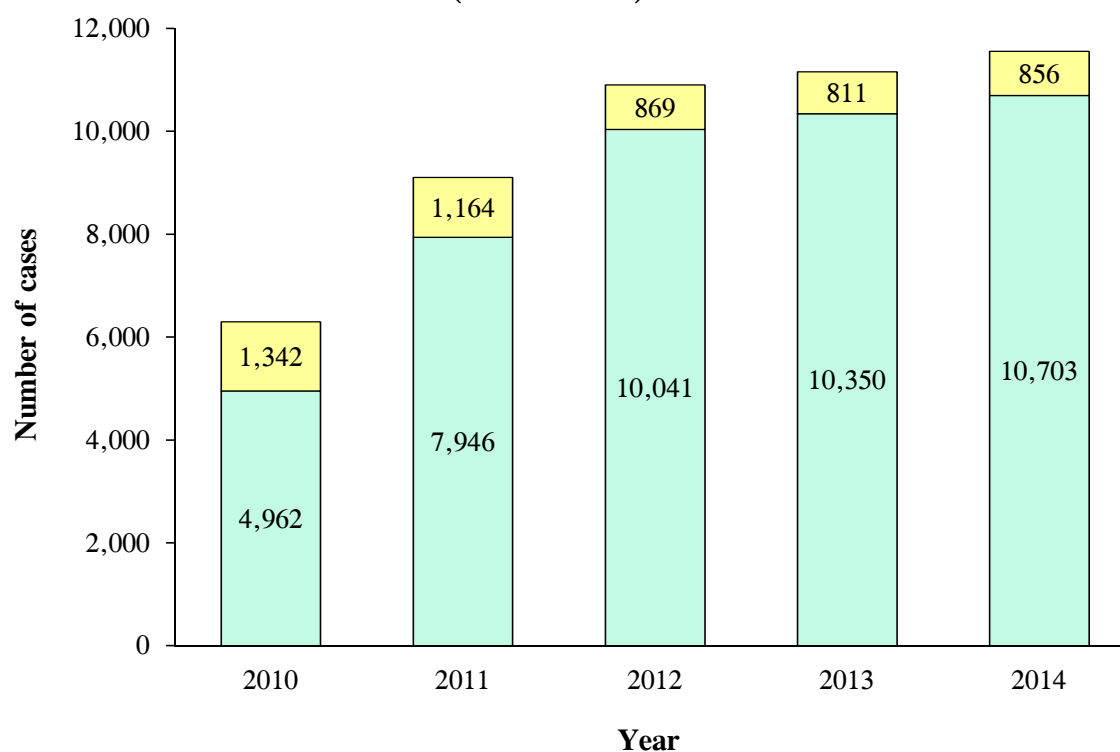
Source: C&ED records

Increasing trend in abuse of duty-free cigarette concession

3.5 In line with the Government’s tobacco control policy, the level of tobacco duty rate increased by 58% (Note 17) from 2010 to 2014. As reflected by the enforcement statistics in Figure 3, illicit cigarette activities had become more active over the same period. Among the 49,044 seizure cases for the five years, 90% (44,002 cases) were related to abuse of the duty-free concession. Figure 6 shows that abuse of the duty-free concession increased by 116% from 4,962 cases in 2010 to 10,703 cases in 2014.

Figure 6

**Analysis of illicit cigarette seizure cases
(2010 to 2014)**



Legend: Other illicit cigarette seizure cases
 Abuse of duty-free concession cases

Source: C&ED records

Note 17: From 2010 to 2014, the tobacco duty rate increased twice, i.e. by 41.5% in February 2011 and 11.7% in February 2014. The current duty rate for 1,000 sticks of cigarettes is \$1,906, i.e. 58% up from \$1,206 in 2010.

Enforcement against abuse of duty-free cigarette concession

3.6 As mentioned in paragraph 3.3, the offence of abuse of duty-free concessions may be dealt with by prosecution or compound penalty. The C&ED has laid down the following guidelines on handling compoundable offence:

- (a) no compounding shall be allowed if:
 - (i) the duty payable on the dutiable goods concerned is over \$10,000;
or
 - (ii) the offender has compounding records reaching the prescribed threshold in the preceding two years, including records of summons case arising from non-payment of compound penalty (Note 18); or
 - (iii) the offender does not have a fixed place of abode in Hong Kong for service of summons (in case he fails to pay the penalty) unless he pays immediately;
- (b) prosecution may be invoked against the offender if there is a reason to believe that the offender shall be better dealt with in court, e.g. joint possession of dutiable goods. In that case, the reason for invoking prosecution and not allowing compounding shall be recorded;
- (c) the offender is allowed to pay the penalty within ten calendar days from the date of offence at a designated Duty Collection Office after verifying the information of the place of abode provided by him; and
- (d) if the offender pays within the specified ten days, the dutiable goods shall be returned to him. If no payment is made within the specified ten days, the offender shall be prosecuted by way of summons for the offence.

Note 18: *When considering compounding an offence against a person, the case officer shall make reference to the Customs and Excise Intelligence System for any previous compounding records of the person concerned.*

Analysis of the enforcement actions taken

3.7 Of the 44,002 cases of abuse of duty-free cigarette concession detected from 2010 to 2014, the C&ED dealt with 37,800 (86%) cases by compound penalty and 1,584 (4%) cases by prosecution. The remaining 4,618 (10%) cases were compounding cases but prosecution actions were subsequently taken as the offenders failed to pay the compound penalty within the specified ten days (see para. 3.6(d)).

3.8 In terms of offenders, 8,096 (18%) of the 44,002 cases of abuse of duty-free cigarette concession were related to 3,184 repeated offenders. The remaining 35,906 (82%) cases were related to one-time offenders.

