



# Combating Tax Fraud



**Yam-yuen Chu**  
**Commissioner**

**Hong Kong Special Administrative Region of  
the People's Republic of China**

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# Outline

- Introduction
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- Tax Fraud
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- Closing Remarks



# Introduction

- Tax fraud deprives governments of revenues needed for public spending
- Forces honest taxpayers to pick up the tab
- Erodes community confidence in the equity of the revenue system
- Hong Kong has zero tolerance for tax fraud



# Current Operating Context

- Hong Kong operates a simple and low (but substantive) tax system
- Adopts territorial source principle
- Maintains a scheduler system
- Business profits, employment income and property rental income derived from Hong Kong is chargeable to tax
- No tax on capital gains, no VAT
- No withholding tax on dividends and interest





# Current Operating Context

- Inland Revenue Department (IRD) is responsible for tax administration in Hong Kong
- IRD administers the Inland Revenue Ordinance (IRO), Stamp Duty Ordinance, Business Registration Ordinance and Betting Duty Ordinance



# Tax Fraud

## (A) What is Tax Fraud?

Section 82 of the IRO provides that a person commits an offence if he ***wilfully with intent*** to evade or to assist any other person to evade tax –

- (a) omits from a return any sum which should be included; or
- (b) makes any false statement or entry in a return; or
- (c) makes any false statement in connection with a claim for any deduction or allowance; or



# Tax Fraud

- (d) signs any statement or return without reasonable grounds for believing the same to be true; or
- (e) gives any false answer whether verbally or in writing to any question or request for information; or
- (f) prepares or maintains or authorizes the preparation or maintenance of any false books of account or other records or falsifies or authorizes the falsification of any books of account or records; or
- (g) makes use or authorizes the use of any fraud, art or contrivance



# Tax Fraud

## (B) Maximum Penalties

- On summary conviction
  - ✿ a fine of HK\$10,000 (US\$1,300) and a further fine of treble the amount of tax undercharged and imprisonment for six months
- On indictment
  - ✿ a fine of HK\$50,000 (US\$6,400) and a further fine of treble the amount of tax undercharged and imprisonment for three years
- The Commissioner of Inland Revenue (CIR) may compound any offence and may before judgment stay or compound any proceedings





# Domestic Level

## (A) Legal Framework on Compliance

### (i) **Taxpayer's Obligations**

- Every Person carrying on business in Hong Kong has to register his business
- Every person chargeable to tax is required to inform chargeability
- Every person carrying on business is required to keep sufficient business records
- Property owner who rents out his properties is required to keep sufficient rental records



# Domestic Level

## (A) Legal Framework on Compliance

### (ii) **Employer's Obligations**

- Employers are required to file annual returns for each employee / director
- Employers are required to notify commencement and cessation of employment, and departure from Hong Kong exceeding 1 month
- Persons carrying on business, profession or trade are required to file notifications of remunerations paid to persons other than employees



# Domestic Level

## (A) Legal Framework on Compliance

### (iii) **Obligations under Stamp Duty Ordinance**

- Stamping of documents are required for property transfers and leases
- A potential source of information on wealth and whereabouts of taxpayers



# Domestic Level

## (A) Legal Framework on Compliance

### (iv) **Wide-ranging Information-seeking Power**

- A person is required to furnish all information in his possession respecting matters affecting the liability of any person under the IRO
- A person may be required to attend an interview and answer truthfully questions put to him
- A search warrant may be applied from the magistrate to enter into the taxpayer's premises and take possession of relevant records, in case of suspected fraud





# Domestic Level

## (A) Legal Framework on Compliance

### (v) **Specific and General Anti-avoidance Provisions**

- To combat blatant tax avoidance schemes and abusive transfer pricing arrangements



# Domestic Level

## (A) Legal Framework on Compliance

### (vi) Penal Provisions for Failure to Make Returns, Making Incorrect Returns, etc.

- Maximum penalty under civil proceedings is a fine of HK\$10,000 (US\$1,300) and a further fine of treble the amount of tax undercharged
- The CIR may compound any offence and may before judgment stay or compound any proceedings



# Domestic Level

## (A) Legal Framework on Compliance

### (vii) **Legislative Changes**

- Identifies areas of legislation where taxpayers will exploit and close the loopholes
- Inland Revenue (Amendment) Ordinance 2004 clarified the scope of interest deduction and help fight tax avoidance



