

Chapter 2

The Customs and Excise Department's efforts to protect government revenue from dutiable commodities

Audit conducted a review to examine the efforts of the Customs and Excise Department (C&ED) to protect the Government's revenue from dutiable commodities and to ascertain whether there were areas for improvement in the C&ED's performance. As 88% of the duty revenue collected in 2001-02 was from hydrocarbon oil and cigarettes, the audit focused on these two dutiable commodities.

2. Prior to the public hearing, the C&ED submitted a paper, in *Appendix 29*, providing supplementary information regarding its responses to the Director of Audit's major recommendations on the subject. At the hearing, **Mr Raymond WONG Hung-chiu, Commissioner of Customs and Excise**, made an opening statement. He said that:

- he appreciated the Director of Audit's efforts in conducting a comprehensive and in-depth review of the C&ED's efforts to protect government revenue from dutiable commodities. The C&ED would seriously take follow-up actions on Audit's recommendations. In fact, it had already implemented some of these recommendations;
- in view of the extremely frequent cross-boundary movements of people and cargo, the C&ED had to combat all forms of smuggling activities on one hand and spare no efforts in facilitating flows of people and cargo on the other hand. The C&ED faced the challenge of finding the proper balance between its two roles;
- protection of government revenue from dutiable commodities was a very complicated and difficult task. The C&ED had all along been endeavouring to perfect its various monitoring systems and enforcement measures and had carried out quite a few significant reforms in the past few years for more effective protection of government revenue. Having said that, the C&ED had realised through the audit review that there were areas for improvement in its performance in protecting government revenue;
- the issue of abuses of cigarette duty-free concessions mainly concerned the measures adopted by the C&ED in processing inbound travellers. In recent years, the number of inbound travellers passing through the Lo Wu Control Point had been increasing rapidly. Currently, there were almost 130,000 incoming travellers each day. In order to handle the huge daily passenger flow with the limited manpower, the C&ED had adopted a set of strategies based on the analysis of intelligence, the concept of risk management and the support of advanced technology. Taking the Lo Wu Control Point as an example, Customs officers, apart from checking travellers at customs examination counters, made verbal enquiries with travellers, checked travellers and baggage by using metal detectors, X-ray scanners and ion-scanners and conducted dog-sniffing checks on travellers;

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- to further improve the hit rate, the C&ED, apart from enhancing the collection of intelligence, regularly carried out the “Yellow Bird Operation”. In the operation, plain-clothes officers would be deployed to conduct surveillance at the Lo Wu Control Point, including the duty-free shops and the railway station concourse. The aim was to detect those travellers who did not declare excessive quantities of cigarettes. Although such efforts were little known to the public, they were effective in detecting contraband goods. For instance, between January and October 2002, about 570,000 sticks of undeclared cigarettes had been seized, with 120 persons under arrest and 180 persons fined in the cases concerned. In addition, there were a total of 162 cases, which involved drugs totalling more than \$4 million, as well as 59 piracy cases in which more than 40,000 pirated compact discs were seized;
- the C&ED agreed with the Director of Audit's view that improvements were needed in areas such as the monitoring of sales activities at the duty-free shops, the enforcement of the 24-hour rule for duty-free concessions and the baggage examination procedures. Hence, the C&ED was conducting a comprehensive review in this regard;
- the C&ED had drawn up a comprehensive action plan to combat the use of illicit fuel in motor vehicles. On the supply side, the C&E had sought the cooperation of the oil companies to check suspicious fuel buyers and, if necessary, would deploy Customs officers to oil depots to check the end use of fuel. On the sale side, the C&ED, in conjunction with other enforcement agencies such as the Hong Kong Police Force (HKPF) and the Fire Services Department, conducted large-scale raids from time to time on illegal detreating plants and filling stations. On the use side, the C&ED selected vehicles for road-side checking and used advanced equipment to test the fuel on the spot. After years of continued efforts, illicit fuel activities were now largely under control. In the light of the latest circumstances surrounding the use of illicit fuel, the C&ED would continue to clamp down on the illicit activities; and
- the C&ED fully agreed with other recommendations made by the Director of Audit, such as those on the implementation of the Open Bond System, the C&ED's audit on oil companies and the monitoring and measurement of the C&ED's performance, and would implement them at an appropriate time.

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Abuses of cigarette duty-free concessions

3. According to paragraph 3.10 of the Audit Report, during the visits in June and July 2002, Audit staff observed the sales activities at the two duty-free shops at the Arrival Hall of the Lo Wu Terminal Building. A total of 72 transactions were observed before 5 July 2002, i.e. before the new duty-free concession of 60 cigarettes for each local resident came into effect. According to paragraph 3.11(d), Audit staff noted that only on two occasions were the customers' requests challenged by the sales staff. The Committee understood from paragraph 3.9 that as the duty-free shops on the Hong Kong side were operated under licences granted by the C&ED, the licensee was required, under the licence conditions, to ascertain the status of the travellers and ensure that the quantities of dutiable goods sold to an arrival traveller should not exceed his or her entitled duty-free concession. Moreover, the invoices should contain the customer's name and the quantities of goods sold. The Committee further noted from paragraph 3.14 that according to the "Guidelines and Procedures on Crowd Control System and Operating Arrangement", the operator of the duty-free shops had to ensure that each transaction could be completed in five seconds in order to avoid obstructions to passenger flow.

