



*Report of
the Director of Audit*

Audit examination of the tax
returns or submissions made
or represented by J. Enterprise
Secretarial and Taxation Limited

July 1999

The Hong Kong Special Administrative Region



審計署署長
香港灣仔
告士打道七號
入境事務大樓
二十六樓

Director of Audit
26th Floor
Immigration Tower
7 Gloucester Road
Wanchai, Hong Kong

圖文傳真 Facsimile : 2583 9063

電話 Telephone : 2829 4200

本署檔號 Our Ref. :

來函檔號 Your Ref. :

4 August 1999

The Honourable TUNG Chee Hwa
The Chief Executive of the Hong Kong
Special Administrative Region
5th floor, Main Wing
Central Government Offices
Lower Albert Road
Hong Kong

Dear Mr Tung,

On 24 June 1999 you requested me, in accordance with section 8 of the Audit Ordinance (Cap. 122), to examine the tax returns or submissions made or represented by J. Enterprise Secretarial and Taxation Ltd. to see whether any of them has been dealt with personally by the Commissioner of Inland Revenue (Mr WONG Ho-sang) since 24 April 1996 and whether the relevant Ordinances and internal directions and instructions have been duly observed.

I have completed the examination and have pleasure in submitting my report.

Yours sincerely,

(Dominic Y T Chan)
Director of Audit

**Audit examination of the tax returns
or submissions made or represented by
J. Enterprise Secretarial and Taxation Limited**

**Audit Commission
Hong Kong
July 1999**

**AUDIT EXAMINATION OF THE TAX RETURNS
OR SUBMISSIONS MADE OR REPRESENTED BY
J. ENTERPRISE SECRETARIAL AND TAXATION LIMITED**

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INTRODUCTION

1. On 24 June 1999, the Civil Service Bureau (CSB) of the Government Secretariat, following recent media reports about Mr WONG Ho-sang, the Commissioner of Inland Revenue, and his investment, issued a press statement that, according to the available records:

- it did not appear that Mr Wong had declared his investment in J. Enterprise Agency Limited despite the requirement of CSB Circular No. 8/98; and
- it did not appear that Mr Wong had made any report to the Secretary for the Treasury, his supervisor, about any potential conflict of interest arising from J. Enterprise Secretarial and Taxation Limited (JEST), which was owned by his wife.

2. The CSB press statement also said that, up to 24 June 1999, the Administration had no reason to believe that any conflict of interest had in fact arisen, or that the due collection of public moneys had been put at risk. However, in order to reassure the public, on 24 June 1999, the Chief Executive requested the Director of Audit to examine the tax returns or submissions made or represented by JEST to see whether any of them had been dealt with personally by Mr WONG Ho-sang since 24 April 1996, and whether the relevant Ordinances and internal directions and instructions had been duly observed.

3. Mr WONG Ho-sang took leave with effect from 24 June 1999. Mrs SIN LAW Yuk-lin, Agnes, Deputy Commissioner of Inland Revenue, has been acting Commissioner of Inland Revenue since 24 June 1999.

ACKNOWLEDGEMENT

4. Audit would like to place on record its appreciation of the full support and cooperation from the Acting Commissioner of Inland Revenue and the staff of the Inland Revenue Department (IRD) during the audit examination. Furthermore, senior staff of the Department of Justice also gave Audit useful advice. The Official Languages Agency completed the Chinese translation of the Report at short notice. Their assistance enabled Audit to complete the examination and the Report within a very tight time schedule.

AUDIT METHODOLOGY

5. The audit examination was carried out mainly by reviewing relevant files of the IRD. Where necessary, Audit also interviewed the IRD officers concerned. In addition, supplementary checks were carried out to ensure the completeness of the cases covered. Audit urged the IRD to seek additional relevant information. An example of this was to ask the IRD to write to JEST requesting it to supply information on its tax clients. Audit also conducted a survey of IRD officers through a questionnaire. Details of the survey are contained in paragraphs 16 to 23 below.

6. In view of the public concern about the conflict of interest that may arise between IRD officers' official duties and their private interests, Audit also reviewed IRD's departmental guidelines and requirements on conflict of interest to see if there is room for improvement.

SUMMARY OF AUDIT FINDINGS

7. The audit examination has revealed that:

Part I — Audit examination of the tax returns or submissions made or represented by JEST

- (a) Mr WONG Ho-sang had, since 24 April 1996, personally dealt with seven tax cases in which JEST acted as the tax representative or tax consultant. Mr Wong initiated action on Case 1. Cases 2 to 7 were submitted to Mr Wong, in accordance with IRD's internal guidelines on division of responsibilities, and they were dealt with personally by him (see paragraphs 24 to 51 below);
- (b) in Case 1, the Assessor of Company B considered that the granting of depreciation allowances to Company A may not be in accordance with the Inland Revenue Ordinance (Cap. 112) or the relevant IRD Circular. Except for this case, Audit cannot find evidence in other cases which suggests that the relevant Ordinances have not been duly observed (see paragraphs 52 and 53 below);

- (c) apart from the possible under-charging of tax payable by Company A in Case 1 due to the granting of depreciation allowances to Company A, Audit cannot find evidence in other cases which suggests that the due collection of public moneys has been put at risk. The IRD is expected to resolve the issue of double claims for depreciation allowances by Company A and Company B in due course (see paragraph 53 below);
- (d) CSB Circular No. 19/92 states specifically that an officer should report to his superior officer any private interest that might influence, or appear to influence, his judgement in the performance of his duties. Mr WONG Ho-sang should have reported his wife's interest in JEST to the Secretary for the Treasury in order to comply with this specific reporting requirement. The Secretary for the Treasury, as required by the CSB Circular, would then have advised him how to proceed (see paragraphs 54 and 56 below);
- (e) the IRD's Departmental Circular Nos. 32/93 and 27/98 state that officers should avoid dealing with files where their spouses have been connected with the preparation of the returns in a professional or representative capacity. Audit considers that Mr WONG Ho-sang failed to comply with this specific requirement, as Mr Wong had personally dealt with some tax cases in which JEST acted as the tax representative or tax consultant (see paragraphs 55 and 56 below);
- (f) in accordance with the requirement of CSB Circular No. 8/98 and the IRD's Departmental Circular No. 27/98, Mr WONG Ho-sang should have reported his shareholding in J. Enterprise Agency Limited (see paragraph 57 below); and

Part II — Audit review of IRD's departmental guidelines and requirements on conflict of interest

- (g) there is room for improvement in the IRD's departmental guidelines and requirements on conflict of interest (see paragraphs 64 to 68 below).

PART I — AUDIT EXAMINATION OF THE TAX RETURNS OR SUBMISSIONS MADE OR REPRESENTED BY JEST

INTRODUCTION

The IRD and the assessment process

8. The IRD raises revenue through taxes, duties and fees in accordance with relevant legislation. As at 30 June 1999, the IRD had a strength of 3,337 officers. The Commissioner of Inland Revenue heads the Department. In the discharge of his functions and responsibilities, the Commissioner is assisted by two Deputy Commissioners and five Assistant Commissioners. The IRD is organised into six Units. The Deputy Commissioners and Assistant Commissioners either oversee or head the operations of the respective Units and perform duties with authority delegated by the Commissioner in accordance with the provisions of the relevant Ordinances.

9. The IRD operates under an Official Assessment System. All tax returns submitted by taxpayers are screened prior to assessment. As may be appropriate in the particular circumstances, returns may be examined in depth through the normal lane, adjusted through the fast or rapid lane or summarily accepted for assessment. For returns which are not considered satisfactory, they will not be accepted for assessment. Instead, queries will be raised and estimated assessment may be made if the queries are not fully answered. For cases with irregularities detected, they will be referred to the Investigation Unit or the Field Audit Group of the Headquarters' Unit for investigation.

10. Any person, whether a tax or accounting professional or not, may be authorised by a taxpayer in writing to act as his tax representative. A tax representative usually provides tax advice to his client, assists his client in preparing tax returns for submission to the IRD and answers, on behalf of his client, queries raised by the IRD. A person may also provide advice to his client on tax matters while not acting as his client's tax representative.

Mr WONG Ho-sang

11. In June 1968, Mr WONG Ho-sang joined the IRD as an Assistant Assessor. From 24 April 1996 to 23 April 1997, Mr Wong served as the Acting

Commissioner of Inland Revenue. On 24 April 1997, Mr Wong was promoted to Commissioner of Inland Revenue. Mr Wong's wife is Ms CHENG Lai-yung, Josephine.

