

## INLAND REVENUE BOARD OF REVIEW DECISIONS

### Case No. D24/96

**Profits tax** – penalty tax – failure to keep accounting books and records of transactions – incorrect profits tax returns – section 82A of the Inland Revenue Ordinance.

Panel: William Turnbull (chairman), Andrew Charles Watson Cleeton and Brian Hamilton Renwick.

Date of hearing: 12 January 1996.

Date of decision: 11 July 1996.

The taxpayer operated 3 businesses. He did not maintain any accounting books and records of any of his businesses. He filed his tax return based on his estimation of profits. The taxpayer was interviewed and the investigation officers adopted the assets betterment approach in assessing the profits of the taxpayer's businesses. Substantial discrepancy between the profits estimated and that after assessment was found. The Commissioner imposed upon the taxpayer additional tax under section 82A of the IRO. The taxpayer appealed against the imposition and quantum of additional tax.

Held:

The taxpayer failed to keep any record and did not report to the Inland Revenue Department any of his other businesses. Although the taxpayer made a number of submissions to the Board, he declined to provide any information in relation to his submission. As to the quantum, it was not possible to reopen the assessment to profits tax which has been assessed based on the assets betterment statement and which had been agreed by the taxpayer.

**Appeal dismissed.**

Cases referred to:

D10/81, IRBRD, vol 1, 404

D29/88, IRBRD, vol 3, 319

D36/88, IRBRD, vol 3, 354

D42/88, IRBRD, vol 3, 395

Tang Ngan Ling for the Commissioner of Inland Revenue.

Taxpayer in person.

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### Decision:

This is an appeal by a taxpayer against a number of penalty tax assessments imposed upon him under section 82A of the Inland Revenue Ordinance (the IRO). The facts are as follows:

1. The Taxpayer is appealing against the imposition and quantum of additional tax by way of penalty assessed upon him under Section 82A of the IRO for making incorrect profits tax returns in respect of ABC Company (the Business) for the years of assessment 1988/89 to 1990/91 inclusive.
2. The Taxpayer and his ex-wife set up the Business in December 1983 and they separated on 27 February 1987. The Taxpayer married Ms L on 9 November 1989. Ms L was a teacher. After separation from his ex-wife, the Taxpayer continued to run the Business as the sole proprietor. The Business was engaged in photo developing and finishing, and selling of films. The Business also took photos for customers at the business premises and group photos for schools. Besides the Business, the Taxpayer operated another business called XYZ (the second Business) which commenced on 15 December 1991.
3. On divers dates, the Taxpayer submitted profits tax returns in respect of the Business for the years of assessment 1987/88 to 1992/93 inclusive and the tax return – individuals for the year of assessment 1993/94. The returned profits of the Business are summarised as follows:

<b>Year of Assessment</b>	<b>Date of Filing Return</b>	<b>Basis Period</b>	<b>Return Profits \$</b>
1987/88	22-4-1991	year ended 31-3-1988	322,351
1988/89	14-12-1990	year ended 31-3-1989	352,554
1989/90	2-11-1990	year ended 31-3-1990	359,332
1990/91	6-11-1991	year ended 31-3-1991	214,385
1991/92	16-11-1992	year ended 31-3-1992	474,688
1992/93	15-11-1993	year ended 31-3-1993	378,677
1993/94	30-9-1994	year ended 31-3-1994	564,072

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4. On divers dates, the assessor raised the following profits tax assessments on the Taxpayer in respect of the Business per the returns submitted.

