

For discussion
on 6 January 2014

Legislative Council Panel on Financial Affairs

**Development of Dutiable Commodities System of
the Customs and Excise Department**

PURPOSE

This paper briefs Members on the proposal of the Customs and Excise Department (C&ED), as a trade facilitation measure, to extend the current electronic mode of operations for permit applications to make it applicable to licence applications as well under the Dutiable Commodities Ordinance (DCO) (Cap. 109). The proposed Dutiable Commodities System (DCS) will replace the obsolete Customs Control System (CCS).

BACKGROUND

2. C&ED is empowered under the DCO to administer a licence and permit system for the regulation of the import, export, storage, manufacture and movement of dutiable commodities (DC). Specifically, C&ED is responsible for the licensing of the import, export, manufacture and storage of DC; assessment and collection of duties and related fees and charges on DC; and regulation of the movement of DC by permits. Duties are levied on four types of DC to be consumed locally, irrespective of whether they are manufactured locally or imported, as follows -

- (a) alcoholic liquors (with an alcoholic strength above 30% by volume measured at the temperature of 20°C);
- (b) tobacco;
- (c) hydrocarbon oil; and
- (d) methyl alcohol.

3. Since 1998, C&ED has been using a computer system (i.e. CCS) to assist in carrying out the above responsibilities and other non-DC related Customs

operations. The CCS has three major DC-related functions as follows -

- (a) to process DC licence applications submitted in paper form and maintain the licensee information;
- (b) to serve as the Government's back-end system for processing DC permit applications submitted by DC traders electronically via Electronic Data Interchange - Dutiable Commodities Permit (EDI-DCP) under Government Electronic Trading Services (GETS); and
- (c) to facilitate the collection of duty and compounding fines at Duty Collection Offices at control points.

4. In 2012, the CCS processed over 2 000 DC licence applications, 105 000 DC permit applications and 23 000 duty payments, with an estimated annual growth rate of 5%. The revenue collected for 2012-13 was \$8,977 million, which accounted for 3% of government revenue.

DEVELOPMENT OF DUTIABLE COMMODITIES SYSTEM IN C&ED

The Proposed E-licensing System

5. The CCS only supports applications for DC permits (not DC licences) in electronic format. Thus while DC traders currently apply DC permits through electronic means, they still need to lodge their DC licence application, renewal, amendment and cancellation requests in paper form as required under the Dutiable Commodities Regulations (Cap. 109A). C&ED proposes to implement an electronic licensing ("e-licensing") system for DC traders to bring it on par with the electronic mode of operation of the permit system, which has been in operation for over ten years and is widely accepted by the trade.

Trade Facilitation

6. The existing CCS does not support full automation in processing DC permit applications (e.g. data validation) and other DC-related operations (e.g. DC sampling for examination by the Government Laboratory). Studies conducted by C&ED between September 2011 and June 2013 revealed that the existing system is deficient in two aspects -

- (a) **system obsolescence** - it has been in use for more than 13 years since its first launch in 1998. Though the CCS was upgraded in 2002 and 2004, given its technical limitations, most of its components have become obsolete. The existing client-server architecture has become obsolete, which has limitation in integrating with department's corporate portal and providing electronic services to the public; and
- (b) **security vulnerabilities** - the obsolete software may pose security vulnerabilities to the system. Given the sensitivity of the data concerned such as assessment data of DC traders, it is essential to pursue new information technology (IT) infrastructure and upgraded hardware and software for enhanced safeguards against risks of data leakage.

The Proposed DCS

7. For the purposes of implementing the proposed e-licensing system and revamping the existing system to facilitate trade, C&ED proposes to implement and manage an electronic platform under the new DCS, which is scheduled to come into operation in January 2017 before the current hardware maintenance contract for the existing CCS expires by end 2016.

8. With the establishment of a more up-to-date and adaptable system infrastructure, the proposed DCS will have the following features and benefits -

- (a) Enhanced operational efficiency and system reliability

The updated IT infrastructure will be using web technology, which can allow new functions to be developed more effectively. The proposed new automation function will enhance the overall operational efficiency in procedures such as application checking, duty rate adjustment and duty assessment.

- (b) Automated DC licence application process

Putting in place the e-licensing function will benefit both the industry and C&ED. Traders can submit licence applications electronically, thus saving their time and efforts spent in preparing paper applications and submitting the relevant documents to C&ED in person. Similar saving will apply in preparing licence amendment, renewal and cancellation. This can also streamline the existing manual processes

and reduce C&ED's processing time for licence applications, as the system will allow automatic checking and cross-referencing of records and information. Moreover, this is an environmental-friendly measure to save paper and storage resources.

