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Dear Ms Ho,

Dutiable Commodities (Amendment) Bill 2002

Thank you for your letter dated 6 February 2002. I set out below the Administration's response to your questions.

Clause 1 - Commencement

2. As stated in the LegCo brief, our intention is to implement the open bond system (OBS) in two phases. The first phase, scheduled for implementation in June 2002 subject to the passage of the Bill, would apply to all bonded warehouses, except distilleries. The second phase, to be implemented some six months after the first phase, would extend the OBS to distilleries.

3. Accordingly, we intend to have two different commencement dates for the two different sets of clauses, one governing all bonded warehouses, and the other governing distilleries. The former set of clauses would commence on the implementation date of the first phase, while the latter set would tie in with the second phase. Specifically, clauses 10, 11 and 12 of the Bill, which seek to repeal regulations 56, 59

and 61(2) of the Dutiable Commodities Regulations, would commence only on implementation of the second phase. This means the requirements contained in the existing Regulations which are necessary for controlling distilleries under the closed bond system (these requirements relate to attendance by Customs and Excise Department (C&ED) officers at distilleries and to keeping of record on the particulars of their employees by distilleries) would remain in force and would not be repealed until the implementation of the second phase.

4. As mentioned in the LegCo brief, a pilot scheme on the open bond system lasting for six months has been conducted to test the implementation of the OBS and to prepare the warehouse operators for the new system. Five bonded warehouses participated in the pilot scheme and the feedback from them was highly positive. The participants expressed strong support for the introduction of the OBS to their bonded warehouses on a permanent basis. The Customs and Excise Department (C&ED) has also conducted a series of consultation briefings with the concerned warehouse operators explaining the requirements and procedures to be followed under an OBS. The C&ED also intends to issue guidelines and hold further seminars for the operators and their staff before actual implementation.

5. On the Administration's part, the C&ED has commissioned a study team to understudy the operation of the OBS in other jurisdictions. It has developed a structured training programme for its officers to familiarise them with the control system, and in particular the post-auditing arrangements and systems required, under an OBS.

Clause 3

6. Under the existing provisions, the Commissioner for Customs and Excise (CC&E) already has the power to approve applications (section 7(1)(a) of the Dutiable Commodities Ordinance refers). The purpose of adding section 8A is to provide clarity by stating the factors which the Commissioner would normally take into account in considering an application. It is possible that factors other than those set out in the proposed section 8A(1)(a)-(d), which are relevant to the consideration of an application, would come to light and a catch-all provision is necessary.

7. “Any other relevant matter” in the proposed section 8A(1)(e) refers to matters which is relevant to the Commissioner of Customs and Excise’s consideration of an application for grant or renewal of licence under section 8A(1). These matters might or might not be relevant, or related, to the matters set out in the proposed section 8A(1)(a)-(d) but are nevertheless relevant to the consideration of an application.

8. In exercising this power, the Commissioner must act reasonably and shall only take into account matters which are relevant to the consideration in accordance with principles under the administrative law. Any decision made by the Commissioner are subject to review by the Administration Appeals Board under section 7(2) of the Dutiable Commodities Ordinance.

Clause 4

9. It is proposed that this section may be repealed as it no longer serves any useful purpose. By virtue of section 29, the licensee is responsible for the duty payable for the goods in his bonded warehouse and by virtue of section 46A, the licensee is responsible for offences under the Ordinance committed by his servants.

Clause 6(b) - compounding of offences

10. Existing sections 47A(2) & (3) appear to suggest that dutiable goods are seized in every case where an offence is compounded. It may give rise to the following anomalous situation -

- (a) a person imports goods over and in excess of the duty-free amount and fails to declare;
- (b) the CC&E seizes that person’s goods and compounds him for the section 34A offence;
- (c) that person pays the level 1 fine penalty in accordance with Schedule 3;

- (d) as the existing section 47A provides, on acceptance of the payment under subsection (2), the CC&E shall release the dutiable goods seized and the full duty payable on the goods is taken to have been paid;
- (e) the CC&E goes on to compound the person for section 17(1), (2) and (6) offence; and
- (f) the person may argue that CC&E is obliged to release the goods seized because he has made a payment in respect of the section 34A offence, although he has not paid a penalty equivalent to 5 times of the duty payable (i.e. for section 17(1),(2) and (6) offence).

11. The purpose of clauses 5 and 6(b) is to make it clear that someone who has been compounded of a section 34A offence and who has dutiable goods seized by the C&ED (as described in paragraph 10 above) must pay a penalty equivalent to a level 1 fine **as well as** 5 times the duty payable before his goods may be released and duty taken as settled.

12. Also, the amendments proposed in clause 5 are required to provide greater clarity for the purpose of clause 6(c). In the light of the new compoundable offence under regulation 99(1), subsection (2) may be interpreted as enabling someone who is compounded of this offence to argue that the sum of money listed in column 4 of Schedule 3 (i.e. level 1 fine) also satisfies the duty payable on the deficient goods. This is clearly not the policy intention.