<b>Year of Assessment</b>	<b>Returned Profits \$</b>	<b>Profits Assessed \$</b>
1987/88	322,351	322,351
1988/89	352,554	352,554
1989/90	359,332	359,332
1990/91	241,385	214,385
1991/92	474,688	474,688
1992/93	378,677	378,677

5. In December 1993, the Inland Revenue Department commenced an investigation into the tax affairs of the Taxpayer. On 14 January 1994, the Taxpayer attended an interview with two investigation officers of the Department. During that interview, the investigation officer explained to the Taxpayer the penalty provisions under the IRO. The Taxpayer admitted that the returns submitted in respect of the Business were estimates made by reference to the bank statements and might be incorrect. He estimated that the profits understated were about \$1,000,000 to \$1,500,000 and mentioned that the Business was at its best during the year of assessment 1989/90. He also informed that the second Business was in fact jointly owned by him and his brother-in-law, although it was registered in his name only. In addition, he disclosed that he had carried on a business of selling the priority right tickets for the purchase of units at various new property sites (the third Business) during the years from 1987 to 1990. The profits derived therefrom were more than \$1,000,000. He confirmed that he and his wife had no overseas property. At the end of the interview, the Taxpayer was requested by the investigation officers to place a deposit of \$500,000 with the Department. A signed note of interview with some amendments was returned by the Taxpayer through his tax representative, on 29 April 1994.
6. The investigation officers made a field visit to the premises of the Business on 21 January 1994.
7. Profits tax returns for the years of assessment 1987/88 to 1992/93 were issued to the Taxpayer on 4 February 1994 for the Taxpayer to report the profits of the third Business. The Taxpayer submitted the returns on 31 March 1994 and the total returned profits in respect of the third Business were \$1,139,800.

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8. On 3 February 1994, the Taxpayer paid to the Department \$500,000 as a deposit against his tax liability.
9. On 28 February 1994, the assessor raised on the Taxpayer the following profits tax assessments in respect of the Business and the third Business for the year of assessment 1987/88:

**(a) The Business**

Estimated Additional Assessable Profits	\$1,000,000
	=====

**(b) The Third Business**

Estimated Assessable Profits	\$1,000,000
	=====

The Taxpayer objected against the above assessments on the ground that the estimated profits were incorrect.

10. By a letter dated 9 May 1994, the Taxpayer was asked to furnish information concerning his assets, business, personal income and expenses, gifts and legacies and overseas remittances.
11. On 27 July 1994, the Taxpayer attended an interview with the investigation officers. At the interview, the Taxpayer submitted a reply to the Department's letter of 9 May 1994. He confirmed in his reply that he and his wife had no overseas property and that he had not maintained any accounting books and records for his businesses. He also claimed that he had held substantial assets as at 31 March 1987 and that he and his wife had received legacies from his late mother and his wife's grandfather respectively but no documentary evidence could be produced in support of the claim. When asked by the investigation officers, the Taxpayer confirmed that the profits tax returns filed in respect of the third Business were prepared based on his memory and that he was unable to supply details of the location of the properties involved and the number of the priority right tickets sold. He also asserted that he and his wife had no overseas bank accounts nor overseas properties. He said he had never operated any bank accounts in name of others nor had he remitted money outside Hong Kong. The investigation officers then reminded the Taxpayer that he should not hide any information from the Department. A note of interview was issued to the Taxpayer on 17 August 1994 for his comment but no reply was received.
12. By letter dated 15 August 1994, the assessor asked the Taxpayer to supply further information and documents in respect of loans to others, funds held in trust for others, overseas remittances, etc.

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13. The Taxpayer supplied the information requested on 19 October 1994. The Taxpayer admitted that he had three properties in Country D and maintained bank accounts with S Bank Ltd in Hong Kong. This information was not previously disclosed despite repeated enquiries made by the investigation officers. The Taxpayer claimed that there were outstanding loans due to him amounting to \$670,000 as at 1 April 1987 and that sums totalling \$1,310,000 were repaid to him subsequently, details of which are summarised as follows:

Name of Borrower	Relationship with the Taxpayer	Outstanding amount as at 1-4-1987 \$	Total repayments from 1988 to 1991 \$
Mr K	brother	300,000	500,000
Ms L	sister	170,000	210,000
Mr M	friend	200,000	600,000

The Taxpayer also claimed that he held \$650,000 in trust for his brother-in-law who had emigrated to Country D but no documentary evidence could be produced in support of the claims.