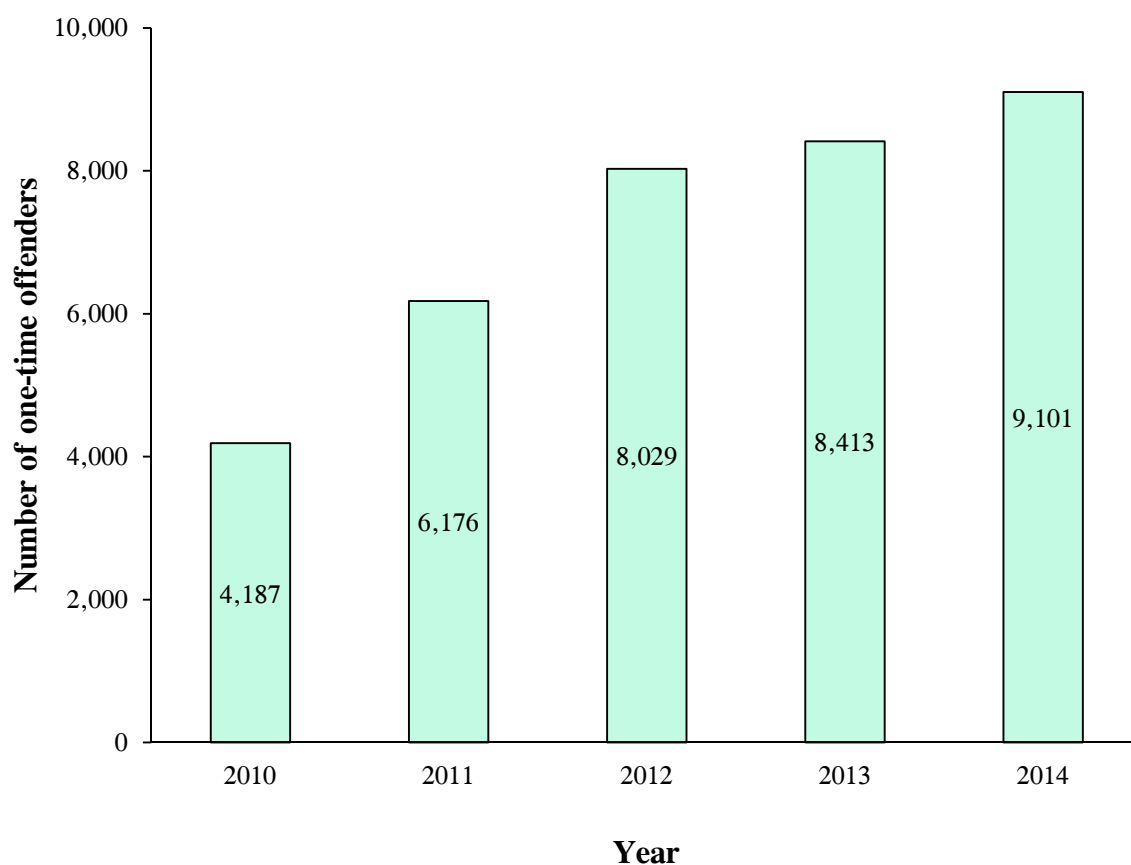
Need for more publicity and education

3.9 For the 35,906 one-time offender cases, the C&ED seized a total of 16.4 million sticks of cigarettes. On average, each case involved 457 sticks of cigarettes. The C&ED dealt with 31,687 (88%) cases by compound penalty and 997 (3%) by prosecution. The remaining 3,222 (9%) cases were prosecuted after the offenders concerned had failed to pay the compound penalty within the specified ten days.

3.10 A trend analysis shows that the number of one-time offenders increased from 4,187 in 2010 by 117% to 9,101 in 2014 (see Figure 7). The increasing number of these relatively minor cases inevitably increased the workload of the Customs officers and diverted their attention from the more important enforcement duties. The C&ED needs to monitor the situation closely and take enhanced measures where warranted by circumstances. In the meantime, the C&ED may consider stepping up publicity and education to encourage law-abiding behaviour as part of the strategy to tackle the increasing problem of abuse of duty-free concession.

Figure 7

**Increasing number of one-time offenders
(2010 to 2014)**



Source: Audit analysis of C&ED records

Need for stronger enforcement actions against recalcitrant offenders

3.11 For the 8,096 repeated offender cases, the C&ED seized a total of 5.5 million sticks of cigarettes. On average, each case involved 679 sticks of cigarettes (i.e. 49% more than the average of 457 sticks for the one-time offender cases). The C&ED dealt with 6,113 (76%) of these 8,096 repeated offender cases by compound penalty and 587 (7%) by prosecution. The remaining 1,396 (17%) offences were dealt with by prosecution after the offenders concerned had failed to pay the compound penalty within the specified ten days. Table 6 is an analysis of the 3,184 repeated offenders by the number of offences.

**Enforcement against illicit dutiable commodities
and management of seized items**

Table 6

**Analysis of the 3,184 repeated offenders by the number of offences
(2010 to 2014)**

Number of offences per offender	Number of offenders	Total number of offences	Total number of sticks of cigarettes involved
16	1	16	47,679
12	1	12	12,320
10	7	70	74,631
9	7	63	62,553
8	16	128	120,764
7	30	210	185,184
6	47	282	216,135
5	88	440	412,328
4	201	804	629,868
3	499	1,497	968,604
2	2,287	4,574	2,731,313
Total	3,184	8,096	5,461,379

Source: Audit analysis of C&ED records

3.12 Audit further analysed the enforcement actions taken against the 109 repeated offenders who had committed six offences or more each for the past five years from 2010 to 2014. Audit has found that:

- (a) two (2%) of the 109 repeated offenders had not been prosecuted although they had compounding records reaching the threshold laid down in the enforcement guidelines within a two-year period (see para. 3.6(a)(ii)). In September 2015, the C&ED informed Audit that prosecution actions had

Enforcement against illicit dutiable commodities and management of seized items

not been taken because in one case, two offences took place within a time span of two days such that the compounding records for the first one were yet to be updated to the system. In the other case, there was a misinterpretation of a summons case relating to non-payment of compound penalty as a prosecution case in counting the compounding records. In Audit's view, the C&ED needs to tighten monitoring of enforcement actions against repeated offenders with a compounding history and take measures to ensure that the information in the enforcement database is kept up-to-date; and

- (b) 27 (25%) of them had not been prosecuted at all for any of their offences because the enforcement guidelines required the Customs officers to take into account the offenders' offence records for the past two years only. For similar reasons, another nine (8%) of them were also not prosecuted for any of their offences initially. They were only prosecuted after failing to pay some of the compound penalty within the specified ten days. Given the worsening situation of abuse of the duty-free concession, there is a need to take stronger enforcement actions against recalcitrant offenders to achieve the necessary deterrent effect. In this connection, the C&ED needs to consider amending the enforcement guidelines such that all of the offenders' past offence records (not limiting to those within the preceding two years) shall be taken into account in determining whether they should be prosecuted or allowed to pay compound penalty in lieu.

Need for stronger enforcement actions against repeated offenders with non-payment records

3.13 According to the enforcement guidelines, a summons will be issued if the offender fails to pay the compound penalty within the specified ten-day period. From 2010 to 2014, there were 4,618 summons cases relating to non-payment of compound penalty. As at 30 April 2015, 117 (3%) of these 4,618 cases remained outstanding as the offenders concerned had failed to show up at court. Tremendous efforts had to be made by the C&ED to bring them to justice (e.g. issuing warrants of arrest). An ageing analysis of these 117 outstanding summons cases shows that 10 (9%) cases had been outstanding for more than three years.

Enforcement against illicit dutiable commodities and management of seized items

3.14 In May 2014, a Magistrate queried why an offender who had a number of compounding records including summons cases arising from non-payment of compound penalty was not formally charged for his subsequent offence but allowed to be compounded. The Magistrate expressed concern that settling such cases by way of compounding would defeat the purpose of the compounding scheme (see para. 3.3) and undermine its deterrent effect. Of the 109 repeated offenders mentioned in paragraph 3.12, 48 (44%) had such non-payment records, i.e. they had been summonsed for failing to pay the compound penalty within the specified ten days. However, the C&ED still dealt with their subsequent offences by compound penalty.

3.15 In June 2014, the C&ED issued a bulletin requiring Customs officers to instigate prosecution actions against repeated offenders with past records of non-payment of compound penalty. However, Audit noted that after the issue of the bulletin, there were still six cases (relating to six (6%) of the 109 repeated offenders) dealt with by compound penalty despite the offenders' previous non-payment records. The C&ED needs to tighten monitoring of enforcement actions against repeated offenders with past records of non-payment of compound penalty.

Need to ensure accuracy of law enforcement database

3.16 When considering compounding an offence against a person, the responsible Customs officer is required to make reference to the previous compounding/prosecution records stored in the computerised Customs and Excise Intelligence System. Accuracy of information in the System is important for Customs officers to make informed decision on the enforcement action to be taken against an offender. However, in the course of reviewing the 8,096 repeated offender cases (see para. 3.11), Audit noted that there were 27 offence records in the System with incorrect offenders' identities. The C&ED needs to take measures to ensure accuracy of the law enforcement database (such as putting in place validation check).