4. It appeared to the Committee that there was a conflict between the licence conditions imposed on the operator of the duty-free shops and the five-second requirement. It seemed that it was not practicable to require the licensee to complete all the procedures within the five seconds allowed for each transaction. The Committee enquired whether it was a requirement imposed by the Kowloon-Canton Railway Corporation (KCRC) on the operator of the duty-free shops.

5. The **Commissioner of Customs and Excise** replied that the duty-free shops were in the KCRC premises. The operator of the shops was the KCRC's tenant. He understood that the KCRC had imposed the five-second requirement as a condition on the tenant.

6. In view of the above reply, the Committee further asked whether:

- the five-second requirement was also a term in the Licence Agreement between the KCRC and the operator of the duty-free shops at the Arrival Hall of the Lo Wu Control Point;
- the "Guidelines and Procedures on Crowd Control System and Operating Arrangement" had been devised by government departments;

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- the status of the Guidelines, specifically its binding effect; and
- the consequences faced by the operator of the duty-free shops for non-compliance with the Guidelines.

7. In his letters of 19 December 2002 and 15 January 2003, in *Appendices 30 and 31* respectively, the **Commissioner of Customs and Excise** advised that:

- the C&ED had received confirmation from the KCRC that the five-second requirement was not a term in the Licence Agreement between the KCRC and the Duty Free Shop at the Lo Wu Terminal. The requirement had been issued by the KCRC as part of a set of operational guidelines for the inbound duty-free business at the Lo Wu Terminal. Its main purpose was to facilitate smooth customer flow and avoid queuing up outside the premises;
- the “Guidelines and Procedures on Crowd Control System and Operating Arrangement” had been devised by the Lo Wu Management Committee comprising the Immigration Department (ImmD), the C&ED, the HKPF and the KCRC. The Duty Free Shop operator had undertaken to observe and comply with these guidelines; and
- the KCRC had confirmed that the Guidelines had no legal status in relation to the Licence Agreement between KCRC and the Duty Free Shop and was not legally binding on the latter. As such, there would not be any legal consequences faced by the Duty Free Shop for not complying with the Guidelines.

8. Noting the need for crowd control and the control of passenger flow, the Committee asked:

- the Director of Immigration to comment on the practicability of the five-second requirement; and
- whether the requirement would be reviewed.

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9. **Mr Raymond LAI Tung-kwok, Director of Immigration,** and the **Commissioner of Customs and Excise** said that:

- from the ImmD's point of view, it certainly hoped that passenger flow was smooth and there were no obstructions; and
- the C&ED would carefully examine whether the licensee was allowed sufficient time under the five-second requirement to complete a transaction in full compliance with the relevant licence conditions. If it was found to be impossible to complete a transaction in five seconds, the C&ED would discuss with the government departments concerned and review the requirement.

10. In the light of the Director of Immigration's above response, the Committee asked the Director to elaborate on the impact of the five-second requirement on passenger flow at the Lo Wu Control Point. The **Director of Immigration** said that:

- there were 7,000 incoming travellers per hour. The problem concerned not only the time allowed for each transaction of dutiable goods but also the behaviour of the travellers. The ImmD was not able to predict the number of travellers who would buy cigarettes at the duty-free shops; and
- the ImmD as well as other government departments were concerned about crowd control at the Lo Wu Control Point. In view of the already huge passenger flow, any obstructions would have a chain effect. Not only would there be long queues waiting for immigration clearance, but also the queues might extend back to the Mainland side, directly impacting on cross-border passenger flow.

11. In response to the Committee's enquiries about the C&ED's review, the **Commissioner of Customs and Excise** informed the Committee that:

- the C&ED was reviewing the licence conditions for the duty-free shops with a view to ensuring that they were effective in protecting government revenue from dutiable commodities. The direction of the review was to trim down the licence conditions as far as possible so that the operator of the duty-free shops would be able to comply with the revised conditions. The C&ED appreciated that cumbersome procedures might result in prolonged transactions; and

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- the C&ED would conduct the review expeditiously and inform the Committee of the outcome or major recommendations of the review.