JEST

12. JEST is a private limited company incorporated in Hong Kong on 1 February 1985 under the Companies Ordinance (Cap. 32). According to records in the Companies Registry, the shareholders of JEST were as follows:

Shareholders of JEST

Period	Shareholders
1 February 1985 to late February 1987	Mr WONG Ho-sang (1 share) Ms CHENG Lai-yung, Josephine (1 share)
Late February 1987 to 1 February 1999 (date of latest Annual Return)	Ms CHENG Lai-yung, Josephine (5,001 shares) An individual (1 share)

One of the business activities of JEST is to provide tax advice, including acting as the tax representative of its clients.

TAX RETURNS OR SUBMISSIONS MADE OR REPRESENTED BY JEST

Cases identified from IRD's records as represented by JEST

13. In this audit examination, Audit asked the IRD to search its records to identify cases with tax returns or submissions made or represented by JEST and processed by the IRD since 24 April 1996. On 30 June 1999, the Acting Commissioner of Inland Revenue handed to Audit a list of cases identified (IRD's list), according to the data for tax representatives as stored in the IRD's computer systems and/or manual records.

Client list supplied by JEST

14. The names of tax representatives are not critical data in the assessment process. Therefore, the maintenance of names of tax representatives in the IRD's computer systems and/or manual records is not subject to the same degree of control as for other critical data. To ensure the completeness of cases identified from the IRD's records as represented by JEST and to identify cases in which JEST had provided tax advice but did not act as a tax representative, Audit urged the IRD to request JEST to provide information on a voluntary basis. On 28 June 1999, the IRD sent a letter requesting JEST to supply a full list of tax clients handled by JEST since 24 April 1996, with a breakdown showing the following:

- clients for whom JEST acted as a tax representative; and
- clients for whom JEST had provided tax advice but did not act as a tax representative.

On 3 July 1999, JEST supplied the requested information and stated that this was to the best of its knowledge.

15. Audit compared the IRD's list with the client list supplied by JEST (JEST's list). Audit found that:

- some of the cases shown in JEST's list as represented by JEST were not included in the IRD's list; and
- some of the cases in the IRD's list were not included in JEST's list.

Audit merged the IRD's list with JEST's list to form a master list of cases for examination.

Audit survey

16. In addition to examining IRD's records and requesting JEST to provide its client list, Audit conducted a survey of all IRD officers of the rank of Assistant Taxation Officer or above through a questionnaire to ensure that all cases handled by JEST were identified for examination. The audit survey also served:

- to determine whether the IRD officers were aware that JEST was owned by the wife of Mr WONG Ho-sang before the case was reported in the media in mid-June 1999; and
- to provide a channel for the IRD officers to provide Audit with information they considered relevant to the audit examination.

17. Audit issued 2,016 questionnaires to all IRD officers in the Assessor Grade, Tax Inspector Grade and Taxation Officer Grade, except 27 officers who were on leave. A sample of the questionnaire is at Appendix I. All the 2,016 questionnaires issued were duly completed and returned to Audit. Paragraphs 18 to 23 below summarise the survey results.

18. **Question 1.** 2,011 officers stated that they were not aware that JEST was owned by the wife of Mr WONG Ho-sang before the case was reported in the media in mid-June 1999. Of the five officers who gave an affirmative answer, three of them stated in Question 2 that they recalled having handled a tax assessment case, since 24 April 1996, in which JEST acted as the tax representative. Audit examined these three tax assessment cases and noted that the three IRD officers concerned had completed processing of the cases before they became aware of the relationship between JEST and Mr Wong.

19. **Question 2.** 1,990 officers stated that they could not recall any tax assessment cases, handled by them since 24 April 1996, in which JEST acted as the tax representative. 26 officers gave an affirmative answer. All of the cases quoted by these officers have already been included in the IRD's list as mentioned in paragraph 13 above.

20. **Question 3.** 2,014 officers stated that they could not recall any tax assessment cases, handled by them since 24 April 1996, in which JEST had provided tax advice to the taxpayer but did not act as a tax representative. The two officers who gave an affirmative answer quoted the same case as reported in Case 7 in paragraphs 43 to 51 below.

21. **Question 4.** The IRD officers were requested to list, to the best of their knowledge and recollections, the names of JEST's tax clients, stated by them in response to Question 2 or 3, whose tax returns or submissions had been referred to Mr WONG Ho-sang for processing. 2,004 officers did not provide any names. 12 officers provided a total of six names, which were the same as those reported in Cases 2 to 7 in paragraphs 32 to 51 below.

22. **Question 5.** 2,014 officers stated that they were not aware of any tax assessment case which may give rise to actual or potential conflict of interest involving Mr WONG Ho-sang. One of the two officers who gave an affirmative answer quoted the four cases as reported in Cases 2 to 5 in paragraphs 32 to 38 below. The information given by the other officer could not be substantiated by documentary evidence.

23. **Question 6.** 1,990 officers did not have other comments. All the general comments given by the other 26 officers have been taken into account in the audit examination.

CASES DEALT WITH PERSONALLY BY MR WONG HO-SANG

24. The IRD has issued guidelines to its officers advising them how to avoid conflict of interest situations in handling tax cases, in particular:

- **IRD officers should avoid dealing with files where their spouses have been connected with the preparation of the returns in a professional or representative capacity (see paragraph 55 below); and**
- it is a direct conflict of interest for an IRD officer to be connected in any way with the issue of his/her own or his/her spouse's or close relatives' tax assessments (see paragraphs 59(a) and 60 below).

Audit has examined the profits tax assessment files of JEST and J. Enterprise Agency Limited (see paragraph 57 below). There is no evidence to indicate that these two profits tax assessment files have been dealt with personally by Mr WONG Ho-sang. For the cases included in Audit's master list mentioned in paragraph 15 above, Audit found that Mr Wong had personally dealt with seven cases.

CASE 1

Background

25. Case 1 involved Company A. JEST acted as the tax representative of Company A in Company A's 1997/98 profits tax return which covered the year ended 31 March 1998. In January 1998, a vehicle was leased by Company B to Company A. The Lease Agreement did not provide an option for Company A to purchase the vehicle. In Company A's audited financial statements, Company A treated the vehicle as a fixed asset acquired under a **finance lease agreement**. However, in Company A's 1997/98 profits tax return, Company A treated the vehicle as an asset acquired under a **hire purchase agreement** and claimed depreciation allowances in respect of the vehicle. Company B did not claim depreciation allowances in respect of the vehicle in its 1997/98 profits tax return because the return covered the year ended 31 December 1997, whereas the vehicle was acquired and leased to Company A in January 1998. However, Company B claimed depreciation allowances in respect of the vehicle in its 1998/99 profits tax return because it was the owner of the vehicle which was leased to a third party.

26. On 8 September 1998, the IRD received the 1997/98 profits tax return of Company A. On 9 September 1998, Mr WONG Ho-sang wrote, on his own initiative, a minute in a miscellaneous correspondence file to the Assistant Commissioner concerned. **Attached to the minute was a copy of the Agreement between Company A and Company B on the lease of the vehicle.** In the minute, Mr Wong said that:

- the attached Agreement was prima facie a hire purchase agreement;
- however, Company B had spelt out in the Agreement that it would retain all depreciation allowance benefits to itself. This would be contrary to IRD's practice of granting depreciation allowances to the purchaser under a hire purchase agreement; and

- the Assistant Commissioner should ask the case officer to look into the case of Company B (and other leasing companies as well) to see if double claims for depreciation allowances had been made (i.e. by both the lessor and the lessee) and, if necessary, ask the Chief Assessor (Field Audit) to help in the investigation.

27. The Assessors concerned later issued separate notices of assessment for 1997/98 to Company A and Company B. **In the notice of assessment to Company A, depreciation allowances were granted in respect of the vehicle.** In January 1999, the Assessor of Company B followed up the particular instructions given by Mr WONG Ho-sang and referred the tax representative of Company B to the Agreement between Company A and Company B on the lease of the vehicle. The Assessor sought further information about the lease transaction. **In response, in March 1999 the tax representative of Company B provided the Assessor with the requested information and a copy of the Lease Agreement between Company A and Company B.**

28. About two weeks after receiving the response from the tax representative of Company B, the Assessor of Company B referred the Assessor of Company A to the particular instructions given by Mr WONG Ho-sang. The Assessor of Company B stated that:

- his understanding of the definition of “hire purchase agreement” in the Inland Revenue Ordinance and the IRD’s Interpretation and Practice Circular No. 37A/1 was that hire purchase applied “only to contracts conferring an option to purchase”; and
- hence, he was of the view that it was defective for Company A to claim the depreciation allowances in question.