Audit recommendations

3.17 **Audit has *recommended* that the Commissioner of Customs and Excise should:**

- (a) **step up publicity and education to encourage law-abiding behaviour of incoming passengers when carrying DCs into Hong Kong and closely monitor the effectiveness of such measures in addressing the increasing problem of one-time abusers of the duty-free concessions;**
- (b) **take stronger enforcement actions against recalcitrant offenders by amending the enforcement guidelines such that all their past offence records will be taken into account in determining whether they should be prosecuted or allowed to pay compound penalty in lieu;**
- (c) **tighten monitoring of enforcement actions against repeated offenders with a compounding history or records of non-payment of compound penalty; and**
- (d) **take measures to ensure that the information in the law enforcement database is up-to-date and accurate.**

Response from the Government

3.18 The Commissioner of Customs and Excise agrees with the audit recommendations. He has said that the C&ED will:

- (a) review the enforcement guidelines on recalcitrant offenders to cope with the prevailing situation; and
- (b) carry out system enhancement work and impose a supervisory checking mechanism to ensure that the information in the law enforcement database is up-to-date and accurate.

Management of seized goods and vehicles

3.19 The C&ED has laid down guidelines for its staff on the receipt, handling, storage and disposal of seized items (Note 19). Having regard to the quantity, value, significance, operational convenience and the relevant instructions concerning the safe or proper custody of the seized goods, they may be stored in one of the departmental seized goods stores (i.e. an exhibit store or a strong room of the major operation units or a C&ED godown — Note 20). All seized vehicles are stored in a vehicle detention centre in Sha Tin. For security control, all the departmental seized goods stores and the vehicle detention centre are installed with closed circuit television systems.

3.20 *Storage records.* Whenever an item has been seized, the case officer is required to input the particulars of the seized item into the computerised Case Processing System (CAPS) which serves as primary records of seizure. On each occasion when a seized item is deposited into, removed from or transferred between storage facilities, the relevant CAPS records are updated accordingly. To enhance data accuracy and safeguard integrity of evidence relating to the seized items, staff members concerned are required to conduct physical count of the seized items in accordance with the laid-down guidelines.

3.21 *Inspection and stocktaking.* In accordance with the Stores and Procurement Regulations and the C&ED's guidelines, surprise inspections of the departmental seized goods stores and the vehicle detention centre shall be conducted at quarterly intervals. In each inspection, at least 3% of the seized items shall be checked. Stocktaking of all seized goods shall be conducted every 18 months for exhibit stores and every two years for godowns (Note 21). The Internal Audit Division of the C&ED also conducts periodic surprise inspections of the departmental seized goods stores to ensure that these stores are properly maintained.

Note 19: *Seized items include detained articles such as those detained for payment of duty or penalty under the Dutiable Commodities Ordinance.*

Note 20: *As at March 2015, the C&ED had 47 exhibit stores, five strong rooms and six godowns for the storage of goods seized under the Dutiable Commodities Ordinance and other legislation within the C&ED's purview. Of the six godowns, two (one in Chai Wan and the other in Kwai Chung) were also used for storing dangerous goods. The C&ED also hired storage space in commercial godowns. For 2014-15, the rental expenditure was \$11.3 million.*

Note 21: *Surprise inspection and stocktaking requirements for seized articles stored in commercial godowns were introduced in 2014.*

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Need to improve safe custody of seized goods and documentary exhibits

3.22 In a surprise inspection of the seized goods in Chai Wan godown in 2013, the Internal Audit Division of the C&ED found a case of discrepancy in the physical quantity of seized motor spirit with the CAPS records. All the original statements of witnesses could not be found in the case file, leaving copies only. Details are shown in Case A.

Case A

Seized motor spirit case with discrepancy in physical quantity and documentary exhibits not located

1. In an anti-illicit fuel operation of 2002, the C&ED seized 8,620 litres of motor spirit comprising 5,120 litres in 256 jerry cans and 3,500 litres in ten plastic tanks. The seized motor spirit was stored in a commercial godown after changing some of the containers, i.e. from ten plastic tanks into 18 metal drums.

2. In 2003, warrants of arrest were issued against some of the accused who failed to turn up in court. Pending the arrest of the absconded offenders, the seized motor spirit still had to be kept as case exhibits. In December 2011, the motor spirit in jerry cans and metal drums was transferred to Chai Wan godown to save rental cost.

3. In a review of the long outstanding warrants of arrest in 2012 (see para. 3.30), the C&ED could not locate all the original statements of witnesses. There were only copies in the case file.

4. In a surprise inspection of the seized goods in Chai Wan godown in August 2013, the C&ED's Internal Audit Division found that all the jerry cans were almost empty probably due to evaporation of the motor spirit over the years. The Internal Audit Division recommended conducting a review of the long outstanding seizure cases so that the seized goods could be disposed of as soon as possible to free up storage space for those from the commercial godown or newly seized goods. In October 2014, the RGIB staff inspected the jerry cans and confirmed that they were empty. As for the 3,500 litres of motor spirit in the metal drums, it was estimated that about 80% (i.e. 2,800 litres) remained (see Photograph 1).

Source: C&ED records

Photograph 1

**Empty jerry cans and metal drums partly filled with motor spirit
at Chai Wan godown**



Source: Photograph taken by Audit staff in June 2015

3.23 In light of the control weaknesses in handling the physical and documentary exhibits revealed in Case A, Audit examined other seizure cases. Similar problems were found as detailed in paragraphs 3.24 to 3.26.

3.24 ***Five more cases with discrepancies in physical quantities of motor spirit.*** In July 2015, Audit inspected five cases of seized motor spirit stored in Kwai Chung godown. Audit found that all the jerry cans containing the seized motor spirit were of unusually light weight. Upon Audit's request, the C&ED took measurement and confirmed that there were discrepancies in the physical quantities of the motor spirit with the CAPS records in all five cases (see details in Table 7).

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and management of seized items**

Table 7

**Discrepancies in quantities of seized motor spirit
stored in Kwai Chung godown
(July 2015)**

Case	Date of seizure (Note)	Quantity per CAPS records (a) (Litre)	Physical quantity measured by C&ED in July 2015 (b) (Litre)	Discrepancies	
				(c) = (b)-(a) (Litre)	(d) = $\frac{(c)}{(a)} \times 100\%$
B	12.6.2001	410	25.0	(385.0)	(93.9%)
C	1.8.2002	100	0.2	(99.8)	(99.8%)
D	1.8.2002	10	0	(10.0)	(100.0%)
E	16.8.2002	290	50.5	(239.5)	(82.6%)
F	6.1.2003	210	17.0	(193.0)	(91.9%)
Overall		1,020	92.7	(927.3)	(90.9%)

Source: Audit analysis of C&ED records

Note: The seized motor spirit of these cases was initially stored in a commercial godown. In October 2012, the motor spirit was transferred to Kwai Chung godown to save rental cost.

