

14 March 2005

Hon. Bernard CHAN  
Chairman of LegCo Panel of Financial Affairs  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong

Dear Sir

**Views on the current Inland Revenue Ordinance (“IRO”) (Cap.112)**

With reference to the message from Hon Tam Heung Man seeking views from our accountancy profession, I am delighted to take this opportunity to comment on the issues as follows:

- (1) Is there currently an adequate channel for practitioners’ and business sectors’ view to be fed through the Financial Services and Treasury Bureau and/or the Inland Revenue Department so that tax law in Hong Kong can be reviewed and reformed from time to time;
- (2) Any issues, inadequacies or uncertainties in the IRO which have been in existence for a long time and which need to be tightened up immediately.

My feedback to the issue (1) above is that continual efforts are needed. Whilst I feel that the society needs more inputs from the practitioners and business sectors about the Hong Kong tax law, I do not agree that they can influence any tax rules and/or interpretations. Those inputs should only be restricted to the sphere of the tax administrative matters, especially in balancing the powers of the government and the rights of the taxpayers.

As regards the issue (2), I observe that the existing assessing procedures, powers of the commissioner and assessors and appeal procedures, etc., have not been reviewed for a long time. It may be the right time, as suggested by Hon Tam, to have an immediate review of the IRO and a fundamental reform is necessary.

Obviously, there is the inclination towards self-assessment tax practice. The IRD has taken an initiative in adopting a practice called “Assess First Audit Later” (“AFAL”). This practice, which involves a number of changes about the administrative matters, should require a plenty of consultations from different sectors. Indeed, if this is the first step of promoting self-assessment, I suggest a detailed review on the IRO and to cope with this assessing practice, any amendments to the IRO would be fundamental ones.

Set out below are the obvious shortcomings of the existing administrative practice under the IRO

that result in less cost-effective tax collecting system.

### **Taxpayer can only make tax payment after receiving a notice of assessment**

The existing practice requires (1) issuance of tax return; (2) receiving of tax return; (3) processing of tax return; (4) making tax assessment; (5) receiving tax payment. Many administrative procedures are required in the middle of any stage, such as letter of extension of time and issuance of reminder, etc. In many cases where the taxpayers take advantage of personal assessment, there are no tax charges collected.

Hong Kong is a famous city having a simple, low-tax system. Taxpayers can work out the amount of their tax liabilities on their own with certainty. Why does the IRO still require the issue of notice of assessment when the taxpayers are able to pay tax when submitting their tax returns? Are there not enough resources allocating to the IRD's helpdesk or inadequate professionals to help those taxpayers in need? When looking at the numbers of tax returns issued, notice of assessment sent and notice chasing after the late return and tax payment, you will surely wonder if the IRO can be made simpler.

### **Confusion of provisional tax**

Provisional tax, albeit not being an up-front payment of tax, is still misinterpreted by many taxpayers as prepayment of tax for the next year. The reason of the imposition of provisional tax is because, as mentioned earlier, it takes a certain months to have a tax demand note which requires an "tax assessment" process. If taxpayers can pay tax when reporting, provisional tax, what I think, will become abolishable. This would invariably remove certain administrative burden in handling holdover application of provisional tax, processing refund and chasing after the second tax instalment!

### **Administrative penalty under s82A under fire**

As can be seen and pointed out by Hon Tam, majority of the cases involves administrative penalty that are the subject of dispute upon conclusion of tax audit/investigation. In my opinion, it is not because the default taxpayers are unwilling to accept a penalty, but because the quantum of the penalty is somewhat arbitrary.

The taxpayers in question, if not agree to the use of contract settlement, will be subject to the penal action under s82A. As the penalty is imposed by the Commissioner, they will attempt to appeal – with the risk of the maximum cost of the appeal is \$5,000 only – to get a chance of reducing the quantum of the penalty.

Under current practice notes, the quantum of such penalty has an element of interest arising from tax underpaid by those default taxpayers. Is it possible to separate the interest element from the penalty equitably when, under the newly invented AFAL, much emphasis is now placed on the field

audit/investigations?

Can the IRO clearly define how penalty is to be calculated, e.g. giving a starting point but allowing to reduce where there are mitigating factors, cooperation of taxpayers and the gravity and culpability of the offence?

### **Power of field audit/investigation used inappropriately under AFAL**

There is a time bar for re-open of assessment. This is to prevent any party, the taxpayers or the IRD, from getting troubles and administrative burdens with another. But, this is now being used as a tool or power in the investigation unit. Even if the assessment is issued, under the AFAL, investigation in the year in question may be coming late, say after 5 years. It is needed for attacking tax evasion, but this will be too wide for the AFAL or self-assessment.

If the tax review or audit under the AFAL is only a test or “on a risk basis”, why is the IRO not modified to cope with the change and to limit the coverage?

### **Other areas to promote self-discipline of taxpayers**

Some of the taxpayers are negligent or ignorant to comply with the IRO. They may not keep books and records properly, file the returns late or fail to pay their tax on time. I see there should be some other ways of promoting compliance and to monitor the taxpayers effectively, on top of the increase in penalty.

For example, there can be a statutory questionnaire for business start-ups which gives sufficient alerts to them about need of proper accounting records and determination of year-end date. It can also be a requirement of filing of accounts together with the accountant’s report annually to have their Business Registration valid.

The government can also consider allowing taxpayers to pay tax monthly, similar to PAYE system, to avoid their raising a significant borrowing during tax season.

All in all, maintaining a simple tax system is one of the priorities of the Hong Kong government. Equally, a simple tax collection system increases discipline and efficiency. I support the self-assessment because it is a cost-effective way to collect tax. I hope the above can be valuable to your panel.

Thank you for your attention.

Yours faithfully

Aaron Wong, CPA(Practicing)