

TAX BULLETIN

**ANNUAL MEETING BETWEEN
THE INLAND REVENUE DEPARTMENT AND
THE HONG KONG SOCIETY OF ACCOUNTANTS — 2002**



**HONG KONG
SOCIETY OF
ACCOUNTANTS**

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Preamble

As part of the Society's regular dialogue with the Government to facilitate tax compliance, improve procedural arrangements and to clarify areas of interpretation, representatives of the Society met the Commissioner of Inland Revenue ("CIR"), and members of her staff in February 2002.

As in the past, the agenda took on board items received from a circulation to members of the Society prior to the meeting. The minutes of the meeting, prepared by the Inland Revenue Department ("IRD") are reproduced in full in this Tax Bulletin and should be of assistance in members' future dealings with the IRD. Part A contains items raised by the Society and Part B, items raised by IRD.

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Full Minutes

The 2001/2002 annual meeting between the Hong Kong Society of Accountants' Taxation Committee and the Commissioner of Inland Revenue was held on Wednesday 6 February 2002 at the Inland Revenue Department.

IN ATTENDANCE

Hong Kong Society of Accountants (the Society)

Mr Tim Lui	Chairman, Taxation Committee
Ms Yvonne Law	Deputy Chairman, Taxation Committee
Mr Paul M.P. Chan	Member, Taxation Committee
Mr David Smith	Member, Taxation Committee
Mr David Southwood	Member, Taxation Committee
Mr Peter Tisman	Deputy Director (Business & Practice)
Mr John Tang	Assistant Director (Business & Practice)

Inland Revenue Department (IRD)

Mrs Alice Lau	Commissioner of Inland Revenue
Mr Tam Kuen-chong	Deputy Commissioner of Inland Revenue (Technical)
Mr Luk Nai-man	Deputy Commissioner of Inland Revenue (Operations)
Mr So Chau-chuen	Assistant Commissioner of Inland Revenue
Mr Chu Yam-yuen	Assistant Commissioner of Inland Revenue
Mr Chan Cheong-tat	Assistant Commissioner of Inland Revenue
Mr Wong Ching-ping	Senior Assessor (Special Duties)

Mrs Alice Lau (CIR) welcomed the Society's representatives to the meeting and introduced the IRD officers in attendance. She reiterated her support for the annual meeting which has been a useful forum of communication on practical issues affecting both the Society's members and IRD. Mr Lui thanked CIR for her words of welcome. The meeting then proceeded to discussion of the agenda items put forward by both sides.

PART A — MATTERS RAISED BY HKSA

AGENDA ITEM A1 – ISSUE OF GUIDANCE

A1(a) Transfer Pricing

The Society observed that IRD had issued no guidance on transfer pricing, although a brief reference to transfer pricing could be found in the Departmental Interpretation & Practice Notes (DIPN) No.11A “Elements of Field Audit”. In this regard, the Society would like to know the current thinking of and methodology used by IRD in respect of transfer pricing and whether the Commissioner would consider issuing a DIPN on transfer pricing.

Mr Tam advised that currently IRD applied the arm’s length principle to evaluate the pricing strategies between enterprises and their non-resident associates. Notwithstanding the lack of specific legislation similar to the OECD guidelines for the adjustment of transfer pricing transactions, it was considered that sections 20, 21A, 61 and 61A of the Inland Revenue Ordinance (the IRO) provided authorities for the IRD to tackle anti-avoidance schemes through transfer pricing arrangements. The application of sections 20, 21A and 61A has been documented in DIPN11A (Elements of Field Audit), DIPN15 (Part C General Anti-Avoidance Provisions) and DIPN22 (Section 21A). These DIPNs were to be reviewed and updated on a regular basis. As such, IRD did not see any immediate need to provide more information now, but the situation would be kept under review in the light of changing circumstances.

CIR added that this matter would certainly be given serious thoughts in due course.

A1(b) Court of Final Appeal decision in the Secan case

The Society noted that two main areas of uncertainty had arisen subsequent to the decision of the Court of Final Appeal in CIR v Secan Limited and Ranon Limited, viz. the timing of deductibility of prepayments and deferred costs. It was of the view that the decision cast doubt on the traditional interpretation of the meaning of “incurred” following the Privy Council decision in CIR v Lo & Lo (2 HKTC 34) i.e. that “an expense incurred” was not confined to a disbursement, and had at least to include a sum of which there was an obligation to pay (p.72 of the Privy Council decision). The Society requested a clarification of the Commissioner’s views on these two areas following the Secan decision. It understood that IRD was preparing a DIPN dealing with the uncertainties raised by the Secan case and urged an early clarification of these issues.

CIR replied that having consulted the Department of Justice, IRD decided to change the practice in relation to the tax treatment of prepayments and deferred costs. Under the new practice, if the expenses were “amortized” in the subsequent accounting period, they would be allowed for deduction in the year in which they were actually charged to the P & L account. In other words, taxpayers could not defer the expenses for accounting

purposes but at the same time claimed a one-off deduction for tax purposes. The tax treatment would follow the accounting treatment. IRD was preparing a DIPN to explain the new practice. The drafted DIPN would be sent to the Joint Liaison Committee of Taxation (JLCT) for comment. Mr So said it would take some time before the first draft was sent to JLCT and undertook to give sufficient time for submissions to be made on the draft DIPN.

AGENDA ITEM A2 – TAX FILING DEADLINES

A2(a) 'M' Code companies

The Society noted that under current practice, the tax filing deadline of block extension for 'M' Code companies with tax losses fell on 31 January. However, companies with assessable profits for the current year which would be completely set off by tax losses were, strictly speaking, not entitled to such an extension and were required to meet the tax filing deadline of 15 November. The Society would like to know if the Commissioner would consider granting a similar extension to such companies (to file returns by 31 January) where applicable.

Mr So explained that IRD had considered the proposal carefully but was of the view that these cases might eventually turn out to be taxable cases e.g. when the current year's assessable profits reported in the return were incorrectly calculated and the assessable profits as adjusted by the Assessor actually exceeded the loss brought forward. To allow sufficient time to process these cases, IRD would therefore not consider changing the current practice i.e. the filing deadline would still be 15 November.

A2(b) Block extension scheme for 'N' Code companies

Currently, profits tax returns for 'N' Code companies are issued in the beginning of April each year. Such companies are required to file profits tax returns (together with their audited financial statements) within one month after issue. The Society requested that the Commissioner to consider granting extensions more flexibly to taxpayers who could justify their applications for extension on reasonable grounds.

Mr Tam responded by saying that the accounting date of most "N" code cases was 30 June. The filing deadline for them fell on 30 April. Therefore, 10 months had been allowed for these "N" code cases. This was longer than the time allowed for "D" and "M" code cases. There was therefore no justification to give a different treatment to "N" code cases. Mr So supplemented that there were few cases closing their accounts in November. CIR added that where justified, IRD would consider applications for extension on a case-by-case basis.

A2(c) Submission of profits tax return for newly incorporated companies

The Society noted that recently profits tax returns had been issued to some newly incorporated companies for the year of commencement of business. It suggested that consideration be given to allowing more time for submission of returns, especially where two years of assessment were covered by the accounting basis period to avoid unintentional late filing and the need to apply for an extension.

