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**Report of the Bills Committee on
Dutiable Commodities (Amendment) Bill 2002**

Purpose

This paper reports on the deliberations of the Bills Committee on Dutiable Commodities (Amendment) Bill 2002.

Background

2. There are currently 53 bonded warehouses storing dutiable commodities in Hong Kong which are licensed and controlled by the Customs and Excise Department (C&ED) under a Closed Bond System (CBS) or an Open Bond System (OBS). Forty-four warehouses, which are mainly for storing liquor and tobacco, are operating under the CBS where Customs officers are stationed full-time at the warehouses to supervise the movement, handling, loading and unloading of dutiable goods. In the absence of C&ED officers, the warehouses are required to be closed under revenue locks. Warehouse operators and traders of dutiable goods have to pay the customs attendance fees which range from \$60,000 to \$330,000 per warehouse per month depending on the number of C&ED officers stationed in the warehouse. About \$70 million was paid to C&ED in 2001-02 for the service of about 150 Customs officers. The remaining nine bonded warehouses, which are oil depots and breweries, are operating under the OBS. No Customs officer is stationed at the premises. The control of dutiable goods mainly relies on self-compliance by the licensees and risk-management and periodic inspections by C&ED.

3. The Administration commissioned a consultancy study in 1999 on the feasibility of extending the OBS to all bonded warehouses in Hong Kong and conducted a pilot scheme on five selected bonded warehouses in 2001 to test the implementation of the system. The consultancy study and the pilot scheme have confirmed the benefits and feasibility of introducing the OBS in Hong Kong. Feedbacks from the participants of the pilot scheme were highly positive. They considered that the OBS has enhanced their management flexibility and brought savings in their operating costs. The consultancy has

recommended to put in place a comprehensive audit and risk-management system on warehouses, which includes tightening of the licensing, record-keeping and audit requirements, upon the implementation of the OBS to guard against risk of revenue loss. The participants encountered no difficulty in complying with the new reporting, record-keeping and audit requirements.

The Bill

4. The Administration introduced the Dutiable Commodities (Amendment) Bill 2002 (the Bill) into the Legislative Council on 30 January 2002. The main purpose of the Bill is to amend the Dutiable Commodities Ordinance (the Ordinance) (Cap. 109) and the Dutiable Commodities Regulations (the Regulations) to implement the OBS in all bonded warehouses in Hong Kong. Some other miscellaneous amendments, including ancillary, minor and consequential amendments to the existing provisions of the Ordinance and the Regulations, are also included.

5. On the implementation of the OBS, the Bill proposes that the system be implemented in two phases. The first phase will apply to all bonded warehouses, except distilleries (which are manufacturing cum storage places for liquor). The second phase will be implemented some six months after the first phase to extend the system to distilleries.

The Bills Committee

6. At the House Committee meeting on 1 March 2002, members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**.

7. Under the chairmanship of Hon HUI Cheung-ching, the Bills Committee has held three meetings with the Administration and invited views from the bonded warehouse trade. A list of organizations which have submitted views to the Bills Committee is in **Appendix II**.

Deliberations of the Bills Committee

Implementation of the OBS in Hong Kong

8. The Bills Committee notes the strong support from bonded warehouse operators and traders in dutiable goods for the full implementation of the OBS in Hong Kong. Members consider that besides facilitating operation of warehouses and reducing the compliance costs, full implementation of the OBS will induce additional business opportunities and enhance Hong Kong's

competitiveness in the international market. The proposal is also conducive to the Government's policy objective of enhancing the business-friendly environment. However, in scrutinizing the Bill, members have raised a number of issues relating to the operation of the OBS. The Bills Committee's deliberations are summarized in the ensuing paragraphs.

Application, renewal and revocation of OBS licences

9. Section 7 of the Ordinance empowers the Commissioner of Customs and Excise (the Commissioner) to grant and issue licences and permits under the Ordinance, to impose conditions to the licences and to revoke licences issued. While members support stating in the proposed new section 8A (Clause 3) the factors that the Commissioner shall take into account when considering the grant, renewal, or revocation of licences in the proposed new section 8A, they are concerned that the existing section 7 and the proposed section 8A may provide the Commissioner with too wide discretionary power in the process. In particular, section 7(1)(a) stipulates that "the Commissioner or other officers deputed by himmay in his absolute discretion grant and issue licences or permits...". Moreover, the context of how far the Commissioner "shall take into account" certain criteria and "any other relevant matter" in the proposed section 8A(1)(e), (3)(e) and (4)(e) is ambiguous. Members are of the view that these provisions are not clear enough to applicants and licensees as to the factors which the Commissioner will consider in the process. They therefore urge the Administration to put proper checks on the power of the Commissioner and review the drafting in this respect.