13. Seen in these lights, the wording of “in satisfaction of the duty and the balance” could cause confusion (in both the cases of section 34A offence and the new reg. 99(1) offence) and we consider that it would be necessary to introduce the proposed amendments in clause 5.

14. In response to your paragraph 10, the person will in no case be required to pay \$3,608. For a person who is compounded of a section 34A offence where goods are seized (goods may be seized only when he has in possession dutiable goods over and in excess of the duty-free

amount), he has to pay a penalty equivalent to a level 1 fine and 5 times of the duty payable. When he has made such a payment, section 47A(3) will come into play, which means that duty is **no longer** payable on the goods. It follows that this person will not be liable to any penalty under e.g. section 17(1), (2) and (6) offence because that penalty is calculated by reference to duty payable.

15. Nevertheless, in reviewing the clauses in question in response to your queries, we have come to a view that with the amendments effected by clause 5, it would be serving our purpose even without clause 6(b). Should it ease your concerns, we are prepared to move a Committee Stage Amendment to withdraw clause 6(b). The question of empowering the Commissioner to impose a fine greater than the fine the Court is empowered to impose will not arise.

Clause 20 – new regulation 98A

16. The new regulation 98A(1)(b) proposes that the warehouse-keeper shall keep every relevant document he issues, prepares or receives. The new regulation 98A(3) provides that for the purposes of the regulation, a document that is issued, prepared or received (as the case may be) in the course of the business of a warehouse shall be regarded as issued, prepared or received (as the case may be) by the warehouse-keeper.

17. It should be noted that similar record-keeping requirements are already stipulated under the existing Regulations. For example, section 98(1) of the Dutiable Commodities Regulations requires that “Whenever any goods are taken into or out of a warehouse or are treated in any manner, the warehouse-keeper shall forthwith make such entries in respect thereof as the Commissioner may require in a stock account or record...”. It is clear from the existing provisions that the requirements of the warehouse-keeper on keeping of record are not necessarily based on the warehouse-keeper’s own personal knowledge of the activities concerned. The requirement is made because it is reasonable, critical and necessary, for regulatory control purposes, that the person in charge of the warehouse is held liable for proper record keeping of the warehouse’s business activities. Otherwise, the integrity of the

monitoring system will be vulnerable and prone to abuse.

18. Requirements on record keeping are especially important under the proposed OBS, where control of dutiable commodities mainly relies on self-compliance by the licensee, post-transaction audits and other means of risk management. It is crucial, for revenue protection purpose, that the warehouse-keeper should be required to keep and produce the relevant documents that would allow C&ED to perform full and effective audit checks. The relevant documents prescribed in the new regulation 98A(2) which are required to be kept by the warehouse-keeper provide an audit trail of the dutiable goods entering and leaving the warehouses. It is necessary for the C&ED officers to cross-check the movements of dutiable goods shown by these relevant documents against the movements shown in other documents, e.g. the warehouse' stock accounts. Without these relevant documents, it would be very difficult for C&ED to perform effective auditing on the bonded warehouses in an open bond environment.

19. For these reasons, it is considered justified that once a document is proved to be issued, prepared or received in the course of the business of a warehouse, it may properly be regarded as having been issued, prepared and received by a warehouse-keeper himself for the purpose of the duty to keep documents provided by the new regulation 98A.

20. It is proposed that a failure to comply with the requirement in the new regulation 98A is an offence under regulation 104(2) (as amended). The new regulation 98A may be construed as creating a strict liability offence.

21. In *Attorney General v Fong Chin-yue and others* (1994) 4 HKPLR 430, the Court of Appeal held that an offence was not automatically open to challenge under the Hong Kong Bill of Rights merely because it is a strict liability offence (at p.440, lines 22-24). The Court of Appeal went on to say that where rules of construction that were sufficiently strongly disposed in favour of individual freedom were employed, and an offence was nevertheless construed, in the public interest, to be one of strict liability, then that result could sit comfortably with the most powerful guarantees of individual freedom, even where the

offence is punishable by a substantial term of imprisonment. Thus, where a court reached the conclusion, after applying the criteria laid down in *Gammon (Hong Kong) Ltd v Attorney-General of Hong Kong* [1985] AC 1, that an offence imposed strict liability, then such a provision would not be inconsistent with the Hong Kong Bill of Rights (at p.440, line 36 to p.441, line 42).