Mr Tam explained that for newly incorporated companies, Profits Tax Returns would be issued some 18 months after the date of incorporation. This practice was based on the provisions of the Companies Ordinance. A company's first annual general meeting should be held within 18 months after its incorporation [s.111(1)] and its profit and loss account and balance sheet made up to a date not earlier than 9 months before the date of the AGM should be laid at that AGM [s.122(1)]. As a result by the time a return was issued, the accounts of the company concerned should have already been approved. A lengthy extension for filing the return was therefore not appropriate. However application for extension would be considered on the merits of the case. Mr Tam said that tax representatives should urge their clients to comply with the Companies Ordinance. CIR added that granting of extension would send a wrong message of encouraging non-compliance of the Companies Ordinance.

AGENDA ITEM A3 – IMPROVING THE LEVEL OF CERTAINTY – PROFIT CASES

A3(a) "Assess First Audit Later" programme

The Society pointed out that practitioners were advised in Commissioner's circular letter dated 30 March 2001 re. "Block Extension Scheme For Lodgement Of 2000/01 Tax Returns" of the "New Assessing Programme-Assess First Audit Later". Tax representatives were often asked by clients if their tax returns for a particular year of assessment had been accepted and agreed by IRD. The Society enquired as to the Commissioner's interpretation of the practical effect of the new "Assess First Audit Later" regime in terms of the timeframe within which tax returns for a particular year of assessment might be regarded as agreed by the IRD. It asked if more assurance could be provided to taxpayers than to state that an assessment could be regarded as concluded only at the expiration of the time period provided for in s.60(1) of the IRO.

CIR replied that IRD's position remained unchanged, i.e. the assessments would be subject to review within the time limit laid down in s.60. In practice, IRD aimed at reviewing most assessments within 2 years after the date of issue. However in some cases, enquiries might be issued after that period. Examples of such cases included:

- (a) Fresh information was received from third parties.
- (b) The review of the current year's return indicated that the same issue existed for past years e.g. s.61A cases, understatement of profits etc.

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- (c) A small number of past years' returns would be picked up by the computer program for review (as a quality assurance measure).

Mr Lui asked if any confirmation of finalization of assessment would be sent after the expiry of the 2-year period. CIR replied that the assessments were still subject to the operation of s.60, therefore, no confirmation would be issued after 2 years. Mr Lui further asked how changes in the prevailing practice or legislation would affect the assessments. Mr So replied that DIPNs would usually be issued subsequent to such changes and the new practice would normally apply only to open cases e.g. cases under objection and unassessed cases. Mr Tam referred the Society to item A8 in the 2001 minutes concerning the operation of s.60. It clarified that according to IRD internal guidelines, the Assessor needed to submit a finalized case to the Assistant Commissioner for approval before re-opening it due to a change of opinion. In general, Mr Tam suggested that a case would only be re-opened where the original decision was not one that could have reasonably been made (based on the relevant facts then known to the Assessor). Mr So added that re-opened cases were few and on such cases before they were re-opened, Assessors would have to raise enquiries. CIR indicated that, given the limited resources, IRD was as mindful as practitioners of the need for tax enquiries to serve their purposes.

Taking the opportunity, CIR gave an outline of the desk audit systems adopted in the Profits Tax Unit and Individuals Tax Unit of IRD. Briefly, cases would be selected for desk audit by a computer program in each system. In Profits Tax Unit which deals with corporation and partnership cases, two selection methods would be used. Method 1, random selection, selects cases purely by random sampling and all returns have equal chances of being selected. The second method is known as risk assessment selection. This method involves the following procedures:

- Step 1 – determine which items in the returns carry risk, e.g. bad debt
- Step 2 – determine weight to be assigned to each risk factor
- Step 3 – calculate the scores for each risk factor by a formula
- Step 4 – select returns on the basis of the total scores, using a formula set by top management

- Returns with higher scores are more likely to be selected.

- Certain number will also be selected from returns with lower scores for audit control purposes.

- The risk factors, the marks and the selection formula will be varied from time to time in the light of findings from cases selected by both methods.

The Individual Tax Unit uses similar methods except in Method 2, different criteria for different source of income and claims/deductions are employed. Mr So confirmed that not every case reviewed would be sent tax enquiries.

A3(b) Form BIR 51 Profits Tax Return – Corporations

The Society enquired whether there was any particular reason why item 5.3 of the tax return referred to “make payments...” whereas IRO s.15(1)(a), (b) and (d) referred to “sums received by or accrued to” rather than just “received by”. In other words, the Society wished to clarify if the Commissioner required s.15(1)(a), (b) and (d) sums that were accrued, but not paid, to be reported at item 5.3.

Regarding the same item 5.3 the Society further asked if a payment was made or accrued to, e.g., a BVI-incorporated company whose directors were resident in Hong Kong and whose central management and control was in Hong Kong, whether IRD regarded the BVI-incorporated company as a “non-resident person” for the purposes of completing item 5.3. In this regard, the Society referred to the Commissioner’s comment in paragraph 65 of DIPN No. 32 that accepted a company was resident in Hong Kong if its central management and control was in Hong Kong.

Mr So clarified that item 5.3 should be answered with “Yes” if payments had been accrued but not paid. This was consistent with item 11.11. In Notes and Instruction on item 11.11, a taxpayer was required to state royalty payments whether paid or accrued. IRD would clarify this point in the “Common Questions and Answers on Completion of BIR51” in the IRD website.

Mr So clarified that in the case of a BVI-incorporated company where the directors were resident in Hong Kong and its central management and control was in Hong Kong, the BVI-incorporated company should not be regarded as non-resident. Again, IRD would clarify this point in the IRD website.

A3(c) Deductibility of listing and share registry fees, etc. for listed companies

The Society pointed out that recent queries in a case issued by IRD indicated that certain Assessors might be of the view that expenses of listed companies in connection with maintaining a listing on the Stock Exchange of Hong Kong, having the share registry maintained by a share registration company and having securities traded in overseas markets are non-deductible. Such expenses would appear to meet all of the criteria for deductibility under the profits tax provisions, and have previously invariably been accepted as deductible. The Society asked if the recent queries reflected a change of Departmental policy with respect to this type of item, namely it was no longer deductible.

Mr Tam confirmed that there was no change in policy for these expenses. The floatation expenses including listing fee, being of a capital nature, were not deductible but annual listing fees and recurrent share registration expenses were deductible. The case mentioned involved some special features which led to enquiries from the Assessor. It would be dealt with by the Assessor in accordance with the existing policy and normal procedure.

AGENDA ITEM A4 – IMPROVING THE LEVEL OF CERTAINTY – LOSS CASES

A4(a) BIR51 – Agreeing on tax losses brought forward

The Society raised the concern that where companies had substantial tax losses brought forward that would take more than one year to be offset by future profits, no confirmation was received from IRD by way of a statement, query or an assessment in respect of the profits tax returns duly completed and filed. The Society suggested that it would be helpful for taxpayers to be given more certainty in terms of their profits tax position for each year, rather than having to go back to the relevant files in several years' time when IRD reviewed and raised queries for each of the earlier years, by which time new tax representatives might have been appointed. The Society further asked if the Commissioner would consider issuing an assessment or other statement, either confirming the profits tax position or raising queries in respect of a profits tax return earlier, and in any case not more than 12 months after receipt of the return.