12. The **Commissioner of Customs and Excise** informed the Committee of the outcome of the review, in his letter of 15 January 2003. He said that:

- the C&ED had completed its review of the licence conditions for the Duty Free Shop at the Lo Wu Terminal. In the review, it had carefully examined all measures to achieve a good balance between the need for revenue protection and the need for facilitating a smooth flow of the huge volume of incoming passengers at the Terminal. It had revised some of the licence conditions to ensure that they were both effective and practicable;
- before implementing the revised licence conditions, the C&ED had consulted the Duty Free Shop and the Department of Justice to ensure that they could be followed in practice and that they were legally proper. A set of guidelines had also been provided to the Duty Free Shop to assist its sales staff in complying with the revised licence conditions. After implementation, on-site inspections had confirmed that the Duty Free Shop was complying with the revised licence conditions without difficulty. The C&ED would continue to closely monitor the sales activities of the Duty Free Shop to ensure its compliance with the revised licence conditions; and
- with the introduction of the revised licence conditions, a transaction for the sale of duty-free cigarettes over the sales counter at the Duty Free Shop at the Lo Wu Terminal could now be completed within five seconds. Hence, it was considered no longer necessary to review the five-second requirement. Nonetheless, the C&ED would continue to closely monitor the sales activities.

13. The Committee noted from the Commissioner of Customs and Excise's letter of 15 January 2003 that under the new licence conditions, if the dutiable goods sold by the licensee exceeded the prescribed quantity, the licensee was required to deliver and hand over the dutiable goods to the passenger in the presence of a Customs officer stationed at the Customs and Excise Duty Payment Office, Lo Wu Terminal. The Committee enquired:

- whether the handing over of dutiable commodities under the new licence conditions took place before the passenger went through arrival clearance;
- whether the Customs and Excise Duty Payment Office functioned as a separate retail outlet from the duty-free shops; and

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- about the details of the procedures in respect of the requirement for the licensee to deliver and hand over the dutiable goods to the passenger in the presence of a Customs officer, specifically the information on:
 - (a) the functions of the Customs officer stationed at the Customs and Excise Duty Payment Office; and
 - (b) whether the Customs officer was required to inspect the passport or travel document of the passenger and, if so, whether the inspection was conducted on every single passenger.

14. The **Commissioner of Customs and Excise** informed the Committee vide his letter of 28 January 2003, in *Appendix 32*, that:

- when the quantity of cigarettes to be purchased by a customer exceeded the duty-free concession, the duty-free shop would issue the customer with an invoice after receiving payment and inform the customer to proceed, through the Immigration counters, to the Customs and Excise Duty Payment Office at the Customs area for duty payment and collection of the cigarettes. Where necessary, the duty-free shop would supply a map to the customer showing how he or she could proceed to the Payment Office;
- at the same time, the duty-free shop would arrange for a staff member to deliver the cigarettes to the Payment Office, which was not another sales outlet, and wait for the customer there. When the customer showed up, the staff member of the duty-free shop would present the cigarettes purchased by the customer to the Customs officer at the Payment Office;
- the Customs officer would then assess duty on the cigarettes. Duty would only be levied on the quantity of cigarettes in excess of the duty-free concession. In suspicious cases, the Customs officer might need to inspect the customer's travel document in order to verify whether the customer had met all the requirements for enjoying the duty-free concession. The customer could collect the cigarettes after payment of duty; and
- this requirement was a measure for the protection of revenue and the duty-free shops had been consulted before its implementation. As the Payment Office was away from the duty-free shop and such occasions were very rare in practice, this arrangement should not cause any congestion in the arrival halls of the Lo Wu Terminal.

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15. To ascertain the practicability of the five-second requirement under the revised licence conditions for the duty-free shops at the Lo Wu Terminal, the Committee invited the Director of Audit to comment on the issue.

16. The **Director of Audit** advised in his letter of 28 January 2003, in *Appendix 33*, that:

- to obtain a better understanding of the implementation of the revised licence conditions, Audit staff had visited the Lo Wu Control Point on 24 January 2003, interviewed the Customs Officer-in-charge and, in his presence, observed on the spot how the revised conditions were applied in practice. Audit staff had also obtained for scrutiny a copy of the new Procedural Guidelines, which supplemented the licence conditions to help the licensee comply with the new licence conditions;
- based on the findings during the visit, he had come to the view that, in terms of practicability, the new licence conditions represented a significant improvement over the previous ones. His main findings were as follows:
 - (a) according to the new licence conditions, the licensee needed not ascertain the status of the customers if their purchases did not exceed the duty-free concessions for local residents. Audit noted that for these purchases, which constituted the vast majority of the transactions, it was possible for the sales staff to complete a transaction in five seconds;
 - (b) if a customer's purchase exceeded the duty-free concession for local residents but did not exceed that for visitors, before selling the goods to him, the licensee was required to ask the customer to prove his visitor status. While it might take more than five seconds to complete the transaction, in Audit's view, this process was necessary to help prevent abuses of duty-free concessions; and
 - (c) if a customer's purchase exceeded the duty-free concession applicable to his resident status, the customer concerned would be asked to go to the Customs and Excise Duty Payment Office to pick up the goods. The dutiable goods would then be delivered to the Payment Office and handed over to the customer in the presence of a Customs officer. The purpose of this arrangement was to ensure that duties were duly assessed and collected. According to the Customs officer in charge of the Lo Wu Control Point, the whole process could take about ten minutes to complete, but so far there had not been any such a transaction. Despite

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the much longer time required to complete the transaction, in Audit's view, this process was necessary for the proper assessment and collection of government revenue; and

- the new licence conditions, supplemented by the Procedural Guidelines, should reduce the risks of abuses of duty-free concessions at source. However, strict compliance with items (b) and (c) above was necessary to ensure the effectiveness of the new procedures.

