

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D28/88

Appeals – assets betterment statement – need for taxpayer to adduce proper evidence to challenge such an assessment.

Assessments – assets betterment statement – function of such a statement.

Panel: William Turnbull (chairman), T J Gregory and Michael A Olesnicky.

Date of hearing: 21 June 1988.

Date of decision: 9 August 1988.

The taxpayer failed to lodge profits tax returns and was assessed on the basis of an assets betterment statement prepared by the IRD. The taxpayer claimed that certain debts owed by him should have been deducted from the compilation of his net worth.

Held:

- (a) An assets betterment statement by its nature cannot be accurate. It merely indicates the means which the assessor used to estimate the taxpayer's assessable profits in default of any other information.
- (b) An assets betterment statement forces the taxpayer to cooperate either by producing acceptable accounts or by otherwise assisting the IRD in its enquiries.
- (c) It is not sufficient for the taxpayer merely to provide estimates as to his liabilities. A taxpayer has an obligation to maintain proper accounts and, if he fails to do so or is otherwise unable to prove that the assets betterment statement is incorrect with proper evidence, the assessment based on the assets betterment statement must be confirmed.

Appeal dismissed.

Luk Nai Man for the Commissioner of Inland Revenue.

Evelyn Chu Fung Ling of C & D Management Services for the taxpayer.

Decision:

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This appeal is by a partnership carrying on business in Hong Kong against four profits tax assessments for the years 1979/80, 1980/81, 1981/82, and 1983/84 and against an additional profits tax assessment for the year 1982/83.

The partnership was represented at the hearing by its tax representative and the precedent partner personally appeared and gave evidence.

The relevant facts are as follows:

1. The partnership comprised two partners, namely Mr X and Ms Y, who commenced business in 1979 in the field of advertising.
2. The partnership did not keep proper accounts and, in the absence of any profits tax returns and in the course of an investigation, the assessor on 17 March 1983 raised estimated profits tax assessments for the years of assessment 1979/80, 1980/81 and 1981/82 in substantial sums as follows:

Year of Assessment	1979/80	1980/81	1981/82
Assessable Profits (section 59(3))	\$600,000	\$1,000,000	\$1,000,000
Tax Payable thereon	\$90,000	\$150,000	\$150,000

3. A former tax representative of the partnership objected to these three assessments and profits tax returns were filed, but the same were not accepted by the assessor.
4. The assessor then embarked upon the compilation of an assets betterment statement covering the period from 1 January 1978 up to 31 December 1983. This assets betterment statement referred to Mr X who was one of the two partners of the partnership and who was the precedent partner of the partnership. The assets betterment statement was submitted to Mr X on 11 February 1987 and showed 'betterment profits' of \$1,294,733 for the six year period covered by the statement. Mr X did not accept and has not accepted the truth or accuracy of this assets betterment statement. Through the tax representative who represented the partnership at the hearing before the Board of Review, Mr X submitted that the assets betterment statement did not reflect certain loans which had been made to him and which should have been deducted from his apparent net worth.
5. On 15 May 1987, the assessor issued a revised assets betterment statement for the period from 1 January 1980 to 31 December 1983 (a four-year period) which showed a reduced betterment profit of \$1,134,469. Mr X refused to

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accept this revised betterment statement as being correct but, notwithstanding, on 18 May 1987 the assessor raised on the partnership an additional profits tax assessment for the year 1982/83 and an assessment to profits tax for the year 1983/84, both based on the revised assets betterment statement.

6. The tax representative objected to the additional assessment and the new assessment on the ground that they had been over-estimated, the reason again being that certain loans due from Mr X had been omitted from the revised assets betterment statement.
7. The objections by the partnership were referred to the Commissioner for his determination and, by a determination dated 14 January 1988, the Deputy Commissioner decided to annul the original assessment for the year 1979/80 of assessable profits of \$600,000 with tax payable thereon of \$90,000; to reduce the profits tax assessment for the year 1980/81 from the amount of the original estimated assessment of \$1,000,000 with tax payable thereon of \$150,000 to a sum of assessable profit of \$250,000 with tax payable thereon of \$37,500; to reduce the profits tax assessment for the year 1981/82 from the amount of the original estimated assessment of \$1,000,000 with tax payable thereon of \$150,000 to a sum of assessable profit of \$250,000 with tax payable thereon of \$37,500; to reduce the additional profits tax assessment for the year 1982/83 to an additional assessable profit of \$224,419 (which when added to the original assessment is the same as the preceding two years namely \$250,000); and to reduce the assessment for 1983/84 to an assessable profit of \$235,469.
8. The justification for the determination of the Deputy Commissioner of Inland Revenue was to bring the estimated assessments into line with the profits which had been revealed by the revised assets betterment statement after taking into account such loans as Mr X alleged were due from him and which had been established to the satisfaction of the assessor prior to the matter being referred to the Deputy Commissioner for his determination.
9. In giving evidence before the Board Mr X stated that:
  - 9.1 The accounts which had been prepared for the purpose of filing tax returns by the partnership were not correct and were only estimated accounts. He said that he did not accept the accuracy of the revised assets betterment statement and challenged the assessments appealed against because they did not include two loans which he said were outstanding between him and two friends of his, one in the sum of \$30,000 and one in the sum of \$100,000; and because a debt due from the partnership to an advertising company of \$69,354 had been omitted from the assets betterment statement or had not been deducted from the profits earned by the partnership.

