

Legislative Council Panel on Financial Affairs

Measures to strengthen enforcement efforts against the supply and use of illicit fuel

PURPOSE

This paper informs members of, and seeks their views on:

- (a) legislative proposals to strengthen the enforcement efforts of the Customs and Excise Department (C&ED) in tackling the problem of supply and use of illicit fuel; and
- (b) the enhanced administrative measures that C&ED has recently taken for the same purpose.

(A) LEGISLATIVE PROPOSALS

Background and Argument

2. Under the Dutiable Commodities Ordinance (the Ordinance), the import and manufacturing of three types of hydrocarbon oil, namely, light diesel oil, petrol (leaded and unleaded) and aircraft spirit for local consumption is chargeable to duty. Supply and purchase of dutiable hydrocarbon oil (i.e. oil for which duty has not been paid) is prohibited.

3. The price difference between duty-paid and duty-not-paid light diesel oil and petrol has given rise to a market for illicit fuel for use by vehicles in Hong Kong. Arising from the recent economic downturn, there has been a noticeable increase in the supply of illicit fuel in recent years. In 1998, C&ED seized 5.23 million of litres of illicit fuel in 856 cases. In the first half of 1999, 4.91 million litres of illicit fuel were seized in 526 cases. The problem has not only led to revenue loss but also caused environmental pollution and fire hazards. In 1998, there were four fires which occurred in premises used for storage and supply of illicit fuel. In the first half of 1999, there were six cases.

4. There are three principal types of illicit fuel, namely -
- (a) dutiable light diesel oil and petrol: these are oils on which the full duty prescribed by law has not been paid. They mainly come from illegal imports or light diesel oil purported to be exported but illicitly diverted into the local market;
 - (b) marked oil: marked oil is light diesel oil to which a prescribed marker and colouring substance have been added to make it red in colour and distinguishable from ordinary light diesel oil. Marked oil is exempted from duty. It is designated for industrial and marine uses by the Ordinance and is not allowed to be used as fuel for motor vehicles except for the following three types of vehicles-
 - (i) vehicles not registered under the Road Traffic Ordinance and solely for industrial use;
 - (ii) franchised public buses operating on specified routes; and
 - (iii) vehicles owned and operated by the Kowloon-Canton Railway Corporation in maintaining bus services within the North-west Transit Service Area.

There have been cases where marked oil was found to be supplied for use in vehicles other than those specified above in order to evade duty payment.

- (c) detreated oil: detreated oil is marked oil with the colouring substance and marker removed or impeded illegally in order to make it visually indistinguishable from ordinary light diesel oil to facilitate sale in the black market for vehicles' use.

To address enforcement difficulties

5. *Under the Ordinance and its relevant Regulations, it is an offence to supply or purchase dutiable light diesel oil, petrol and*

detreated oil or to supply or use marked oil as fuel in motor vehicles.

However, when taking enforcement actions under these provisions, C&ED has encountered two major difficulties, and we propose to overcome them as set out in the following paragraphs.

Difficulty in proving the supply of certain illicit fuel

6. Since dutiable light diesel oil, petrol, and detreated oil are no different in appearance from those which are duty-paid, it is difficult for C&ED to establish a case to take prosecution action against the supply, sale and use of illicit fuel even if they suspect such activities taking place. C&ED may make inquiry into the activities but the suspect can claim, without any proof, that duty has been paid for the fuel in question. It is difficult for C&ED to rebut the claim and take further action. Currently, C&ED can only rely on section 40(c) of the Ordinance to address the problem. This section presumes hydrocarbon oil to be dutiable under certain conditions and puts the burden of proof on the suspects. However, the presumption can be invoked only if a person is actually transferring hydrocarbon oil to or from a vehicle's fuel tank at any locations other than those premises licensed under Part VI of the Dangerous Goods (General) Regulations (DGR). The problem is that in many cases the supply of illicit fuel does not necessarily involve a transfer of the fuel to a vehicle on the spot. For example, illicit light diesel oil and petrol can be sold in takeaway cans for drivers to refuel their vehicles at locations other than the supplying station.