17. The Committee noted from paragraph 3.8 of the Audit Report that for inbound travellers at the Lo Wu Control Point, duty-free shops were located on both the Mainland side and the Hong Kong side. Travellers could buy duty-free cigarettes from these shops after departure clearance on the Mainland side or before arrival clearance on the Hong Kong side. The Committee pointed out that if the licensee fully complied with the licence conditions mentioned in paragraph 3.9, inbound travellers would prefer buying duty-free cigarettes at the duty-free shops on the Mainland side at which the sales staff neither ask them questions about their status nor ask them to give their names. In this case, the duty-free business on the Hong Kong side would suffer, and abuses of cigarette duty-free concessions would be mainly detected by intercepting travellers for customs checking. As such, the Committee enquired whether the C&ED could seek the cooperation of the Shenzhen authority to tighten the control on the sale of duty-free cigarettes on the Mainland side.

18. The **Commissioner of Customs and Excise** responded that:

- it was the C&ED's responsibility to prevent abuses of cigarette duty-free concessions. Hence, in response to Audit's recommendation on the 24-hour rule for duty-free concessions and after discussion with the ImmD, the C&ED would install at the Lo Wu Control Point a computer workstation which was linked to the ImmD's database. Customs officers could verify with the ImmD in suspicious cases to confirm whether the travellers had been away from Hong Kong for more than 24 hours; and
- according to international practice, restrictions were normally not imposed by duty-free shops on departing passengers regarding the purchase of duty-free cigarettes. Thus the Shenzhen authority was not responsible for enforcing the relevant Hong Kong legislation on behalf of the C&ED. He could discuss the matter with the Shenzhen authority but could not undertake that it would have positive results. He had no authority to demand that the control on the sale of duty-free sales be tightened on the Mainland side.

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19. According to paragraph 3.26 of the Audit Report, in 1991, the Commissioner of Customs and Excise imposed the 24-hour rule under which local residents returning to the territory after an absence of less than 24 hours would not qualify for duty-free concessions. However, as the Home Visit Permit would eventually be replaced by the Home Visit Card, the 24-hour rule would be more and more difficult to uphold. The Committee asked whether there was a need to review the 24-hour rule.

20. **Hon Frederick MA Si-hang, Secretary for Financial Services and the Treasury**, said that:

- in the past, Hong Kong residents used the Home Visit Permit for travels to the Mainland. Customs officers could rely on the date chop on the traveller's Home Visit Permit for verification of the traveller's claim about his duration of stay outside Hong Kong. With the introduction of the Home Visit Card, the C&ED could still check the departure date of a traveller through the ImmD, but the process would take longer time; and
- the Administration would review the policy concerning the 24-hour rule for duty-free concessions. It would take into account the need to protect government revenue and the need to enforce the 24-hour rule.

21. The Committee enquired about the reasons for retaining the 24-hour rule. The **Commissioner of Customs and Excise** replied that in many places in the world, inbound travellers were entitled to duty-free concessions. The 24-hour rule introduced in 1991 only applied to Hong Kong residents returning to the territory. In the light of the circumstances at that time, the aim was to prevent "itinerant traders" from bringing back duty-free cigarettes from the Mainland to Hong Kong several times a day.

22. The Committee pointed out that the 24-hour rule was specified in the Dutiable Commodities (Exempted Quantities) Notice made under the Dutiable Commodities Ordinance. The Commissioner of Customs and Excise had been empowered to make decisions to revise the rule. The **Commissioner of Customs and Excise** responded that as the issue concerned protection of government revenue, he might not be able to make a decision on his own.

23. Referring to C&ED's plan to install a computer workstation at the Lo Wu Control Point to facilitate its speedy verification with the ImmD on the duration of a traveller's absence from Hong Kong, the Committee enquired about the details of the proposed mechanism.

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24. The **Director of Immigration** provided the tentative proposal by the C&ED on the mechanism vide his letter of 14 December 2002, in *Appendix 34*. The Director said that comments from the Privacy Commissioner for Personal Data and the Independent Commission Against Corruption (ICAC) on the proposed mechanism were being sought.

25. Noting the C&ED's proposed installation of three workstations at its offices at Lo Wu, Lok Ma Chau and the Hong Kong-Macau Ferry Terminal, the Committee considered that there was a need to protect personal data and prevent abuse on the use of the facility. The Committee therefore enquired:

- about the safeguards against the possible abuse on the use of the facility;
- about the timetable for the implementation of the verification mechanism; and
- whether the C&ED would consult the relevant LegCo Panel on the issue of protection of personal data in relation to the implementation of the mechanism.

