



中華人民共和國香港特別行政區政府
The Government of the Hong Kong Special Administrative Region
of the People's Republic of China

Development of the Tax Audit Framework of Hong Kong, China¹

¹ The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB) or its Board of Directors or the governments they represent. ADB makes no representation concerning and does not guarantee the source originality, accuracy, completeness, or reliability of any statement, information, data, finding, advice, opinion, or views presented.

Content

- Policy Objectives of Tax Audit
- Tax Audit Evolutions in Hong Kong, China
 - Legal Dimension
 - Voluntary Compliance and Compulsory Enforcement
 - Technology Dimension
 - Intelligence Dimension
 - Coordination
 - Operation Dimension
 - Control Dimension
- Conclusion

Defining the Tax Audit Function

- Limits of tax administration
- Equitable tax system
- Realistic solutions
- Tax audit function

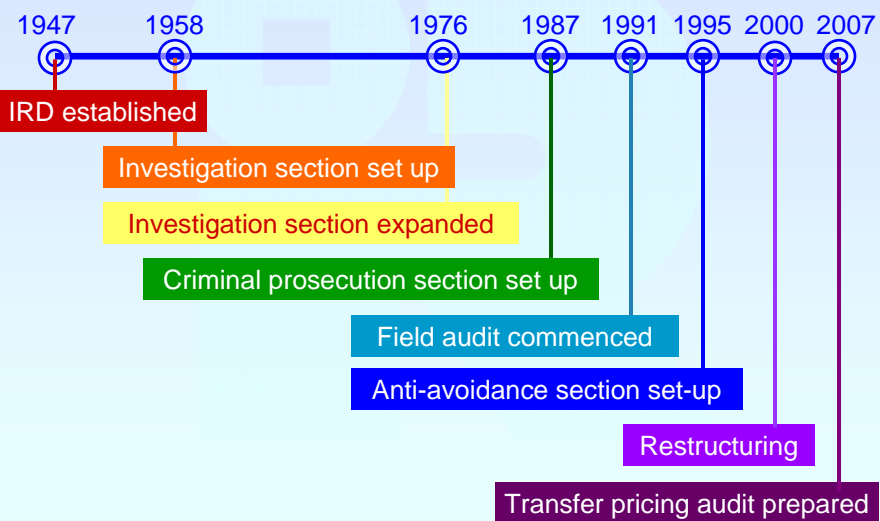
Policy Objectives of Tax Audit

1. Promote compliance
2. Combat evasion and avoidance
3. Create deterrence

Evolution of Tax Audit Function in Hong Kong, China

- HMRC
- ATO
- OECD

History of Tax Audit Function



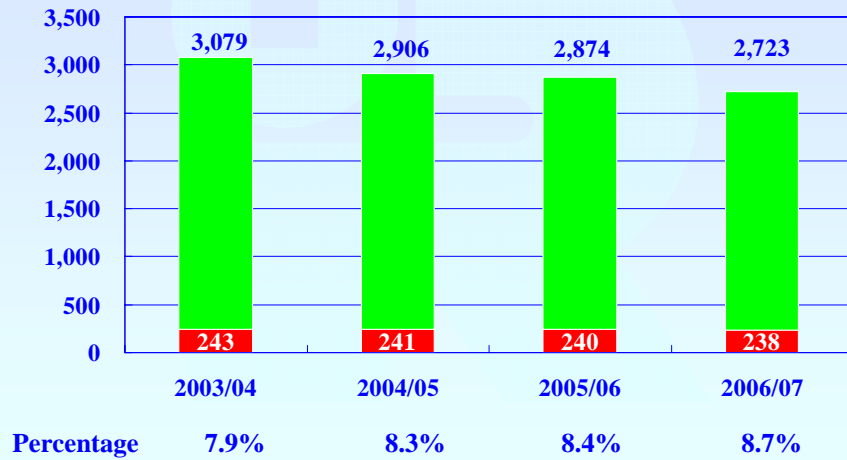
Tax Assessment System

- Computerised Assess First Audit Later System (AFAL System)
- Automated assessments
- Redeployment of resources
- Focus on high yield cases