14. On 19 December 1994, the assessor raised the following estimated profits tax assessments for the years of assessment 1988/89 to 1993/94 on the Business:

Year of Assessment	* Assessable Profits/ Additional Assessable Profits \$
1988/89	2,500,000
1989/90	2,500,000
1990/91	2,500,000
1991/92	2,500,000
1992/93	2,500,000
1993/94	2,500,000 *

Estimated assessments in respect of the second Business for the years of assessment 1991/92 to 1993/94 and the third Business for the years of

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assessment 1988/89 to 1993/94 were also issued to the Taxpayer on the same date. Valid objections were lodged against all these assessments by the Taxpayer.

15. On 28 December 1994, the Taxpayer and his wife attended an interview with the investigation officers. During that interview, the Taxpayer admitted that he had deposited his money into the bank accounts of his elder sister, maintained with the S Bank Ltd., and placed money with his father. In the absence of accounting books and records, the investigation officers suggested that the profits of the Taxpayer's businesses be quantified by means of the assets betterment approach. The mechanism of the Assets Betterment Statement was explained to the Taxpayer. A draft yearly Assets Betterment Statement (the ABS) covering the period from 1 April 1987 to 31 March 1993 showing a total discrepancy of \$12,289,508 was then shown to the Taxpayer for discussion. The Taxpayer and his wife raised many deduction claims and the investigation officers asked the Taxpayer to produce evidence to substantiate the claims. The note of interview was issued to the Taxpayer on 6 February 1995 for his comment.
16. By letters dated 11 January 1995 and 16 January 1995, the assessor asked for further information and documents in respect of his overseas assets and income, and the claims for deduction from the ABS, which he made during the interview on 28 December 1994.
17. On 24 February 1995, the Taxpayer and his wife were interviewed by the investigation officers. They furnished some information requested in the assessor's letters of 11 January 1995 and 16 January 1995. Quantification of the profits of his businesses by reference to the ABS was again discussed. An updated yearly ABS covering the period from 1 April 1987 to 31 March 1993, which reflected a total discrepancy of \$10,785,682, was shown to the Taxpayer for discussion. A detailed and thorough discussion was held and all the deduction claims made by the Taxpayer and his wife were considered carefully by the investigation officers. Despite the absence of documentary evidence and full explanations, some of the deduction claims, including unidentified bank withdrawals, payments to others, his brother-in-law's share of investment in the second Business, loans to brother and sister, money held in trust for sister and payments to brother in respect of the joint property dealing business were nevertheless allowed as deductions in computing the betterment profits. The discrepancy for the period from 1 April 1987 to 31 March 1993, after deducting the returned profits of the Taxpayer's businesses, was finally agreed to be \$9,000,000. It was also agreed that the discrepancy be assessed under the Business according to the yearly ABS in the following manner:

**Year of Assessment**

**Additional Assessable Profits**

**\$**

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1987/88	370,000
1988/89	2,100,000
1989/90	1,700,000
1990/91	2,500,000
1991/92	1,300,000
1992/93	<u>1,030,000</u>
	9,000,000
	=====

The Taxpayer also agreed that the assessable profits in respect of the Business for the year of assessment 1993/94 be projected to a sum of \$880,000. The Taxpayer was reminded of the penalty provisions under the IRO. He signed an agreement for settlement. The note of interview was sent to the Taxpayer on 27 February 1995 for his comment. Again, no reply was received from the Taxpayer.