3.25 Audit found that all six cases (i.e. Cases A to F) with discrepancies in quantities of motor spirit shared the following common control weaknesses:

- (a) unlike other seized articles, the jerry cans and metal drums containing the motor spirit were not sealed. According to the C&ED, there were practical difficulties to affix seals to these containers. As such, the motor spirit stored in these unsealed containers was exposed to tampering and evaporation risks;

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- (b) there was no laid-down procedure for surprise check and stocktaking of seized goods in commercial godowns before 2014 (see Note 21 to para. 3.21). In other words, for some nine years (before transfer to Chai Wan godown in 2011), the motor spirit of Case A was not subject to any physical checks. Similarly, for some nine to eleven years, the motor spirit of Cases B to F was not subject to any physical checks before transfer to Kwai Chung godown; and

- (c) physical stocktaking of the motor spirit for Case A was conducted in 2011 when it was transferred to Chai Wan godown. Similar physical stocktaking was conducted in 2012 for the motor spirit of Cases B to F upon transfer to Kwai Chung godown. Thereafter, the motor spirit of all six cases was covered in the biennial stocktaking exercises (see para. 3.21) of the respective godowns. However, no discrepancy in quantity was reported in all these stocktaking exercises (except for the Internal Audit Division's inspection of Case A in August 2013). The stocktaking results were not consistent with the Internal Audit Division's suggestion that the motor spirit had probably evaporated over time (see para. 4 of Case A).

3.26 ***One more case with documentary exhibit not found in case file.*** Audit examined the documentary exhibits kept in the case files of ten seizure cases (including Cases B to F). In one case (Case E), the original interview notes of a defendant could not be located, i.e. only copies were found in the case file.

3.27 It is a cause for concern that both physical and documentary exhibits which could be used for prosecution were not properly handled for Cases A to F. Upon Audit's enquiries, in September 2015, the C&ED said that:

- (a) it had obtained advice from the Government Laboratory that motor spirit was volatile with an evaporation rate eight times faster than 95% ethyl alcohol. In the C&ED's view, the discrepancies in physical quantities of the seized motor spirit were due to natural evaporation over the years of storage. It was a matter of lack of proper record to note the decreasing quantity of motor spirit as a result of natural evaporation; and

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- (b) both Cases A and E (with mislaid documentary exhibits) involved long outstanding warrants of arrest. In 2008, the C&ED reviewed case documents of long outstanding warrants of arrest cases. In 2009, the C&ED issued guidelines requiring the staff concerned to ensure incorporation of all original copies of documents in the relevant case files and their safe custody.

3.28 Audit considers that the C&ED needs to draw lessons from these cases to improve the safe custody of physical and documentary exhibits. For physical exhibits, there is a need to improve the storage method of volatile materials and enhance the stocktaking procedures for ascertaining physical quantities so that any discrepancies can be detected for early remedial action. For documentary exhibits, there is a need to conduct a comprehensive check on other seizure cases with outstanding legal proceedings to ascertain whether there are problems similar to Cases A and E. The C&ED needs to step up efforts to locate any mislaid documents and take measures to ensure compliance with the 2009 guideline requirements.

Need to monitor progress of seizure cases under legal proceedings

3.29 As at April 2015, there were 750 seized dutiable goods cases still in progress, comprising 45 (6%) cases under investigation, 65 (9%) cases under legal proceedings and 640 (85%) cases pending forfeiture and disposal of the seized items.

3.30 Of the 65 cases under legal proceedings, the defendants of 23 (35%) cases had failed to appear in court and warrants of arrest had been issued accordingly. In 19 (83%) of the 23 cases, the warrants of arrest had been issued for over five years. According to the C&ED's guidelines, long outstanding warrants of arrest should be reviewed every five years to determine the way forward. Audit found that the five-year review frequency was not observed in the 19 cases, i.e. the stipulated reviews had been overdue for an average of 7.8 years (ranging from 5.3 to 12.7 years). There is a need to closely monitor the progress of seizure cases under legal proceedings.

***Need to expedite action on cases
pending forfeiture and disposal of seized items***

3.31 According to the Dutiable Commodities Ordinance, wherever there occurs a contravention of the Ordinance in respect of any goods, such goods shall be liable to forfeiture whether or not any person is convicted of any offence. The C&ED has laid down the following requirements on the forfeiture and disposal of seized articles:

- (a) ***Obtaining a confiscation order.*** After the conclusion of criminal proceedings relating to the seized articles, the Service Prosecution Group of the C&ED is responsible for applying to the court for forfeiture proceedings if there is a claim for the seized goods. For cases without any notice of claim received by the C&ED, the seized goods shall be deemed as forfeited in accordance with the Dutiable Commodities Ordinance and the Service Prosecution Group shall issue a confiscation order accordingly;
- (b) ***Obtaining a destruction certificate.*** After a confiscation order has been obtained for articles that should be disposed of by destruction (e.g. illicit cigarettes), an application should be made to the C&ED's Supplies Section for a destruction certificate; and
- (c) ***Disposal of auctionable goods.*** For auctionable goods such as vehicles, a draft auction list should be prepared for the Government Logistics Department's consideration and auction arrangement after obtaining the confiscation order.

3.32 In 2012, Audit completed a review of the management of intellectual property rights enforcement work of the C&ED (Chapter 6 of the Director of Audit's Report No. 59 of October 2012). The review found that there were delays in arranging forfeiture and destruction of seized infringing articles. Since then, the C&ED has implemented the following measures to monitor the management of seized goods:

Enforcement against illicit dutiable commodities and management of seized items

- (a) ***Monitoring long outstanding cases.*** Since September 2012, monthly reports from the CAPS have been generated for the Review Committee of Seizure Management (Note 22) to monitor the progress of disposal actions on seized goods. Separate alerts have also been generated for cases outstanding for more than 2.5 years from the dates of seizure (defined as long outstanding by the C&ED) for special attention; and

- (b) ***Monitoring cases with incomplete tasks within specified timeframe.*** In 2014, the C&ED specified that the following cases should be brought up for monitoring by the respective Branch Heads and follow-up actions by relevant staff:
 - (i) cases with notices of claims which have not been brought up to the Service Prosecution Group of the C&ED for forfeiture application for two months from the dates of conclusion of the criminal proceedings;
 - (ii) concluded cases which have not applied for destruction certificates after 30 days from the dates of receipt of confiscation orders;
 - (iii) concluded cases pending destruction after 60 days from the dates of receipt of destruction certificates; and
 - (iv) concluded cases pending disposal after 90 days from the dates of receipt of confiscation orders.

3.33 Prolonged holding of seized goods and vehicles should be avoided as they take up storage space and their resale value (for auctionable items) could diminish with time. From 2012-13 to 2014-15, the C&ED disposed of a total of 131,931 items of seized goods and 487 seized vehicles related to 15,462 seizure cases of DCs and other infringing articles. However, Audit examination of the storage records of DC-related seizure cases as at April 2015 has revealed that there is still a need to expedite action to clear the long outstanding cases (see paras. 3.34 and 3.35).

Note 22: *The Committee, chaired by an Assistant Commissioner of the C&ED, is responsible for monitoring the performance of seizure management and providing steer for clearing long outstanding cases with seized or detained articles.*

Enforcement against illicit dutiable commodities and management of seized items

3.34 *Seized dutiable goods pending disposal/destruction.* As at April 2015, there were 490 cases of seized dutiable goods kept in the godowns. Of the 490 cases, 483 cases (involving 4,095 items) were pending disposal/destruction, i.e. concluded cases or cases without prosecution and their seized items had been deemed as forfeited. An ageing analysis of the 483 cases shows that 35 (7%) cases had been outstanding for more than one year (see Table 8). In September 2015, the C&ED informed Audit that:

- (a) the normal processing time for completion of investigation into forfeiture cases was 150 days from the dates of conclusion of the criminal proceedings or dates of seizure for cases without prosecution. Lengthy processing time was required for some cases especially those involved appeals, forfeiture hearings and warrants of arrest; and
- (b) from May to August 2015, action had been taken to dispose of the seized goods of 304 of the 483 outstanding cases mentioned in Table 8.