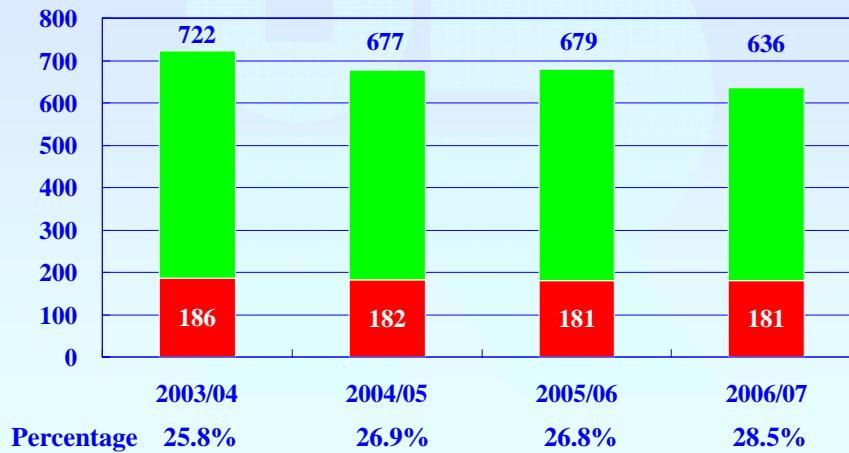
Audit Trilogy (Civil Approach)

1. Desk Audit
2. Field Audit
3. In-depth Investigation

Human Resources of IRD



Human Resources (Professional Staff) of IRD



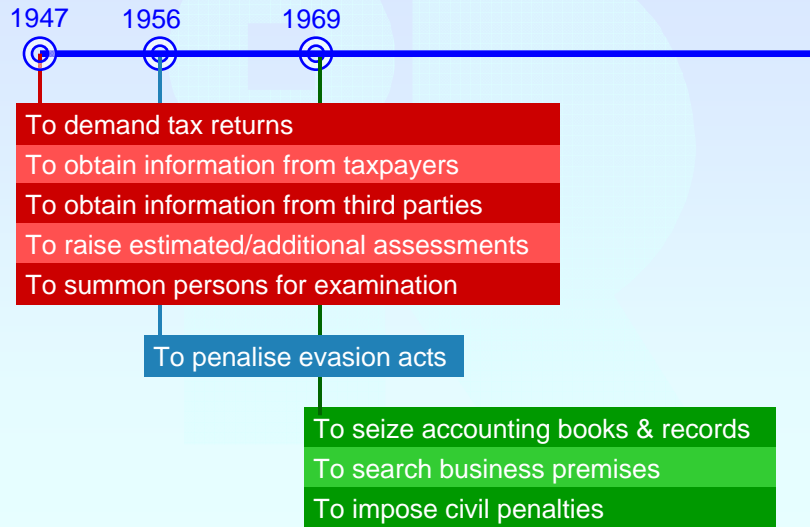
Legal Dimension - Court Cases

- Power to conduct a tax audit
 - Power to raise additional assessments in a tax audit
 - Assessments subject to review in a tax audit
 - Further investigation and requests for information can be required in a tax audit
 - Alternative assessments can be raised as a protective measure
 - Basis of assessment can be re-opened in a tax audit
-

Voluntary Compliance versus Compulsory Enforcement

- Continuous shifting of priorities
 - Efficiency and effectiveness of tax audit
 - Tax audit powers
 - Human rights issues
 - Abuse of powers
 - Clear and transparent policy and procedures
-