26. In his letter of 25 January 2003, in *Appendix 35*, the **Commissioner of Customs and Excise** stated that:

- to enable the C&ED to effectively enforce the 24-hour rule in relation to the duty-free concession for incoming passengers, it was now putting in place an on-line communication arrangement between the C&ED and the ImmD. Under the arrangement, three computer workstations dedicated for limited on-line enquiry function were installed at the C&ED's offices at the Lo Wu Control Point, the Lok Ma Chau Control Point and the Hong Kong-Macau Ferry Terminal to enable the C&ED to make verification with the ImmD in suspicious cases, e.g. couriers seen crossing the Lo Wu Terminal several times a day. The C&ED would not conduct such verification on every incoming passenger;
- upon an on-line enquiry through one of the workstations, an authorised C&ED officer of the rank of Inspector or Senior Inspector would see on the screen of the workstation a "Yes" or "No" which indicated whether an incoming passenger travelling on a Hong Kong identity card had spent more than 24 hours or less outside Hong Kong. Apart from this information, the workstations would not allow any enquiry to be made on personal data of any kind and there would be no release of personal data either;

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- the C&ED and the ImmD had consulted the Office of the Privacy Commissioner for Personal Data (PCO), the ICAC and the Department of Justice when formulating the operating procedures for the new arrangement. All measures on protection of personal data and prevention of abuse on the use of the facility, including those suggested by the PCO and the ICAC, had been incorporated into the finalised procedures;
- installation work of the workstations at the three control points had been completed. The C&ED intended to implement the verification mechanism by the end of February 2003; and
- the C&ED's operating procedures had contained sufficient safeguards for protecting the personal data collected under this new arrangement and preventing abuse on the use of the facility. Notices would be put up at all control points to inform passengers of their rights under the Personal Data (Privacy) Ordinance. The C&ED would also widely publicise the arrangement through the mass media before it commenced using the verification mechanism.

27. The Committee invited Audit's comments on the new verification mechanism proposed by the C&ED. In his letter of 28 January 2003, in **Appendix 36**, the **Director of Audit** commented that the new verification mechanism would enable the C&ED to enforce the 24-hour rule more effectively. In particular, he welcomed the C&ED's proposal to widely publicise the new verification mechanism through the mass media before its commencement. In his view, the C&ED's efforts would have a definite deterrent effect on the couriers and other habitual abusers. More importantly, it would help the otherwise law-abiding citizens better understand the 24-hour rule.

28. Referring to the summary of comments from the PCO in the Commissioner of Customs and Excise's letter of 25 January 2003, the Committee sought the Privacy Commissioner for Personal Data's comments on whether the C&ED's response therein had adequately addressed the suggestions made by the PCO on the protection of personal data and the prevention of abuse on the use of the facility.

29. The **Acting Privacy Commissioner for Personal Data** advised in his letter of 29 January 2003, in **Appendix 37**, that the PCO welcomed the C&ED's response to its comments. The Acting Privacy Commissioner also made suggestions on certain items stated in Part B of Annex IV of the Commissioner of Customs and Excise's letter.

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30. In his letter of 5 February 2003, in *Appendix 38*, the **Commissioner of Customs and Excise** informed the Committee that in response to the suggestions of the Acting Privacy Commissioner for Personal Data in his letter of 29 January 2003, the C&ED had consulted the PCO again and revised its operating procedures for the new verification mechanism accordingly.

31. The Committee understood from paragraph 3.19 of the Audit Report that during the visits paid in June and July 2002, Audit staff observed the activities at selected customs examination counters and, in particular, noted the number of inbound travellers intercepted for checking during the periods under observation. Audit staff reported that of the 36,420 travellers passing through the selected counters, 322, i.e. 0.88%, were intercepted for customs checking. The Committee further noted from paragraph 3.20 that the small percentage of travellers intercepted for checking was at variance with the C&ED's performance data which showed that 10% of the travellers were checked. The Committee enquired about the reasons for the variance and the international standard in respect of the percentage of travellers intercepted for customs checking.

32. The **Commissioner of Customs and Excise** explained that:

- the performance data of 10% came from the internal data on the performance of the Control Points Command. The number of travellers checked, as shown by the C&ED's performance data, included not only the number of travellers intercepted for checking at the customs examination counters, but also the number of travellers processed through other means. For instance, the C&ED had deployed more narcotics sniffer dogs to the Lo Wu Control Point. The data on "dog-sniffing" operations was also included in the performance data of the C&ED. In response to Audit's recommendation on the C&ED's preparation of records on the number of travellers checked, he had issued an instruction to capture the breakdown of such data. Front-line officers were required to input the data in a timely manner; and
- in line with international practice, the C&ED adopted a risk management approach in processing travellers. There was no norm in respect of the percentage of customs checking. Moreover, the percentage varied from one control point to another due to different numbers of travellers and different levels of manpower resources.

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33. In the light of the above reply, the Committee asked:

- about the current number of narcotics sniffer dogs and the success rate in the detection of smuggling and drug trafficking activities; and
- whether the C&ED had planned to increase the number of narcotics sniffer dogs.