CIR responded by saying that the crux of the matter was to agree on the loss. She went on to say that IRD had a performance pledge of assessing 95% of corporation profits tax returns within 12 months from the date of issue of returns (N.B. not date of receipt of returns). The remaining 5% were complicated cases. This target had all along been achieved by IRD.

In the cases cited, it would appear that the root of the problem was the reaching of agreement on the quantum of the loss to be brought forward. If in this process there were several enquiries and follow-up enquiries, the case might drag on for a long time. It appeared that in this type of cases the only practical solution was for both parties to act faster. It was considered not necessary to change the existing performance pledge.

A4(b) Tax loss for companies exempt from annual filing

To assist companies ascertaining their financial position for accounting purpose, the Society suggested that IRD considered confirming the amount of loss carried forward when it exempted a company from filing its annual profits tax return.

CIR replied that the standard practice was to agree the loss before exempting a company from filing returns, i.e. before transferring the files to the Review Section.

However, in some exceptional cases where the Assessor and the Tax Representative could not agree on the loss after lengthy discussion and where it appeared that the business was unlikely to have profits in the near future, the cases would also be transferred to the Review Section. For this type of case, the Tax Representative could ask the Assessor to issue a loss statement showing the items in dispute, if this was not already done.

A4(c) Assessments/statements of loss

As assessments and statements of loss were currently issued by IRD without indicating whether the assessments would be subject to review or enquiries, most taxpayers would therefore assume in such cases that the assessments had been agreed by IRD. The Society queried if IRD would consider including an Assessor's note in an assessment to indicate whether the assessment would be subject to review or enquiries to be issued shortly.

CIR said that at the time the assessment was issued, it was not known whether the assessment would be selected by the computer program for review at a later stage. Taxpayers should be advised that all assessments had equal chance of being selected for review. They should not assume that the assessments would not be subject to review. That said, enquiry would only be raised on doubtful cases which has been selected for review.

AGENDA ITEM A5 – IMPROVING THE LEVEL OF CERTAINTY – HOLDOVER APPLICATIONS IN RESPECT OF PROVISIONAL PROFITS TAX

The Society raised the concern that in cases where there was an extremely tight period in which holdover requests of provisional profits tax could be lodged, different approaches had been taken by different Assessors in relation to similar cases where fewer than eight months' management accounts, as required, had been submitted. Although ultimately such cases might in practice be satisfactorily resolved, there appeared to be no simple and consistent route to their resolution. In addition, in some cases it might be impossible for the taxpayer to apply for a holdover of provisional tax if the policy of eight months' management accounts was rigidly applied and the holdover deadline was less than 3 weeks after the end of the 8-month period. The Society would therefore like to request the following:

- (i) Clarification of the IRD's policy on handling such holdover requests;*
- (ii) Clarification as to whether seven months' management accounts would be accepted by IRD in exceptional cases as the basis for holdover requests (and if so what would be regarded as exceptional?); and*
- (iii) Whether, if accepting seven months' accounts was a problem, flexibility would be exercised and applied consistently in granting reasonable extensions for eight months' accounts to be prepared for holdover purposes.*

Mr Luk pointed out that this topic had been discussed on many occasions in the past (*in 1994, 1999 and 2000 annual meetings*). The IRD's position remained the same as before. He reiterated that the issue date of the assessment should not be considered as the trigger point for taxpayers to begin considering whether they had grounds for applying holdover. This should be done as soon as possible after the close of the 8-month period (from the last accounting date). The assessment issue date should be seen as fixing the time for lodgment, not preparation, of the claim.

For “N” and “D” code cases, eight months’ management accounts were required. In practice, there was seldom any problem with these cases. For “M” code cases, the eight months’ period ends on 30 November and the due date for payment might be set at mid-January in the following year. There was therefore a tight schedule for making holdover claims. In the 1999 annual meeting, IRD agreed to accept, for “M” code cases only, management accounts drawn up either to a date within 7 weeks of the due date for payment of tax or for an 8-month period, whichever was shorter. This policy was still valid. In the 2000 annual meeting, the society asked whether around the Christmas holiday period, IRD would accept 7 months’ management accounts. IRD agreed “very exceptionally, in large, urgent cases, acceptance of 7 months’ accounts might be considered if sufficiently justified”. This policy also stood.

Mr Luk commented that it was not possible to define “exceptional”. Examples included loss of data because of computer virus and sudden serious sickness of the financial controller at the critical time for preparing the 8 months’ accounts. Each case would be considered on its own merits. On the last point raised by the Society, Mr Luk said that IRD was not in favour of granting of extension for submitting the 8 months’ accounts because this would create additional administrative work and would have the practical effect of extending the statutory holdover period.

Mr So supplemented that in December 2001, the Profits Tax Unit processed 1,100 “M” code account holdover cases. According to available information, there were 60 cases asking for acceptance of 7-month management accounts and 10 of them had been accepted as being exceptional cases. The number of exceptional cases in question was therefore not significant. The fact that over 1,000 cases were able to produce 8-month accounts indicated that this was not a serious problem.

Mr Southwood said he came across a case where 3 companies in the same group each applied for holdover of provisional profits tax with 7-month accounts but each received a different treatment. The application of one company was accepted, another was declined and the third one was asked to submit 8-month accounts. Eventually the issue was amicably resolved. Mr So replied that apparently the three files were handled by different assessing officers who were not aware of similar applications in the same group. CIR suggested that at the time of application, attention be drawn to the assessing officers that the companies were of the same group in order that a consistent treatment could be given.

AGENDA ITEM A6 – IMPROVING THE LEVEL OF CERTAINTY – OTHER AREAS

A6(a) Requesting information on issue of returns

Referring to the need of companies exempt from annual filing to ascertain whether a tax return had been issued to them each year, the fact that at present IRD did not entertain such enquiries over the phone and that generally Assessors insisted such enquiries be made in writing, the Society would like to know if the Department would consider the following:

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- (i) *Entertaining such enquiries from tax representatives over the phone so as to reduce administrative effort and improve efficiency for the block extension exercise; and*
 - (ii) *Providing tax representatives with a list of relevant profits tax returns which had been issued, as the tax representatives annually updated the IRD with their list of clients.*

In reply to the first question, Mr Tam informed the Meeting that the Assessor would not reject enquiry over the phone in every case. From experience, some tax representatives had not checked with their clients about the receipt of returns. They preferred to call the Assessors to read out a long list of clients' names and asked the Assessors to confirm whether the returns had been issued. It was therefore suggested that tax representatives should check with their clients first. Meanwhile, Assessors had been instructed to take a more relaxed approach in entertaining telephone enquiries.