(c) Open new opportunity for trade facilitation

At present, after traders have applied for a DC licence, they need to register with the designated Service Providers (SPs) under GETS for permit application, and the SPs are required to validate licence information with C&ED by email exchanges before accepting the permit application. With the implementation of e-licensing, it becomes technically feasible for the validation to be done electronically via the systems of the SPs and the DCS. Consequently, this will shorten traders' registration time from the current five working days to three.

(d) New services offered

New functions will be built into the system whereby the trade will receive automatic reminders of licence renewal and electronic payment of licensing/renewal fees. This can suit present-day business needs.

(e) Enhanced system and data security

With the adoption of up-to-date technology, the overall system security can be enhanced with protection against security threats and the encryption features will be strengthened for data security control.

Legislative Timetable

9. The Administration plans to submit the funding application for developing the DCS to the Finance Committee (FC) of the Legislative Council (LegCo) in May/June 2014 for approval. Subject to funding being approved, it will take about 29 months to develop the DCS. Given the lead time required, the e-licensing system is tentatively scheduled for implementation in January 2017.

10. Implementing e-licensing, which is one of the prime objectives of developing the DCS, will require legislative amendments to the existing Dutiable Commodities Regulations (Cap. 109A) which provides that applications for DC licences can only be submitted in paper form. In order to provide for a legal

framework for implementing e-licensing, we plan to table relevant legislative amendments at the LegCo for negative vetting no later than May 2014. We propose to provide for six months for the transition of the licensing regime from paper mode to electronic mode upon the launch of the DCS.

FINANCIAL IMPLICATIONS

11. Implementation of the DCS will incur a total non-recurrent expenditure of \$33 million over a period of three years from 2014-15 to 2016-17. The cost breakdown is at **Annex A**. Non-recurrent staff cost of \$15.6 million will be incurred for overseeing procurement, system development and implementation of the DCS, which will be absorbed from within C&ED's existing resources.

12. We estimate that the recurrent expenditure will be \$5.4 million per year from 2019-20 onwards. A detailed breakdown is set out at **Annex B**. The recurrent staff resources for supporting the existing CCS will be deployed for requirement for the proposed project. C&ED will absorb the relevant expenditure and staff costs from within its existing resources.

13. The proposed DCS will bring about annual savings of \$5.6 million from 2017-18 onwards, which comprises -

- (a) realisable savings of \$3.5 million per annum, mainly from savings in the maintenance cost of the existing system. The savings will be used to absorb some of the recurrent expenditure of the project; and
- (b) notional staff cost savings of \$2.1 million per annum, as a result of reduction of manual efforts and paper work in the licence / permit processing due to the re-engineered workflow. The fragmented savings will be redeployed to support the DCS and other tasks of C&ED.

PUBLIC CONSULTATION

14. In July and September 2013, C&ED consulted the trade on the proposal of electronic licensing. Major stakeholders, including the Dutiable Commodities Customer Liaison Group¹, in general support the proposal. No objection has been

¹ The Dutiable Commodities Customer Liaison Group comprises the Warehouses/Duty-free Shop Operators/Ship Stores Suppliers Sub-group, Hydrocarbon Oil Sub-group, Tobacco Sub-group and Liquor Sub-group.

received from the existing DC licensees.

IMPLEMENTATION PLAN

15. We plan to implement the proposed DCS according to the following schedule -

Task	Target completion date
System analysis and design	February 2015
Procurement and system development	March 2016
User acceptance test	August 2016
Training (including briefing sessions to the trade)	November 2016
System roll-out	November 2016

ADVICE SOUGHT

16. Subject to Members' views, we plan to seek funding approval from the FC of the LegCo in May/June 2014 and table the necessary amendments to the Dutiable Commodities Regulations (Cap. 109A) in the LegCo no later than May 2014.

Financial Services and the Treasury Bureau
December 2013

**Non-recurrent Expenditure Required for the
Proposed Implementation of Dutiable Commodities System**

Expenditure Item	\$ '000				
	2014-15	2015-16	2016-17	2017-18	Total
(a) Hardware	160	1,300	3,440	2,100	7,000
(b) Software	160	900	2,160	800	4,020
(c) Implementation and contract staff services	2,200	7,480	7,200	1,100	17,980
(d) Training	-	-	1,000	-	1,000
(e) Contingency	250	970	1,380	400	3,000
Total	2,770	10,650	15,180	4,400	33,000

**Recurrent Expenditure Required for the
Proposed Implementation of Dutiable Commodities System**

Expenditure Item	\$ '000		
	2017-18	2018-19	2019-20 onwards
(a) Hardware maintenance	100	700	1,300
(b) Software maintenance	200	800	800
(c) On-going system support services	3,000	3,000	3,000
(d) Consumables and miscellaneous	300	300	300
Total	3,600	4,800	5,400