34. The **Commissioner of Customs and Excise** informed the Committee in his letter of 6 January 2003, in *Appendix 39*, that currently, the C&ED had 25 narcotics sniffer dogs. In 2001 and 2002, seven drug seizures with a total value of \$2 million had been detected by the sniffer dogs. The C&ED planned to increase two specially trained dogs in 2003 for detection of bombs and explosives.

35. The Committee understood that the “Yellow Bird Operation” was a means to prevent abuses of the duty-free concessions by travellers bringing excessive duty-free cigarettes into Hong Kong. According to the Commissioner of Customs and Excise’s response in paragraph 3.35(1) of the Audit Report, successful cases had been effected. The Committee enquired about the number of such operations conducted since the release of the Audit Report.

36. The **Commissioner of Customs and Excise** replied that the C&ED had conducted about ten such operations every month. The team concerned, apart from combating cigarette smuggling, were also required to discharge other anti-smuggling duties.

37. Paragraph 3.18 of the Audit Report stated that customs control activities at the Lo Wu Control Point were conducted on a selective basis. The Committee enquired:

- about the criteria for and guidelines on sample selection for customs checking;
- whether C&ED had set performance targets on the daily average number of inbound travellers to be intercepted for checking by a Customs officer and the daily percentage of the number of inbound travellers intercepted for checking against the number of inbound travellers passing through the customs examination counters; and

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- the percentage, for each day of the month of November 2002 at the Lo Wu Control Point, of inbound travellers intercepted for checking, the daily number of Customs officers deployed for this purpose, and the daily average number of travellers checked by each Customs officer.

38. The **Commissioner of Customs and Excise** stated in his letter of 6 January 2003 that:

- the C&ED adopted a risk management approach in processing passengers at various control points. Internal guidelines had been distributed to front-line officers to assist them in applying risk indicators for passenger selection. Such risk indicators included a passenger's behaviour and physical appearance, passport information, and the type and content of baggage he or she was carrying. Prevailing smuggling trends and methods and the background of a particular passenger would also be important elements to assist the Customs officers' judgement; and
- selection of a passenger for checking was an individual assessment based on the experience of a Customs officer. Therefore, the C&ED had not set any performance target on the number of passengers to be selected for customs checking.

The Commissioner also provided the operational statistics for the month of November 2002 vide his letter.

39. Turning to Audit's recommendation on the imposition of adequate penalties on abusers of duty-free concessions mentioned in paragraph 3.34(i) of the Audit Report, the Committee asked whether the C&ED would consider imposing heavier penalties on such abusers so as to increase deterrence.

40. The **Commissioner of Customs and Excise** responded that:

- under the Dutiable Commodities Ordinance, if a traveller declared to the Customs officers that he was in possession of excessive cigarettes, he or she would be allowed to pay the duty or surrender the cigarettes to customs. If a traveller was found to have made a false declaration, he or she would be prosecuted or fined under the "Compounding Scheme". Currently, the maximum penalty was very heavy, which was a fine of \$1 million and two years' imprisonment; and

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- the C&ED had recently introduced a new Customs clearance mode. The pilot run of "Customs Clearance Cubicle" had been launched at the Hong Kong-Macau Ferry Terminal. The C&ED was exploring ways to improve the mode of declaration in the context of the new Customs clearance mode. It would examine the need to provide a special channel for declaration of dutiable goods by travellers.

Monitoring and measurement of the C&ED's performance in tackling cigarette smuggling

41. As revealed in paragraph 4.7 of the Audit Report, the Anti-Illicit-Cigarette Task Force (AICTF), now comprising 84 officers, was dedicated to tackle all forms of cigarette smuggling activities. According to paragraph 4.13, 44 of the posts might be deleted in April 2003. The Committee enquired:

- about the effectiveness of the AICIF in combating cigarette smuggling; and
- how the C&ED would cope with the possible reduction of anti-smuggling resources.

42. The **Commissioner of Customs and Excise** replied that:

- as far as C&ED's enforcement action against street-peddling activities was concerned, the AICTF had arrested 502 sellers in 2000, 658 sellers in 2001 and 751 sellers in the first ten months of 2002. As regards arrests of buyers of illicit cigarettes, 98 persons, 131 persons and 109 persons had been arrested in 2000, 2001 and the first ten months of 2002 respectively; and
- regarding the 44 posts for the AICTF, they had been created on a temporary basis for a period of three years. Given the overall fiscal stringency, the C&ED would not be allocated resources to retain the 44 temporary posts. In addition to regular deployment of staff of other Commands in some large-scale operations, the C&ED would deploy the Special Task Force to assist in combating street-level peddling activities.

43. The Committee was concerned about a possible increase in cigarette smuggling activities consequent upon the reduction of anti-smuggling resources. The **Commissioner of Customs and Excise** responded that:

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- combating illicit sale of cigarettes at street level, illicit fuel activities and pirated optical discs business would remain the priorities in the C&ED's enforcement actions. He would ensure optimal deployment of resources as far as possible and hoped that effectiveness of the actions would not be reduced following the deletion of the 44 posts for the AICTF; and
- although the Government was facing fiscal constraints, he, as Head of Department, had the responsibility to do his best with the resources available.