As regards the second question, Mr Tam explained that IRD issued over 200,000 returns each year. The bulk of them were issued in April and the rest were issued at different dates in the year. Currently there were about 1,500 tax representatives. This issue had previously been visited and the IRD stance had not changed. It was taxpayers' prerogative whether to continue to engage a particular tax representative to handle the current year return and taxpayers could change their tax representatives during the year without informing IRD. The Society's idea could perhaps lead to the breach of the secrecy provision. It was considered that maintaining client details was the responsibility of individual tax representatives who no doubt were in a better position to compile their own control lists to ensure timely compliance by their clients.

From an administrative point of view, the provision of a list of issued returns to each tax representative would be onerous and costly. If tax representatives were able to update IRD for changes of their clients' addresses timely, the chance of sending returns to the wrong addresses of their clients would be greatly reduced. In fact, only a small number of requests for duplicate returns were received by IRD each year. It was therefore considered not justifiable to commit scarce resources on providing the lists.

A6(b) Assessors' queries

- (i) *The Society noted that where an assessment had been issued with a note that it was subject to review, after the Assessor's queries arising from such a review had been dealt with, it was not unusual for taxpayers to receive no confirmation from the Assessor as to the correctness of the assessment. The Society would like to know if IRD would, for the sake of clarity, consider confirming the assessment previously raised if there were no further queries.*
- (ii) *Whilst The Society acknowledged the duty of Assessors to ask questions where there was a need to do so, and that a similar issue was raised in the previous Annual Meeting (under the heading " Agenda item A10 – Minimizing the requirement to produce extraneous information"), a member had pointed out to the Society that some Assessors had recently tended to ask long questions and the amount of*

information requested was also getting more voluminous and detailed. He referred to the case of a management fee charged by the headquarters of a multi-national corporation where there was no suggestion that this was part of a transfer pricing or tax planning arrangement, but which nevertheless resulted in considerable correspondence and which ultimately dragged on for two years. The tax representative was given the impression that the Assessor was unwilling to accept the replies at face value. The Society would like to know if there was any IRD policy or guideline issued internally in relation to ensuring that queries were kept within reasonable bounds and did not place an undue burden on the taxpayer in cases where there were no obviously exceptional circumstances. If there were such guidelines, the Society questioned what steps had been taken by IRD in ensuring compliance with them.

In response to the first question, CIR told the Society that it was the existing IRD practice for the Assessor before closing a case to issue a standard letter to advise the taxpayer that no taxation adjustment was required in relation to the issues previously raised. The Tax Representative may contact the Assessor to check if a case was closed and asked for the standard letter.

CIR pointed out that the issue in the second question was basically a matter of judgement. Assessors had all the time been reminded not to ask irrelevant questions. However, it was not practicable to set out any strict rules or guidelines. If taxpayers had genuine difficulties in providing the information requested, they should discuss the matter with the Assessor. There were cases where alternative methods had been used to establish certain factual matters and the disputes were settled smoothly.

A6(c) Payment of tax by instalments

The Society was aware that currently tax assessments were issued for discharge either by two instalments or by a single payment normally towards the end of the year, e.g. November, at the discretion of the Assessor. The Society would like to know:

- (i) If there were any criteria for determining whether a particular assessment should be discharged by two instalments or by a single payment; and*
- (ii) Whether the Commissioner would consider providing that all assessments should allow for payment in two instalments?*

In reply, CIR said that the existing policy with regard to due dates was to demand tax payment as soon as possible but not before the income was earned. Two instalments were therefore normally allowed for current year demand notes with provisional tax charged, except for N code profits tax cases and property tax cases.

For corporation profits tax cases, the criterion was that if the due date for payment was earlier than the accounting date of the taxpayer, two instalments would be allowed. Therefore for N code profits tax cases, where the income had been fully earned by the time provisional tax was charged, there was no justification for allowing two instalments. Further,

taxpayers would normally be given 6 weeks to settle their tax bills. Towards the end of the fiscal year, when the '6-week allowance' extended the due date beyond 31 March, a single payment would be demanded.

On the issue of Property Tax due dates, Mr Chu explained that provisional Profits Tax and Salaries Tax were currently largely payable by two instalments - the first falling due in the period from January to March in the same financial year and the second in the period from April onwards in the following financial year with exception for N-code Profits Tax cases, for which one due date was set in November, as explained earlier. However, for provisional Property Tax, only one due date falling in the period of November to February within the same financial year was set. It had now been decided to bring the due date system for Property Tax in line with that for Profits Tax and Salaries Tax by allowing taxpayers to pay provisional tax in two instalments.

With effect from 1 April 2003, provisional Property Tax would be payable by 2 instalments. The first instalment would be made up of 7/12 of the provisional tax (reflecting the income earned in the 7-month period from April to October) and payable in November in the same financial year (in the majority of cases). The second one would be made up of 5/12 of the provisional tax (reflecting the income earned in the 5-month period from November to March) and payable in April in the following financial year. Preparatory work including enhancement of the relevant computer programmes was in progress.

AGENDA ITEM A7 – PROCEDURES FOR DEALING WITH INCOMING DOCUMENTS

A member of the Society complained about a particular case, apparently involving some mislaid accounts, which had now been resolved but which suggested that there may be problems with the procedures for dealing with incoming documents. A similar issue was being raised under Agenda Item A11. The Society acknowledge that, ultimately, in the example quoted, IRD issued a letter apologizing for not informing the tax representative more promptly of the missing accounts and also cancelling the previously issued IRC 1802 (a standard letter sent by IRD indicating a failure to comply with section 51(1) of the IRO to submit a tax return in time and making a compound offer if the return was lodged within a certain period of time and a penalty was paid).

Mr So replied that this was an isolated case. In this case, it could not be verified if the accounts had been mislaid by IRD. It was also possible, for reasons unknown, that the accounts had never reached the IRD. Such accidental omission was not uncommon and IRD had kept the relevant statistics. From April 2001 to October 2001, the average number of such cases was 50 each month. These returns were of course not valid returns and a standard letters IR670 were sent by IRD to notify the Tax Representatives. Usually, an IR670 would be issued within 7 working days (it may take longer in peak seasons) from the date of receipt of the invalid return. In this particular case, the file was in action at the relevant time, therefore the IR670 was issued much later than the normal time. For this reason, the Assessor saw fit to cancel the compound offer (IRC1802), although she did not concede that the accounts had been mislaid.

AGENDA ITEM A8 – TAXPAYER’S/TAX REPRESENTATIVE’S REFERENCE NUMBER

The Society noted that, on occasion, unnecessary delay had been experienced in trying to match correspondence from IRD with the tax representative’s file where such correspondence had not quoted the reference number of the taxpayer or his tax representative. The Society requested IRD to consider updating the relevant records and correspondences with the taxpayers/tax representatives’ file references.

CIR assured the Meeting that taxpayers/tax representatives’ file references were updated regularly. IRD staff had been instructed to quote the updated references in every notice or letter. There might be cases of omission, but the number should be very small. In any event, CIR indicated that IRD staff would be reminded to check that they had quoted the tax representatives’ current file references.