Powers Entrusted to IRD



Human Rights Legislations

Ways to Cope with Human Rights Issues

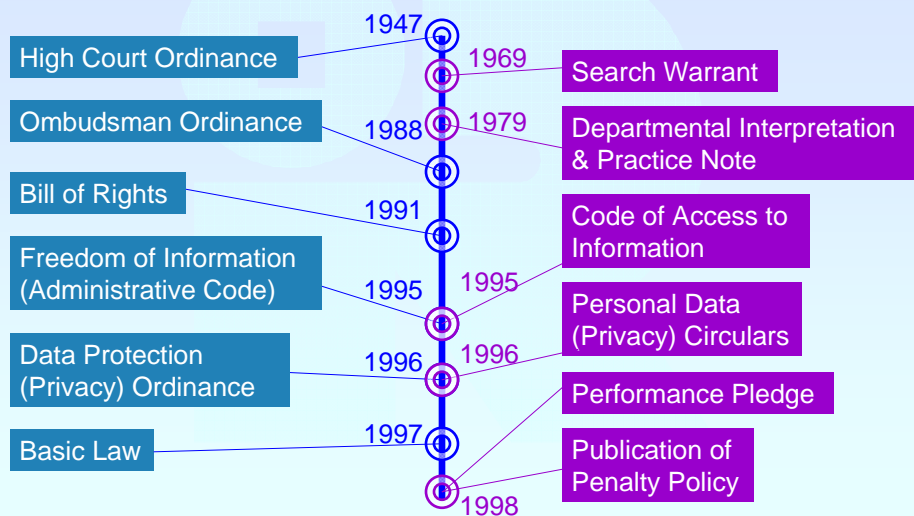


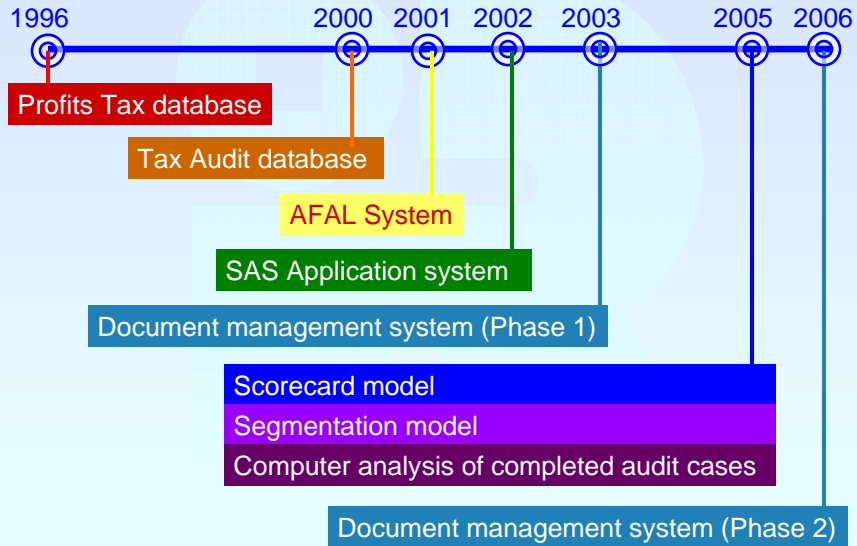
Illustration - Design of Administrative Penalty

1. Predictability
2. Consistency
3. Proportionality
4. Fairness

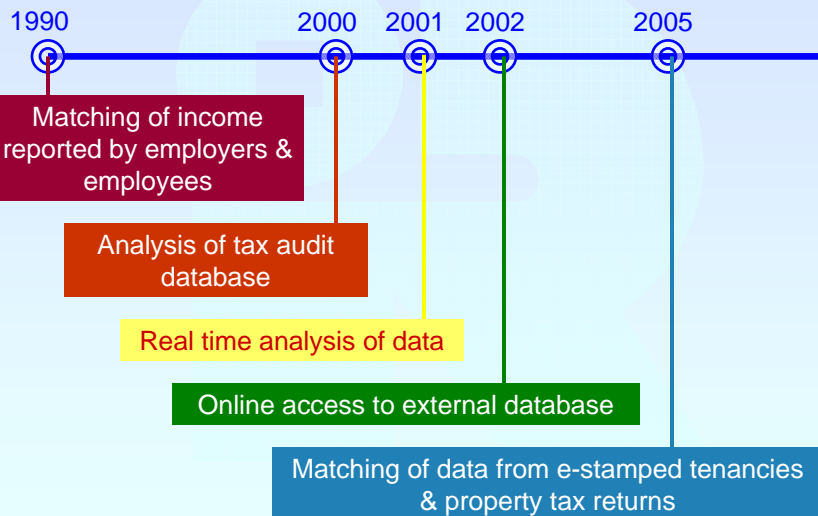
Technology Dimension

- Computers
- Processing software
- Audit and forensic software
- Database
- Technology made tax audit more complex