Illegal vehicle refuelling activities

44. On the problem of illicit use of synthetic motor spirit, the Committee noted from the paper submitted by the C&ED before the public hearing that the C&ED had launched an action plan on 25 November 2002 to strengthen the effectiveness of actions against the illicit activities. Within a week from 25 November 2002, oil companies only registered sales of 240,000 litres of rubber solvent, toluene and xylene, which were the ingredients for making synthetic motor spirit. Paragraph 6.11 of the Audit Report revealed that the C&ED was aware that there were a few chemical companies which had bought drums of such chemicals and repacked them into small tins for local use as cleansing agent and solvent. It was estimated that each month, 20,000 to 30,000 litres of such chemicals would be sufficient for local industrial use.

45. It appeared to the Committee that a high percentage of the locally consumed rubber solvent, toluene and xylene were still being illegally used for making synthetic motor spirit after the implementation of the action plan. It wondered whether the C&ED was able to combat the widespread misuse of the chemicals.

46. **Mr CHOW Oi-tung, Assistant Commissioner (Intelligence and Investigation)**, replied that:

- since 25 November 2002 and after seeking cooperation from the oil companies, Customs officers were deployed to oil depots to check the end use of the chemicals. If the backgrounds of the purchasers of these chemicals were found to be doubtful, Customs officers would escort the chemicals to the declared destinations; and

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- following the implementation of the above measures, there were clear indications that sales of the chemicals had dropped substantially. The C&ED considered that the actions had contained the problem of the misuse of the chemicals. As the C&ED had collected information on the end use of the chemicals, it would make continued efforts to tackle the problem.

47. The Committee further enquired whether Customs officers would escort the chemicals to the declared destinations in all cases. The **Assistant Commissioner (Intelligence and Investigation)** explained that many purchasers were aware of the new measures and gave up the purchases, which represented a substantial volume of sales. As regards purchases claimed to be for legal uses, Customs officers would escort the chemicals to the declared destinations. There were not many such cases.

48. Turning to the C&ED's efforts in tackling illicit oil refuelling activities, the Committee noted from paragraph 6.16 of the Audit Report that in one case, the C&ED had since 1998 conducted 35 raids on an illegal detreating plant with underground storage tanks. As at July 2002, the C&ED believed that the plant was still operating actively. However, it was stated in the C&ED's paper that according to the C&ED's latest intelligence, all illegal detreating plants with underground storage tanks had ceased operation. The Committee wondered why the C&ED had not been able to remove the detreating plant after the 35 raids.

49. The **Assistant Commissioner (Intelligence and Investigation)** explained that in the past, the major difficulty was the complicated network of the underground storage tanks. After the C&ED blocked the tanks in a raid, the operator would re-open the detreating plant. In the 36th raid, the C&ED, in conjunction with the HKPF, deployed more than 400 officers. The HKPF sent a search team to assist in the operation and used radars to obtain a full picture of the network of all the tanks. Hence, the C&ED was able to completely block all the tanks. The operator could no longer use the site to operate the detreating process. The operation was very successful. According to intelligence from various sources, the plant had now ceased operation.

50. The Committee further asked why the C&ED had not sought the cooperation of the HKPF in earlier raids. The **Assistant Commissioner (Intelligence and Investigation)** responded that:

- the C&ED had set up an Intelligence and Investigation Branch on 2 July 2002, which enabled the C&ED to deploy manpower more flexibly and strengthen the collection of intelligence; and

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- the C&ED had all along sought the cooperation of the HKPF in various operations. The raid on the detreating plant on 16 September 2002 was of the largest scale, which resulted in the removal of the plant.

51. Conclusions and recommendations The Committee:

Abuses of cigarette duty-free concessions

- expresses concern:
 - (a) that because of the small percentage of travellers intercepted for checking at the customs examination counters, abusers of cigarette duty-free concessions could easily escape customs detection;
 - (b) that the Customs and Excise Department (C&ED) did not monitor the sales activities at the duty-free shops to ensure compliance with the licence conditions;
 - (c) about the practicability of requiring duty-free shops to complete each transaction in five seconds as specified in the "Guidelines and Procedures on Crowd Control System and Operating Arrangement";
 - (d) about the slow progress made by the C&ED in implementing the measures identified in the February 2000 departmental paper for enforcing the 24-hour rule; and
 - (e) that the existing baggage examination procedures at the customs examination counters have little deterrent effect on abusers of duty-free concessions, because the procedures allow abusers to escape penalty even if they are intercepted at the counters for checking;
- acknowledges that:
 - (a) the C&ED has revised the licence conditions for the duty-free shops to ensure that the new procedures implemented from 1 January 2003 are effective and practicable under the five-second requirement; and
 - (b) the C&ED, with the assistance of the Immigration Department (ImmD), will implement new measures to enforce the 24-hour rule and has completed the installation work of the workstations at the three control points, with a view to obtaining speedy confirmation with the ImmD on the duration of a traveller's absence from Hong Kong;