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- 9.2 As with the accounts for the partnership, he could not state with certainty how much money he owed to either of his two friends because, periodically and frequently, he asked them for loans of various small sums of money which he apparently never repaid. Neither he nor his friends ever kept a record of moneys which they lent to him.
10. The two friends had refused to appear before the Board of Review to give evidence to substantiate the debts alleged to be due to them and had failed to answer letters dated 16 March 1987 sent to them by the Inland Revenue Department. These letters from the Inland Revenue Department to them requested full particulars of the loans which it was alleged had been made.
11. The tax representative of the partnership who appeared before us had obtained 'audit confirmations' from the two individuals in question confirming that the sums of \$30,000 and \$100,000, respectively, were due and owing to them. The audit confirmations were dated by the tax representative 28 November 1986 but referred to a balance due on 31 December 1983 and were returned to the tax representative in one case undated and in the other case bearing the date 16 December 1986. It was not disputed that these two audit confirmations were obtained for the purpose of making representations to the Inland Revenue Department and not for routine audit purposes, and it was also confirmed that the tax representative was not in fact the auditor of the partnership for the year ended or as at 31 December 1983. It was also the evidence of Mr X that the figures shown in the audit confirmations were no more than estimates made by him of amounts owed by him and were not the true and correct amounts actually owed by him.
12. On the day before the hearing of the appeal, namely 20 June 1988, two letters in Chinese had been received by the senior assessor (appeals) of the Inland Revenue Department in charge of this case. These letters were pro forma statements signed by the two lenders purporting to confirm amounts due to them of \$30,000 and \$100,000 respectively. The pro forma statements in each case read as follows:

'I have been a friend of Mr X for many years. Every time I met Mr X, I lent money to him, each loan amounting to several thousand dollars. I am, therefore, unable to recall the exact date and amount. Up to the present moment, Mr X owes me about [30,000][100,000] odd dollars.'

The pro forma statement in each case went on to say that the moneys had been paid by cash, that repayment had never been requested, that no interest had ever been charged, that no written contracts of loan had ever been made and that the amount in each case was approximately \$30,000 or \$100,000.

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13. With regard to the amount due by the partnership to the advertising company of \$69,354, the evidence in support of this debt was an invoice dated 22 May 1984. The representative for the Taxpayer stated that the amount had in fact fallen due at some earlier date and that the invoice was merely a statement of account due and rendered and should have been taken into account in the assets betterment statement for the period ended 31 December 1983.

This Board of Review has repeatedly drawn the attention of taxpayers to their obligations to file true and correct business profits tax returns. To achieve this, it is essential that proper and detailed accounts of a business be maintained. If a taxpayer fails to meet his obligations under the Inland Revenue Ordinance, he has no one to blame but himself. That is the situation in the present case.

In giving evidence, Mr X told the Board that he had embarked on a number of unfortunate speculative property transactions starting in 1979/80 which had resulted in him losing substantial sums of money. Reference was made to three units in a building in Mongkok and one in an industrial building in Tai Kok Tsui. Reference was also made to an alleged series of transactions which had taken place between the Taxpayer and one or more other persons which had also resulted in significant losses to Mr X. Mr X was given the opportunity and indeed assisted by the Board of Review in trying to provide details of the losses which he alleged he had made. He was not able to produce detailed or itemised accounts and the Board was left with only such information as was already contained in the revised assets betterment statement.

Mr X was also given the opportunity of challenging other information contained in the assets betterment statement or supplementing the same. Ultimately the appeal came down to the inclusion of the two debts alleged to be due to his two friends and the trading debt alleged to be due to the advertising company.

As stated, it is the duty of a taxpayer to keep adequate accounts to enable him to handle his taxation affairs in accordance with the requirements of the Inland Revenue Ordinance.

