

THE BOUNDARIES OF INDIRECT ENFORCEMENT OF FOREIGN REVENUE LAW

AUTONOMOUS NON-COMMERCIAL ORGANIZATION “ORGANIZING COMMITTEE OF XXII OLYMPIC WINTER GAMES AND XI PARALYMPIC WINTER GAMES OF 2014 IN SOCHI” V PICO PROJECTS (INTERNATIONAL) LTD [2021] HKCA 1798

Background

It has long been established that foreign penal and revenue laws are not enforceable, whether directly or indirectly, through the Hong Kong civil courts. The case of *Autonomous Non-Commercial Organization “Organizing Committee Of XXII Olympic Winter Games and Xi Paralympic Winter Games of 2014 In Sochi” v Pico Projects (International) Ltd*, the Court of Appeal (CA)¹ recently upheld the decision of the Court of First Instance (CFI)² that the enforcement of a Russian judgment involving profits tax paid to the Russian Budget did not amount to an indirect enforcement of Russian revenue law.

Facts

The Plaintiff is an autonomous non-commercial organisation registered in Moscow and established for purposes of organising the 2014 Sochi Winter Olympic Games and Paralympic Games (Games). It entered into two contracts with the Defendant, a Hong Kong company, by which the Plaintiff leased tents and other structures for the use as the Coastal Cluster at the Games. Pursuant to those contracts, the Plaintiff paid the Defendant a total amount of just over US\$12 million. The Plaintiff later discovered that it ought to have withheld a profits tax of 20% from the contract price otherwise payable to the Defendant, pursuant to the Russian Tax Code. The Plaintiff demanded the Defendant refund the profits tax (approximately US\$2 million) but the Defendant refused to do so because at that time, there was a dispute as to the amount which was due under the contracts.

The Plaintiff filed a claim at the Arbitration Court of Krasnodar Region, which is part of the Russian Federation court system. The matter was subsequently escalated to the 15th Arbitration Court of Appeal which decided in favour of the Plaintiff. In particular, it was confirmed that the Plaintiff had discharged the Defendant’s liability

to the Russian Federation by making the payment to the Russian Budget and the Russian Federation no longer had any debt owed to it and had no interest in whether the Plaintiff recovered the amount from the Defendant.

The Defendant further appealed to the Arbitration Court of North Caucasian District, the Court of Cassation, which decided that the Defendant was obliged to return the profits tax on the basis that the Plaintiff had paid that amount to the Russian Budget and the Defendant had been unjustly enriched by the same amount (the **Cassation Judgment**).

The Plaintiff sought to enforce the Cassation Judgment in Hong Kong at common law. The Defendant, however, disputed the jurisdiction of Hong Kong courts in enforcing the judgment.

Decision of the CFI

It was not in dispute that Hong Kong courts have no jurisdiction to entertain an action: (1) for the enforcement, either directly or indirectly, of a penal, revenue or other public law of a foreign state or (2) founded on an act of state (the **Rule**).

Recognising that there are only two cases in Hong Kong which touch upon the Rule, the CFI reviewed a number of cases addressing the scope and application of the Rule, including decisions of English courts, the British Columbia Court of Appeal, the Cayman Islands Grand Court, the Alberta Court of Appeal and a Scottish court. In particular, the CFI considered that this case was closest to *Re Reid*³, a case decided by the Court of Appeal in British Columbia. An English trustee of an estate of the executrix was accountable to the English Revenue for estate duty. As the estate did not have sufficient assets in England to pay the estate duty, the trustee looked to the estate’s assets in British Columbia. A remainderman under the will contended that since foreign revenue law

¹ [2021] HKCA 1798.

² [2021] HKCFI 606.

³ (1970) 17 DLR (3d) 199.

could not be directly enforced in British Columbia, the trustee's entitlement to be reimbursed should be denied. However, the Court of Appeal held that the English Estate Duty Office was not seeking to lay its hands on any property in British Columbia or otherwise to enforce its tax claims there. The success of the trustee in getting reimbursement out of the assets in British Columbia was a matter of no concern to the Estate Duty Office and, on that basis, did not fall foul of the Rule.

However, as none of these authorities referred to are binding on Hong Kong courts, the CFI looked at the matter from first principles.

The CFI discerned from the authorities referred to in which the Rule had been applied that there had to be an outstanding debt owed to the foreign revenue. It therefore took the view that the existence of an unsatisfied tax claim is an essential prerequisite to the application of the Rule, justifying a conclusion that the tax authority is enforcing its own tax laws. As the Plaintiff had already discharged the tax liability which was imposed on the Plaintiff (and not the Defendant) under the Russian Tax Code, the Russian Budget would not be enriched by any success of the Plaintiff in recovering the tax from the Defendant. In the circumstances, it was difficult to see how the enforcement of the Cassation Judgment could be considered as an indirect enforcement of the foreign revenue law. On this basis, judgment was entered for the Plaintiff.