7. To address the above problems, we propose to amend the Ordinance and its Regulations to expand the scope of the presumption provision in section 40(c) of the Ordinance so that it can be invoked where any of the following activities take place other than in licensed premises-

- (a) sale and supply of light diesel oil (which covers detreated oil by its definition under the Ordinance) or petrol;
- (b) purchase and receipt of light diesel oil or petrol; and
- (c) any other dealings in light diesel oil or petrol.

8. We further propose to exclude only premises licensed specifically for storage of diesel oil and petrol under Part VI of the DGR from the application of the presumption. In other words, licensed premises under that Part of the Regulations which are not for the purpose of storage of diesel oil and petrol should also be subject to the expanded presumption provision.

9. The proposed presumption will not apply to marked oil which is easily distinguishable from normal light diesel oil.

Difficulty in proving the use of detreated oil or dutiable light diesel oil as fuel by vehicles

10. Detreated oil used to be detectable through chemical testing on the spot. However, culprits have recently been able to remove the marker and colouring substance of marked oil. C&ED is no longer able to detect the colouring substance or the marker through chemical testing on the spot. This renders the setting up of roadblocks to check vehicle fuel ineffective.

11. There remains, however, one identifiable difference between detreated oil and dutiable light diesel oil on the one hand, and duty-paid light diesel oil on the other. This is their sulphur content. Detreated oil and dutiable light diesel oil have a sulphur content of more than 0.05% by weight while duty-paid light diesel oil has a sulphur content lower than 0.05%. This is so because detreated oil originates from marked oil which is mainly for industrial use, and dutiable light diesel oil is sourced from illegal imports or relandings, which all have a higher sulphur content. Marked oil, for example, may have a sulphur content as high as 0.5% by weight. As for duty-paid light diesel oil, the current Air Pollution Control (Motor Vehicle Fuel) Regulations under the Air Pollution Control Ordinance prohibits the supply of light diesel oil with a sulphur content higher than 0.05% by weight for vehicular use. Therefore, in practice, only light diesel oil with a sulphur content at or below 0.05% is available from legitimate sources. It follows that all light diesel oil used by vehicles with a sulphur content above 0.05% is likely to be detreated oil or dutiable light diesel oil. Nevertheless, it remains difficult for C&ED to

show that the light diesel oil in question is duty-not-paid even if they can prove that the oil has a sulphur content over 0.05%. This is because, under the existing provisions, the vehicle driver can always claim, without giving any proof, that duty has been paid for the oil. It will then be up to C&ED to prove otherwise, which has not been practicable in many cases.

12. To address this problem, we propose to add a presumption to the Ordinance to the effect that any light diesel oil found in the fuel tank of a motor vehicle with a sulphur content in excess of the maximum sulphur content (at present 0.05%) prescribed under the Air Pollution Control (Motor Vehicle Fuel) Regulations is presumed to be dutiable. The presumption will not apply to light diesel oil in the fuel tank of vehicles arriving from the Mainland, for use in those vehicles. This is because such light diesel oil, which may or may not have a sulphur content above 0.05%, is currently exempted from payment of duty under the Dutiable Commodities Regulations. Also, for the reason given in paragraph 9 above, the presumption will not apply to marked oil.

To rationalise the penalty levels for using illicit fuel in vehicles

13. At present, the maximum penalty for the supply or use of marked oil for vehicular use and the supply or purchase of detreated oil is a fine of **\$200,000** and imprisonment for 2 years while the maximum penalty for supply or purchase of dutiable light diesel oil (other than marked oil) is **\$1,000,000** and imprisonment for 2 years. Given that both offences involve an intention to avoid payment of duty on hydrocarbon oils, we propose to rectify this discrepancy by increasing the maximum penalty for offences in relation to marked oil and detreated oil to a fine of \$1,000,000 and imprisonment for 2 years. For the sake of consistency, we also propose to take this opportunity to increase the maximum penalty for illegal use of kerosene in vehicles to the same level, as the nature of the offence is similar to that of offences for marked oil and detreated oil.