Furthermore, in mid-April 1999, the Assessor of Company B wrote to the tax representative of Company B, requesting Company B to remedy the situation with Company A on the issue of depreciation allowances claim in question and to forward a written agreement for the IRD’s perusal. The Assessor also stated that the IRD would otherwise withdraw the depreciation allowances from both Company A and Company B until an agreement was reached. The tax representative of Company B replied in mid-May 1999 and maintained that the provisions of the

Inland Revenue Ordinance did not allow Company A to claim the depreciation allowances and it was therefore Company A, instead of Company B, that should be questioned. Up to the date of this Audit Report, the issue has not yet been resolved.

Audit observations

29. Audit noted that a copy of the Lease Agreement between Company A and Company B was attached to the minute sent by Mr WONG Ho-sang to the Assistant Commissioner. Apparently, this minute originated from Mr Wong's office. **However, Audit could not ascertain from available records why Mr Wong initiated enquiry on this case and how Mr Wong had obtained a copy of the Lease Agreement in September 1998.** It is worthy of note that Company B only provided a copy of the Lease Agreement to the IRD in March 1999.

30. In Company A's audited financial statements, the vehicle was treated as a fixed asset acquired by Company A under a finance lease agreement. In Company A's profits tax return, for the purposes of claiming depreciation allowances, the vehicle was treated as an asset acquired under a hire purchase agreement. Mr WONG Ho-sang indicated that the Agreement was prima facie a hire purchase agreement. However, as the Agreement did not provide Company A with an option to purchase the vehicle, it seems that the relevant IRD Circular should apply and the Agreement is not a hire purchase agreement. Therefore, it is questionable whether Company A is eligible for claiming depreciation allowances in respect of the vehicle.

31. Audit noted that both Company A and Company B claimed depreciation allowances in respect of the vehicle leased by Company B to Company A. However, up to 24 June 1999, only Company B (the lessor) had been queried about its entitlement to the depreciation allowances, even though the Assessor of Company B was of the view that it was defective for Company A to claim the depreciation allowances. This may have been due to Mr WONG Ho-sang's instructions to the Assistant Commissioner, which specifically requested the case officer to look into the case of Company B.

CASES 2 TO 5

Background

32. Cases 2 to 5 involved the following four entities:

Case	Entity involved
2	Firm C
3	Firm D
4	Firm E
5	Company F

These four entities (hereinafter collectively referred to as the Group) were under the control of the same individual. Tax Agent G acted as the tax representative of the Group in the profits tax returns from 1994/95 to 1997/98.

33. In mid-October 1998, the IRD informed the Group and Tax Agent G that the IRD would conduct a field audit of the Group's 1997/98 profits tax returns. In late October 1998, Tax Agent H informed the IRD that the Group had appointed it as the tax representative, replacing Tax Agent G. In mid-November 1998, Tax Agent H told the IRD that all the books and records of the Group were in its custody. **In mid-December 1998, JEST informed the IRD that it had been appointed as the tax representative to replace Tax Agent H for handling the IRD's field audit.**

34. From mid-December 1998 to the completion of field audit in mid-March 1999, JEST assisted the Group to:

- provide the information and documents that the IRD requested;
- agree with the IRD the amount of understatement of profits and tax undercharged in each case; and
- propose the amount of compound penalty in full settlement of each case.

35. In late March 1999, the Assessor responsible for the field audit completed an audit completion report for each of the four cases. The Assessor submitted the reports with a covering minute through his supervisors (i.e. the responsible Senior Assessor, Chief Assessor and Deputy Commissioner) to Mr WONG Ho-sang. The reports set out in detail the Group's proposals for settlement and of compound penalties. In the covering minute, the Assessor stated that:

- JEST was the tax representative of the Group; and
- he recommended acceptance of the amount of compound penalties proposed by the Group.

The Assessor's supervisors supported his recommendation. **Mr Wong initialled and indicated that he agreed with the total amount of compound penalties.**

Audit observations

36. Section 80 of the Inland Revenue Ordinance provides for penalties for failure to make returns and making incorrect returns. The Commissioner of Inland Revenue may compound any offence under this section. According to IRD's internal guidelines on division of responsibilities, compound penalties are to be determined personally by the Commissioner for cases in which the tax undercharged exceeded a predetermined amount, and by other authorised IRD officers for cases which involved undercharged tax of smaller amounts.

37. The IRD's internal guidelines state that the following factors are taken into account in assessing the amount of compound penalty:

- the degree of disclosure and cooperation by the taxpayer;
- the nature of tax evasion; and
- the compound interest on the amount of undercharged tax.

The IRD has issued internal guidelines to help Assessors evaluate the degree of disclosure and cooperation by the taxpayer and the nature of tax evasion. However, the Commissioner or the authorised IRD officer has, to a certain extent, discretion in determining the amount of compound penalty for a particular case. It is, therefore, essential that the Commissioner or the authorised IRD officer does not have any private interest that would influence, or appear to influence, his judgement in determining the amount of compound penalty.

38. As far as Cases 2 to 5 are concerned, Audit noted that:

- (a) the four cases involved alleged offences under section 80 of the Inland Revenue Ordinance. In view of the amount of tax undercharged, the compound penalties had to be determined personally by the Commissioner according to IRD's internal guidelines on division of responsibilities;
- (b) JEST proposed the amount of compound penalties on behalf of the Group;
- (c) after consideration of all the circumstances of the case following the relevant internal guidelines, the Assessor accepted, and documented his reason for accepting, JEST's proposals. He then submitted the case to Mr WONG Ho-sang through his supervisors for approval;
- (d) the Assessor informed all his supervisors, including Mr WONG Ho-sang, that JEST was the tax representative of the Group;
- (e) the Senior Assessor, the Chief Assessor and the Deputy Commissioner all endorsed the Assessor's recommendation that JEST's proposals of compound penalties should be accepted; and
- (f) Mr WONG Ho-sang approved the proposals, as submitted.

CASE 6

Background

39. Case 6 involved Firm I. In December 1996, the IRD requested Firm I to submit information relating to the remuneration of its employees for investigation. In January 1997, Tax Agent J informed the IRD that it had been appointed by Firm I as the tax representative. In mid-February 1998, the Assistant Commissioner concerned reported the progress of the tax investigation to Mr WONG Ho-sang and indicated that a close examination of Firm I's books of account was warranted. In late February 1998, Mr Wong and the Assistant Commissioner met the representatives of Firm I and Tax Agent J, and agreed on the general approach to finalise the investigation of Firm I's employees. Firm I undertook to settle the back tax and the penalties on behalf of its employees. Firm I also agreed to the submission of books of accounts to the IRD for examination.

40. In mid-August 1998, after examining Firm I's books of account, the IRD requested Firm I and Tax Agent J to provide further information for the quantification of understatement of assessable profits. Firm I told the IRD that it might take months to retrieve all the requested information due to limited capacity of Firm I's computer system. It was agreed that Firm I would provide the IRD with part of the information in the meantime. Based on the information submitted, the IRD computed the respective understatements of Firm I and its employees. The IRD's computations were issued to Tax Agent J for comment. **In late September 1998, Firm I informed the IRD that it had appointed JEST as its tax consultant to assist Tax Agent J in handling the tax investigation.** In mid-October 1998, Firm I agreed to the basis of settlement for its employees. In early November 1998, JEST wrote a letter to the IRD to seek agreement on the amount of understatement of Firm I's assessable profits, and to propose the amount of compound penalties in full settlement of the investigation on both Firm I and its employees.

41. In mid-November 1998, the Acting Assessor responsible for the investigation submitted through her Senior Assessor a report to the Assistant Commissioner. The Acting Assessor considered that the compound penalties offered by the tax consultant were acceptable. The Senior Assessor supported the Acting Assessor's view. The Assistant Commissioner submitted the file containing the Acting Assessor's report to Mr WONG Ho-sang. Specifically, the Assistant Commissioner stated that he supported the total amount of compound penalties offered by the tax consultant in its letter dated early November 1998. **Mr Wong**

initialled and indicated that he agreed with the total amount of compound penalties.