Impact of Information Technologies



Technologies Applied in Tax Audit



Inherent Limitations of Information Technologies

1. Tax motivated transaction
2. Culpability or gravity of the offences
3. Correlations among enterprises or transactions
4. Transactions booked offshore
5. Audit plans & settlement methods

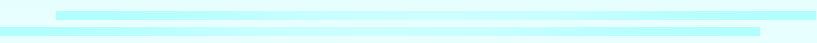


Illustration - Tax Audit Case that Demands a High Level of Skills

Tax Structures (Problem)	A trading enterprise can be fragmented into various operations undertaken by various offshore entities: marketing (offshore); licensing of intangibles (offshore); risks bearing sales (offshore); administration (onshore); limited risks sales (onshore)
Audit Tactics (Solution)	A flank movement by auditing/ checking the goods flow, the cash flows, the location of customers, the location of expertise, the location of suppliers, the trade financing methods might prove to be more effective. Critical examination of the terms of agreements to check the terms have been carried out is extremely important.

Intelligence Dimension

- Possession of information is vital
- Information asymmetry
- Information gathering techniques

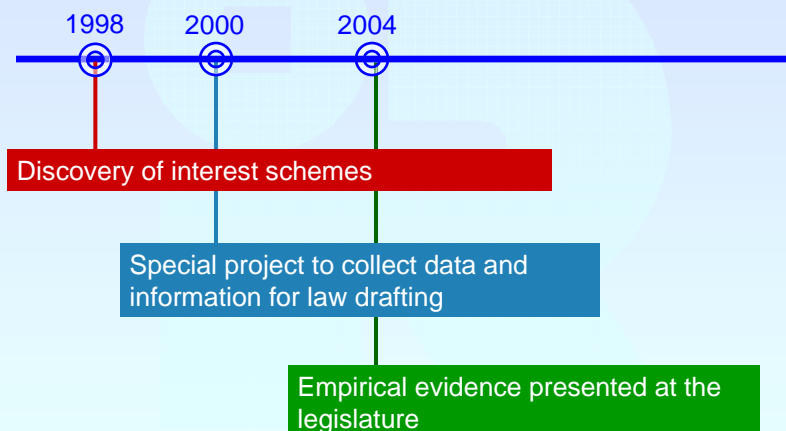
Ways to Collect Intelligence

1. Identify the way assets used
2. Work out the business model
3. Identify the vertical and horizontal relationships
4. Sample check the transactions
5. Extrapolate the results of other years and recompute the significant financial ratios

Coordination

- Information technology, prosecution and legislation
- Non-fiscal issues demand closer partnership with other law agencies
- Enhance audit capabilities to deal with different industries, tax schemes etc.

Illustration - Coordination of Tax Audit and Law Drafting Functions



Operation Dimension

- Operational targets
- Operational efficiency
- Organisational cultures
- Objective and quantifiable
- Tax audit tactics require time to refine
- Extensive experimentation

Cases Completed

	2003/04	2004/05	2005/06	2006/07
No. of cases	1,863	1,863	1,873	1,875
Total understatement	\$9,745m	\$13,814m	\$10,935m	\$10,474m
Average understatement	\$5.2m	\$7.4m	\$5.8m	\$5.6m

Tax and Penalty Recovered per Dollar Spent

	2003/04	2004/05	2005/06	2006/07
Total back tax and penalty assessed (a)	\$2,059m	\$2,828m	\$2,118m	\$2,196m
Total provision (b)	\$166m	\$162m	\$156m	\$159m
Back tax and penalty per dollar spent (a)/(b)	\$12.40	\$17.50	\$13.50	\$13.83