An assets betterment statement is not the best way of ascertaining the assessable profits of a business or of an individual. It is a last resort when all else fails. It is important to bear in mind that, when a return of income is not made or is not accepted by an assessor or a case arises under section 60 of the Ordinance, the assessor is entitled and indeed has a duty to make an estimated assessment. In default of accurate information, it is customary for the assessor to protect the public revenue by issuing an assessment which is not less than whatever profit the taxpayer might have made. This imposes the obligation or burden on the taxpayer to come forward with what is his true taxable income. It forces the taxpayer to cooperate either by producing acceptable accounts or by assisting in the preparation of a meaningful assets betterment statement.

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An assets betterment statement in its final or revised form is nothing more than an account of how the assessor has arrived at estimating the taxable profit of a taxpayer. It is not and does not pretend to be accurate or precise. It is merely a calculation of a taxpayer's income on a 'net assets basis' in default of any other available information. If a taxpayer is aggrieved by an assessment founded on such a statement, it is for him to show how and to what extent it is incorrect or excessive. If he fails to do that, the assessment will be confirmed. It is for the taxpayer to displace the assessment. The taxpayer can blame no one except himself for such a state of affairs having arisen and can blame no one except himself if he finds it difficult to discharge the burden and prove that the betterment profit revealed by the assets betterment statement is wrong. The onus is not discharged by the taxpayer simply appearing before the Board and saying that the assets betterment statement is wrong. The onus is not discharged by the taxpayer if he leaves the Board in a state of conjecture by his failure to give evidence on matters peculiarly within his knowledge. If he elects to remain silent or is unable to give detailed and acceptable evidence or is unable to obtain independent acceptable documentary evidence and to call witnesses to substantiate the truth of what he says, then he leaves the Board with no alternative but to uphold the assessments based on the assets betterment statement because, like the Commissioner before it, the Board has no better means of ascertaining the true profits of the taxpayer.

The assets betterment statement method of estimating the income of a taxpayer provides the taxpayer with the opportunity, if he is aggrieved by the assessment raised on that basis, of satisfying the Board that the increase in his wealth did not arise from his business activities. If at the end of the Board hearing there is no acceptable evidence or insufficient evidence to warrant a conclusion that the assessments are excessive, then the same must stand.

In the present case, on Mr X's own evidence the amounts due from him to his two friends were not \$30,000 and \$100,000. These sums are nothing more than Mr X's own estimates of what he may have borrowed from the two persons in question, and significant weight must be given to the fact that the two persons in question declined to come before the Board to give evidence. We do not know the relationship between Mr X and his two friends but it would appear that the relationship was not satisfactory from their point of view if, as Mr X alleged, every time that they met Mr X they felt obliged to lend him sums of money with no prospect of being repaid. We cannot even guess at what such relationships could have been and indeed it is not for the Board of Review to enter into conjecture.

We find as a fact that the evidence adduced is insufficient to establish that as at 31 December 1983 Mr X owed either of the two sums of \$30,000 or \$100,000 as alleged by him. Accordingly, we reject the appeal so far as it is based on this ground.

Likewise, we reject the appeal based on the ground that the revised assets betterment statement as amended by the Commissioner's determination is incorrect. There is no evidence before us on which we can hold that the assets betterment statement is incorrect: the appellant has failed to discharge the onus of proof on him.

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With regard to the statement of account of the sum of \$69,354 due to the advertising company, we find as a fact that it is correct that this should not have been taken into account as at 31 December 1983. On the evidence before us, there is nothing to indicate that this debt was due and owing as at that date. However, it is apparent that this debt was due and owing as at 22 May 1984 and it is reasonable and correct that it should be taken into account when ascertaining the taxable profit of the partnership for the year ended 31 December 1984, that is, the year following the assets betterment statement. We understand from what was stated to us at the hearing that the sum of \$69,354 may not have been deducted from the partnership's taxable profits for the financial year ended 31 December 1984. If that is the case, we direct that the assessment for that year should be re-opened and revised accordingly. As the year of assessment in question, namely 1984/85, is not the subject matter of this appeal, our direction has no legal effect but we have no doubt that, upon an application being made on behalf of the partnership and it being substantiated that the amount due to the advertising company has not been taken into account when the accounts of the partnership were prepared for the year ended 31 December 1984, the Commissioner will re-open the assessment under section 70A of the Ordinance because clearly an error or omission has been made.

For the reasons stated, we dismiss the appeal and confirm the determination of the Commissioner and direct that the assessments appealed against be confirmed in the reduced amounts as contained in the Commissioner's determination which includes the discharge of the assessment for the year 1979/80.