Audit observations

42. Case 6 was a tax investigation case. Similar to Cases 2 to 5 above, Audit noted that:

- (a) the case involved alleged offences under section 80 of the Inland Revenue Ordinance. In view of the amount of tax undercharged, the compound penalties had to be determined personally by the Commissioner according to IRD's internal guidelines on division of responsibilities;
- (b) Firm I appointed JEST as a tax consultant for the specific purpose of handling the IRD's investigation;
- (c) JEST proposed the amount of compound penalties on behalf of Firm I;
- (d) after considering all the circumstances of the case following the relevant internal guidelines, the Acting Assessor accepted, together with the reasons, JEST's proposals. She then submitted the case to her supervisors for approval;
- (e) although the name of JEST was not mentioned in the Acting Assessor's report which was submitted to Mr WONG Ho-sang, there were a number of enclosures in the file containing the report which indicated that JEST was the tax consultant. In particular, the Assistant Commissioner drew Mr Wong's attention to the folio number of the offer letter from JEST dated early November 1998;
- (f) the Senior Assessor and the Assistant Commissioner both endorsed the Acting Assessor's recommendation that JEST's proposals of compound penalties should be accepted; and

- (g) Mr WONG Ho-sang approved the proposals, as submitted.

CASE 7

Background

43. Case 7 involved Company K. Company K had appointed JEST as its tax representative since May 1994. Individual L and Individual M were beneficial owners of Company K and Company N. Individual L served as a director of Company K while Individual M served as a director of both Company K and Company N. Individual L and Individual M also served as directors of a group of other companies (hereinafter referred to as Group O). Tax Agent P was the tax representative of Company N and Group O.

44. In the years of assessment 1991/92 to 1995/96, fees were paid by Group O to Company K and Company N. For Company K and Company N, the fees from Group O were assessed as their taxable income on which profits tax was payable.

45. In early December 1997, the Assistant Commissioner concerned said that he shared the Assessor's view that this looked like a disguised employment case in order to reduce tax liability. The Assessor requested Company K and Company N to provide information about the fees from Group O. In early January 1998, JEST submitted, on behalf of Company K, the requested information to the IRD. **On the same date, Company N also sent a letter, with the requested information, to the IRD. In late January 1998, JEST confirmed to the IRD that the letter dated early January 1998 sent to the IRD by Company N was prepared by JEST.** As the IRD indicated that an attachment to the letter was missing, JEST sent a copy of the particular attachment to the IRD by fax.

46. In mid-February 1998, pending further information and in order to protect revenue, the IRD issued salaries tax assessment for 1991/92 to Individual L and Individual M, and treated the fees received from Group O as salaries income on which salaries tax was payable. The IRD indicated that the assessable profits of Company K and Company N would be revised to exclude the fees when the salaries tax assessment had become final and conclusive. In late February 1998, Individual L and Individual M both raised objection to the salaries tax assessment.

47. In late July 1998, the IRD issued salaries tax assessments for 1992/93 to 1995/96 to Individual L and Individual M, treating the fees from Group O as salaries income. The IRD also indicated that the assessable profits of Company K and Company N would be revised to exclude the fees when the salaries tax assessments had become final and conclusive. In early August 1998, Individual L and Individual M both raised objection to the salaries tax assessments.

48. In early April 1999, having thoroughly reviewed all information and documents, the Assessor wrote a letter each to Individual L and Individual M proposing (on a without prejudice basis and subject to the Commissioner's approval) a basis of settlement of their objection. The Assessor's proposal, which was accepted by Individual L and Individual M, was that:

- the fees paid by Group O to Company N should be subject to profits tax in assessing the profits tax of Company N;
- the fees paid by Group O to Company K should be assessable to salaries tax in the names of Individual L and Individual M; and
- the personal expenses of Individual M charged in the accounts of Company N should be assessable to salaries tax in the name of Individual M.

49. In late May 1999, the Assessor sought the Senior Assessor's endorsement on the proposed basis of settlement. The Senior Assessor submitted the case with a covering minute to Mr WONG Ho-sang for approval. The Senior Assessor referred Mr Wong to the Assessor's submission and indicated that the proposed basis of settlement was reasonable and was therefore recommended. **Mr Wong initialled and indicated that he agreed with the proposed basis of settlement.**

Audit observations

50. Case 7 was an objection case concerning the tax liabilities of Company K, Company N, Individual L and Individual M. As the tax representative, JEST answered IRD's queries on behalf of Company K. However, although JEST was not the tax representative of Company N (which was represented by Tax Agent P), Audit noted that JEST had also assisted Company N in answering IRD's queries.

51. According to IRD's internal guidelines on division of responsibilities, where the Assessor recommends settlement of an objection by agreement with the taxpayer, approval of the Commissioner of Inland Revenue or the Deputy Commissioner may be required according to the complexity of the case. As far as the settlement of Case 7 is concerned, Audit noted that:

- after consideration of all the circumstances of the case, the Assessor proposed, together with her reasons, the basis of settlement. She then submitted the case to the Senior Assessor for endorsement;
- the Senior Assessor endorsed the Assessor's proposed basis of settlement. According to IRD's internal guidelines on division of responsibilities, the Senior Assessor submitted the case to Mr WONG Ho-sang with a covering minute;
- neither the Assessor nor the Senior Assessor specifically indicated in their submissions that JEST was involved in this case. However, there were a number of enclosures in the file which showed that JEST had been involved in this case; and
- Mr WONG Ho-sang approved the Assessor's proposal, as submitted.

RELEVANT ORDINANCES

52. As the Commissioner of Inland Revenue, Mr WONG Ho-sang is generally responsible for the administration of the Inland Revenue Ordinance, Estate Duty Ordinance (Cap. 111), Stamp Duty Ordinance (Cap. 117), Betting Duty Ordinance (Cap. 108), Tax Reserve Certificates Ordinance (Cap. 289), Business Registration Ordinance (Cap. 310) and Hotel Accommodation Tax Ordinance (Cap. 348), including the provision of technical advice to the Secretary for the Treasury on any policy issues concerning these Ordinances.

53. In Case 1, the Assessor of Company B considered that the granting of depreciation allowances to Company A may not be in accordance with the Inland Revenue Ordinance or the relevant IRD Circular (see paragraph 28 above). Except for this case, Audit cannot find evidence in other cases which suggests that the

relevant Ordinances have not been duly observed. Apart from the possible under-charging of tax payable by Company A in Case 1 due to the granting of depreciation allowances to Company A, Audit cannot find evidence in other cases which suggests that the due collection of public moneys has been put at risk. The IRD is expected to resolve the issue of double claims for depreciation allowances by Company A and Company B in due course.

RELEVANT INTERNAL DIRECTIONS AND INSTRUCTIONS

Background

54. Paragraph 3 of CSB Circular No. 19/92 of 4 December 1992 states that civil servants should at all times make a conscious effort to avoid or declare, as appropriate, any conflict of interest that may arise or has arisen. Failure to do so may render them liable to disciplinary action which may result in removal from the civil service. **Paragraph 6(d) of the Circular states specifically that an officer should report to his superior officer any private interest that might influence, or appear to influence, his judgement in the performance of his duties.** Paragraphs 16 and 17 of the Circular elaborate on this specific reporting requirement and state that:

- a conflict of interest may arise because a civil servant is asked to work in his official capacity in an area where he already has a private interest. In such cases, the officer should declare his private interest to his superior officer, who will then advise him how to proceed; and
- officers are reminded in particular that they should declare any investments held by themselves and by their close relations if they are asked to work in an area where a conflict of interest could arise between these investments and their official duties.

55. The IRD has issued Departmental Circulars to provide guidelines and specific requirements to help IRD officers avoid entering into a conflict of interest situation. Paragraph 1 of Departmental Circular No. 32/93 dated 16 July 1993 (Appendix II) stated specifically that **officers should avoid dealing with files where their spouses have been connected with the preparation of the returns in a professional or representative capacity.** Paragraph 13 of Departmental Circular No. 27/98 dated 17 December 1998 (Appendix III), which replaced Departmental

Circular No. 32/93, imposes the same specific requirement and states that failure to do so may render an IRD officer liable to disciplinary action.

