

HONG KONG TAX TECHNICAL UPDATE Issue No. 2 – July 2010



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An Update on Yue Yuen Marketing Co Ltd & Ors v CIR

As reported in our Hong Kong Tax Technical, May 2010, Yue Yuen Group (“Yue Yuen”) had been under a tax audit by the IRD since January 2004. From 2004 to 2008, the Hong Kong Inland Revenue Department (“IRD”) issued protective profits tax assessments for the years of assessment 1997/1998 to 2001/2002 to Yue Yuen. Yue Yuen lodged objections with the IRD which agreed to holdover the tax in dispute on the condition that the Group purchased Tax Reserve Certificates (“TRCs”) of a total amount of around HK\$314.5 million.

In March 2009, the IRD further issued protective profits tax assessments to Yue Yuen for the year of assessment 2002/2003. Yue Yuen lodged objections with the IRD against these protective profits tax assessments. Again, the IRD agreed to holdover the tax in dispute, subject to the purchasing of TRC in a total amount of around HK\$118.4 million.

Frustrated by the lack of response from the IRD, Yue Yuen sought for a judicial review in a tax dispute with the IRD in May 2009. The case was heard on 11 March 2010.

On 17 March 2010, the High Court handed down its judgment to refuse Yue Yuen’s request to annul the assessments as it was inappropriate and beyond the power of High Court to consider the merits of the assessments since this would take over the functions of the CIR and the Board of Review. The High Court also refused to conclude that the CIR has acted in bad faith because there has been delay on the CIR’s part or that the CIR has requested the Applicants to purchase TRCs. Further, the High Court did not agree to the assertion by Yue Yuen that the amount of TRCs involved was so large that there has been some kind of extortion by the CIR. However, the High Court considered that more than a reasonable time had been lapsed for the CIR to make the determination of Yue Yuen’s objections and ordered the CIR to determine the objections within 6 months from the date of judgment the latest.

As disclosed in note 5 to Yue Yuen’s unaudited interim results for the 6 months ended 31 March 2010 on “Income Tax Expense”, subsequent to the order handed down by High Court in March, Yue Yuen and the IRD have reached a compromised settlement in early June at a sum of around merely HK\$194 million (US\$25 million) as a full settlement of the whole tax audit case for 1997/1998 to 2008/2009, compared with the TRCs of HK\$314.5 million purchased for 1997/1998 to 2002/2003 only. The small amount of final payment will be a great surprise to many people. It casts doubts on whether the

IRD in fact demanded the purchasing of TRCs for tax audit cases on a reasonable basis, why the case had been dragged on for so long and why it could be settled so quickly with such a drastic reduction of tax, and possibly, penalty payable. As the tax audit case has never gone through the appeal process, the facts of the case and the basis on reaching the compromised settlement amount of merely HK\$194 million will remain unknown to the public.

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