10. As regards members' concern about the term "absolute discretion" in section 7, the Administration explains that the discretionary power of the Administration in granting licences or giving approval is very common in the laws of Hong Kong. In general, when departments consider application or renewal of licences, they have the flexibility and discretion under section 41(1) of the Interpretation and General Clauses Ordinance (Cap. 1) to consider all relevant matters. However, the term "absolute discretion" when used in relation to the exercise of administrative powers is already being subject to limitations. The Administration assures members that in exercising the discretionary power, the Commissioner must act reasonably, in good faith and upon lawful and relevant grounds of public interest in accordance with the administrative law principle. "Absolute discretion" is also adopted in a good number of existing laws relating to licensing. Furthermore, any decision of the Commissioner under section 7 is appealable to the Administrative Appeals Board under section 7(2) of the Ordinance and subject to judicial review of the court.

11. On the concern about the drafting of the proposed section 8A, the Administration reiterates that section 8A is to provide clarity by stating the factors which C&ED will normally take into account in considering OBS

licences. These factors have been adopted with reference to the relevant section of the Customs Act 1901 of Australia as the Australian OBS has particular relevance to Hong Kong because of the similar principal commodities and control systems of the two places. While factors including the financial status of the applicants, the suitability of the documents they kept for C&ED's auditing, the systems and procedures in respect of inventory control, record-keeping and security of the warehouses, and the fitness and propriety of the applicant and the responsible personnel could be stipulated in the subsections, the Administration points out that it is possible that other factors, which are relevant to the Commissioner's consideration may come to light. For instance, the Commissioner will only grant a licence to premises which has a fixed address in order to facilitate C&ED's enforcement action. The Commissioner must also take into consideration circumstances which are specific to the type of bonded warehouse under application. For example, a duty-free shop must operate within an entry point. The Administration stresses that it will be impossible to provide an exhaustive list of the scenarios and circumstances as they differ from case to case and may change over time. Hence, it is necessary to include a provision, i.e. "any other relevant matter", in the proposed section 8A that is capable of covering these circumstances. The Administration further advises that the existing provisions which have similar structure with the proposed section 8A (i.e. "shall take into account" certain criteria, and "any other relevant matter") are found in section 21 of the Electronic Transactions Ordinance (Cap. 553), sections 7K, 7L and 36AA of the Telecommunications Ordinance (Cap. 106), and sections 12, 12A, 27, 32, 33 and 46C of the Firearms and Ammunition Ordinance (Cap. 238).

12. Notwithstanding the Administration's explanation, since the Commissioner is not obliged to give reasons for refusing to grant, renew, or revoking OBS licences, members remain concerned about the wide discretionary power given to the Commissioner. With a view to enhancing transparency in the process, members consider it necessary to include a provision in the proposed section 8A to require the Commissioner to give reasons on his decision in refusing to grant or renew, or for revoking OBS licences. The Administration has taken on board members' views and agreed to move CSAs to this effect. The Administration points out that the reasons to be given by the Commissioner will set out the matters that he is required to take into account under the proposed section 8A, and where applicable, will include "other relevant matters" considered by him. As such, the Administration considers that the new requirement for the Commissioner to give reasons will provide the trade with certainty, as well as form the bases of appeal action that may be taken by applicants or licensees aggrieved by the Commissioner's decision.

Submission of application or renewal for OBS licences

13. Under the Administration's proposal, OBS licences are valid for one year and application or renewal of licences is to be made in printed form. In order to facilitate applicants and licensees, as well as to enhance efficiency and to reduce workload for C&ED, members suggest that the validity of OBS licence be extended beyond one year and applications or renewals for licences be allowed to be submitted in electronic form.

14. On the validity of OBS licence, the Administration points out that the proposed validity period of one year is consistent with that of existing bonded warehouse licences. It further stresses that the annual renewal process, through which C&ED will review the financial status, fitness and propriety of the warehouse operator, and conduct comprehensive audit on the warehouse records, is an important element of the risk-management system to help identify revenue fraud and high-risk areas for revenue loss in a timely manner after implementation of the OBS. Hence, the Administration considers it important and prudent to maintain the validity of the OBS licence at one year, in particular for the initial period in implementing the OBS.

15. As regards the suggestion for accepting application or renewal by electronic means, the Administration considers that the proposal may not be feasible and practicable. It explains that applicants or licensees are required to submit comprehensive supporting documents, such as proof of their financial status, books and account, details in inventory control systems and layout plans of the warehouses etc., which may not be available in electronic form. Moreover, the Administration will need to discuss with traders on the electronic formats and systems involved to ensure that electronic submission is feasible and secure.

16. Members appreciate that there are practical difficulties in taking forward the above proposals at the initial stages of implementation of the OBS. They welcome the Administration's undertaking to re-examine these proposals in the context of the review on the OBS to be conducted within one year after the full implementation of the system.