Audit observations

56. **Audit noted that Mr WONG Ho-sang initiated action on Case 1. Cases 2 to 7 were submitted to Mr Wong, in accordance with IRD's internal guidelines on division of responsibilities, and they were dealt with personally by him. In all cases, Mr Wong had not reported his wife's interest in JEST to the Secretary for the Treasury. Mr Wong should have reported his wife's interest in JEST to the Secretary for the Treasury in order to comply with the specific reporting requirement of CSB Circular No. 19/92. The Secretary for the Treasury, as required by the CSB Circular, would then have advised him how to proceed and address the issue. Audit considers that Mr Wong failed to comply with the specific requirement of the IRD's Departmental Circular Nos. 32/93 and 27/98, as Mr Wong had personally dealt with some tax cases in which JEST acted as the tax representative or tax consultant.**

57. In respect of J. Enterprise Agency Limited, the CSB stated that, according to available records, it did not appear that Mr WONG Ho-sang had declared his investment in that company despite the requirement of CSB Circular No. 8/98 (see the first inset of paragraph 1 above). Audit conducted a search at the Companies Registry and found that:

- J. Enterprise Agency Limited was a private limited company incorporated in Hong Kong on 3 January 1986 under the Companies Ordinance;
- the shareholders of J. Enterprise Agency Limited were as follows:

Shareholders of J. Enterprise Agency Limited

Period	Shareholders
3 January 1986 to late March 1989	Ms CHENG Lai-yung, Josephine (1 share) Mr WONG Ho-sang (1 share)
Late March 1989 to 3 January 1999 (date of latest Annual Return)	Ms CHENG Lai-yung, Josephine (501 shares) Mr WONG Ho-sang (1 share)

- the registered office of J. Enterprise Agency Limited was the same as that of JEST.

In accordance with the requirement of CSB Circular No. 8/98 and the IRD's Departmental Circular No. 27/98 (see paragraph 59(d)(i) below), Mr Wong should have reported his shareholding in J. Enterprise Agency Limited.

PART II — AUDIT REVIEW OF IRD'S DEPARTMENTAL GUIDELINES AND REQUIREMENTS ON CONFLICT OF INTEREST

GUIDELINES AND REQUIREMENTS ON CONFLICT OF INTEREST

CSB Circulars

58. CSB's guidelines and requirements on conflict of interest are stipulated in the following two CSB Circulars:

- *CSB Circular No. 19/92 dated 4 December 1992.* This Circular sets out the common areas in which a conflict of interest may arise between the officer's official duties and his private interests. It also gives general guidance on how such conflicts can be avoided and the appropriate course of action to be taken when such a conflict, whether real or apparent, arises; and
- *CSB Circular No. 8/98 dated 18 September 1998.* This Circular announces revised guidelines for civil servants to declare private investments in and outside Hong Kong.

Both Circulars indicate that Heads of Department may consider, in the light of their operational needs, drawing up additional guidelines and requirements on conflict of interest.

IRD Circulars

59. IRD's current and additional departmental guidelines and requirements on conflict of interest are stipulated in Departmental Circular No. 27/98 dated 17 December 1998. The key provisions are as follows:

- (a) *Handling of one's own tax assessment.* It is a direct conflict of interest for an IRD officer to be connected in any way with the issue of his/her own or his/her spouse's tax assessments, whether salaries tax or otherwise. If an officer is called upon to deal with his/her own assessments, he/she must report to his/her supervisor for alternative arrangement. Normally another

officer will be assigned to handle the file, or the file may be passed on to the next most senior officer. **An IRD officer should also avoid dealing with files where his/her spouse has been connected with the preparation of the returns in a professional or representative capacity.** Failure to do so may render him/her liable to disciplinary action;

- (b) ***Advice and information.*** IRD officers should pay attention to the fact that a conflict of interest may arise if an officer is asked to assist or advise a relation, friend or person to whom he/she owes a favour in his/her dealing with the Government. For an officer to whom such a request is made, he/she should follow the guidelines set out in CSB Circular No. 19/92. In particular, where the advice or assistance cannot be given because it would give the recipient an unfair advantage over other people, the request should be refused. The officer may wish to explain that it is against the rules for him to provide the information, advice or assistance requested;
- (c) ***Private investments.*** All IRD officers should consider carefully, before acquiring any private investment or other interest, whether this could lead to a real or apparent conflict with their official duties;
- (d) ***Declaration and reporting of investments.*** In line with the requirements of CSB Circular No. 8/98, holders of Tier II posts in the IRD (Note 1) are required to declare/report the following biennially:
 - (i) their investments (Note 2) in and outside Hong Kong;
 - (ii) occupation of their spouses;

Note 1: *Tier II posts in the IRD include all directorate posts and a number of non-directorate posts which have high risk of exposure to potential conflict of interest situations.*

Note 2: *If interests in a private company are included, a brief indication of the following should be given:*

- (a) *the nature of its business;*
- (b) *whether the company has active business activities;*
- (c) *whether the officer has actively participated in the business(es) of the company; and*
- (d) *the officer's shareholding and names of other shareholders.*

- (iii) their company directorships; and
- (iv) any single investment transaction (see Note 2 above) equivalent to or exceeding \$200,000, or three months' salary, whichever is the less, within seven days of the transaction between the biennial declaration.

Other officers in the IRD are requested to exercise great care in making any investment and are required to report any possible conflict of interest. The onus for reporting such conflict of interest situations rests with individual officers; and

- (e) ***Company directorships.*** An IRD officer who is a company director must not take any part whatsoever in handling the tax affairs of the company.

60. Unit 2 of the IRD handles salaries tax, property tax, profits tax for sole proprietorship businesses and personal assessment. On 23 February 1995, the Assistant Commissioner of Unit 2 (who was Mr WONG Ho-sang) issued Unit 2 Circular No. 26/95 (Appendix IV) to all officers in Unit 2. The Circular states that:

- officers in Unit 2 should refrain from handling files of one's own self or one's close relatives; and
- on encounter with such a file (including businesses owned by one's family interests), an officer should submit the case to his supervisor who would either take over the case for processing or assign another officer to handle it.

61. Audit noted that, in April 1995, the IRD proposed to require all officers in the rank of Assessor or above to declare if they have a spouse, parent or child, who is a shareholder, sole proprietor, partner or employee of a firm of tax representatives, accountants or solicitors. The aim of the proposed declaration requirement was to draw management's attention to possible conflict of interest, as tax officials have extensive day to day contact with members of the tax, accounting and legal profession. To avoid accusations that the IRD was forcing officers to disclose personal and private matters, the IRD did not propose to take disciplinary

proceedings against officers who failed to observe the proposed declaration requirement. On 27 April 1995, the IRD requested the Department of Justice to provide advice as to whether the proposed declaration requirement would be seen as breaching or impinging upon the privacy of individuals.

62. On 24 July 1995, the Department of Justice responded and asked how the proposed declaration requirement could achieve the purpose of avoiding conflict of interest situations if there was no consequence even if the officers failed to disclose the required information. The Department of Justice also asked how the administrator would use the disclosed information to avoid conflict of interest. As an alternative, the Department of Justice asked whether it was feasible to set out clear guidelines that in the event of a possible conflict of interest arising, officers were under a duty to disclose it to their supervisors, otherwise, disciplinary action would follow. The Department of Justice stated that the benefits of this alternative method were to minimise the interference to the privacy of the officers and to lessen the workload of the administrator.

63. Having considered the advice of the Department of Justice, the IRD decided to drop the proposed declaration requirement. However, on 30 November 1998, the issue was further reviewed by the IRD's senior directorate at an in-house Operations Review and Monitoring Committee meeting chaired by the Deputy Commissioner of Inland Revenue (Operations). The meeting noted the Department of Justice's advice of 24 July 1995 and agreed that comprehensive departmental instructions on avoidance of conflict of interest would suffice. The view of the Committee, together with the draft circular (i.e. Departmental Circular No. 27/98 — see paragraph 59 above), was endorsed by the Commissioner of Inland Revenue on 11 December 1998.

Audit observations

64. Paragraph 13 of CSB Circular No. 8/98 states that Heads of Department may consider, in the light of their operational needs, drawing up additional investment guidelines, including requiring staff to avoid or declare certain specified investment activities because of apparent conflict of interest. The declaration of company directorships is an additional declaration requirement of the IRD imposed on its Tier II officers (see paragraph 59(d)(iii) above). Audit noted that, in the light of their operational needs, additional declaration requirements had also been imposed on the staff of 22 bureaux and other departments. Examples are as follows:

- ***Lands Department.*** Additional requirements to declare investment transactions in property shares in Hong Kong are imposed on all staff;
- ***Transport Department.*** Additional requirements to declare direct investment in transport businesses and details of relatives working in the transportation business are imposed on all staff; and
- ***Trade Department.*** Additional requirements to declare investment within and outside Hong Kong relating to textiles and clothing and rice and strategic commodities are imposed on holders of Tier II posts, Trade Officer grade posts and certain other designated posts.