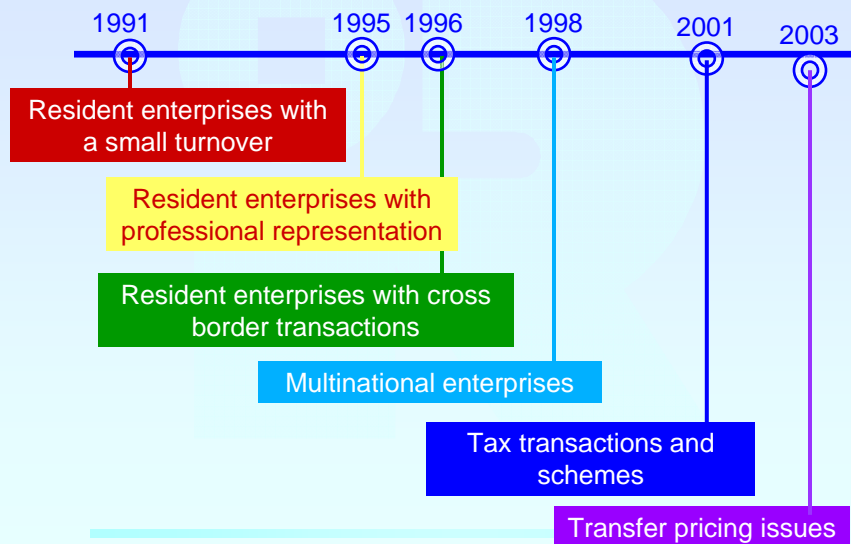
Tax Avoidance Cases Completed

	2003/04	2004/05	2005/06	2006/07
No. of cases	196	213	209	195
Total understatement	\$3,769m	\$7,508m	\$4,542m	\$4,608m
Average understatement	\$19.2m	\$35.2m	\$21.7m	\$23.6m

Performance Pledge of IRD

Finished in	Targets	2003/04	2004/05	2005/06	2006/07
6 months	45%	74.7%	74.4%	74.7%	77.7%
1 year	65%	81.1%	81.4%	81.1%	83.3%
2 years	80%	87.2%	88.3%	86.9%	89.8%
3 years	90%	92%	92.2%	92.6%	93.4%

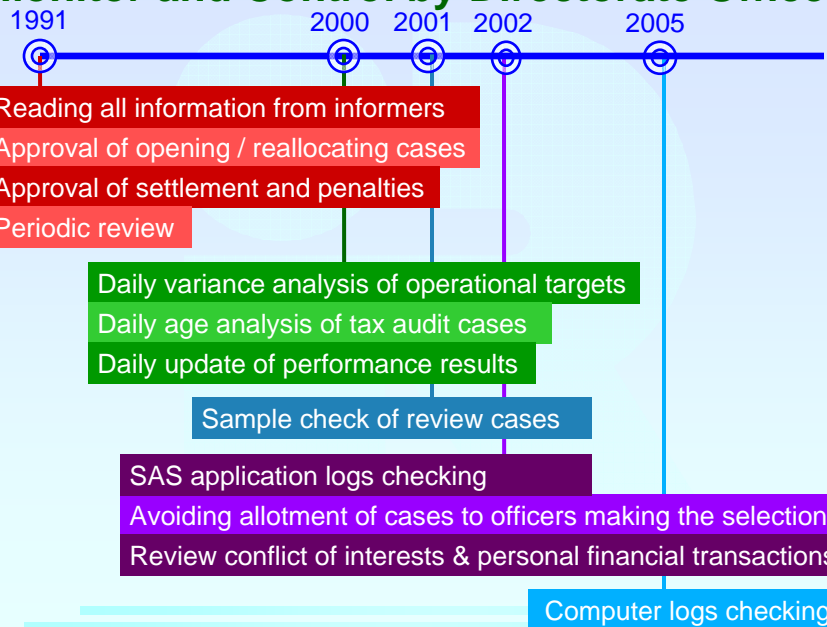
Tax Audit Skills Built-up in IRD



Control Dimension

- Defects in organisational cultures
- Demanding style of control
- Refine monitoring and control systems

Monitor and Control by Directorate Officers



Conclusion

- Tax audits are not about technology
 - Tax audits utilise technology to achieve larger purposes
 - Tax audits require a coherent framework of doctrines and concepts
 - Deeply realistic work cultures
-

Thank You