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- urges the Commissioner of Customs and Excise to:
 - (a) closely monitor the sales activities at the Lo Wu duty-free shops to ensure compliance with the new procedures;
 - (b) consider implementing the measure of routing day-trippers through a special channel, with a view to facilitating risk-based customs checking of inbound travellers, effective enforcement of the 24-hour rule and the imposition of adequate penalties on abusers of duty-free concessions;
 - (c) consult the Legislative Council on the proposed mechanism for verification of the duration of a traveller's absence from Hong Kong and, upon implementation of the mechanism, publicise the details of the mechanism and travellers' rights under the Personal Data (Privacy) Ordinance;
 - (d) notwithstanding the need to prevent, detect and deter abuses of cigarette duty-free concessions, ensure that any new measures to be adopted are enforceable and will not cause obstructions to passenger flow; and
 - (e) conduct a comprehensive post-implementation review of the new procedures associated with the revised licence conditions for duty-free shops and of the new verification mechanism at an appropriate time;

Illegal vehicle refuelling activities

- expresses concern that:
 - (a) there are indications of a widespread misuse of rubber solvent and toluene for making synthetic motor spirit, and that the C&ED had faced difficulties in its enforcement against such misuse;
 - (b) the C&ED had encountered difficulties in closing down and removing illegal detreating plants with underground storage tanks. For instance, in one case, an illegal detreating plant was still operating actively after the 35 raids conducted since 1998 by the C&ED;
 - (c) the turnover of marked oil had tripled from 3 billion litres in 1997 to 9 billion litres in 1999, and that although the turnover had subsequently gone down to 5 billion litres in 2001, it was still much higher than the turnover in 1997; and

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- (d) even if the percentage of the marked oil sold by oil companies and diverted to illegal use as vehicle fuel was small, the revenue loss suffered by the Government could be substantial;
- acknowledges:
 - (a) that the C&ED launched an action plan in November 2002 to strengthen the effectiveness of actions against the illicit use of synthetic motor spirit;
 - (b) that an inter-departmental working committee, led by the C&ED, was set up in April 2002 to address the problem of illegal detreating plants with underground storage tanks;
 - (c) that the C&ED, in conjunction with the Hong Kong Police Force, successfully launched a large-scale raid in September 2002 to remove the illegal detreating plant on which the C&ED had previously conducted 35 raids, and that according to the intelligence as at early December 2002, all the illegal detreating plants had ceased operation;
 - (d) the Commissioner of Customs and Excise's assurance that, to detect illegal users, the C&ED will continue to take various control measures to prevent the illegal use of marked oil and will conduct verification exercises (similar to the one mentioned in items (e) and (f) of Table 4 in paragraph 6.21 of the Audit Report) on a regular basis; and
 - (e) the Commissioner of Customs and Excise's undertaking that the C&ED will study the control system in the United Kingdom to see whether it is feasible to adopt it in Hong Kong;
- urges the Commissioner of Customs and Excise to continue the actions on controlling the sale and use of those chemicals that can be used as ingredients for making synthetic motor spirit;

Fuel oil duty-free concessions for cross-boundary vehicles

- expresses concern that under the existing duty-free arrangement, cross-boundary goods vehicles bring into Hong Kong an estimated 679 million litres of Mainland diesel a year, which far exceeds their estimated operational needs of 236 million litres a year;

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- acknowledges the Commissioner of Customs and Excise's assurance that the problem of illicit transfers of Mainland diesel from cross-boundary vehicles to local vehicles is under control, and that the C&ED will make sustained efforts to prevent possible resurgence of the problem;
- notes the comments of the Secretary for the Environment, Transport and Works that there are no strong environmental grounds for reducing the duty-free concessions at this time, and that she will consider the need for reducing the concessions on environmental grounds in the light of the effectiveness of the C&ED's enforcement actions;
- urges the Commissioner of Customs and Excise and the Secretary for the Environment, Transport and Works to remain vigilant in managing the risk of illicit transfers of Mainland diesel, having regard to the fact that the quantity brought into Hong Kong by cross-boundary vehicles far exceeds their operational needs and that there is a significant price difference between Mainland and Hong Kong diesels;

Other audit findings

- supports Audit's recommendations in paragraphs 2.16, 2.25, 4.14 and 5.11 of the Audit Report;
- urges the Commissioner of Customs and Excise to expeditiously follow up Audit's recommendations; and

Follow-up actions

- wishes to be kept informed of the progress made in:
 - (a) preventing, detecting and deterring abuses of cigarette duty-free concessions, including:
 - (i) the results of the post-implementation review of the new procedures associated with the revised licence conditions for the duty-free shops; and
 - (ii) the results of the post-implementation review of the new verification mechanism;
 - (b) combating illegal vehicle refuelling activities;

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- (c) managing the risk of illicit transfers of Mainland diesel; and
- (d) implementing Audit's recommendations in paragraphs 2.16, 2.25, 4.14 and 5.11 of the Audit Report.