18. The Taxpayer and his wife attended interviews with the investigation officers on 3 March 1995 and 10 March 1995. They asked for further explanation and clarification of the settlement previously agreed on 24 February 1995. After the officers' explanation, the Taxpayer confirmed that he agreed to finalise the investigation in accordance with the agreement signed by him during the interview held on 24 February 1995. The Taxpayer was again reminded of the penalty provisions under the IRO.
19. Based on the settlement agreement, the profits tax assessments in respect of the Business for the years of assessment 1987/88 to 1993/94 inclusive were revised as follows:

**(a) The Business**

Year of Assessment	Additional Assessable Profits \$
1987/88	370,000
1988/89	2,100,000

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1989/90	1,700,000
1990/91	2,500,000
1991/92	1,300,000
1992/93	1,030,000
1993/94	880,000

**(b) The Second Business and Third Business**

The profits tax assessments in respect of the second business for the years of assessment 1991/92 to 1993/94 and the third Business for the years of assessment 1987/88 to 1993/94 were also revised per the returns submitted.

20. The following is a comparative table of the assessable profits in respect of the Business before and after investigation and the amount of tax undercharged in consequence of the Taxpayer's submission of incorrect profits tax returns:

Year of Assessment	Assessable Profits Before Investigation \$	Assessable Profits After Investigation \$	Profits Understated \$	Tax Undercharged \$
1987/88	322,351	692,351	370,000	61,050
1988/89	352,554	2,452,554	2,100,000	325,500
1989/90	359,332	2,059,332	1,700,000	255,000
1990/91	214,385	2,714,385	2,500,000	375,000
1991/92	474,688	1,774,688	1,300,000	195,000
1992/93	378,677	1,408,677	1,030,000	154,500
1993/94	<u>564,072</u>	<u>880,000</u>	<u>315,928</u>	<u>47,389</u>
	2,666,059 =====	11,981,987 =====	9,315,928 =====	1,413,439 =====

The percentage of profits understated to total profits assessed after investigation is 77%.

21. The Commissioner of Inland Revenue was of the opinion that the Taxpayer had without reasonable excuse made incorrect profits tax returns in respect of the Business for the years of assessment 1987/88 to 1993/94 inclusive. On 10



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April 1995, he gave a notice to the Taxpayer under section 82A(4) of the IRO informing the Taxpayer of his intention to assess the Taxpayer to additional tax by way of penalty in respect of the years of assessment 1987/88 to 1993/94.

22. On 12 May 1993, the Taxpayer submitted written representations to the Commissioner. Having considered and taken into account the Taxpayer's representations, the Commissioner issued on 25 May 1995 notices of assessment and demand for additional tax under section 82A of the IRO for the years of assessment 1987/88 to 1993/94 inclusive in the following amounts:

Year of Assessment	Tax Undercharged \$	Section 82A Additional Tax \$	Additional Tax as percentage of Tax Undercharged
1987/88	61,050	82,000	134%
1988/89	325,500	420,000	129%
1989/90	255,000	318,000	124%
1990/91	375,000	447,000	119%
1991/92	195,000	218,000	111%
1992/93	154,500	162,000	104%
1993/94	<u>47,389</u>	<u>47,000</u>	99%
	1,413,439 =====	1,694,000 =====	120%

23. By a letter dated 22 June 1995, the Taxpayer gave notice of appeal to the Board of Review against the assessments to additional tax for the years of assessment 1988/89 to 1990/91.

At the hearing of the appeal the Taxpayer appeared in person together with his wife who made representations to the Board on behalf of the Taxpayer. She said that the photofinishing business of the Taxpayer could only produce a limited number of prints so that the assessments which had been raised in excess of \$2,000,000 were very wrong. She submitted that she and her husband had won money gambling when travelling overseas. She gave further information as to why she considered the assets betterment statement and the assessment to profits tax to be incorrect. In answer to a question from the Board she said that there was also a business in Country E dealing in coins and antiques. However she said that for political reasons she did not wish to provide information.

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At this point the Board explained to the Representative for the Taxpayer that it was not possible to reopen the assessment to profits tax which had been based on an asset betterment statement and which had been agreed by the Taxpayer.

The Representative for the Taxpayer then began to submit that the profit which had been taxed arose outside of or was derived outside of Hong Kong. She said that such income should not be taxed and penalties should not be based on it.

