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Handling tax disputes in Hong Kong – ‘pay first, argue later’

BY BRIAN GILCHRIST, ELAINE CHEN AND ALEX WONG

Hong Kong operates a ‘pay first, argue later’ regime. When taxpayers receive a tax assessment issued by the Commissioner of Inland Revenue (Commissioner) in Hong Kong and wish to exercise their statutory right to challenge this assessment, they have three options pending the outcome of the challenge. First, there will be no hold over of tax, and the tax assessed is payable immediately. Second, there will be unconditional hold over of tax. And third, there will be conditional hold over of tax by the provision of security.

These options often result in taxpayers facing difficult dilemmas owing to the implications associated with choosing one of them.

If there is no hold over of tax, (i.e., option one), taxpayers are immediately liable to pay the tax assessed despite an objection or

appeal, and even if they ultimately succeed in this challenge, the refund of the tax paid (under the excessive tax assessment) will not be accompanied by any interest.

On the other hand, if the Commissioner allows tax to be held over unconditionally (i.e., option two), taxpayers will not have to pay the tax upfront. Should they fail in their objection or appeal, they will be required to pay the tax assessed, as well as pay interest on tax assessed by the District Court Judgment Rate, presently at 8 percent per annum.

In the event that the Commissioner orders that the tax to be held over on the condition that tax reserve certificates be purchased, (i.e., option three), taxpayers’ financial position is practically no different from there being no hold over of tax, except that if the challenge is successful, they will be repaid the principal value of the tax reserve

certificate with only minimal interest at 0.1333 percent per annum from 6 June 2022 onwards.

Under the statutory framework in Hong Kong, when taxpayers object to any tax assessment, the Commissioner is given a wide discretion in deciding whether to make a hold over order, however taxpayers may find themselves facing undue financial hardship due to the ‘pay first, argue later’ regime.

This article seeks to explore the statutory mechanism for taxpayers to challenge tax assessments made and highlights some practical considerations in relation to these procedures.

Objection against an assessment to the Inland Revenue Department

Lodging an objection is the first step for a taxpayer to challenge a tax assessment, and

the objection should generally be lodged within one month after the issuance of the assessment setting out the detailed grounds.

There is no prescribed form of such objection, but it must be in writing. The Inland Revenue Department (IRD) of Hong Kong has made available some template forms to taxpayers. When the IRD receives an objection, there are normally two ways of resolving the matter. The case officer may negotiate with the taxpayer informally. Depending on the result of the negotiation, the IRD may issue a revised tax assessment to settle the matter fully and finally. This is often the best way to deal with any objection 'amicably' between a taxpayer and the IRD, consuming the least time and cost.

However if no agreement can be reached, the case will be transferred to the Appeal Section of the IRD. The Commissioner, upon considering the objection, will issue a determination together with a statement of fact and the reasons. The determination may confirm, reduce, increase or annul the assessment being challenged. The Commissioner is not bound to follow the initial assessment in his determination. Any further challenge by the taxpayer against the determination will be by way of appeal to the Board of Review (BOR).

While taxpayers may have lodged an objection, they are still required by law to pay the full amount of tax demanded unless the Commissioner allows the tax to be held over.

Appeal to the BOR

The BOR is a statutory body, independent of the IRD, established to determine tax appeals. The board is often made up of members with legal qualifications and experience in dealing with tax-related issues in Hong Kong.

After receiving the determination issued by the Commissioner, a taxpayer may write to the clerk of the BOR within one month to lodge a notice of appeal against the determination. This notice of appeal should set out all grounds of appeal and be accompanied by the Commissioner's written determination. One peculiar feature in the Hong Kong legislative framework is that the taxpayer or the Commissioner has the

option of transferring the matter from the BOR to the Court of First Instance (CFI).

In practice, the Commissioner would only agree to a transfer to the CFI where there is no factual dispute, there are complex legal issues involved or it is expected that the case will proceed to further appeal and therefore it will save time and costs by skipping one tier of the appeal procedure.

Settlement negotiation remains a prominent feature in tax disputes, and therefore taxpayers and the IRD often engage in settlement negotiations before the appeal hearing. If a settlement can be reached, the terms of the settlement will be reduced in writing and be submitted to the BOR for endorsement.

Solicitors and barristers are often engaged to deal with the appeal process and to attend the appeal hearing before the BOR, which is very similar to a court hearing. Parties may file documentary evidence to support their cases and call witnesses (including factual and expert witness) to give evidence at the hearing.

Nonetheless, the BOR has wider powers than a court in terms of admitting, rejecting and adducing evidence, and it need not adhere to the evidential rules strictly. It should also be noted that the taxpayer bears the burden of proving that the tax assessment is incorrect or excessive, and there is no burden on the IRD to prove otherwise.

After hearing the appeal, the BOR will deliver its decision in writing. The BOR may confirm, reduce, increase or annul the assessment appealed against, or remit the case back to the Commissioner. Although the hearing of the tax appeal is not open to the public, the decision of the BOR (with certain information, including the identity of the taxpayer, redacted) may be published in hard and soft copies and uploaded onto the BOR's website.

Appeal to the courts

If the taxpayer or the Commissioner is dissatisfied with the decision of the BOR, they may lodge an appeal to the CFI. An application for permission to appeal to the CFI should be made within one month from the date on which the decision of the BOR is made. Permission will only be granted if

the court is satisfied that a question of law is involved, and the proposed appeal has a reasonable prospect of success.

Similar to the leapfrog arrangement at the BOR, parties may also apply for permission to appeal the decision of the BOR directly to the Court of Appeal. The court may grant such permission if it considers it desirable for the appeal to be heard by the Court of Appeal, taking into account the amount of tax in dispute, whether the issues involved are of general or public importance or the matter is extraordinarily complex.

If there is no leapfrog and a party is not satisfied with the decision of the CFI, with permission from the court it can further appeal to the Court of Appeal. A party can ultimately appeal to the Court of Final Appeal, being the highest judicial authority in Hong Kong. Unless the intended appeal involves a question of great general or public importance or the Court of Final Appeal considers there to be other reasons to proceed with the appeal, it is often not easy to obtain permission to appeal to the Court of Final Appeal.

Practical considerations

Even though the disparity in the interest payable by the Commissioner and the taxpayer during the appeal process is significant, the Hong Kong Court has confirmed that such disparity is authorised under the legislation and hence, is lawful and binding.

Taxpayers should also consider the following matters when deciding whether to lodge an objection or appeal against an assessment.

First, they will need to strictly adhere to the deadline for lodging an objection or appeal. Unless with persuasive and reasonable cause, the prescribed time limit will not be extended.

Second, considerable time and costs will be required to deal with the appeal. Even if the taxpayer is successful in its appeal, the Commissioner may wish to further appeal the matter and bring it to the next level in view of any significant ramifications. Furthermore, significant legal costs may be incurred in bringing the appeal to the higher courts. A successful taxpayer in

court proceedings will only be able to recover a portion of legal costs from the Commissioner.

Third, under the 'pay first, argue later' regime, taxpayers are often deprived of the use of funds during the appeal process, as they either have to pay the tax assessed or purchase tax reserve certificates.

Finally, there may also be publicity surrounding the appeal if the matter is litigated in court. Details of the taxpayer and its operations will enter the public domain.

Though challenging a tax assessment is often an uphill battle for a taxpayer, incurring significant cost and time, it also

opens up dialogue between the taxpayer and the IRD. Thus, the taxpayer may make better tax planning decisions in the future, including restructuring business arrangements and tax risk diversification. ■

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