AGENDA ITEM A9 – NEW BIR51 – AUDIT OF SMALL CORPORATIONS

The Society asked for an update on the situation regarding submission of returns from small corporations. Last year the Commissioner indicated that in a sample check only one corporation had submitted a return without having its accounts audited first. The Society questioned, generally, if there had been any difficulties with this initiative either on the part of small corporations or IRD.

CIR said IRD had not identified any problem with small corporations. The system ran smoothly. As in the previous year, sample checks had been carried out and no irregularities were found.

AGENDA ITEM A10 – DEALINGS WITH TAXPAYERS AND TAX REPRESENTATIVES

The Society would like to know about any on-going programmes or initiatives undertaken by IRD to encourage staff to maintain a culture of public service and courtesy at all times in their dealings with the public.

Mr Luk stressed that IRD was committed to providing courteous and effective services to the taxpayer public. A Service Standard Committee, chaired by him, had been established to oversee and monitor the service standard of IRD. Furthermore, a Users’ Committee consisting of members from the academic, professional and business sectors was formed to advise IRD on means to improve its services. Mr Luk further listed the following initiatives which had been adopted to maintain a public service culture and to provide a courteous service to the public:

- Conducting discussion sessions among enquiry service centre staff on a daily basis.
- Running regular workshops on skill and manner in handling taxpayers’ enquiries.

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- Holding seminars on telephone and interview manners and emotion control.
 - Issuing Departmental circular on courtesy to the public
 - Reminding IRD staff at all time of its commitment to provide courteous services to the taxpayer public, as enshrined in the Taxpayer's Charter.
 - Launching an annual Best Customer Service Competition, which lasted for 6 weeks and was a major event to motivate and cultivate IRD staff in providing quality service to taxpayers.

CIR informed the Meeting that from time to time IRD was complimented for the service it provided either in taxpayers' letters or in the press.

AGENDA ITEM A11 – PROCEDURES REGARDING INCOMING DOCUMENTS AND REQUESTS FOR MORE INFORMATION

A11(a)

The Society had been informed of two cases, one relating to a claim to treat termination payments as non-taxable income for salaries tax purposes, and the other, to a claim under the 60-day exemption rule (section 8(1A)(c) of the IRO), in which IRD apparently ignored or rejected the claims after a period of 4-5 months without asking for any further information, even though the Assessors involved subsequently quoted failure to supply additional information as the reason for not accepting the claims.

In the first case the taxpayer's tax return (BIR60), with relevant supporting documents regarding the termination, was apparently submitted on 17 July 2001. On 14 November 2001 a salaries tax assessment was issued which treated the amount as taxable income. Initially the Assessor apparently indicated that no information had been provided but later suggested that in fact additional information was required, although the taxpayer had not been asked to provide more information.

In the second case the BIR60 was filed on 15 June 2001 together with details of the taxpayer's visits to Hong Kong. Without any further exchanges, a salaries tax assessment was issued on 5 November 2001 with an assessor's note that stated "Exemption is not allowed". In subsequent conversation, the Assessor apparently indicated that the taxpayer had not provided additional information which the IRD required and that an objection would have to be lodged.

Both of the above cases were now under objection. The Society would like to clarify the IRD's policy generally in relation to discussing with taxpayers potentially significant adjustments to salaries tax and profits tax returns. Generally speaking more extensive discussion ought to help reduce the need to raise assessments and dealing with the corresponding objections.

Mr Chu explained that the reasons for disallowing the claims and issuing assessments in the quoted cases could be:

- The relevant box (Box 26) of the Return and of the Appendix (Section 6) might not have been properly completed to indicate the claims for exclusion/exemption of income.
- The supporting details/information might not have been supplied, sufficient or lost in transit.
- The taxpayer/tax representative might have failed to respond to the Assessors' queries or did not supply the required information.
- The claim might have been previously considered and disallowed.
- There might be clerical errors in failing to classify the cases as non-AFAL cases.

He commented that the two quoted cases were apparently isolated cases and there was no change in the IRD's policy in raising queries before making substantial adjustments in the generality of cases. Mr Southwood said he believed that full disclosure had been made in both cases at the time of submission of tax returns. The concern was that the assessments had been raised without any prior correspondence from the assessors even though, as far as the tax representative was concerned, full disclosure had been made. [Post-Meeting Note: Mr Southwood had since sent particulars of the cases to Mr Chu to look into them.]

A11(b)

At a more minor level, the Society had been informed of cases where a tax representative had apparently requested (by ticking the appropriate box) that his clients' receive English-language returns. Following the request it appeared that all the relevant returns were issued in bulk in Chinese. After this was resolved, on another occasion some of the returns were still issued individually in Chinese. The Society asked if there were any procedures in place to verify that such requests by taxpayers had been dealt with efficiently and effectively.

CIR advised that a language indicator was kept for each taxpayer record in the computer. When a new CTR file was opened, the computer would check the record of the taxpayer concerned to see if it carried a C.C.C. code, i.e. having a Chinese name. If so, the language indicator would be updated as "C" and a Chinese version of CTR would be issued in the next Bulk Issue. If not, the language indicator would be updated as "E" and an English version of CTR would be issued.

The quoted incidents were apparently isolated cases, in which updating action had not been taken properly. In any event, the management would bring the matter to the attention of the staff concerned and monitor the situation more closely. CIR assured the meeting that it was IRD's policy to emphasis bilingualism.

As a side issue, Mr Tisman enquired why the English session of the annual Tax Representatives Seminars was not held last year. Mr So explained that, for logistical reasons, it had been made clear in the invitation letters that if there were less than 100 applicants indicating a preference to attend the seminar in English, it would not be conducted. In that event, IRD invited the tax representatives to send a member of staff who understood Cantonese to attend the Chinese session. If this could not be done, IRD would send a package of information materials in English to them. These tax representatives were further invited to telephone IRD in relation to any queries arising from the materials covered by the seminar.

AGENDA ITEM A12 – PLACE OF RESIDENCE PROVIDED BY EMPLOYER

The Society had previously brought up with the Commissioner the question of the IRD policy on the computation of rental values where the employer leased premises owned by its employee or his relative for use as the employee's quarter. In the minutes of the Annual Meeting 1996/97 held on 17 January 1997, the then Deputy Commissioner confirmed that the IRD would usually accept arm's length transactions, but said that in the case of controlled companies, the situation was closely monitored.

However, the Society noted that there had recently been a number of published Board of Review decisions [e.g. Case No D28/00, Vol 15, 330; Case No D56/00, Vol 16, 563; Case No D140/00, Vol 16, 29] in which the Commissioner had argued, and the Board of Review has accepted, that the tenancy agreements concerned were "artificial" for the purposes of s.61 of the IRO. The Society would like to know if these decisions indicated that there had been a change in IRD policy so that it could no longer be said that IRD would usually accept arm's length transactions not involving controlled companies.