# Domestic Level

## (B) Organisational Structure to Improve Efficiency

### (i) **Whole Department Strategy**

- The CIR also administers other ordinances (the Business Registration Office is part of the tax department)
- Centralized tax administration enables a close liaison and ready exchange of information to combat tax fraud





# Domestic Level

## (B) Organisational Structure to Improve Efficiency

### (ii) **Special Unit**

- Field Audit and Investigation Unit (FAI) deals with field audits and investigations
- 2 field audit sections concentrate on tackling tax avoidance schemes (the Anti-tax Avoidance Sections)
- 1 investigation section focuses on criminal investigation (the Prosecution Section)



# Domestic Level

## (B) Organisational Structure to Improve Efficiency

### (iii) **Prosecution Section**

- The Prosecution Section was set up in 1987 to deal with tax fraud investigations
- Most of the tax fraud investigations arise from field audit or civil investigation work
- Once probable criminality is detected, the case is referred to the Prosecution Section for tax fraud investigation



# Domestic Level

## (B) Organisational Structure to Improve Efficiency

### (iv) **Build up Internal Capability**

- Active participation in international conferences and overseas training courses
- Equip staff with capabilities to identify and combat tax fraud



# Domestic Level

## (C) Administrative Approach to Promote Compliance

### (i) **Compliance Audit**

- “Assess First Audit Later” (AFAL) system
- Annual compliance audit on 3 business segments, corporations, partnerships and sole proprietorships
- Compliance rates consistently at high level



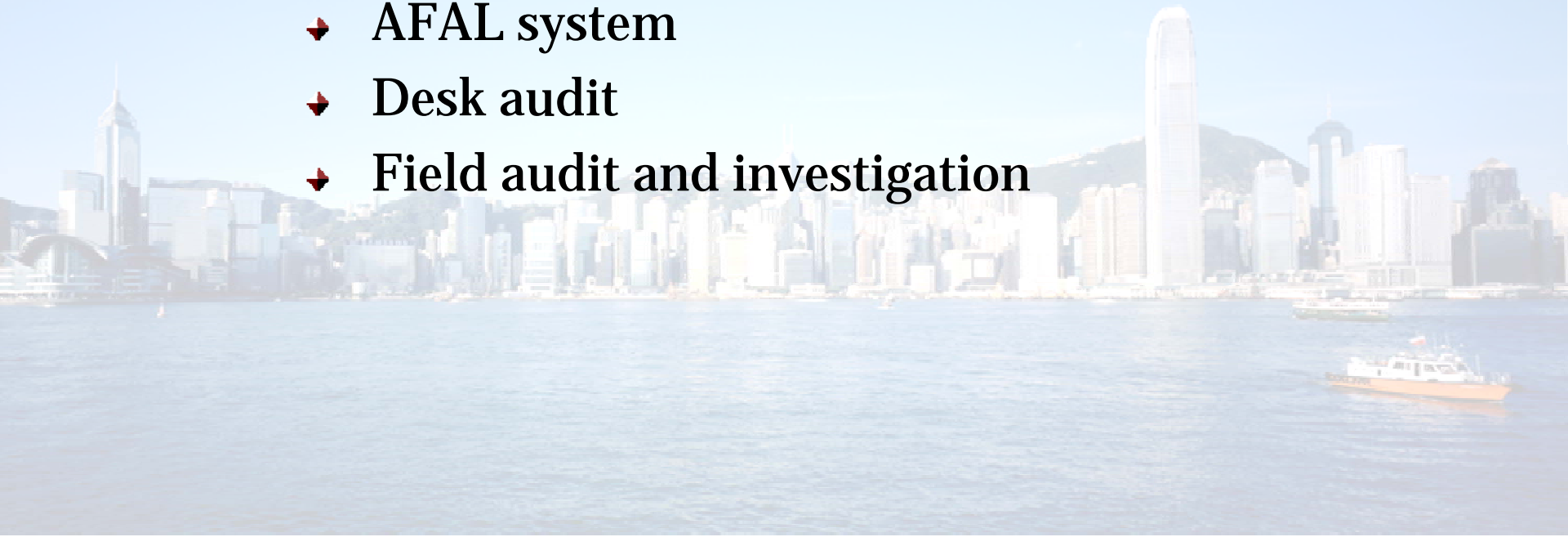


# Domestic Level

## (C) Administrative Approach to Promote Compliance

### (ii) **Audit Trilogy**

- ➔ AFAL system
- ➔ Desk audit
- ➔ Field audit and investigation





# Domestic Level

## (D) Methodologies and Tools

### (i) **Expanded Returns to Identify High Risk Cases**

- Businesses are required to provide specified information in returns, e.g. transactions with closely-connected non-resident persons
- Employees are required to report in returns income received from an overseas company
- Employers are required to report in returns whether the employee was paid by an overseas company