65. While Audit appreciates the concerns of the Department of Justice about the declaration requirement proposed by the IRD in April 1995, Audit considers that the alternative method adopted by the IRD of drawing up guidelines, in lieu of requiring specific declaration, is not entirely satisfactory. There is a need to introduce a system of compulsory declaration to provide IRD management with the required information to ensure that IRD officers comply with the departmental instructions on the avoidance of conflict of interest.

66. For Tier II officers in the IRD, same as the requirement of CSB Circular No. 8/98, they are required to declare the occupation of their spouses (see paragraph 59(d)(ii) above). Audit considers that this declaration requirement does not meet the operational needs of the IRD as it is the nature of a business, rather than the title of a post, which would indicate whether a conflict of interest could arise. In Audit's view, there are potential conflicts of interest if the spouse of an IRD officer works in a taxation-related business. This has been recognised by the IRD, as reflected in the departmental requirement that an IRD officer should avoid dealing with files where his/her spouse has been connected with the preparation of the returns in a professional or representative capacity (see paragraph 59(a) above).

67. **Audit considers that, in addition to the requirement to declare the occupation of their spouses, information relating to whether and how the spouse of an officer is connected with the preparation of tax returns in a professional or representative capacity should also be declared. As tax assessments are directly handled by Assessor Grade officers, the additional declaration requirement should be imposed not only on Tier II officers but on all officers in**

the Assessor Grade. The IRD should also regularly review the declaration requirements to see if additional or revised declaration requirements should be imposed because of operational needs.

68. Audit noted that there was inconsistency between Departmental Circular No. 27/98 and Unit 2 Circular No. 26/95. Departmental Circular No. 27/98 states that it is a direct conflict of interest for an IRD officer to be connected in any way with the issue of **his/her own or his/her spouse's** tax assessments. Unit 2 Circular No. 26/95 states that officers in Unit 2 should refrain from handling files of **one's own self or one's close relatives**. **Audit considers that guidelines on conflict of interest should be consistent at both departmental and unit levels.**

Audit recommendations

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

- consider imposing additional declaration requirements on all officers in the Assessor Grade. These requirements should include the provision of information relating to whether and how the spouse of an officer is connected with the preparation of tax returns in a professional or representative capacity;**
- regularly review the departmental guidelines and requirements on conflict of interest; and**
- ensure that consistent guidelines and requirements on conflict of interest are set at both departmental and unit levels.**

**PART III — RESPONSE FROM MR WONG HO-SANG
AND THE ACTING COMMISSIONER
OF INLAND REVENUE**

RESPONSE FROM MR WONG HO-SANG

70. On 21 July 1999, Audit provided Mr WONG Ho-sang with a draft of the Audit Report for his comments. On 23 July 1999, Mr Wong sent a letter to Audit giving his comments. At Mr Wong's request, the letter is incorporated as Appendix V to the Audit Report.

**RESPONSE FROM THE ACTING
COMMISSIONER OF INLAND REVENUE**

71. The **Acting Commissioner of Inland Revenue** has said that:

*Part I — Audit examination of the tax returns or submissions made or
represented by JEST*

- (a) after perusal of the files in Cases 1 to 7, the IRD confirmed that these cases had been processed by the case officers concerned in accordance with laid down departmental procedures, practices and guidelines. These cases were handled in a normal and usual manner both with regard to the courses of action taken on the taxpayers and the recommendations made in the case officers' submissions;
- (b) for Case 1, there was a frequent transfer of officers handling Company A's case during the period April to May 1999. Therefore, the case was not under close scrutiny during this period. Furthermore, the question of depreciation allowances on leased assets is a complicated issue and a review of the existing practice would appear necessary;

Part II — Audit review of IRD's departmental guidelines and requirements on conflict of interest

Imposition of additional declaration requirements

- (c) the IRD has recently reviewed its declaration of investments procedures and monitoring arrangements and has come up with a host of improvement measures. Specifically, the Department plans to request all professional officers who are not in the Tier II posts but with spouses in the taxation-related businesses outside the IRD to provide **detailed** information of the occupations of their spouses. The information sought includes the name of the company of the spouse of the officer concerned, the address and the nature of business of the company, the position held by the officer's spouse in the company and the description of duties in the company. This declaration requirement will be imposed on officers in the rank of Assistant Assessor or above. To facilitate monitoring, such declaration will also be drawn to the attention of the supervisor(s) of the officers concerned. However, in view of previous legal advice on this matter, the Department has recently written to the relevant authorities to seek policy and legal clearance prior to the imposition of this additional declaration requirement on its professional officers;
- (d) the following improvement measures have also been introduced by the departmental management recently:
 - (i) ***Interviewing of all Tier II officers.*** She has started "monitoring interview" with Tier II officers in the Department to go through their declarations. One of the purposes of the interview is to afford her the chance to seek further information on the occupations of spouses of those officers who are working in the taxation-related businesses and to remind them of the need to avoid handling files with returns prepared by their spouses in any manner. Points covered during the interviews have been properly recorded and documented;
 - (ii) ***Involving the supervising officers in the monitoring process.*** Since mid-July 1999, declarations made by Tier II officers with spouses working in the taxation-related businesses have been passed to their

immediate supervisors for information so as to engage the latter in the enforcement and monitoring process. In the event of a change of supervisor(s) of such officers, the new supervisor(s) will also be made aware of the information immediately; and

- (iii) ***Designation of additional Tier II posts.*** The IRD has also critically reviewed its current list of Tier II officers and, as a result, a number of posts which are exposed to some risk of potential conflict of interest situation have been designated as Tier II for investment declaration purpose;

Review of guidelines and requirements on conflict of interest

- (e) the IRD is mindful of the need to constantly update and review procedures and measures to avoid any potential conflict of interest. On 24 February 1998, an in-house Operations Review and Monitoring Committee was set up to “review and monitor” the procedures and departmental guidelines to enhance the probity of dealings within the Department. The Committee is chaired by the Deputy Commissioner of Inland Revenue (Operations) and attended by other members of the senior directorate of the Department. As far as the review of the declaration requirements and guidelines on conflict of interest is concerned, the Committee will conduct review biennially to tie in with the biennial declaration requirement of Tier II officers. At its second meeting on 30 November 1998, the Committee considered the declaration requirements then in force and, following the review, issued a new Departmental Circular (No. 27/98) on the subject. Other than the biennial review, the Committee will also review the matter at shorter intervals if there are operational needs;
- (f) at the unit level, sub-committees of the Committee have also been set up to review the practices and procedures in various areas of the respective Unit’s operations and to take remedial action so as to strengthen internal controls. The sub-committees submit reports to the Committee for scrutiny on a half-yearly basis;

Consistency of guidelines and requirements at departmental and unit levels

- (g) the IRD does not consider that there is inconsistency between Departmental Circular No. 27/98 and Unit 2 Circular No. 26/95. Departmental Circular No. 27/98 prohibits an officer from dealing with his own and his spouse's tax assessments. This applies to officers in all Units in the Department. Unit 2 Circular No. 26/95 prohibits officers serving in the Unit from dealing with files of one's own self and one's close relatives. Naturally "close relatives" would include one's spouse. Unit 2's control over the conflict of interest as stipulated in Unit 2 Circular No. 26/95 is more stringent than, but not contradictory to, that set out in the Departmental Circular; and
- (h) however, in view of Audit's comment, the IRD agrees that the Operations Review and Monitoring Committee will further review the matter with the sub-committee at Unit 2 to see if the Unit Circular in question should be refined. Moreover, the Committee and its sub-committees at the unit level will continue to work closely at their regular forum to ensure consistency in their directives to staff.

Serial No. _____

**Audit Commission Survey Questionnaire
on the audit examination under the Audit Ordinance**

1. Were you aware that J. Enterprise Secretarial and Taxation Ltd. (JEST) was owned by the wife of the Commissioner of Inland Revenue, Mr WONG Ho-sang, before the case was reported in the media in mid-June 1999?

Yes ☐ No ☐ (please tick)

If yes,

(i) when were you aware of the above relationship?
_____ (please specify month and year to the best of your knowledge and recollection)

(ii) how did you become aware of the relationship?