**Enforcement against illicit dutiable commodities
and management of seized items**

Table 8

**Ageing analysis of seized dutiable goods pending disposal/destruction
(April 2015)**

Number of years since the case was concluded or the seized goods were deemed as forfeited for a case without prosecution (Year)	Case pending confiscation order (Number)	Case with confiscation order pending destruction certificate (Number)	Case pending disposal/destruction (Number)	Total (Number)
≤ 1	161	138	149	448
> 1 to 2	4	—	21	25
> 2 to 5	2	—	4	6
> 5 to 10	3	—	—	3
> 10	1	—	—	1
Total	171	138	174	483

Source: Audit analysis of C&ED records

3.35 **Seized vehicles pending disposal.** As at April 2015, there were 158 seized vehicles kept in the vehicle detention centre, of which 141 were pending disposal, i.e. concluded cases or cases without prosecution and their vehicles had been deemed as forfeited. An ageing analysis of the 141 seized vehicles pending disposal shows that 97 (69%) had been outstanding for more than one year (see Table 9). In September 2015, the C&ED informed Audit that:

- (a) the processing time for disposal of vehicles was also lengthy because it involved checking the information of the vehicles with the TD and arrangement of auctions or sale contracts; and

**Enforcement against illicit dutiable commodities
and management of seized items**

- (b) from May to August 2015, 85 of the 141 vehicles mentioned in Table 9 were disposed of by auction (12 vehicles) and as scrap (73 vehicles), and two vehicles were returned to the owners concerned.

Table 9

**Ageing analysis of seized vehicles pending disposal
(April 2015)**

Number of years since the case was concluded or the seized vehicle was deemed as forfeited for a case without prosecution (Year)	Seized vehicle pending confiscation order (Number)	Seized vehicle with confiscation order pending disposal (Number)	Total (Number)
≤ 1	21	23	44
>1 to 2	1	30	31
>2 to 5	2	12	14
>5 to 10	1	45	46
>10	1	5	6
Total	26	115	141

Source: Audit analysis of C&ED records

Remarks: Since vehicles are auctionable items, a destruction certificate is not required for their disposal.

Enforcement against illicit dutiable commodities and management of seized items

Need to review storage space requirements

3.36 As at June 2015, the C&ED had six godowns with a total floor area of 27,810 square metres (m²) for the storage of seized goods (see Table 10). Five of the godowns are in government-owned premises and one (i.e. the Logistics Centre) is in a commercial building. The annual rent for the Logistics Centre under a three-year tenancy (from 2013 to 2016) is \$6.9 million. The C&ED also rented storage space of 13,910 cubic metres in other commercial godowns (mainly for cold storage) at a total cost of \$4.4 million in 2014-15.

Table 10

Occupancy rates of C&ED godowns (2013-14 to 2015-16)

C&ED godown	Area (m ²)	Occupancy rate		
		2013-14 (%)	2014-15 (%)	2015-16 (up to June 2015) (%)
1. Kwai Chung (including Dangerous Goods Store)	9,265	92	87	64
2. Cheung Sha Wan	8,665	91	91	85
3. Chai Wan (including Dangerous Goods Store)	5,204	77	69	84
4. Logistics Centre	4,530	76	92	98
5. Airport	101	95	95	89
6. Lo Wu	45	47	69	71
Overall	27,810	86	86	80

Source: C&ED records

3.37 With the disposal of 131,931 items of seized goods (both DCs and other non-DC items) in the past three years (see para. 3.33), the overall occupancy rate of the six godowns had decreased from 86% in 2013-14 to 80% in June 2015. In particular, the occupancy rate of Kwai Chung godown had decreased from 92% to

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64% (see Table 10 and Photograph 2). Given that the C&ED has also put in place measures to monitor and clear the long outstanding seizure cases, there could be reduction in the overall storage space requirement in the long term. The C&ED needs to conduct a review in this regard to see if there is scope for reducing the leased storage spaces in the Logistics Centre.

Photograph 2

Available storage space in Kwai Chung godown



Source: Photograph taken by Audit staff in July 2015

3.38 As for the vehicle detention centre which covers a site area of 45,828 m² in Sha Tin, the occupancy rate had decreased from 76% in 2011-12 to 63% in June 2015. According to the C&ED, the Sha Tin site has been earmarked for use by a works project of the Drainage Services Department in 2017. Audit considers that the C&ED needs to take the opportunity of reprovisioning the vehicle detention

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centre to critically review the actual vehicle storage requirements, taking into account the on-going measures to monitor and clear the long outstanding seized vehicle cases.

Audit recommendations

3.39 Audit has *recommended* that the Commissioner of Customs and Excise should:

- (a) draw lessons from Cases A to F (see paras. 3.22 to 3.26) to improve the safe custody of physical and documentary exhibits, including:**
 - (i) improving the storage method of volatile seized goods;**
 - (ii) enhancing the stocktaking procedures for ascertaining physical quantities of seized goods so that any discrepancies can be detected for early remedial action;**
 - (iii) conducting a comprehensive check on other seizure cases with outstanding legal proceedings to ascertain whether there are problems similar to Cases A and E for documentary exhibits; and**
 - (iv) stepping up efforts to locate any mislaid documents and taking measures to ensure compliance with the 2009 guideline requirements;**
- (b) closely monitor the progress of seizure cases under legal proceedings, such as the compliance with the stipulated frequency of review of outstanding warrants of arrest;**
- (c) expedite action to clear long outstanding cases of seized goods and vehicles;**
- (d) conduct a review of the long-term storage requirements of seized goods to see if there is scope for achieving cost savings by reducing the leased storage spaces; and**

- (e) **in the planned reprovisioning of the vehicle detention centre, critically review the actual vehicle storage requirements, taking into account the on-going measures to monitor and clear the long outstanding seized vehicle cases.**

Response from the Government

3.40 The Commissioner of Customs and Excise agrees with the audit recommendations. He has said that the C&ED:

- (a) has taken measures to improve the stock recording and checking of volatile seized goods, and is exploring ways to improve the storage of volatile seized goods. A comprehensive check on other seizure cases with outstanding legal proceedings was kicked off in September 2015 to ensure compliance with the 2009 guideline requirements. Efforts have also been taken to locate any mislaid documents;
- (b) has put in place a quarterly reporting system for monitoring the progress of seizure cases under legal proceedings;
- (c) has already put in place a mechanism to monitor seizure disposal actions and long outstanding cases. The C&ED will continue such monitoring to prevent any unnecessary delays in seizure disposal;
- (d) has put in place on-going measures to monitor and clear the outstanding seizure cases. Hence, the yearly total rental costs for storage of seized goods had been reduced from \$16.7 million in 2011-12 to \$11.3 million in 2014-15. The C&ED will review the long-term storage requirement of seized goods and critically examine if there is scope for achieving further cost savings; and
- (e) will review the vehicle storage requirements, taking into account the enforcement needs and progress in disposal of seized vehicles.

PART 4: ADMINISTRATION AND PROTECTION OF FIRST REGISTRATION TAX

4.1 This PART examines the C&ED's efforts in administering and protecting FRT. Audit has found room for improvement in the following areas:

- (a) control over registered traders (paras. 4.11 and 4.12);
- (b) control over reassessment cases (paras. 4.13 to 4.16); and
- (c) enforcement against contravention cases (paras. 4.17 to 4.20).