In the course of her submission she said that the Taxpayer had transferred to Hong Kong from outside of Hong Kong \$4,500,000 during the years 1988 to 1992 and this sum had been taxed. As the Representative either could not or would not explain what was the source of these moneys the Taxpayer himself intervened and said that the matter was sensitive and that he would rather pay tax as otherwise his friends in Country E would be affected.

The Representative then went on to say that the photofinishing shop had been affected by flooding. The Representative went on to try to explain why records had not been kept for the Business. She also tried to explain the failure by the Taxpayer to disclose particulars of overseas property by placing the blame on an advisor who had said that the Taxpayer should not or need not report such matters in Hong Kong.

The Taxpayer himself then took over from his wife and addressed the Board further. He summarized the case saying that the main reason for the appeal was that the photofinishing business could not have made such high profit as had been assessed and that money had come from other non taxable sources.

The Representative for the Commissioner submitted with regard to the photofinishing business that records had not been maintained so that it was not possible accurately to estimate what profit had been made.

The Representative explained the background and procedure relating to the asset betterment statement. She drew our attention to a number of matters which had come to light because of enquiries made by the staff of the Inland Revenue Department and which had not been volunteered by the Taxpayer. She further pointed out that the total discrepancy of \$9,000,000 for the six years in question had been accepted and agreed by the Taxpayer.

Section 70 of the IRO makes the assessment to profits tax final and conclusive for all purposes of the IRO and the Representative referred us to previous D10/81, IRBRD, vol 1, 404, D29/88, IRBRD, vol 3, 319, D36/88, IRBRD, vol 3, 354 and D42/88, IRBRD, vol 3, 3...

The Representative for the Commissioner pointed out that the Taxpayer had failed to cooperate with the Revenue during the investigation and referred to a number of instances of lack of cooperation.

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She went on to point out that the Taxpayer was not an unsophisticated person but was a very clever person who had managed his affairs and businesses well. She pointed out that the Taxpayer had tried to hide his assets by placing substantial amounts of money in bank accounts opened in the name of his sister and father.

She pointed out that the total amount of the penalties for the years of assessment 1988/89 to 1990/91 was 124% of the tax undercharged and she submitted that the penalties were not excessive in the circumstances.

In reply the Taxpayer sought again to raise matters relating to the original profits tax assessment. Inter alia he sought to explain why money had been transferred to his father's account and sought to blame advice given by an accountant. At the very end of the case the Taxpayer began to indicate remorse and to say that in future he would keep proper accounting records because he had had to pay a large amount of tax. He said that the high amount of profits tax had already had a deterrent effect.

With due respect to both the Taxpayer and his wife we find little substance in their submissions. Most of what they said was directed towards trying to prove that the asset betterment statement and the agreed compromise sum of \$9,000,000 were incorrect. It is not for this Board to investigate the compromise agreement which the Taxpayer reached with the Commissioner. The Taxpayer sought to show that his photofinishing business could not have earned the profits for which he had been assessed. This is not material. The truth is that the Taxpayer was apparently carrying on a number of complex businesses apart from the photofinishing business. He totally failed to keep any record or report any of his other business transactions to the Inland Revenue Department. Gradually the truth came out during the course of the investigation. For convenience and with the agreement of the Taxpayer it was decided that the unreported profits, whatever they might be, would be attributed to the photofinishing business. Having so agreed the Taxpayer had then tried to go back on his agreement with the Commissioner by arguing that the photofinishing business could not have earned such profits. With due respect to the Taxpayer this is not material. In the course of the submission the Board were informed that some of the business transactions of the Taxpayer took place overseas and the sum of \$4,500,000 was mentioned in relation to alleged business in Country E. The Board tried to understand what was being submitted but the Taxpayer and his Representative declined to provide information. In such circumstances we can give little or no weight to the submission made by or on behalf of the Taxpayer.

Having carefully considered this case and the submissions made by and on behalf of the Taxpayer we find that the penalties imposed are not excessive in the circumstance. Accordingly we dismiss the appeal and confirm the assessments against which the Taxpayer has appealed.