

Revenue Authority Discretions and the Rule of Law in Hong Kong

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Constitutional power to impose tax in Hong Kong

- Basic Law:
 - HK will have an “independent tax system”
 - The laws previously in force in HK (which for our purposes includes the IRO) shall be maintained except for any that violate the Basic Law
- It is important for us to consider the constitutional position in order to:
 - Properly understand the doctrine of the separation of powers, and thus
 - Assist us to determine the legal boundaries of the IRD’s discretions

A [civil law?] perspective

- The topic of this talk is perplexing since, in common law jurisdictions which adhere to the rule of law, the respective roles of the legislature (which has exclusive competence to enact law) and the courts (which have the power to interpret the law and control its application by the tax authority) there is no place for administrative discretion in a law making context
- → we must clearly define what we mean by “rule of law” and “discretion”

Definitions

- “rule of law” – adopt Dicey
 - The executive arm of government must do nothing without clear legal authority permitting its actions, and that government must govern in accordance with known rules rather than by whim or arbitrariness
- “discretion”
 - The choice between two or more alternatives *authorised by law* and choice implies a subjective assessment of the concrete circumstances of each individual case which goes beyond interpretation

The definitions in a HK tax law context

- Hong Kong is a rule of law jurisdiction, which adheres to the doctrine of separation of powers (✓)
- Taxation must only be imposed by LegCo enacting valid law (✓)
- Any discretion exercised by the IRD in imposing and collecting tax is itself authorised by law, since a tax authority is not inherently vested with law making functions

Virtually all tax systems rely, to some degree, on tax authority discretions

- Most commentators agree that some level of discretion is necessary for a tax authority to assess and collect tax
- Thus, we will consider:
 - What discretions are exercised by the CIR under the IRO?
 - How should these be categorised?
 - What are the legitimate boundaries for the existence of such discretions? and
 - How can taxpayers' rights best be protected against improper use of discretion?

One reading of this paper

- The big (historical) picture – Colonial Model (1922) – low rates, simple system, ease of compliance, [AND revenue productive: see Littlewood]
→ a very stable taxation system that has seen *very little systemic change* since 1947
- Taxation is clearly imposed under the IRO in terms of the subject of taxation, the tax base and the tax rate
- There is very little delegated legislation under the IRO
- The CIR is provided with very few statutory discretions
- No retroactive legislation, unless a concession or exemption is involved
- From a black letter law perspective, the IRO looks like – and indeed is – a very user friendly tax regime that is both clear and transparent
- → from these perspectives, the balance between the rule of law and taxation by discretion is tilted firmly towards the former

A second reading of this paper

- The first reading is neither complete nor nuanced. It ignores:
 - The tax compliance / administration environment in HK
 - The importance of DIPNs, their pervasiveness, and the reliance placed upon them by taxpayers
 - The difficulties faced by taxpayers wishing to challenge departmental action both within and outside the objection and appeals regime in the IRO
 - The shortcomings of the Taxpayers' Charter
 - The role played by Advance Rulings
 - The role played by extra-statutory concessions and their legality
 - More generally, that many of the CIR's powers relating to administration of the IRO and collection are not spelt out specifically by legislation →
- we must appreciate the tension arising from the necessity for the CIR to operate the IRD with limited resources and administer the IRO efficiently and fairly**

Taxation legislation in HK and the (limited) role of discretion

- Very few instances of delegated legislation – the two most important being (a) the Inland Revenue Rules and (b) the IR (Disclosure of Information) Rules – only 11 rules in total
- Both were made subject to the approval of LegCo
- It is straightforward to compile a complete list of the specific discretions provided to the IRD under the IRO, which we can conveniently categorise as follows:
 - Power to assess tax
 - Relieving provisions
 - Other provisions involving wording such as “opinion” or “satisfied” or “reasonable” or “where similar” (which we can subdivide into general, transfer pricing and anti-avoidance categories)

Categorising general discretions

- Some relate to administrative matters (e.g. power to extend deadlines and agree payment terms)
- Others relate to factual issues (e.g. determining monetary values of assets and whether apportionment is appropriate)
- Unlike the UK, NZ etc HK has no Tax Administration Ordinance → difficulty in determining how to categorise the IRD discretions and whether their exercise is legal
- Unlike Singapore, South Africa etc the IRD is not a statutory body given wide statutory powers to perform its functions

Administration of tax law in HK – cooperation or confrontation?

- Littlewood – the IRD’s administration and interpretation of the IRO has been “incomprehensibly unassertive”
- The IRD and tax advisers seem to operate in an environment of mutual respect and trust, as distinct from confrontation:
 - Bauhinia Foundation Research Centre Report
 - Cullen and Simmons
 - Very little tax litigation (e.g. only 20 published court cases on the source of profits – see volumes 1 – 7 of HKTC)

The Taxpayers' Charter

- Underpinned by performance pledges, monitored by a Users' Committee
- But the Charter is aspirational only:
 - Providing no additional taxpayers' rights, and
 - Is not justiciable
- → should it be viewed as little more than mere commitment to meet the minimum service expectation of the taxpaying community?