22. The *Gammon* criteria are –

- (a) there is a presumption of law that ‘mens rea’ is required before a person can be held guilty of a criminal offence;
- (b) the presumption is particularly strong where the offence is “truly criminal” in character;
- (c) the presumption applies to statutory offences, and can be displaced only if this is clearly or by necessary implication the effect of the statute;
- (d) the only situation in which the presumption can be displaced is where the statute is concerned with an issue of social concern, and public safety is such an issue;
- (e) even where a statute is concerned with such an issue, the presumption of ‘mens rea’ stands unless it can also be shown that the creation of strict liability will be effective to promote the objects of the statute by encouraging greater vigilance to prevent the commission of the prohibited act.

23. Applying the *Gammon* criteria to the new regulation 98A, it is clear that : (i) the offence in question are not “truly criminal” in character; (ii) the presumption of ‘mens rea’ (i.e. knowledge that the relevant documents were issued, prepared or received (as the case may be) in the course of the business of a warehouse) is intended to be displaced by the legislative scheme; (iii) the statute deals with an issue of social concern, namely, to raise and to protect revenue; and (iv) the creation of strict liability will be effective to promote the objects of the statute by encouraging greater vigilance to prevent the commission of the prohibited act – greater vigilance would be encouraged by not requiring the

prosecution to prove that the warehouse-keeper has personal knowledge of the issuance, preparation or receipt of the relevant documents.

24. The warehouse-keeper is encouraged to set up an effective record-keeping system to enable him to comply with the requirements in the new regulation 98A. He has to ensure that the system would enable him to keep proper record of all relevant documents that are issued, prepared or received (as the case may be) in the course of the business of his warehouse. This is a reasonable requirement as it is entirely within the control of the warehouse-keeper to keep proper record of the relevant documents.

25. The Court of Appeal held that in the absence of an expressed statutory defence provision, the court would imply a defence for the accused to prove on the balance of probabilities that he believed for good and sufficient reason that the provisions of the Dutiable Commodities Ordinance had been complied with. Indeed, such a defence would advance the legislative objective by permitting it to be attained without convicting blameless persons (at p.445, line 40 to p.446, line 24).

26. Accordingly, it will be an implied defence under the new regulation 98A for a warehouse-keeper to prove on the balance of probabilities that he believed, for good and sufficient reason, although erroneously, that the provisions of the new regulation 98A have been complied with.

27. If there is genuine concern with the wording of the new regulation 98A(3), we are prepared to consider alternative drafting proposals. Subject to further views of the draftsman, we may delete it and replacing the phrases of "he prepares" or "he receives" in regulation with "is prepared" and "is received" - as per the Annex. This alternative drafting will bring the construction of the regulation 98A to be completely in line with the rest of the existing regulations on record keeping and should allay your concern. It should be pointed out nevertheless that in the new regulations 98A(3) we are not creating a presumption in the sense that the burden of proof is shifted. The burden lies with the Prosecution, whether under the bill as drafted or under the alternative drafting.

28. In response to paragraph 12 of your letter, the purpose of proposing the requirement under regulation 98A(1)(b)(i), i.e. unissued relevant documents should also be kept, is for auditing purpose. The intention is that those unissued relevant documents which are needed for auditing should be kept by the warehouse-keeper for inspection by C&ED. Relevant documents are commonly pre-printed with serial numbers. The serial numbers help the warehouse-keeper and the auditor trace the full set of records and guard against the issue of false invoice, receipts, etc. Therefore, the warehouse-keeper himself or his staff should keep all the relevant documents including those which are cancelled and not issued. C&ED will provide clear guidelines to warehouse-keepers on the requirement under regulation. Similar requirement also exists in the UK's legislation.

29. I hope the above helps to clarify matters. Please feel free to contact me if you have any questions concerning this reply.

Yours sincerely,

(Miss Erica Ng)
for Secretary for the Treasury

Encl.

"(1) A warehouse-keeper shall keep -

- (a) a copy of every relevant document that ~~he is~~ issued; and
- (b) every relevant document that ~~he~~
 - (i) ~~is prepared~~, including one that is prepared for the purpose of issuing but not issued; or
 - (ii) ~~is received~~,

until the expiration of 2 years from the relevant date.

(2) In this regulation -

"relevant date" (有關日期) means -

- (a) where the relevant document relates to the movement of goods into and out of the warehouse, the date on which the goods are taken out of the warehouse;
- (b) in any other case, the date on which the document is issued, prepared or received (as the case may be);

"relevant document" (有關文件) means any document that relates to—

(a) is issued, prepared or received (as the case may be) in the course of the business of the warehouse; and

(b) relates to:—

(ai) the movement of goods into and out of the warehouse, including delivery orders, goods receipt notes, invoices, credit notes, debit notes, bills of lading or air waybills and air consignment notes; or

(bii) payments made and received in the course of the business of the warehouse, including ledgers, statements of accounts, profit and loss accounts, balance sheets and auditor's reports.

~~(3) For the purposes of this regulation, a document that is issued, prepared or received (as the case may be) in the course of the business of a warehouse shall be regarded as issued, prepared or received (as the case may be) by the warehouse keeper."~~