Timetable

14. The above proposals will be introduced as part of the Dutiable Commodities (Amendment) Bill 1999 into this Council on 17 November

1999. The Bill will be gazetted on 5 November 1999. A Legislative Council brief on the Bill has been issued today. Members may refer to the brief for details of the proposed amendments in the Bill.

(B) ENHANCED ADMINISTRATIVE MEASURES AGAINST ILLICIT FUEL

15. In addition to the above legislative proposals, C&ED recently devised an Action Plan to further enhance their enforcement actions against the supply and use of illicit fuel. The plan was implemented on 22 September 1999. The key measures in the plan are as follows:

(a) To mount more large scale operations and joint operations on the sale of illicit fuel

11 large scale operations on the sale of illicit fuel have been mounted from late September onwards (as compared with 7 similar operations in 1998), resulting in the arrest of 21 persons and seizure of 20,361 litres of light diesel oil, 6,035 litres of marked oil, 15,098 litres of detreated oil and 15,693 litres of petrol. Among these operations, three were joint operations with the Hong Kong Police. The Environmental Protection Department also participated in one of these joint operations. C&ED will also carry out joint operations with the Marine Police and strengthen sea patrol at notorious spots to deter the smuggling and relandings of hydrocarbon oil.

(b) Review of reward scale

C&ED is reviewing the scale of its reward scheme with a view to adjusting it so as to attract more informers. Under the existing reward scheme, reward is paid to a person providing information leading to a seizure of illicit fuel. The amounts of the rewards range from \$0.75 to \$1.5 per litre of diesel oil seized and \$1.00 to \$2.00 per litre for petrol seized (depending on whether there is any conviction), or 20% of fine whichever is the higher. C&ED will also work with the major oil companies to review the scale of reward scheme of these companies. The amounts of rewards

currently range from \$3,000 to \$140,000 depending on the type of fuel, nature of offence and whether there is any conviction.

(c) Publicity

C&ED will step up publicity efforts aimed at deterring the use of illicit fuel. For example, C&ED will organise intensive media campaigns in conjunction with oil companies, with a particular focus on the message that purchasing and using illicit fuel is not only illegal, but can also be dangerous. One such campaign has been organised in September 1999.

(d) Tightening control on relandings of hydrocarbon oil

(i) To tighten control against the relandings of hydrocarbon oil initially for export purpose, C&ED has instituted a mechanism of exchange of intelligence with enforcement agencies in other places. Under such mechanism, when a permit is granted to an exporter to export hydrocarbon oil in large quantity, C&ED would, where necessary, notify the recipient country or place of the particulars of the shipment so that the latter can monitor movement of the shipment upon arrival.

(ii) In addition, the following measures will be implemented with effect from 1 November 1999 to provide more effective control on relandings of hydrocarbon oil:

- Export permit for hydrocarbon oil will be issued only on production of invoice/sales contract and shipping order. For export to the Mainland, import authorization from the competent authority of the Mainland is also required;
- Warning notices will be posted at all oil company wharves informing crew members of hydrocarbon oil exporting vessels that re-landing of hydrocarbon oil is an offence;
- Oil companies will be required to inform C&ED two hours prior to departure of an exporting vessel from the oil depot

where hydrocarbon oil is drawn and to return a duplicate export permit to C&ED together with bill of lading within 14 days to ensure that the shipment has actually been exported. Moreover, for suspicious shipments, oil companies are required to deposit security and to submit a landing certificate to C&ED; and

- The period of removal of hydrocarbon oil from an oil depot has been shortened to four days instead of seven days as previously allowed. In addition, unless with the permission of the Commissioner of Customs and Excise, hydrocarbon oil covered by an export permit has to be exported within 12 hours after its loading onto a departing vessel.

Finance Bureau
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