

Constant Vigilance – Two Recent Tax Decisions

Summary

The courts have recently handed down two separate tax decisions, both highlighting the need for vigilance from the taxpayer when managing its tax affairs. First, the Court of Appeal (CA) has granted leave to the liquidators of Moulin Global Eyecare Trading Limited (Moulin) to have their appeal determined by the Court of Final Appeal (CFA). This provides an opportunity for Hong Kong's highest court to determine whether the primary or special rules of attribution should apply to attribute knowledge of fraudulent directors to the company. The second case involves Mr. Chan Chun Chuen (Mr. Chan), the erstwhile Fung Shui Master. The District Court has granted summary judgment against Mr. Chan in respect of more than HK\$340 million of tax together with interest assessed at judgment rate (8 percent).

Moulin Liquidators granted leave to appeal to the CFA

Can a taxpayer company, having paid tax on the strength of grossly inflated profits invented by the board of directors, years later turn round and reclaim the profits tax paid to the Inland Revenue Department (IRD)? The key issue in *Moulin Global Eyecare Trading Limited (in Liquidation) v. The Commissioner of Inland Revenue & Another* CACV 64/2011 has been that of attribution, and whether the taxpayer could use this as a "reasonable cause" to re-open a tax assessment out of time. We discussed the issues and the CA's findings in our previous legal update "*Court of Appeal's Recent Tax Decisions*" dated 27 June 2012.

On 22 February 2013, the CA granted leave to the liquidators of Moulin to appeal to the CFA, on the basis that the issues raised are of great general or public importance and the question of law raised on appeal was reasonably arguable. The liquidators of Moulin had to overcome these hurdles before the CA would grant leave to appeal because of the finding by the CFA Appeal Committee last year that there is no automatic right of appeal to the CFA for tax disputes.¹

The CA formulated the appeal in broad terms, inviting the CFA to lay down a general statement of law. The issues on appeal are as follows:

1. Whether the primary rules of attribution should apply to attribute knowledge of the fraudulent directors to Moulin?
2. If not, whether the special rules of attribution should apply to attribute knowledge of the fraudulent directors to Moulin?

The forthcoming decision from the CFA may have broad ramifications on tax law, agency and corporate governance generally.

Judgment Interest Adds to a Hefty Tax Liability

When a taxpayer wishes to dispute a tax assessment, he or she may apply to the Commissioner to "hold over" payment. Typically the taxpayer is required to purchase a tax certificate in the disputed sum, while awaiting the determination of this objection.

In *Commissioner of Inland Revenue v. Chan Chun Chuen & Another* DCTC 2290/2010, Mr. Chan, a household name and possibly the most infamous

¹ *CG Lighting Limited v CIR* [2011] HKCU 1651.

Fung Shui Master in Hong Kong, disputed tax assessed on the Fung Shui consultation fees received from the late Mrs. Nina Wang in the years 2005 to 2007. The Commissioner took the view that the fees were taxable profits, and assessed the same at HK\$340,852,444.60. Mr. Chan had not objected to the assessments within time (see below) and the IRD applied for summary judgment.

Mr. Chan raised a number of defences to the claim, however the court held the defences were contrary to section 75(4) of the IRO, which prohibits the court from entertaining any plea that amounts to a challenge to the taxpayer's liability to pay tax. This is something which must be pursued by the objection process under the IRO.

Mr. Chan contended he had not been made aware of the service of the tax assessments. The documents had been served on Mr. Chan's previous solicitors, and Mr. Chan had contended that the service was defective. Mr. Chan had pursued separate judicial review proceedings on this point. Last year, the CA held that actual notice of the assessments was deemed where they were sent to Mr. Chan's solicitors, who were designated to receive correspondence from the IRD on behalf of Mr. Chan, and the fact that Mr. Chan was not made aware of the service until some months later was not a proper basis for a time extension. The court concluded that the Commissioner had produced sufficient evidence to prove Mr. Chan was in default of payment of the profits tax and Mr. Chan had no valid defence. Mr. Chan appealed to the CFA but he was denied leave. The Appeals Committee of the CFA held that the Commissioner had no duty to make enquiries into whether a given arrangement of a taxpayer for receiving notices of assessment would function as intended.²

Mr. Chan argued that interest at judgment rate was at the discretion of the court, and that previous cases had never set out reasons why judgment rate was to be applied. At 8 percent, judgment rate interest would be a very substantial addition to the multi-million dollar tax bill. In rejecting Mr. Chan's argument, the court pointed out that a taxpayer who provides a banker's undertaking and lodges his objections within time, but loses in the courts, would still have to pay judgment rate under section 71(10) of the IRO. If Mr. Chan should succeed in his argument, a taxpayer who did not hold over, and did not file his objection in time, could potentially pay a lesser rate of interest than a taxpayer who followed the rules. This would lead to an unfair and absurd result.

The judge further held that a stay of execution, where Mr. Chan would not have to pay the full amount pending review of one of the assessments, was without merit. As the statutory scheme is for the taxpayer to pay first and argue later, any stay would by definition be contrary to the IRO.

COMMENTS

The net result of this case serves to drive home the point that any taxpayer must be vigilant regarding the rules of taxation. The decision serves as a warning to all future taxpayers that they refrain from paying tax at their own peril, even if they believe they have a valid objection. If key deadlines are missed, such as the one-month deadline for lodging objections, or certain steps are not taken, such as holding over of tax, then the penalties will be severe.

² See *Chan Chun Chuen v. The Commissioner of Inland Revenue*, FAMV 23/2012, 27 November 2012.

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