CIR first confirmed that there was no change in IRD's policy of accepting arm's length transaction of leasing an employee's self-owned property to his employer for use as the employee's quarters. She said the three quoted cases were decided on particular facts. Mr Chu went on to say that the three decisions could be classified into 2 categories:

- (i) Retrospective alteration of nature of taxpayer's salary [D28/00 & D140/00]

In both cases, the taxpayers and the employers attempted to alter the nature of the taxpayers' salary (from salary to a salary plus rent refund) only at or after the years of assessment concerned. The alteration was supposed to take retrospective effect for those years of assessment. The Board held that there was no authority known or given to it that allowed the parties to do so for taxation purposes. This was sufficient for the Board to dismiss the appeals.

- (ii) No intention to create legally binding agreements [D56/00]

In this case, the taxpayer's wife let her property to him under 2 tenancy agreements in respect of 2 years of assessment and the taxpayer claimed that part of his salary was

rent refunds for renting the property. The Board found that the taxpayer and his wife did not intend to create legally binding agreements between them in respect of the property nor did they intend to discharge their respective legal obligations under the 2 agreements. In short, the Board found that the transactions were not genuine, not to mention at arms' length.

Mr Chu concluded that the 3 quoted cases did not involve arms' length transactions as found by the Board.

AGENDA ITEM A13 – POLICY ON POST-DATED CHEQUES

The Society understood that most taxpayers received tax demands several months before the due date. Payments made late were subject to a significant surcharge and the taxpayers were then required to pay all the tax due in one lump sum. Although the option of purchasing TRCs was available, the rate of return on these was relatively low and taxpayers might not want to have money tied up unnecessarily for a long period, particularly in a difficult economic climate. At present IRD would not accept payment by post-dated cheques. The Society asked whether IRD had considered reviewing this policy. It was aware that some tax authorities (e.g. in Canada) would accept post-dated cheques.

CIR reiterated that it was a government policy not to accept post-dated cheques. She referred the meeting to Financial and Accounting Regulations 560 which provides:

“Cheques drawn on banks situated outside Hong Kong, bills of exchange, promissory notes and post-dated cheques may not be accepted without the prior sanction of the Director of Accounting Services. A receipt must not be given in respect of a post-dated cheque until the cheque matures.”

To avoid forgetting due dates, taxpayers could use the IRD electronic TRC service. Automatic redemption of TRC for payment of tax would be arranged about 2 weeks before the due date and the TRC account holders would be advised of the balance of tax payable, if the total amount of principal redeemed together with the interest payable were insufficient.

AGENDA ITEM A14 – INTEREST ON PROVISIONAL TAX REFUNDS IN CASES OF DISPUTE

In cases where companies had long-standing disputes with IRD in respect of a year of assessment for which provisional tax had already been paid, the Society asked if IRD would consider compensating the taxpayers for the loss of interest on the provisional tax paid where the dispute was ultimately resolved in the taxpayer's favour.

CIR commented that the IRO does not provide for payment of interest in the situation cited as there was no legal basis for IRD to do so. In any event, the matter could be considered in a different perspective. There were situations where the provisional tax was held over when there were disputes for the preceding year's assessment and no interest was payable

to IRD when the matter was finally resolved in IRD's favour. Having said that, CIR indicated that this issue could be a subject for longer-term study.

AGENDA ITEM A15 – LODGEMENT OF TAX RETURNS

The Society asked for the latest lodgement figures at hand and, as usual, should be happy to discuss them.

Mr So provided the following lodgement statistics for 2000/01 corporation and partnership returns.

A. Lodgement Comparison from 1998/99 to 2000/01

	Y/A <u>1998/99</u>	Y/A <u>1999/2000</u>	Y/A <u>2000/01</u>	Comparison 1999/2000 and <u>2000/01</u>
1. Bulk issue (on 1 April)	151,000	144,000	145,000	< +1%
2. Cases with a failure to file by due date: -				
'N' Code	2,000	2,000	1,800	-10%
'D' Code	5,000	4,500	4,000	-11%
'M' Code	9,000	8,600	8,700	+1%
	<u>16,000</u>	<u>15,100</u>	<u>14,500</u>	-4%
3. Compound offers issued	6,900	7,200	7,000	-3%
4. Estimated assessments issued	4,600	3,900	3,700	-5%

B. 2000/01 Details Profits Tax Returns Statistics

	<u>'N'</u>	<u>'D'</u>	<u>'M'</u>	<u>Total</u>
Total returns issued	17,500	41,500	101,000	160,000
Failure to file on time	1,800	4,000	8,700	14,500
Compound offers issued	900	2,200	3,900	7,000
Estimated assessments issued	500	1,000	2,200	3,700

C. Represented Profits Tax Returns – Lodgement Patterns

Code	Lodgement Standard	Actual Performance	
		1999/2000 PTRs	2000/01 PTRs
D – 31 July	60%	79% ⁽¹⁾	38%
D – 31 August	100%	91%	85% ⁽²⁾
M – 31 August	25%	13%	14%
M – 30 September	55%	20%	20%
M – 31 October	80%	39%	40%
M – 15 November	100%	83%	83% ⁽³⁾

⁽¹⁾ Against 100% lodgement standard for 1999/2000

⁽²⁾ 23% lodged within a few days around 31 August 2001 (45% lodged within a few days around 31 July 2000 for 1999/2000 PTRs)

⁽³⁾ 35% lodged within the period 1-15 November 2001 (35% for 1999/2000 PTRs)

D. Tax Representatives with Lodgement Rate of less than 83% of 'M' code Returns as at 15.11.2001

1,446 T/Rs have 'M' Code clients. Of these, 651 firms were below the average performance rate of 83%. An analysis of the firms, based on size, is: –

	Late Year's Performance					Current Year's Performance			
	No. of clients per firm	Total No. of firms	No. of firms below the average of 83%	No. of non-compliance Cases	% of non-compliance Cases	Total No. of firms	No. of firms below the average of 83%	No. of non-compliance Cases	% of total non-compliance Cases
Small size firms	100 or less	1,245	592	4,157	73%	1,290	607	4,285	73%
Medium size firms	101 - 300	143	43	1,401	25%	140	41	1,395	24%
Large size firms	Over 300	15	2	105	2%	16	3	156	3%
		<u>1,403</u>	<u>637</u>	<u>5,663</u>	<u>100%</u>	<u>1,446</u>	<u>651</u>	<u>5,836</u>	<u>100%</u>

Overall, Mr So commented that Lodgement of "M" code returns showed no improvement. Despite the extension (from 31 July to 31 August) for "D" code returns (see table C), the final performance (as at 31 August) was worse than last year. Only 38% and 85% of the "D" code returns were received on by 31 July and 31 August respectively. Regarding the

analysis of tax representatives with lodgement rate of less than 83%, the overall position was similar to that of last year.

[See also Agenda Item B2]

AGENDA ITEM A16 – LEGISLATION

A16(a) Inland Revenue (Amendment) Bill 2000

The Society wished to learn the current position with respect to the above Bill.

Mr Tam informed that IRD had considered very carefully the ten various deputations made by interested parties to the original Bill. The Law Draftsman had finished drafting the Committee Stage Amendments (CSA), accommodating views made in so far as possible. The Finance Bureau would consult the Financial Services Bureau and the Hong Kong Monetary Authority about the CSA, and, subject to any refinements as a result of comments made, would send the CSA together with a summary showing deputations as well as the IRD's response to them to the interested parties for reference and comments.