2. Can you recall any tax assessment cases, handled by you since 24 April 1996, in which JEST acted as a tax representative?

Yes ☐ No ☐ (please tick)

If yes, please list below, to the best of your knowledge and recollection, the names of the JEST's tax clients concerned.

3. Can you recall any tax assessment cases, handled by you since 24 April 1996, in which JEST had provided tax advice to the taxpayer but did not act as a tax representative?

Yes ☐ No ☐ (please tick)

If yes, please list below, to the best of your knowledge and recollection, the names of the JEST's tax clients concerned.

4. Please list below, to the best of your knowledge and recollection, the names of JEST's tax clients, shown in Items 2 and 3 above, whose tax returns or submissions had been referred to the Commissioner of Inland Revenue, Mr WONG Ho-sang, for processing.

5. Are you aware of any tax assessment cases which may give rise to actual or potential conflict of interest involving the Commissioner of Inland Revenue, Mr WONG Ho-sang?

Yes ☐ No ☐ (please tick)

If yes, please provide details to the best of your knowledge and recollection.

6. Please provide any other comments you consider relevant to this survey.

Please return the completed Questionnaire as soon as possible but not later than three working days directly to the Audit Commission's branch office, 4/F Revenue Tower, 5 Gloucester Road, Wan Chai.

Signature: _____

Post: _____

Name: _____

Date: _____

HO 334/74

TO : ALL STAFF

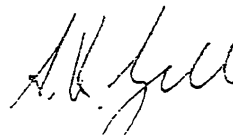
DEPARTMENTAL CIRCULAR NO. 32/93

Conflict of Interest

I wish to remind officers of the standing instruction that they should not be connected in any way with the issue of their own or their spouse's tax assessments, whether salaries tax or other taxes. The file should be passed on to the next most senior officer. Officers should also avoid dealing with files where their spouse has been connected with the preparation of the returns in a professional or representative capacity.

2. It is not feasible to issue a comprehensive instruction covering all situations, but officers should be guided by common sense and avoid placing themselves in positions which could give rise to any real or apparent conflict of interest.

3. This circular supersedes Departmental Circular No. 2/84.



(A. K. Gill)

Deputy Commissioner of Inland Revenue
16 July 1993

To : All Staff

INLAND REVENUE DEPARTMENTAL CIRCULAR NO. 27/98

Conflict of Interest

Introduction

Given the widespread concern of members of the public about the conflict of interest that may arise between an officer's official duties and his private interests, it is important that all staff members of IRD are fully aware of their general responsibility laid upon them to take every reasonable step to avoid such conflict of interest, apparent or real.

2. Departmental circulars have been issued by the management to provide guidelines and impose specific requirements to help colleagues avoid entering into a conflict of interest situation. Some Units have also issued supplementary directives to protect staff in this aspect. This circular up-dates the relevant guidelines and requirements in the light of new guidelines issued recently by the Civil Service Bureau.

Conflict of Interest and Private Investments

3. Civil Service Regulations 461 to 466 impose requirements on civil servants to avoid making private investments which may lead to a real or apparent conflict of interest with their official duties. As a general rule, an officer must observe the following principles while making any private investments : -

- (a) an officer must take due care to avoid taking investment risks beyond his/her financial means;
- (b) an officer is required to uphold the honesty and impartiality of the civil service and to observe an exemplary standard of personal integrity in making private investments;
- (c) an officer must not use confidential or unpublished information obtained in his/her official capacity to profit financially. It will be deemed a conflict of interest between an officer's official duties and his/her investments if he/she could profit financially as a result of the information obtained in his/her official capacity; and

- (d) an officer must not disclose to anyone who does not have an official need to know such information from which he/she and other can profit financially.

4. All officers in IRD are therefore remind that they should consider carefully, before acquiring any private investment or other interest, whether this could lead to a real or apparent conflict with their official duties. The word "investment" means any investment, shareholding or direct or indirect interest in land and buildings (including self-occupied property) in Hong Kong and / or in places outside Hong Kong.

Declaration and Reporting of Investments by IRD staff

(a) Tier II officers

5. In accordance with guidelines issued recently by the Civil Service Bureau, the Commissioner of Inland Revenue, as head of the Department, has designated a number of posts in IRD as "Tier II posts", holders of which are required to declare/report the following biennially : -

- (a) their investments in and outside Hong Kong;
- (b) occupation of their spouses;
- (c) their company directorships; and
- (d) any single investment transaction equivalent to or exceeding HK\$200,000, or three months' salary, whichever is the less, within seven days of the transaction between the biennial declaration.

6. The above declaration requirements apply to all officers filling Tier II posts on a substantive basis as well as to those filling the posts on an acting basis for 30 days or more. Tier II posts in the Department basically include all directorate posts, plus a number of non-directorate posts which have high risk of exposure to potential conflict of interest situations. Tier II officers are informed in writing individually by the Management of their declaration requirements.

(b) Other officers

7. All other officers in IRD, while not subject to the same "declaration of investments" requirement as their "Tier - II" colleagues, are requested to exercise great care in making any investment. They are required to report any possible conflict of interest to the Commissioner. If in doubt, they should consult their supervisors and the departmental management on whether a private investment constitutes a conflict of interest. The onus for reporting such conflict of interest situations rests with individual officers.

Company Directorships

8. As a rule, any member of staff (Tier II or otherwise) who is a company director must not take any part whatsoever in handling the tax affairs of the company. In this connection, your attention is drawn to IRD Circular No. 45/95 on "Outside Work" which stipulates that "Completion of a tax return, preparation of accounts for submission to the Department, or rendering assistance in these matters outside normal officer hours, whether or not payment is involved, is considered to be in direct conflict with the principles governing outside work".

Conflict of interest arising from requests for advice and information

10. Your attention are also drawn to the fact that a conflict of interest may arise if an officer is asked to assist or advise a relation, friend, or person to whom he/she owes a favour in his/her dealing with the government. For example, a conflict of interest will arise if you are asked to help in making a tax return.

11. The management appreciates that it is very difficult to refuse such request without giving offence, especially when the person making the request is a close relation or an esteemed friend or acquaintance. For an officer to whom such a request is made, he/she should follow the guidelines set out in CSB Circular No. 19/92 and proceed as follows :-

- (a) Where the advice or assistance cannot be given because it would give the recipient an unfair advantage over other people, the request should be refused. The officer may wish to explain that it is against the rules for him to provide the information, advice or assistance requested.
- (b) Where the advice or assistance can be given legitimately, the person seeking the advice should be asked to contact the subject officer in the normal way.
- (c) Where the request is legitimate and the civil servant approached is himself the subject officers, then the advice or assistance sought may be given, but a note must be made on the relevant file that this has been done and of the relationship between the officer and the person concerned.

Handling of one's own tax assessment

12. It is a direct conflict of interest for an IRD officer to be connected in any way with the issue of his / her own or his / her spouse's tax assessments, whether salaries tax or otherwise. If an officer is called upon to deal with his / her own assessments, he / she must report to his / her supervisor for alternative arrangement. Normally another officer will be assigned to handle the file, or the file may be passed on to the next most senior officer.

13. An IRD officer should also avoid dealing with files where his / her spouse has been connected with the preparation of the returns in a professional or representative capacity. Failure to do so may render him/her liable to disciplinary action.

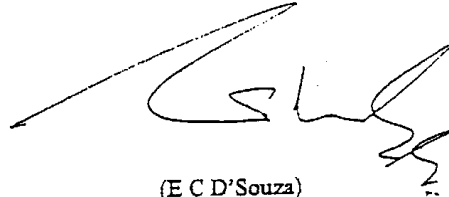
Enquiries

14. This circular attempts to set out some common areas in which a conflict of interest may arise. Nevertheless, it is not feasible to cover all conflict of interest situations in one circular. Officers should be guided by common sense and also take note of relevant Civil Service Bureau circulars on relevant topics which are circulated from time to time.

15. Units/sections may also issue additional directives or instructions in the light of their own special operational needs. Officers with enquiries in relation to this circular and / or on the subject of conflict of interest in general should seek the advice of their superior officers or the Departmental Secretary.

Re-circulation

16. This circular supersedes Departmental Circular No. 32/93. It should be re-circulated to all staff members on a half-yearly basis.