17. Regarding members' concern that the requirement in the proposed new Regulation 22AA (Clause 8) for OBS licensee to submit renewal application no earlier than two months before expiry of the licence is too restrictive, the Administration explains that the requirement will ensure the information submitted with the application is up-to-date to facilitate C&ED in making licensing decision, identifying high-risk areas and devising the appropriate audit plan in a timely manner. C&ED's pledge is to grant the renewal application within 12 working days after receipt of the application. Hence, a licensee who submits renewal application two months before will have one and a half months before licence expiry to make necessary preparation. The

Administration further assures members that the new Regulation 22AA already provides flexibility for the Commissioner to consider out-of-period applications. The Commissioner would consider such applications favourably for trade facilitation if valid reasons are given.

Control mechanism and risk management under OBS

18. As no Customs officers will be stationed at the open bonded warehouses and control of dutiable commodities will mainly rely on self-compliance by licensees, members consider it important to put in place comprehensive control mechanism and risk-management system to guard against the risk of duty evasion. They share that apart from tightening the licensing requirements for OBS licences, there should be detailed storage, record-keeping and audit requirements on licensees.

19. On the storage requirements on warehouses, the Bills Committee notes that the new Regulation 83A (Clause 14) will stipulate the ways in which dutiable goods shall be stored and require a warehouse-keeper to produce goods for inspection when requested by C&ED. Members support the new requirements as they will ensure proper inventory control by warehouses to facilitate efficient and effective Customs checks.

20. As regards record-keeping requirements, the Bills Committee welcomes the new Regulation 98A (Clause 20) which seeks to expand the list of information required to be kept and produced by the warehouse-keeper to include all the movement and payment records, balance sheets and audit reports on goods, in addition to stock account recording the movement of goods into and out of the warehouse. On the period for keeping the records, some members comment that the proposed two-year period may not be adequate in providing a sufficient audit trail of records. The Administration is of the view that the proposed period is appropriate. Since annual comprehensive audit checks on individual warehouses will be conducted, the two-year record-keeping requirement will allow C&ED to examine the documents at least in two consecutive years. Having considered that a longer record-keeping period will add compliance cost on warehouse operators, the Bills Committee agrees with the proposed record-keeping period. It further welcomes the undertaking of the Administration to review the issue in the light of operational experience gained after the full implementation of the OBS.

21. Regarding audit and compliance checks on open bonded warehouses, the Bills Committee notes that besides annual comprehensive checks on warehouses to ensure maintenance of proper internal control systems on goods inventory and operational procedures by licensees, C&ED will conduct surprise checks at least once a month to individual warehouses to examine documents against physical stocks on selected items. Furthermore, Customs officers will conduct surprise checks on the loading and unloading processes of dutiable

goods to ensure the particulars of goods tally with the declared details on the related permit to prevent duty evasion. C&ED will take appropriate enforcement action on revenue frauds discovered during compliance and audit checks to protect Government revenue. Where necessary, additional licence conditions will be imposed to strengthen the control on the warehouses, and the licences will be revoked in serious cases of non-compliance. The Bills Committee further notes that with a view to enhancing the professionalism in conduct of audit checks, C&ED has recruited accounting professionals to help formulate the audit planning and provide training to Customs officers on relevant audit techniques.

Commencement of the Amendment Ordinance

22. While expressing support on the proposed licensing requirements and new control measures under the OBS, members urge the Administration to explain the details to warehouse operators as soon as possible to enable them to make necessary preparation for the new requirements and to facilitate their compliance. The Administration stresses that a series of briefing sessions and seminars have been organized to consult and explain the proposed legislative changes and detailed arrangements and requirements under the OBS to existing licensees and traders of dutiable goods. Where appropriate, their views and suggestions have been incorporated in the Bill and the guidelines on implementation of the OBS which will be promulgated after enactment of the Amendment Ordinance. According to the Administration, the warehouse trade is fully prepared and has expressed wish for early implementation of the OBS. This is also reflected in the trade's submissions to the Bills Committee. Hence, the Administration will move a CSA to stipulate that the Amendment Ordinance will commence operation on 1 April for implementing the first phase of the OBS, and on 1 October 2003 for the second phase respectively. The Bills Committee notes the CSA.

Drafting issues relating to the Bill

Clause 6 - Compounding of offence

23. Without C&ED's attendance in the open bond warehouses, there will be more unintended mistakes in the stock account of the quantity and description of dutiable goods. Members note that Clause 6(c) of the Bill is to amend Schedule 3 to the Ordinance to empower the Commissioner to subject such mistakes to the compounding procedure under section 47A where the deviation from the stock account does not exceed \$10,000 in terms of the duty value of the goods involved. Section 47A provides that the Commissioner may compound minor offences as contained in Schedule 3 by imposing an administrative monetary penalty on offenders in lieu of prosecuting them in court. Schedule 3 provides that offences for the failure to comply with section 17(1), (2) and (6) and section 34A(1) and (2) may be compounded.