A16(b) Inland Revenue (Amendment)(No.2) Bill 2001

The Society wished to know the timetable for the implementation of the above Bill.

CIR told the Meeting that the House Committee of the Legislative Council has decided on 18 January 2002 that a Bills Committee would be formed to scrutinize the Bill. The implementation date of the relevant bill would depend on when the Bills Committee would be set up and complete scrutinizing the bill. In any event, CIR said that there was strong support from certain LegCo members.

AGENDA ITEM A17 – DOUBLE TAX AGREEMENTS AND EXCHANGE OF INFORMATION ARTICLES

Following the recent consultation by IRD on the issue of exchange of information articles in tax treaties, the Society would like to learn about any further developments in relation to double tax agreements and, particularly, in relation to exchange of information articles.

CIR said that the Government was still actively pursuing the policy of exploring opportunities of concluding double taxation agreements. There had been positive response from some countries. As regard the "Exchange of Information" article, it was quite clear that many countries regarded the OECD 1995 Model Convention as the starting point. In IRD's recent consultation with tax professional bodies on the "Exchange of Information" article in a Comprehensive Double Tax Agreement, the majority recognized the merits of entering into the international treaty arena and agreed that liberalization of the information exchange

provisions would be necessary in order to get through the hurdle. (CIR noted that the Society had expressed some reservations on the liberalization of the information exchange provisions) The OECD 1995 version was preferred. The policy bureau was prepared to extend the consultation to chambers of commerce. Their views would be considered in determining the list of negotiating partners.

AGENDA ITEM A18 – POSITION ON SELF-ASSESSMENT

The Society enquired whether there had been any further developments on the issue of self-assessment and IRD's current thinking on this. It noted that in the Annual Meeting 2001, IRD also said that the publication of the Assessor's Manual should move hand in hand with the decision to move to a self-assessment regime.

CIR said that at present the Government had no concrete plan to implement a "self-assessment" system to replace the "official assessment" system.

A move to "self-assessment" would bring about a fundamental change in the taxation system, therefore the feasibility of adopting such a system and various other factors had to be carefully studied before a decision was taken. These factors included the acceptability of such a system by the public, the ability of taxpayers to compute accurately the tax payable and the availability of the related supporting measures. As a matter of fact, many countries and regions took a considerably long time to complete such studies before putting forward recommendations for implementation. IRD had conducted some technical and operational studies on the subject.

The major challenge currently faced by IRD was to strengthen and improve the tax administration and technical support. This in turn would benefit the study on the "self-assessment". A case in point was the Assess First Audit Later (AFAL) system in the second Information System Strategy (ISS) Plan, rolled out in April 2001. This AFAL system sought to replace the existing manual system of screening tax returns for assessment of Profits Tax, Salaries Tax and Property Tax by an automatic process according to pre-set criteria. It would streamline the function of raising assessments and as a result would allow the professional staff in the assessment sections to concentrate their efforts more on complex cases and on the sampling check of the assessed cases. It would also enhance the effectiveness of field audit and promote voluntary compliance. At the same time, the professional staff of IRD could be more efficiently and effectively redeployed.

AGENDA ITEM A19 – POSITION ON PAY AS YOU EARN (PAYE)

The Society wished to know the latest position on the issue of PAYE.

CIR replied that the Government had not taken a position as to whether or not a PAYE system should be introduced. Before introducing any fundamental change to the tax collection system of Hong Kong, extensive consultations would be required. Amendments to be the law would also be necessary. As such, the matter would need to be very thoroughly studied.

AGENDA ITEM A20 – TERMINATION OF DEPARTMENTAL PRACTICE NOTES DISTRIBUTION SERVICE

The Society noted that with effect from April 2002 IRD was planning not to issue individual copies of new DIPNs to tax representatives and other persons on the circulation list. Instead all interested persons would be referred to the IRD website where DIPNs were now posted. It also understood that upon individual written request from current recipients, IRD would consider extending the deadline for ceasing to provide hard copies. The Society asked:

- (i) For how long IRD envisaged that it would issue hard copies to recipients who request this.*
- (ii) After the service had been discontinued if there would be any other way of obtaining copies of individual DIPNs (e.g. in person at the IRD).*

CIR replied that when a new DIPN was issued, IRD would send e-mails to registered users and attach a soft copy of the DIPN. At present, there were 753 registered users. As announced in July 2001, for those who had difficulty in setting up the e-mail account, IRD had agreed to extend the hard copies services to them on special grounds. However such request had to be made in writing on or before 28 February 2002.

In reply to the second question, CIR said that no hard copies would be provided after 1 April 2002. Taxpayers and tax representatives were permitted to print the DIPNs from the IRD website provided the source of information was acknowledged and that re-dissemination or reproduction was for a non-commercial purpose.

AGENDA ITEM A21 – COMPOSITION OF CONSULTATIVE BODIES – THE BOARD OF INLAND REVENUE

With electronic filing likely to be used increasingly in the future, the Society enquired whether IRD had considered inviting persons onto the Board of Inland Revenue (BIR) who possessed specific knowledge of procedures and possible issues in respect of electronic transactions.

CIR informed that members of the BIR were appointed to give technical advice and they did not represent the interests of any particular sector of the community. They were expected to possess the relevant knowledge and exposure to the range of issues covered by the BIR in its deliberations. Conventionally, the unofficial members were recruited from the accounting profession, legal profession and the finance sector with arguably the most interest in BIR's work and the greatest ability to contribute towards its functions. As the 3 unofficial members of the BIR were appointed by the Chief Executive [s.3(1)(a) of the IRO] in their personal capacity, eligible candidates with various backgrounds might be considered when a vacancy arises. As the three current non-official members had only been appointed for a few years, it was unlikely that a vacancy would arise through resignation in the near future.

AGENDA ITEM A22 – SECTION 16(2)(b) RATE OF INTEREST

The Society welcomed the increasing provision of information on the IRD Home Page, in particular, the rates of interest for tax reserve certificates and the judgment interest rate table. Being able to find this information easily and at one convenient place was very beneficial for taxpayers and tax representatives. The Society asked if the Commissioner would also publish in the same way the rate of interest applying for s16(2)(b) of the IRO, i.e. the rate specified by the Financial Secretary by notice in the Gazette? This was an extremely difficult rate to ascertain when one needed to know it quickly.

CIR pointed out that only three companies were concerned with this provision. There was not much value to publish the rate in IRD website. Nevertheless for the sake of completeness, IRD would agree to do that as soon as possible.

AGENDA ITEM A23 – “TECHWATCH” AND “THE HONG KONG ACCOUNTANT” PUBLICATIONS

The Society’s Professional and Technical Department started issuing a monthly publication in December 2001 to alert members to topics and issues that are relevant to their professional practice and working environment. If IRD wished to notify members of the Society about upcoming publications, DIPNs, events, etc. then “TechWatch” would provide an effective vehicle to alert them. For more in-depth articles, the revenue column in “The Hong Kong Accountant” would still be the most suitable channel of communication. It invited contributions to both.