Advance rulings

- Authorised by the IRO but, unlike many other jurisdictions such as the US and France, this procedure has rarely been utilised and does not form any real tier of extra-statutory rule making or practice

Extra-statutory concessions

- They do exist, but only in very limited circumstances
- As was the case when categorising the discretions under the IRO, a full list can be easily compiled
- → conclusion: extra-statutory concessions are not a particularly important feature of HK's tax system
- But, since they exist, we must ask:
 - What is the legal basis for these concessions? and
 - How can taxpayers enforce their rights to such concessions?
 - *Tsai Ge Wah* (CFI) and *R v IRC ex parte Wilkinson* (HL)

Pervasiveness and importance of the DIPNs

- Each DIPN proclaims it is “not binding”
 - But they are critically important for taxpayers and their advisers because:
 - IRO sets out taxing rules, but often at a high level of generality → the need for guidance and clarification of the IRD’s assessing practices
 - The DIPNs are pervasive
 - They are relied upon by taxpayers and their advisers
- The certainty of HK’s tax system is one of its greatest strengths (see Bauhinia Foundation Research Report)**

DIPNs continued

- The difficulties for taxpayers to challenge the DIPNs cannot be downplayed:
 - An appeal from the BoR can only be on a “question of law” under an arcane case stated procedure;
 - Judicial review (outside the normal appeals regime) is still comparatively rare;
 - Substantive legitimate expectation is very restricted;
 - The cost of litigation tends to be prohibitive
- However, the IRD has been careful to draft the DIPNs with the aim of clarifying the law (in its view, albeit in a pro revenue manner) without disadvantaging taxpayers
- *Quaere*: should these practices be codified?

Conclusions – 1 (continuation of a long-standing status quo)

- On the basis of either reading (basic v. nuanced), the balance of power between the legislature and the IRD is very much tilted in favour of LegCo
- My research shows that discretionary power and rule making authority granted to the IRD under the IRO in relation to both its assessing and administrative functions are, and always have been, fairly limited
- *Quaere*: to what extent does LegCo (or indeed government generally) have independent access outside the IRD when considering enacting / reforming taxation legislation?

Conclusions – 2 (the CIR's care and management functions)

- Unlike many other jurisdictions (e.g. NZ and the UK), the CIR's general powers of management are implied, rather than set out explicitly in legislation
- Ideally, these should be codified

Conclusions – 3 (tax compliance environment and Taxpayers' Charter)

- The prevailing relationship between the IRD and taxation advisers and taxpayers generally is co-operative rather than confrontational
- This conclusion is bolstered by a system of performance pledges and the promulgation of the Taxpayers' Charter
- However, the Charter is an old-style aspirational document which is not, but should be, underpinned by statute

Conclusions – 4 (extra-statutory concessions)

- Extra-statutory concessions are not a particularly significant aspect of HK's taxation system
- This is pleasing, since the legal basis for their application is unclear and determining the extent to which they bind the IRD is problematic
- The problem can be solved by either (a) legislating specifically for them, or (b) by making the 'care and management' functions of the CIR subject to specific statutory wording (in order to solve the problem of the CIR needing to run the IRD sharply, but whose statutory duty is to assess and collect tax)

Conclusions – 5 (DIPNs)

- An arguably less rosy picture is the pervasiveness and controversy surrounding the DIPNs
- Criticised by some commentators (e.g. VanderWolk) as being unclear, unhelpful and taking too extreme positions
- Taxpayers, and their advisers, *do* rely upon them
- Whilst the IRO contains a comprehensive objection and appeals regime, there *are* many legal and practical difficulties in challenging departmental action – the most significant of which is cost
- The sum of all these factors makes the DIPNs a particularly important yet sensitive issue

Conclusions – 5 (DIPNs continued)

- Important to appreciate that the IRD has not abused its powers in drafting DIPNs:
 - It seems generally to have been careful in clarifying the law (in its view) without disadvantaging taxpayers

what really concerns HK taxpayers?)

- Two surveys indicate that HK taxpayers most want clear tax laws and certainty in the application of those laws (as well as low rates)
- This indicates that it is not so much the content or reach of the DIPNs that are objectionable per se, but rather any perceived lack of clarity and precision therein
- Thus, all DIPNs should:
 - Show how, and when, any past versions have been altered
 - Avoid the inclusion of blanket caveats (such as stating that an interpretation does not apply if there is perceived tax avoidance)
 - Clarify whether the IRD considers the contents to be interpretative or concessionary
 - Aim for precision and clarity as the first priority

Conclusions – 6 (a third reading focusing upon the tax compliance and administration environment: a delicate balance)

- HK is not drifting towards authoritarian and discretionary taxation and away from the rule of law
- But we, and the IRD, cannot be self-satisfied since the conclusions reached in this talk must be judged in the context of HK's tax paradox – a “featherweight” but “revenue productive” tax system
- The IRD's image remains largely positive – but the maintenance of a cooperative taxation compliance environment is essential and the words “trust”, “respect” and “balance” are crucial in reaching a consensus as to what is acceptable and what is not
- The IRD is aware that a strong departmental culture is critical – but it is a weak response to the need to provide taxpayer protection in response to administrative discretion
- → my plea for formalising all the protections for taxpayers suggested in this talk – since the relationship between the people and the government (and its executive arm) is never a place for complacency