

# Field Audit and Investigation

The Field Audit and Investigation Unit is responsible for conducting field audits and investigations on businesses and individuals with a view to combating tax evasion and avoidance.

Back tax is assessed and penalties are generally imposed where discrepancies are detected. During 2005-06, the Field Audit and Investigation Unit completed 1,873 cases (including avoidance and prosecution cases) and assessed back tax and penalties of about \$2.12 billion (**Figure 32**). The amount assessed, though lower than that of the year 2004-05, is at the same level as that of 2003-04 and prior years. The increase in 2004-05 mainly came from the successful crackdown of a few large tax avoidance schemes in that year.

**Figure 32 Results of the Field Audit and Investigation Unit**

|  | 2002-03 | 2003-04 | 2004-05  | 2005-06         |
|--|---------|---------|----------|-----------------|
| Number of cases completed              | 1,862   | 1,863   | 1,863    | <b>1,873</b>    |
| Understated earnings and profits (\$m) | 9,316.3 | 9,744.8 | 13,814.3 | <b>10,934.9</b> |
| Average understatement per case (\$m)  | 5.0     | 5.2     | 7.4      | <b>5.8</b>      |
| Back tax and penalties assessed (\$m)  | 2,052.5 | 2,059.2 | 2,828.2  | <b>2,118.3</b>  |
| Back tax and penalties collected (\$m) | 1,949.1 | 2,039.9 | 2,887.6  | <b>2,189.2</b>  |

## Field Audit

Field audit is conducted on both corporations and unincorporated businesses. The work of field auditors entails site visits to business premises and examination of accounting records of taxpayers in order to ascertain whether correct returns of profits have been made.

In 2005-06, there were 17 Field Audit sections.



## Anti-Tax Avoidance

Two of the 17 Field Audit sections concentrate on tackling tax avoidance schemes, whereas other investigation officers and field auditors handle avoidance cases on an operational need basis.

During 2005-06, the Field Audit and Investigation Unit completed 209 tax avoidance cases and assessed back tax and penalties of about \$624 million (**Figure 33**).

**Figure 33 Results of the Audit on tax avoidance cases**

|  | 2002-03 | 2003-04 | 2004-05 | 2005-06        |
|--|---------|---------|---------|----------------|
| Number of cases completed              | 200     | 196     | 213     | <b>209</b>     |
| Understated earnings and profits (\$m) | 3,131.0 | 3,769.3 | 7,507.6 | <b>4,542.3</b> |
| Average understatement per case (\$m)  | 15.7    | 19.2    | 35.2    | <b>21.7</b>    |
| Back tax and penalties assessed (\$m)  | 565.4   | 636.2   | 1,375.7 | <b>624.2</b>   |

## Investigation

Investigation officers are responsible for conducting in-depth investigations where tax evasion is suspected, and taking penal action (including prosecution proceedings in appropriate cases) to create a deterrent to tax evasion.

In 2005-06, there were 5 Investigation sections.



## Prosecution

One of the 5 Investigation sections focuses on criminal investigation of tax evasion.

Tax evasion is a serious crime. If a person is convicted of tax evasion, the Inland Revenue Ordinance provides for a maximum custodial sentence of three years.

In 2005-06, 3 prosecution cases were heard before the court. In the first case, a property owner was fined a total of \$130,000, about 32% of the tax undercharged, for failure to inform his chargeability to tax. In the second case, a couple were sentenced to two months' imprisonment, suspended for two years, and fined a total of \$450,000 for understating rental income of their properties. In the third case, a property owner was sentenced to two months' immediate imprisonment and fined a total of \$180,000, representing 138% of the tax evaded, for omitting rental income which should have been included in the tax returns and making a false statement to claim the loss arising from the sale of a property. The defendant appealed against the sentence immediately and was granted bail. Hearing on appeal against the sentence is pending.

## Property Tax Compliance Checks

In addition to conducting audits on businesses, the Unit also carries out verification checks on the correctness of rental income reported by property owners. In 2005-06, the Department strengthened the review on cases with rental income. The Unit has completed compliance check on 10,294 property tax cases (**Figure 34**).

**Figure 34 Results of the Property Tax Compliance Checks**

|                                       | 2002-03 | 2003-04 | 2004-05 | <b>2005-06</b> |
|---------------------------------------|---------|---------|---------|----------------|
| Number of cases completed             | 4,600   | 4,600   | 4,600   | <b>10,294</b>  |
| Understated rental income (\$m)       | 194.0   | 194.0   | 194.0   | <b>330.1</b>   |
| Back Tax and penalties assessed (\$m) | 23.2    | 23.3    | 23.3    | <b>40.9</b>    |