(E C D'Souza)
for Commissioner of Inland Revenue
17 December 1998

AC2/STF/31
HQ 224/17/02

To: All Officers, Unit 2

Unit 2 Circular No. 26/95

Conflict of Interest

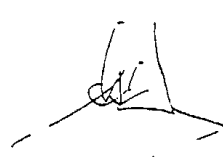
This Unit handles the largest number of tax files, and has the largest establishment amongst all the divisions of the Department. Since last April, this Unit has, in addition to Salaries Tax, also handled Property Tax, Profits Tax for Sole Proprietorship Businesses and Personal Assessment.

2. This is to remind officers to beware of Conflict of Interest. Always distant oneself from cases which a conflict of interest is likely to arise. CSB Circular No. 19/92 paragraph 4 thus reads:

"A conflict of interest is likely to arise when an officer's loyalty to the Government conflicts with his loyalty to:

- (a) his family and other relations;
- (b) his personal friends;
- (c) the clubs and societies to which he belongs;
- (d) his professional colleagues in the private sector; or
- (e) any person to whom he owes a favour or is obligated in any way."

3. In particular, one should refrain from handling files of one's own self or one's close relatives. On encounter with such a file (including businesses owned by one's family interests), an officer should submit the case to his supervisor who either would take over the case for processing or would assign another officer to handle it.



(WONG Ho-sang)
Assistant Commissioner (1), Unit 2
23 February 1995

69A Blue Pool Road, 5/F.
Happy Valley
HONG KONG
23 July 1999

Mr. Dominic Y.T. Chan
Director of Audit
26/F., Immigration Tower
HONG KONG

Your Ref.: (45) in CI/IRD/JES/O

Dear Dominic,

Thank you for your letter of 21 July 1999 and for showing me the draft report.

2. I hereby give you my comments as follows:

(a) First of all, I wish to make two general points:

- (i) Judging from the trilateral matching of lists of cases handled by J. Enterprise Secretarial and Taxation Limited (JEST), it should by now be clear that the number of taxation clients is very small. This is so notwithstanding the fact that the professional practice of JEST has been in existence for over 15 years.
- (ii) It should be borne in mind that Inland Revenue Department (IRD) is an operational department handling millions of taxpayers, with statutory duties vested on Commissioner of Inland Revenue (CIR) personally, such as imposition of penalty and determination of objection cases. Daily a large number of cases pass through the desk of CIR. It is not readily discernible which professional firm represents a taxpayer.

(b) Next, I shall deal with the specific cases referred to in your Report:

(i) Case 1

The document is entitled Proposed Sales Agreement. It bears all the hallmarks of a Finance Lease rather than an Operating Lease. You will find those particulars clearly spelt out on the first page:

“Hire Purchase Amount	\$500,000
Interest Rate	5.75% “

The last paragraph of the lease terms gives the lessee the right to sell the goods as agent for the lessor and thereupon receive a rebate of rentals equal to 99% of the net sale proceeds.

The whole purpose of my giving instruction to the Assistant Commissioner (Profits Tax) was, **for the protection of revenue**, by alerting him of a possible Double Claim of depreciation allowance, once by the customer (as in the case of Company A here) and once by the Financier (as in the case of Company B here). As Company B is the Finance Company, assessing officers have to approach it to find out the list of customers, so as to identify any other possible double claims. Furthermore, the Profits Tax Unit was asked to watch out for other leasing companies with similar terms used in their documents. See Paragraph 26.

Had I not given the instruction, there is every possibility that the small print on the lease agreement will escape the attention of assessing officers, resulting in granting Depreciation Allowances to both the Lessor and the Lessee. In that event, there will be a loss of revenue.

As the issue is highly technical and involves a correct legal interpretation of the lease arrangement, I think it is premature at this stage to say that the relevant Inland Revenue Circular or Ordinances have not been observed – see Paragraph 7 (b), Paragraph 30 and Paragraph 53.

(ii) Case 2 to 5 (a composite case of 4 files)

Case 6

Both cases have been subject to substantial penalty, without any sign of reduction or waiver.

According to internal Standing Instructions governing Delegation of Authority, such "penalty" cases (with Back Duty exceeding certain amount) have to come before CIR for deciding on the quantum of penalty. Prior to this stage, such cases have already been settled, in the sense that the discrepancies have been ascertained and Back Duty assessments issued or to be issued, as approved by the Deputy Commissioner or Assistant Commissioner. Thus in the above Composite Case of 4 files, the Deputy Commissioner wrote on 31.3.99, "Settlement approved...Penalty (tabulated below) supported." And in Case 6, the Assistant Commissioner wrote on 20.11.98, "Settlement .. approved. Recommended to accept Compound Penalty in the total of \$__."

Invariably, the "penalty" is calculated in accordance with Internal Guidelines (as laid down in the Assessor's Manual) and recommended by the various levels of officers (at least 3 levels) through whom the case is routed.

In each of the present cases, the penalty recommended by all the officers concerned was endorsed by CIR. There was no reduction from the quantum recommended. There was no waiver of penalty. There is no loss of revenue.

If ever in doubt, a case like this is always subject to review by an internal committee, the ORAMCO, to check the adequacy of the penalty.

(iii) Case 7

It is true JEST did handle some correspondence for the taxpayers at the early stage. There is however no evidence that JEST has since continued to act for the taxpayers. Or else the Appeals Officer should have written the Letter of Proposed Settlement dated 7.4.99 to JEST instead of the taxpayers direct. It is noted that the Appeals Officer did not even copy the letter to JEST.

In any event, the proposed settlement was made in line with the standing policy of tackling tax avoidance through the Service Company. As the Senior Assessor (Appeals) wrote on 27.5.99, "As no tax has to be conceded in accepting the arrangement, the settlement is therefore recommended." In other words, the case was drawn to a close without any loss of revenue. It was settled entirely in favour of the Revenue.

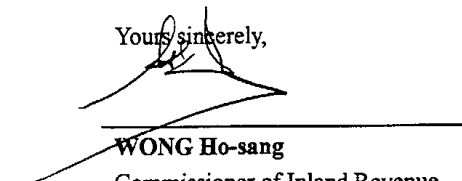
- (c) Last but not least, I should also deal with the Paragraphs 56 and 57

Full disclosure of my wife's professional practice as involving taxation was made to the then Deputy Financial Secretary. I have always recalled it was around 1990. But as admitted by SCS to the press, it was made in 1988. In addition, such disclosure was again made in the Extended Checking Questionnaire in early 1996 when I assumed the CIR post.

As to J. Enterprise Agency Limited, I was granted the one Subscriber Share of \$10 as early as in November 1985. It has since been forgotten by me. To report this investment today, I would still put down as "one Subscriber Share of HK\$10". (Even if you value the net asset value of the Company, the HK\$10 Subscriber Share represents at most \$1,341 – see Appendix). It is insignificant as one share out of 502 shares issued gives rise to the negligible interests of 0.0019 i.e. 0.19% only. Furthermore, this Subscriber Share is in J. Enterprise Agency Limited which is a pure property holding company. It is **not** a share in JEST which is the professional practice.

3. In conclusion, with all the statutory duties to be discharged by CIR, it is essential to note that the assessment (or determination) actions involved here are not initiated by CIR and that CIR has not abused his power by :-
- waiving or reducing penalty which should not be waived or reduced;
 - allowing taxable cases to be reduced or exempted where reduction or exemption is not due;
- in the rare cases represented by JEST which pass through CIR's desk. Justice and righteousness have prevailed throughout all the cases identified.
4. In view of the wide range of points covered above, I wonder if you could incorporate this letter as the last appendix to your report for the sake of completion.

Yours sincerely,



WONG Ho-sang

Commissioner of Inland Revenue

Appendix

Valuation of Company Shares of J. Enterprise Agency Limited based on the Audited Accounts as at 31 March 1998

Assets	HK\$	HK\$
Fixed assets – Properties (Note 1)	18,105,320.50	
Shares Investment	7,758.72	
Current assets	56,174.10	18,169,253.32
<u>Liabilities</u>		
Current Liabilities	10,022,232.72	
Long Term Liabilities	7,473,427.37	17,495,660.09
<u>Represented by Shareholders' Equity:</u>		
Share Capital	5,020.00	
Retained Profit	668,573.23	673,593.23

Note 1 : Market value of landed properties as at to-date should be lower than that on 31.3.1998.

Valuation of Market Value of ONE (1) share of J. Enterprise Agency Limited

Total no. of shares = 502 @ HK\$10 each

The most optimistic market value of ONE (1) share = HK\$ 673,593.23 x 1/502
= HK\$1,341