Administration of FRT

4.2 All motor vehicles for use on the roads of Hong Kong and have not been first registered in Hong Kong are subject to the FRT under the Motor Vehicles (First Registration Tax) Ordinance. The TD is responsible for the overall administration of the FRT. The Commissioner for Transport has authorised C&ED officers to exercise certain powers and duties under the Ordinance, such as registering motor vehicle traders, processing import returns and PRP lists (Note 23), assessing the provisional taxable values of motor vehicles, and taking enforcement action on any contravention cases.

4.3 ***Registration of motor vehicle traders.*** A person who carries on business of importing and/or distributing motor vehicles for use in Hong Kong is required to be registered within 30 days of commencing that business. As at April 2015, there were 1,974 registered motor vehicle traders. A registered trader has to comply with the following statutory provisions for the import and distribution of motor vehicles:

- (a) a registered importer is required to file an import return within 30 days of the importation and not less than five working days before delivering the motor vehicles for trade purpose; and

Note 23: *The PRP includes the retail prices of the motor vehicle, optional accessories (e.g. audio equipment and anti-theft device) and warranties.*

Administration and protection of first registration tax

- (b) a registered distributor is required to publish the retail price of motor vehicles (i.e. the PRP) before offering them for sale for use in Hong Kong. In this connection, he is required to submit the proposed PRP list of a motor vehicle to the C&ED for assessment and approval not less than seven days before its publication. The taxable value of a motor vehicle is calculated based on the approved PRP.

4.4 The C&ED uses a computerised FRT system for processing trader registration and assessing the provisional taxable values of motor vehicles. Traders can submit import returns, proposed PRPs and requests for assessment of provisional taxable value electronically through the system. The FRT system also allows the public to have access to the approved retail prices of vehicles via the Internet. To promote public awareness of the obligations of vehicle buyers and sellers under the Motor Vehicles (First Registration Tax) Ordinance, the C&ED has produced an Announcement of Public Interest for broadcast on television and radio, and also developed a free mobile application “HK Car Tax” for the public to check the valid PRP lists of motor vehicles.

4.5 ***Processing of import returns.*** A registered importer is required to provide vehicle details (e.g. vehicle model and landed value — Note 24) and supporting documents (e.g. the vehicle registration document issued by the exporting country and invoice(s) from the manufacturer or the supplier) for his import return. Besides document check, the C&ED may conduct an inspection of the vehicle to check against the declared details (e.g. the vehicle model and accessories) in an import return. The C&ED is assisted by the FRT system in detecting any delay in submission of import returns. An importer is liable on conviction to a fine of \$500,000 and imprisonment of 12 months for providing false/inaccurate information in an import return or late submission of the return.

4.6 The requirement of filing an import return also applies to persons who import motor vehicles for personal use. In such case where there is no approved PRP, the provisional taxable value is assessed based on the declared value (including the cost, insurance and freight charges) of the motor vehicle or the C&ED’s assessed value if the declared value does not reflect the market value.

Note 24: *The landed value shall include the cost of purchase, insurance and freight charges in the original currency, and shall include any other costs incidental to the purchase and importation of the motor vehicle (e.g. inland freight charges).*

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4.7 ***Processing of PRP.*** Under the law, if the C&ED is of the opinion that the proposed PRP submitted by the registered distributor does not reflect the market value of the motor vehicle, it may reject the proposed PRP and assess a PRP based on the market value of the motor vehicle. The market value is established by reference to previously endorsed PRP records (for motor vehicles of the same model and make) and the latest market information through market research. If the assessed PRP is disagreed, a registered distributor may submit a written representation to the C&ED with reasons. The C&ED will carry out a reassessment of the PRP and respond within 14 days upon receipt of the representation.

4.8 A registered distributor commits an offence if he sells a motor vehicle at a price higher than the approved PRP, without obtaining the C&ED's prior consent. Given that the value of a motor vehicle may be adjusted in response to the changing market environment and any addition of accessories, the law allows a registered distributor to notify the C&ED not less than five working days before an intended change in the PRP of a motor vehicle. In case of a price reduction notification, reasons for the reduction should be given to support the C&ED's assessment.

4.9 ***Assessment of provisional taxable value.*** After having filed an import return and obtained an approved PRP, a registered distributor may apply for a notification of provisional taxable value to enable him to apply for first registration of the vehicle with the TD. The C&ED will assess the provisional taxable value of a motor vehicle based on the approved PRP. A registered distributor/owner who is aggrieved at the assessed provisional taxable value may request the C&ED to carry out a reassessment.

4.10 Table 11 below shows the C&ED's workload statistics on FRT from 2010 to 2014.

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Table 11

**Major workload statistics on FRT
(2010 to 2014)**

Work	2010	2011	2012	2013	2014
(a) New trader applications processed	151	132	123	128	145
(b) Import returns processed	7,911	7,843	7,941	6,945	7,602
(c) Inspection and verification of imported vehicles for FRT purposes	452	471	478	1,206 (Note)	1,428
(d) PRP lists processed	22,121	20,991	18,080	14,554	17,142
(e) Assessment of provisional taxable value on imported vehicles completed	58,514	63,707	60,609	67,652	77,690
(f) Reassessment of provisional taxable value on imported vehicles completed	13,738	16,722	17,057	16,213	25,944

Source: C&ED records

Note: With an increase of 18 staff (comprising 12 time-limited civil service posts and six non-civil service contract staff) in 2013, the C&ED stepped up verification of information of imported vehicles and investigation of suspected offence cases.

Control over registered traders

4.11 The C&ED has adopted a risk-based approach in managing registered traders. More stringent procedures will be applied to a high-risk trader when processing his submissions and requests, as follows:

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- (a) in processing a high-risk trader's import return and PRP application, his vehicle will be selected for inspection. Intensive mode of inspection will be applied with focus on verifying the make, model code, distinctive features, and standard and additional optional accessories declared by him; and
- (b) a high-risk distributor may be disallowed to obtain automatic generation of the notification of provisional taxable value (see para. 1.14) through the FRT system. The C&ED has to conduct a vehicle inspection and verify the declared PRP before generation of the notification.

4.12 ***Failure to update risk status records.*** According to the C&ED, traders' records of serious offence are one of the factors for adjusting their risk status. However, Audit noted the following issues in maintaining records of traders' risk status:

- (a) as at April 2015, of the 45 traders who had contravened the statutory provision by selling vehicles higher than the approved PRPs (see para. 4.8) from 2011 to 2014, ten traders still had their risk status recorded as "Nil" in the FRT system; and
- (b) in addition, the risk status of six traders who were involved in four investigation cases had not been adjusted to "Medium" or "High" although the adjustment of risk status was endorsed by a Superintendent of the ODCA in charge of FRT matters in 2013 and 2014 (see Table 12).

Audit considers that the C&ED needs to tighten controls to ensure that the records of risk status of registered traders are kept up-to-date.

Table 12

**Risk status of six traders not yet updated
(April 2015)**

Case	Registered trader	Date of endorsement	Endorsed risk status	Risk status per the FRT system
A	1	20.8.2013	High	Nil
	2	20.8.2013	High	Medium
B	3	7.4.2014	High	Nil
	4	7.4.2014	High	Nil
C	5	31.3.2014	Medium	Nil
D	6	7.4.2014	Medium	Nil

Source: C&ED records

Control over reassessment cases

4.13 From time to time, registered distributors may for various reasons, submit requests for reassessment of the PRP of vehicles. The C&ED has laid down the following guidelines for its staff in processing reassessment cases:

- (a) requests for reduction in the assessed PRP may be acceded to after considering factors such as the market trend, vehicle's condition, vehicles which have been used for demonstration and/or test driven over a period of time, and outdated or phased-out model;
- (b) justification for granting reduction should be recorded in the FRT system; and
- (c) if the reduction granted exceeds 10% of the originally assessed PRP or equals to \$50,000 and above, the endorsement of the head of the ODCA (i.e. at Senior Superintendent level — see para. 1.17) is required.