# Domestic Level

## (D) Methodologies and Tools

### (ii) Comprehensive Database

- Access to diverse sources of data within and outside IRD
- Data used to facilitate intelligent and risk-based selection of cases for audit and investigation



# Domestic Level

## (D) Methodologies and Tools

### (iii) **Data Matching to highlight disparities**

- Use unique identifier in data matching, i.e. the Hong Kong Identity Card number for individuals, and the business registration number for businesses





# Domestic Level

## (D) Methodologies and Tools

### (iii) **Data Matching to highlight disparities**

- Match employment income reported by employer against reported income of employee
- Match lease data captured in Property Stamping System against rental income reported by property owners (Property Tax Compliance Check)
- Identify property speculation cases from Property Stamping System
- Return data of payers for commission, rebates and discounts matched against reported income of recipients



# Domestic Level

## (D) Methodologies and Tools

### (iv) **Field Visits**

- Gives enforcement powers a visible presence
- Enhances understanding of taxpayer's actual business operations



# Domestic Level

## (D) Methodologies and Tools

### (v) **Computer Technology to Detect Tax Fraud**

- Use statistical analysis software, SAS query tool, to identify high risk cases
- OSIRIS database to find comparables for transfer pricing abuses



# Domestic Level

## (D) Methodologies and Tools

### (v) **Computer Technology to Detect Tax Fraud**

- Scorecard (risk scoring system) and Segmentation models to select cases for audits
- Computer forensics applied in obtaining, preserving and documenting evidence from digital storage devices in criminal investigation



# Domestic Level

## (E) Facilitation

- Broaden and strengthen taxpayers' tax knowledge to help them understand tax obligations
- Enhance taxpayer service to make compliance easy





# Domestic Level

## (F) Measuring Result

### Results of the Field Audit and Investigation Unit

	2007-08	2008-09	2009-10	2010-11
<b>Number of cases completed</b>	1,864	1,862	1,803	<b>1,805</b>
<b>Understated earnings and profits (\$m)</b>	12,133.2	9,084.7	12,192.8	<b>19,470.1 (US2,500)</b>
<b>Average understatement per case (\$m)</b>	6.5	4.9	6.8	<b>10.8 (US 1.4)</b>
<b>Back tax and penalties assessed (\$m)</b>	2,528.5	2,181.2	2,590.4	<b>3,827.4 (US 490)</b>
<b>Back tax and penalties collected (\$m)</b>	2,548.3	2,566.6	2,385.1	<b>3,881.3 (US 500)</b>



# Domestic Level

## (F) Measuring Result

- Prosecution proceedings will be taken on cases involving persistent evasion, large sums or criminal activity

### Results of the criminal investigation of tax evasion cases

	2007-08	2008-09	2009-10	2010-11
<b>Number of cases with prosecution instituted</b>	8	3	4	3
<b>Number of prosecution cases completed with conviction</b>	8	2	3	4
<b>Number of prosecution cases completed with acquittal</b>	-	-	1	-



# International Level

## (A) Effective Cooperation

- Improved transparency is crucial to detect tax evasion and avoidance in the globalised world
- Hong Kong is a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum)



# International Level

## (B) Implemented International Standards

### (i) Law Amendment in March 2010 –

- Enabling Hong Kong to adopt the 2004 OECD's version of Exchange of Information (EoI) article
- Providing legislative authority to IRD to disclose information requested by treaty partners, irrespective of whether a domestic interest exists



# International Level

## (B) Implemented International Standards

### (ii) Expanding Tax Treaty Network

- To date, a total of 22 comprehensive double taxation agreements were signed (14 OECD countries, 19 Global Forum members)
- 19 of these with 2004 EoI article
- A few more agreements concluded pending formal signature





# International Level

## (B) Implemented International Standards

### (iii) Tax Information Exchange Agreement

- Hong Kong passed the Phase 1 Peer Review of the Global Forum in October 2011, with some recommendations which are being rigorously pursued
- Spare no effort to facilitate information exchange



# Closing Remarks

- An ongoing challenge to identify and manage new tax risks
- Tax coordination and exchange of best practices among peer jurisdictions are vital
- Enhanced dialogues with other tax administrations to secure a win-win situation



**Thank you**