Decision of the CA

The Defendant lodged an appeal against the CFI's decision. To the CA, the crucial question was, in bringing the claim, whether the Plaintiff is directly or indirectly doing an act which is of a sovereign character or which is done by virtue of sovereign authority, and whether the claim involves the exercise or assertion of a sovereign right extra-territorially. This issue involved a question of characterisation. In resolving the issue, the court should examine and identify the central interest served by the pursuit of the claim and look into the substance of the matter but not the technical form.

The CA considered that as a matter of form and substance, the central interest in bringing the claim was that of the Plaintiff itself, in repairing the hole in the Plaintiff's own pocket as a result of the mistaken overpayment and reversing the matching windfall to the Defendant. The Plaintiff's claim was effectively an unjust enrichment claim. All the proceeds of the claim were to benefit the Plaintiff only, and not the Russian Budget.

This did not amount to indirect enforcement of foreign revenue laws since those laws were enforceable in Russia at the point of payment and had already been enforced in Russia. This case is far removed from the type of cases in which it was held that a foreign tax authority was effectively behind the liquidator pursuing the claim.

The Defendant contended that the CFI was wrong in deciding that the application of the Rule requires the existence of an unsatisfied tax claim (referred to in the decision as the Debt Requirement) as otherwise it would be easy to circumvent the Rule by having an intermediary first make a payment to the tax authority and then proceed to bring a claim against the taxpayer. Since the CA concluded that it was tolerably clear that this case did not fall foul of the Rule, it was not strictly necessary to deal with the Defendant's argument on the Debt Requirement. Nevertheless, the presiding judges expressed slightly different views on the issue. Kwan VP expressed that no case had been cited in which it was said that the Debt Requirement was wrong and indeed, the Requirement appeared to have formed a significant part of the thinking in most cases in which similar issues had arisen. Her Ladyship clarified, however, that while the presence of an unpaid tax claim is a necessary condition, it is not sufficient to support the application of the Rule. There are other conditions, namely that the proceeds of the claim will go to the foreign revenue authority and that the claim is in substance an attempt to collect foreign tax, as suggested in *Wahr-Hansen v Compass Trust*⁴.

In *Wahr-Hansen v Compass Trust*, the plaintiff was appointed by the Norwegian Probate Court to trace assets belonging to the estate of a deceased person that were allegedly misappropriated with the defendants' assistance. The action was partly funded by the Norwegian government since the estate had an outstanding tax liability to the Norwegian Revenue. Most of the proceeds of the action would be used to satisfy the estate's outstanding tax liability.

Despite the funding provided by the Norwegian government and the close cooperation between the plaintiff and the Norwegian Revenue, the Cayman Islands Grand Court decided that the case was not an indirect enforcement of foreign revenue law. The court took into consideration the fact that the defendants were not taxpayers, the claim was not driven by the Norwegian Revenue and the plaintiff was recovering misappropriated funds, rather than recouping overpaid tax.

⁴ (2007) 10 ITLR 283.

Lam JA and Chow JA on the other hand were reluctant to hold that the Debt Requirement was an essential requirement to the application of the Rule in a tax context. In the circumstances, the issue as to whether it is necessary to show there is an outstanding tax liability is left open.

Takeaways

The CA's decision is helpful for us to better understand the boundaries of the rule against indirect enforcement of foreign penal and revenue laws given the authorities on this issue have been scarce.

Whilst a company involved in a dispute which concerns penal, revenue or other public law of a foreign country should be aware of the Rule, this case illustrates that in applying the Rule, the Hong Kong courts would look past the form of the claim and closely examine and identify

the central interest concerned and the substance of each case.

Hong Kong courts will consider who will ultimately benefit from the success of the claim. It is unlikely that Hong Kong courts would refuse to enforce foreign judgments on the basis of contravening the Rule where the interests of foreign revenue authorities would not be affected by the outcome of the case and the proceeds of the case would not flow to such authorities.

Whilst it is not settled whether the presence of an outstanding tax liability is an essential prerequisite to the application of the prohibition against enforcement of foreign revenue law, it seems more likely that a claim to recover monies in order to settle an outstanding tax debt would be considered as falling foul of the Rule as the foreign revenue could be said to be the sole party benefiting from the judgement entered by a Hong Kong court.

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