Supervisory endorsement for granting reduction in PRP not always obtained for multiple reassessments cases

4.14 In 2014, the C&ED processed 605 requests for PRP reassessment. Audit analysed the C&ED's database and found nine cases of downward adjustments exceeding \$50,000 or 10% of the originally assessed PRPs after multiple reassessments (involving 20 (3%) of the 605 requests). In five (56%) of these nine cases, the supervisory endorsement for downward adjustment of PRP was not obtained (see para. 4.13(c)). Audit considers that the C&ED needs to take measures to ensure that the stipulated supervisory endorsement for downward adjustment of PRP is always obtained in cases with multiple reassessment requests.

Granting reduction in provisional taxable values of vehicles imported for personal use without Senior Superintendent's endorsement

4.15 In contrast to the procedures for PRP reassessment cases where Senior Superintendent's endorsement is required for downward adjustment of PRP exceeding 10% of the original assessment or equal to \$50,000 and above (see para. 4.13(c)), those for the reassessments of provisional taxable values of vehicles imported for personal use do not involve the Senior Superintendent. For such reassessment cases, granting reduction in provisional taxable values is handled by a Senior Inspector and endorsed by a Superintendent irrespective of the amount of reduction.

4.16 From January 2012 to April 2015, the C&ED carried out 115 reassessments for 99 vehicles imported for personal use. Audit examined 44 of these reassessments for 30 vehicles and found that the downward adjustments in taxable values totalled \$5 million, representing 20% of the taxable value of \$25 million before the reassessments. Of the 30 vehicles, 17 (57%) were each granted reduction in taxable value over \$100,000 (ranging from \$101,001 to \$539,430). Another ten vehicles (33%) were each granted reduction exceeding \$50,000 or 10% of the original taxable value (i.e. the stipulated limit for Senior Superintendent's endorsement of PRP reassessment cases). To ensure adequate checks and balances, there is a need to lay down requirements on Senior Superintendent's endorsement for granting reduction in provisional taxable values of vehicles imported for personal use similar to the PRP reassessment cases.

Enforcement against contravention cases

4.17 The C&ED has laid down guidelines for its staff in handling cases of breach of the Motor Vehicles (First Registration Tax) Ordinance. For an offence of a minor or trivial nature (e.g. late submission of import return for vehicle imported for personal use), a warning letter may be issued in lieu of prosecution if the following criteria are met:

- (a) the violation does not involve evasion of FRT;
- (b) the offender has not been prosecuted for the same offence; and
- (c) the Department of Justice's advice has been obtained.

In other cases, prosecution action should be instigated. From 2010 to 2014, the C&ED issued 224 warning letters for minor offences. Table 13 shows the prosecution statistics for the five years.

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Table 13

Prosecution of contravention cases (2010 to 2014)

Offence	2010	2011	2012	2013	2014
	(Number of cases)				
Late import return	21	29	28	37	40
Selling higher than the approved PRP	—	5	32	8	6
False or inaccurate return	—	—	—	4	5
Failure to submit PRP 7 days before publication	—	—	2	3	1
Others (Note)	—	—	1	5	—
Total	21	34	63	57	52
Number of persons prosecuted	21	38	71	57	57
Total court penalty (\$'000)	56	330	6,587	1,473	1,049

Source: C&ED records

Note: Others included failing to keep records (one case each in 2012 and 2013), delivering motor vehicles to buyers before payments of the FRT (two cases in 2013) and failing to register as traders (two cases in 2013).

Difficulties in instituting prosecution within the statutorily specified period

4.18 Any prosecution of an offence under the Motor Vehicles (First Registration Tax) Ordinance shall be instituted within:

- (a) two years after the date on which the offence is committed; or

- (b) six months after the date on which the Commissioner for Transport first has knowledge that the offence has been committed, whichever is the earlier.

4.19 In a sample check of 30 completed investigation cases for the period from 2012 to 2014, Audit found that in five cases, the TD referred to the C&ED for investigation a total of 692 vehicles suspected to have been sold higher than the approved PRPs from March to November 2012. After screening the cases, the C&ED considered that investigations should be conducted for 681 vehicles. However, given the prosecution time bar (see para. 4.18(b)), the investigations focused on 529 (78%) vehicles, i.e. those with registration taken place on or after July 2012 (with the corresponding prosecution time limit ended in January 2013). In the event, the suspected offences in respect of 152 (22%) vehicles (with prosecution time limit ended earlier than January 2013) were not investigated.

4.20 In 2013, the C&ED reviewed the provisions of the Motor Vehicles (First Registration Tax) Ordinance in light of operational experience gained in administering FRT and taking enforcement actions. The C&ED considered that there was a need to amend various provisions of the Ordinance, including extending the time bar for taking prosecution action. Thereafter, the C&ED continued to monitor the effectiveness of the control regime and work on legislative proposals for enhancement. In July 2015, the C&ED informed Audit that the review on the proposed legislative amendments was still in progress. Audit considers that there is a need to introduce legislative amendments so that the C&ED can take enforcement actions effectively.

Audit recommendations

4.21 **Audit has *recommended* that the Commissioner of Customs and Excise should:**

- (a) **tighten controls to ensure that the records of risk status of registered traders are kept up-to-date;**
- (b) **take measures to ensure that the stipulated supervisory endorsement for downward adjustment of PRP is always obtained in cases with multiple reassessment requests;**

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- (c) **lay down requirements on Senior Superintendent's endorsement of downward adjustment of provisional taxable values in reassessment cases concerning vehicles imported for personal use similar to the PRP reassessment cases; and**
- (d) **in consultation with the Financial Services and the Treasury Bureau, the Department of Justice and the TD, work on legislative amendments to the Motor Vehicles (First Registration Tax) Ordinance to improve the control regime over FRT, including extension of the time bar for taking prosecution actions.**

Response from the Government

4.22 The Commissioner of Customs and Excise agrees with the audit recommendations. He has said that the C&ED:

- (a) completed a full-scale updating of traders' risk status on 28 August 2015 and has put in place a supervisory monitoring mechanism to ensure timely updating of the records;
- (b) will review the procedures and incorporate into the guidelines the requirement for Senior Superintendent's endorsement of downward adjustment of provisional taxable values in reassessment cases concerning vehicles imported for personal use similar to the PRP reassessment cases; and
- (c) will continue to work on the legislative proposals for enhancing the FRT control regime in consultation with the Financial Services and the Treasury Bureau and other relevant bureaux and departments.

4.23 The Secretary for Financial Services and the Treasury supports the need to amend the Motor Vehicles (First Registration Tax) Ordinance to further enhance the effectiveness of the FRT regime for the purpose of protecting the government revenue and consumers' interest.

