

# **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 (m<sup>2</sup>) and a vehicle detention centre of 45,828 m<sup>2</sup> 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.