

# HONG KONG TAX TECHNICAL UPDATE Issue No. 1 – May 2010



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## **Can delay by the IRD be an adequate excuse to quash an assessment under Judicial Review – a lesson learnt from Yue Yuen Marketing Co Ltd & Ors v CIR**

Yue Yuen Industrial (Holdings) Ltd has been listed on the Main Board since 1992. The Group is an OEM/ODM of athletic and casual footwear for major brand name companies such as Nike, Adidas, Reebok, New Balance, Asics, Puma, Timberland and Rockport etc. Yue Yuen Group has been under a tax audit by the Inland Revenue Department (“IRD”) since January 2004. Frustrated by the lack of response from the IRD, Yue Yuen sought for a judicial review in a tax dispute with the IRD.

### **The Facts**

The tax audit case involves eight BVI subsidiaries of Yue Yuen Group (“the Applicants”). Three of them took up the manufacture of athletic shoes in the Mainland from Yue Yuen Industrial Limited (a Hong Kong company) when the Group was listed in 1992. The other five were engaged in the manufacturing and sales of athletic shoes in the Mainland and Taiwan. Apart from the profits tax assessments for the year of assessment 1997/1998 which were raised in 2004, other assessments in dispute were protective profits tax assessments raised by the IRD for the years of assessment 1998/1999 to 2002/2003, just before the expiry of the 6-year statutory limit for raising assessments under Section 60 of the Inland Revenue Ordinance (“IRO”). The Applicants objected to the assessment. The IRD agreed to holdover the tax in dispute on the condition that the taxpayers purchased certain amounts of Tax Reserve Certificates (“TRCs”). The taxpayers have purchased TRCs of around HK\$315 million in total for the years of assessment 1997/1998 to 2001/2002.

When the IRD demanded for purchase of TRCs of around HK\$118 million for the protective profits tax assessments for 2002/2003 in March 2009, the Group has not purchased these TRCs. Instead, the Applicants filed an application to High Court in May 2009 for a judicial review of the years of assessment 1997/1998 to 2002/2003.

The Applicants stated that the various assessments raised against them were unlawful on the grounds that:

- (a) The Commissioner of Inland Revenue (“CIR”) abused her powers by making the assessments because the Applicants’ profits were not sourced in Hong Kong;
- (b) The CIR has failed to deal with the Applicants’ objections within a reasonable time, contrary to the CIR’s duty under Section 64 (2) of the IRO.

The Applicants applied for a judicial review and sought to have the assessments (including the requirement for the Applicants to purchase TRCs for holdover the tax payments) cancelled.

### **Judicial Review**

Pursuant to Order 53 of The Rules of the High Court, "application for judicial review" includes an application in accordance with that Order for a review of the lawfulness of:

- (a) An enactment; or
- (b) A decision, action or failure to act in relation to the exercise of a public function.

Judicial review is a type of court proceeding in which a judge reviews the lawfulness of a decision or action made by a public body. In other words, judicial review is a challenge to the way in which a decision has been made, rather than the rights and wrongs of the conclusion reached. It should be noted that judicial review is not an appeal. The Court will not stand in the shoes of the IRD. The role of the Court is to review the decision of the IRD, not to make the decision itself. The Court will not substitute its view for that of the authority even if it has a different view.

The grounds for judicial review only include the followings:

- (a) Illegality [e.g. decision not supported by law (err in law), abuses of power, ultra vires rule etc.];
- (b) Procedural impropriety [e.g. Legitimate expectation, bias, breach of the rules of natural justice etc.]; or
- (c) Irrationality [e.g. bad faith, irrationality: so unreasonable no reasonable body could have come to the decision or so outrageous in defiance of logic and moral standards that no sensible person could have arrived at them etc.].

Application for judicial review will be refused if there is an alternative remedy. In case of disputes with IRD on profits charged to tax, they should be settled by objection and appeal under the IRO. Time limit for applying a judicial review is 3 months from the date when the grounds for the application first arose.

## **The High Court's Judgment**

The High Court handed down the decision on 17 March 2010:

- (a) The Applicants' request to annul the assessments was refused. The High Court considered that 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.
- (b) The High Court 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. The delay may be due to many reasons and the delay by itself cannot be an adequate foundation for an allegation of bad faith.
- (c) The High Court did not agree to the assertion by the Applicants that the amount of TRCs involved was so large the there has been some kind of extortion by the CIR. The High Court considered that the CIR's requirement for the Applicants to purchase TRCs was an inevitable consequence of the Applicants' sizeable manufacturing profits which were considered by the CIR to be sourced in Hong Kong.
- (d) The High Court considered that more than a reasonable time had been lapsed for the CIR to make the determination of the Applicants' objections and ordered the CIR to determine the objections within 6 months from the date of judgment the latest. The Court also ordered the CIR to bear 75% of the Applicants' cost of the JR.

## **Mazars Observation**

Although the Court ordered the CIR to determinate the case within 6 months and to bear 75% of Yue Yuen's legal costs of the judicial review, these are not what Yue Yuen was seeking for. The group would like to have the assessments (including the requirement for the Applicants to purchase TRCs for holdover the tax payments) cancelled. The High Court considered that the delay in the determination process may be due to many reasons and the delay by itself cannot be an adequate foundation for an allegation of bad faith. The purchase of TRCs was "an inevitable consequence of the Applicants' sizeable manufacturing profits which were considered by the CIR to be sourced in Hong Kong". Further, the High Court considered that it was inappropriate and beyond the power of High Court to consider the merits of the assessments in a Judicial Review since this would take over the functions of the CIR and the Board of Review.

Companies being frustrated by the lengthy field audit process which are considering applying for a judicial review of their tax disputes should bear in mind that judicial review is not the same as an appeal. Judicial review is not the right course of action for them unless they want to speed up the CIR's determination process so that they can appeal to the Board of Review.

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