

- (1) **Is there any loophole in the “Assess First Audit Later” (“AFAL”) system, which is a customized computer-assisted case selection programme devised for audit based on risk assessment? How do the customized computer-assisted case selection programme and the audit mechanism work?**

The AFAL system adopted by the Inland Revenue Department (“IRD”) has been built on an analytical solution to screen tax returns for issuing tax assessments first and then select cases for post-assessment audits and investigations. Under the AFAL system, the data reported in tax returns is stored in IRD’s database. Tax assessments will then be selected by either “Random Selection” or “Risk Assessment” for desk audit. Under “Random Selection”, all returns have equal chances of being selected. Under “Risk Assessment”, a customized computer-assisted case selection programme is used to assess the risk level of each return to ensure that returns with high risk are selected. Taking into account compliance trend and past audit findings, risk factors are assigned to different items annually. Depending on the facts of each case, cases selected will be allocated to the assessing officers to conduct “desk audit”, to the field auditors to conduct “field audit” or to the investigators to conduct “in-depth investigation”. By automating and computerizing the screening and selection process, the AFAL system enables the selection of cases for audit to operate in a more objective and efficient manner.

- (2) **Currently, it is not a statutory requirement for the employers to provide a copy of the completed “Employer’s Return of Remuneration and Pension” (“Employer’s Return”) to their employees concerned. Is it one of the reasons causing the filing of incorrect return or false report? Is there a trend for the employers to file incorrect tax information?**

Although it is not a statutory requirement for the employers to provide a copy of the completed Employer’s Return to their employees concerned, the employees can request a copy from the employers. Moreover, under the audit mechanism mentioned in (1) above, when conducting “desk audit”, “field audit” or “in-depth investigation” on the salary expenses charged in the accounts of the employers, if in doubt, IRD’s assessing officers will request the employers to furnish further supporting information and documents, such as a copy of employment contract, salary payment records, employee’s acknowledgement and bank statements. IRD may also request the employee concerned to provide relevant information to verify the correctness of the remuneration reported in the Employer’s Return.

According to the Inland Revenue Ordinance (Cap. 112) (“IRO”), any person who fails to comply with the requirements specified in the IRO or makes an incorrect return or false report with intent to evade tax or assist any other person

to evade tax would be subject to heavy penalties. The maximum penalty for tax evasion is a fine of \$50,000 plus a further fine of three times the amount of tax undercharged and imprisonment for three years.

IRD has not observed any trend of filing incorrect tax information due to lack of statutory requirement for the employers to provide a copy of Employer's Return to their employees.

(3) Has IRD assessed the amount of revenue loss per annum caused by the filing of incorrect tax information?

IRD does not have statistical data on revenue loss arising from incorrect tax information filed. However, employees' remuneration, being one of the expense items charged in employers' accounts, is subject to normal checks under the AFAL system. Under the computerized risk-based audit system, IRD can effectively identify high-risk cases for audit and investigation, thereby minimizing the risk of revenue loss due to tax evasion and tax avoidance.

In the course of its audit and investigation of suspected cases, IRD will verify the respective amounts of staff remuneration charged in the accounts of the employers' businesses with those reported in the Employer's Returns. For cases found to have reported incorrect remuneration in the Employer's Returns, IRD will take penal actions in accordance with the provisions of the IRO, including imposition of penalty by way of additional tax. IRD will also continue its effort to combat tax evasion and tax avoidance and to reinforce the use of information technology, staff training and investigation techniques so as to enhance the overall effectiveness of its work.

In the past 15 years, IRD had initiated prosecution against four employers for submitting incorrect Employer's Returns.