CIR promised that the information would be related to the IRD officers responsible for the respective subject matters. She reminded the Society that Mr Tam was IRD’s Departmental spokesman.

PART B – MATTERS RAISED BY IRD

AGENDA ITEM B1 – DISCREPANCIES DETECTED BY FIELD AUDIT

Same as in the previous years, Mr Chan presented two tables to demonstrate the specific problem areas detected in the tax audit of corporations between 1 January 2001 and 31 December 2001. Table 1 showed the common types of discrepancies detected and Table 2 showed how the discrepancies were uncovered.

Referring to Table 1, Mr Chan commented that the total number of corporation cases audited [164] dropped (about 19% comparing with last year, 2000) as IRD had been engaged in a project involving individuals. IRD's audit teams continued to uncover discrepancies in cases with clean auditors' reports. These cases accounted for 71% of the discrepancies of all corporation cases. It represented a noticeable increase over the last year's figure. The percentage for the previous year was 60%.

In Table 2, IRD identified cases where items of discrepancy were considered detectable through statutory audit (Table 2). Mr Chan said he only mentioned three cases where the mistakes were obvious. It was of the view that all items identified could easily be detected if the auditors exercised reasonable care in the conduct of the audit. Mr Lui believed that the Society's Practice Review System would pick up such matters were the relevant practices to undergo a review. He also pointed out that, in order to put the matter in perspective, individual audit firms could have hundreds of clients, whereas the Field Audit statistics highlighted what might be only a very small proportion of these.

CIR expressed concern on the high percentage (about 80%) of completed field audit corporation cases with discrepancies, including omitted sales, overstated purchases, understated closing stock and over-claimed expense, which had not been uncovered by statutory audits. She appealed to the Society for maintaining a high professional standard on audit of companies. Mr Lui replied that there were rules and standards governing the conduct of auditors. He undertook to bring the matter to the attention of the Council of the Society.

AGENDA ITEM B2 – LODGEMENT OF 'D' CODE ACCOUNTS

Mr So said in the last annual meeting, IRD agreed to relax the filing deadline for 'D' code returns from "31 July" to "60% by 31 July and 40% by 31 August" on a trial basis (see Item A3 of the minutes for the 2001 Annual Meeting). It had been stressed that this extension was on a trial basis subject to review a year later.

The actual performance, as shown below, was far from satisfactory and it fell short of the 60:40 lodgement pattern anticipated.

	<u>Lodgement Standard</u>	<u>Actual Performance</u>
By 31 July 2001	60%	38%
By 31 August 2001	100%	85%

It had also come to IRD's knowledge that this trial arrangement with two lodgement dates had not been well received by some tax representatives. The preliminary view was therefore that this trial arrangement had not been a success. After discussion, it was agreed that the lodgement date of 'D' Code Accounts be extended to 15 August this year.

AGENDA ITEM B3 – PAYMENT DUE DATE FOR PROVISIONAL PROPERTY TAX

[See Agenda Item A6(c)]

AGENDA ITEM B4 – TIMELY RESPONSE TO ASSESSORS' QUERIES

Mr So pointed out that a reply to the Assessor's queries could now take months. In order to expedite the finalization of assessments, it would be in the best interest of both parties that such replies could be provided in a timely manner.

AGENDA ITEM B5 – MATTER ARISING FROM 2001 ANNUAL MEETING

CIR informed the Society that the following guidelines/information had been issued since the last meeting:

- DIPN No. 39 on "Profits Tax: Treatment of Electronic Commerce" had been issued in July 2001. *[Item A1(b) of the 2001 minutes]*
- Selected advanced ruling cases had been uploaded to the IRD Homepage for general reference since November 2001. *[Item A1(c) of the 2001 minutes]*
- A list of "major financial centres" recognized by the Commissioner for the purpose of section 16(2)(f)(ii) was, since August 2001, available on IRD Homepage. *[Item A1(d) of the 2001 minutes]*

AGENDA ITEM B6 – DATE OF NEXT ANNUAL MEETING

CIR suggested fixing the date of the next annual meeting. After discussion, it was decided that the 2003 Annual Meeting would be held on Friday 17 January 2003.

Table 1

Analysis of Completed Field Audit Corporation Cases for the year ended 31 December 2001

Auditor's Report = Unqualified	No. of Cases	Discrepancy Amount by Nature	Tax Undercharged by Nature
Sales omitted	11	\$27,406,649	\$4,244,385
Purchases overstated	7	\$10,710,316	\$1,530,702
Closing stock understated	4	\$1,186,821	\$175,183
Gross profit understated	32	\$71,679,646	\$11,682,074
Expenses over-claimed	42	\$15,683,318	\$1,687,279
Technical adjustments	30	\$3,560,472	\$447,817
Other	65	\$12,656,113	\$2,227,129
TOTAL	132*	\$142,883,335	\$21,994,569

* in one case there may be more than one type of discrepancy

Total Discrepancy for All Years \$604,517,394

Total Tax Undercharged for All Years \$91,730,208

Other statistics for the above cases:

Auditor's Report = Qualified	No. of Cases	Discrepancy Amount by Nature	Tax Undercharged by Nature
Sales omitted	8	\$9,246,059	\$557,182
Purchases overstated	4	\$6,224,164	\$956,076
Closing stock understated	1	\$3,199,310	\$437,587
Gross profit understated	11	\$22,407,626	\$3,152,089
Expenses over-claimed	10	\$5,488,148	\$735,731
Technical adjustments	5	\$3,818,223	\$554,117
Other	15	\$8,416,850	\$1,566,124
TOTAL	32*	\$58,800,380	\$7,958,906

* in one case there may be more than one type of discrepancy

Total Discrepancy for All Years \$250,632,791

Total Tax Undercharged for All Years \$35,017,925

Other statistics for the above cases:

FOR AUDIT YEAR ONLY

FOR AUDIT YEAR ONLY

Table 2

Field Audit Cases with some items of discrepancy considered detectable through statutory audit for the year ended 31.12.2001

Name of Auditor	Items that should be detected by Auditor	Amount of item(s) for audited year that should be detected	Reasons why the item should be detected	Auditor's Report	Disc Amt for Audited Year	Tax Undercharged for Audited Year	Total Discrepancy Amount	Total Tax Undercharged
Auditor 1	Closing Stock Understated	1,848,654	Taxpayer admitted that no stocktaking was performed for at least six consecutive years of assessment. However, the auditor's reports for the relevant years were unqualified, contrary to SAS 401 and SAS 600 issued by HKSA.	Unqualified Report	4,388,034	702,086	16,442,119	2,625,400
Auditor 2	Purchases Overstated	2,124,881	Stock denominated in Japanese Yen was adjusted using closing rate while no similar adjustment for Japanese Yen denominated Accounts Payable was done.	Unqualified Report	3,069,979	491,197	1,459,128	491,197
Auditor 3	Sales Omitted	2,300,152	The balance accumulated in "marginal deposit account" had not been verified by the auditor.	Qualified Report	1,792,243	286,759	4,887,423	770,870
Total		14,126,905			9,250,256	1,480,042	22,788,670	3,887,467



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