**Duty rates on dutiable commodities
(September 2015)**

Type of DC	Rate
1. Liquor Liquor with an alcoholic strength of more than 30% by volume measured at a temperature of 20°C	100% of value
2. Tobacco (a) Cigarette (b) Cigar (c) Chinese prepared tobacco (d) All other manufactured tobacco except tobacco intended for the manufacture of cigarette	(\$ per 1,000 sticks) 1,906 (\$ per kilogram) 2,455 468 2,309
3. Hydrocarbon oil (a) Aircraft spirit (b) Motor spirit (leaded petrol) (c) Motor spirit (unleaded petrol) (d) Light diesel oil (except Euro V diesel)	(\$ per litre) 6.51 6.82 6.06 2.89
4. Methyl alcohol (a) Methyl alcohol and any admixture containing methyl alcohol measured at a temperature of 20°C (b) In addition, for every 1% by which the alcoholic strength by volume exceeds 30%	(\$ per hectolitre) 840 28.1

Source: C&ED records

**First registration tax rates on different classes of motor vehicles
(September 2015)**

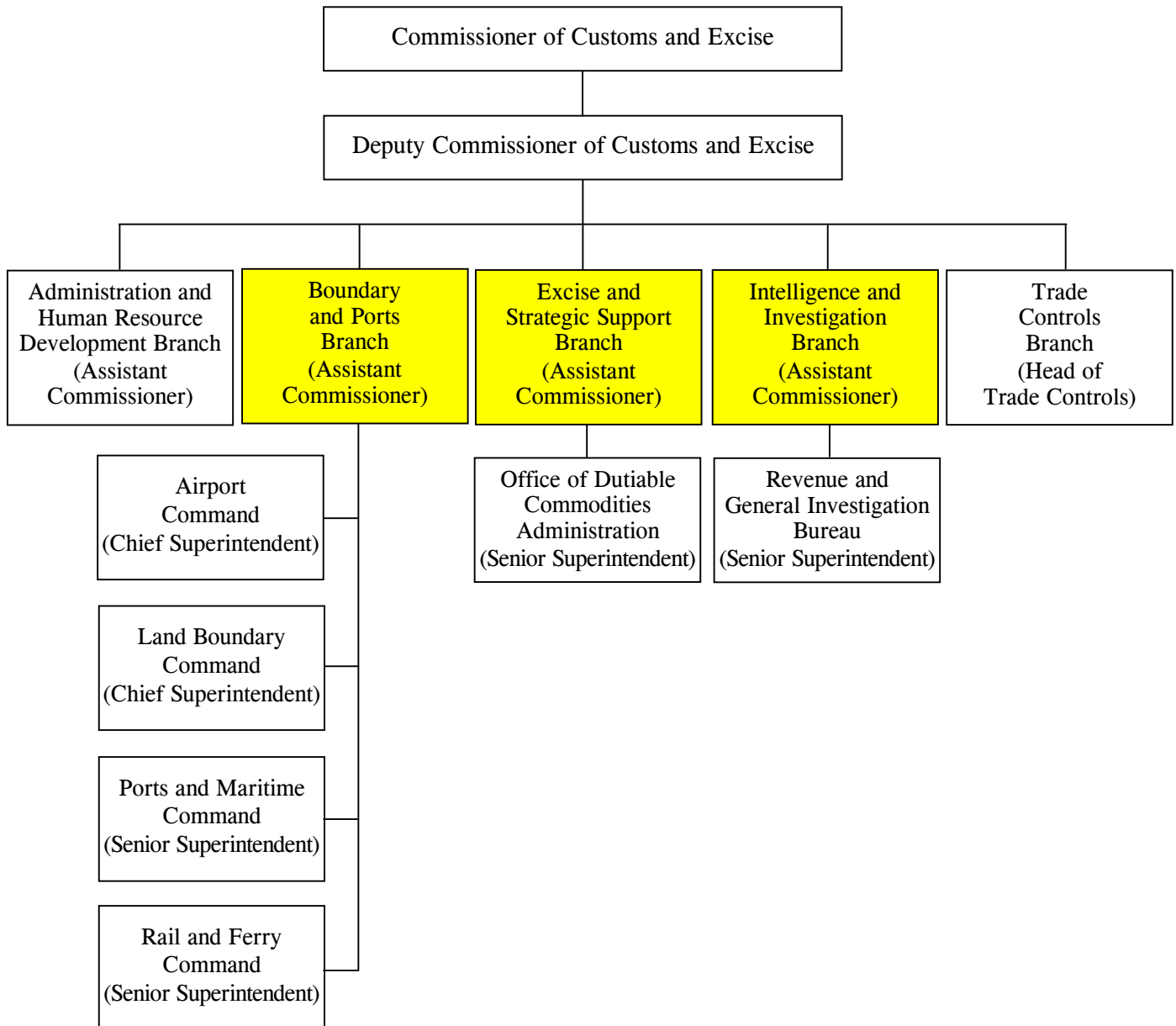
Class of motor vehicle	Tax rate on taxable value (Note)
Private car	
(a) on the first \$150,000	40%
(b) on the next \$150,000	75%
(c) on the next \$200,000	100%
(d) on the remainder	115%
Motor cycle and motor tricycle	35%
Goods vehicle	
(a) Goods vehicle, other than van-type light goods vehicle	15%
(b) Van-type light goods vehicle not exceeding 1.9 tonnes permitted gross vehicle weight:	
(i) on the first \$150,000	35%
(ii) on the next \$150,000	65%
(iii) on the remainder	85%
(c) Van-type light goods vehicle exceeding 1.9 tonnes permitted gross vehicle weight	17%
Taxi, light bus, bus and special purpose vehicle	3.7%

Source: C&ED records

Note: The taxable value of a vehicle is calculated on the basis of the PRP of the vehicle or the provisional taxable value assessed by the C&ED.

Remarks: According to the Motor Vehicles (First Registration Tax) Ordinance, motor vehicles propelled solely by electric power are exempted from FRT up to 31 March 2017 (or such later date as the Legislative Council may determine). There are also FRT concessions for other types of environment-friendly commercial vehicles (e.g. goods vehicles, taxis, light buses, buses) complying with the qualifying standard.

**Customs and Excise Department:
Organisation chart (extract)
(31 March 2015)**



Source: C&ED records

Red and Green Channel System for passengers' customs clearance at all entry points

Features of the Red and Green Channel System are as follows:

Red Channel



- (a) Passengers should proceed to this channel upon their arrival and make a declaration to the Customs officers if they have:
- any DCs not entitled to or exceeding their exempted quantities; and/or
 - any prohibited/controlled items.
- (b) These passengers are liable to:
- duty payment or confiscation of the DCs which are not entitled to or in excess of the exempted quantities; and/or
 - prosecution and confiscation of the prohibited/controlled items if they are unable to produce a valid licence or permit.

Green Channel



- (a) Passengers should enter this channel upon their arrival if they:
- do not have any DCs or prohibited/controlled items; or
 - have DCs in compliance with the exempted quantities.
- (b) These passengers are liable to:
- prosecution/penalty if they are found having undeclared/incompletely declared DCs; and
 - prosecution and confiscation of the prohibited/controlled items if they are found having any of them without a valid licence/permit.
- (c) These passengers are not exempted from any customs examination when using the Green Channel.

Source: C&ED records

Acronyms and abbreviations

Audit	Audit Commission
BPB	Boundary and Ports Branch
CAPS	Case Processing System
CCS	Customs Control System
C&ED	Customs and Excise Department
DCs	Dutiable commodities
e-DCP	Electronic Dutiable Commodities Permits
FRT	First registration tax
ICAC	Independent Commission Against Corruption
ITFS	Intermodal Trans-shipment Facilitation Scheme
m ²	Square metres
OBS	Open Bond System
ODCA	Office of Dutiable Commodities Administration
PRP	Published retail price
RGIB	Revenue and General Investigation Bureau
ROCARS	Road Cargo System
TD	Transport Department