Section 17 deals with restrictions on possession of dutiable goods. Section 34A provides for the declaration requirements in relation to dutiable goods carried by persons entering Hong Kong. The penalty stipulated in Schedule 3 for the section 17(1), (2) and (6) offence is five times the duty payable on the goods seized while that for the section 34A(1) and (2) offence is a fine at level 1, i.e. currently \$2,000.

24. Members have no disagreement to the arrangement of compounding the offence relating to mistakes in the stock account of OBS licensee and the proposed penalty of a fine at level 1 as stipulated in Clause 6(c) of the Bill. They note the Administration's view that there are merits in the compounding arrangement under which minor offences can be disposed of expeditiously and the administrative work of C&ED and the workload of the Judiciary can be relieved. They further note that as provided in section 47A(3)(a) where no further proceedings on the relevant offence shall be taken against the person on his acceptance of the compounding penalty, there will not be any double jeopardy on the offender.

25. However, members have expressed concern over Clause 6(b), which proposes to amend Schedule 3 to add a further penalty of five times the duty payable on the goods seized on breach of section 34A(1) or (2), in addition to the present fixed fine of \$2,000. Noting that if an offence on section 34A is brought to the court the maximum penalty to be imposed is a fine of \$2,000, members are concerned that Clause 6(b) may empower the Commissioner to impose even a larger fine than the court.

26. The Administration explains the purpose of Clauses 5 and 6(b) and the effect of the existing section 47A(2) and (3). The existing section 47A(2) provides that if the Commissioner compounds an offence in Schedule 3, the person reasonably believed to have committed the offence shall pay specified sum in satisfaction of the duty and the balance as a penalty. On acceptance of payment, the Commissioner shall release the goods seized and the full duty payable on the goods is taken to have been paid. So when the Commissioner has compounded an offence under section 34A and accepted the fine from the offender, he shall release the goods seized. But when the Commissioner goes on to compound the section 17(1), (2) and (6) offence, the offender may argue that he has paid the duty and the penalty already. This is not the policy intent. The intent is that the offender must pay a penalty equivalent to a level 1 fine as well as five times the duty payable before his goods may be released and the duty taken as settled. Hence, to avoid the confusion caused by the wording "in satisfaction of the duty and the balance", the Administration has made proposals to rectify this anomalous situation through Clause 5 (to delete the above words) and Clause 6(b).

27. In view of members' concerns over Clause 6(b) and after further consideration, the Administration considers that the policy intent behind

Clause 5 will be achieved even without Clause 6(b). it will move CSA to delete Clause 6(b). The question of empowering the Commissioner to impose a fine larger than the court is empowered to impose will not arise.

Clause 20 - The new Regulation 98A

28. The new Regulation 98A(1)(b) provides that the warehouse-keeper shall keep every relevant document he issues, prepares or receives. The new Regulation 98A(3) further provides that a document that is issued, prepared or received in the course of the business of a warehouse shall be regarded as issued, prepared or received by the warehouse-keeper. There is concern that such a clause might have the effect of displacing the prosecution's burden of proof. The Administration clarifies that it has no intention to shift the burden of proof which lies with the prosecution. However, to allay the concern, the Administration will move CSA to delete the proposed section 98A(3) and to suitably amend the drafting of sections 98A(1) and (2).

Committee Stage Amendments

29. The Bills Committee notes the CSAs proposed by the Administration to address their various concerns. The Bills Committee has not proposed any CSAs.

Recommendation

30. The Bills Committee supports the resumption of the Second Reading debate on the Bill on 19 February 2003.

Consultation with the House Committee

31. The House Committee at its meeting on 24 January 2003 supported the recommendation of the Bills Committee to resume the Second Reading debate on the Bill on 19 February 2003.

Bills Committee on Dutiable Commodities (Amendment) Bill 2002

Membership list

Chairman	Hon HUI Cheung-ching, JP
Members	Hon Mrs Selina CHOW LIANG Shuk-ye, GBS, JP Hon CHAN Kam-lam, JP Hon SIN Chung-kai Hon Andrew WONG Wang-fat, JP Hon Abraham SHEK Lai-him, JP Hon Audrey EU Yuet-mee, SC, JP (Total : 7 members)
Clerk	Ms Connie SZETO
Legal Adviser	Miss Anita HO
Date	18 December 2002

Appendix II

Bills Committee on Dutiable Commodities (Amendment) Bill 2002

List of organizations which have submitted views to the Bills Committee

1. Crown Worldwide Holdings Ltd.
2. Cathay Pacific Catering Services (HK) Ltd.
3. Nanyang Brothers Tobacco Co., Ltd.
4. Hong Kong Air Cargo Terminals Ltd.