

Case No. D38/10

Profits tax – assessment by way of Assets Betterment Statement (‘ABS’) – burden is on a taxpayer to prove that the assessment based on the ABS is incorrect or excessive – Revised DIPN No.11: Field Audit and Investigation.

Panel: Horace Y L Wong SC (chairman), Catherine Yip Miu Chun and Wendy W Y Yung.

Dates of hearing: 27-28 March 2008 & 14-16 April 2008.

Date of decision: 14 January 2011.

The Appellant was the sole-proprietor of a business (‘the Business’). The Business commenced its operation on 1 April 1961 and was terminated on 1 April 2001.

In September 2000, the Commissioner commenced a tax audit of the tax returns filed by the Appellant and requested the Appellant to supply the accounting books and records of the Business covering the period from 1 April 1994 to 31 March 2001.

The Deputy Commissioner confirmed the revised additional profits tax assessments for the years of assessment 1994/95 to 1998/99, and also the revised profits tax assessment for the years of assessment 1999/2000 to 2000/01 raised on the Appellant computed by way of Assets Betterment Statement (‘ABS’) as the accounting books and records of the Business supplied by the Appellant was either unreliable or unavailable.

The Appellant contended that the use of the ABS was inappropriate and even if it was justified to adopt the ABS, a number of deductions, should have been, or should be, made to the ABS.

Held:

1. The adoption of the ABS method is appropriate:
 - There is a possible understatement of the profits of the Business.
 - The books and records of the Business, when judged as a whole, are unreliable, and cannot be relied upon to construct an account which is reasonably correct in showing the profits and loss of the Business.
2. The Appellant had not discharged his onus in showing that the Wife was the beneficial owner of the Mainland Business, or that the alleged dividend payments made by the Mainland Business were in fact monies properly payable to the Wife.

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3. As there was no other known source of income of the Wife (except the rental income from a property which was solely owned by her) that could explain the Wife's assets, it is right for the Commissioner to include the Wife's Assets in the computation of the ABS.
4. The Board is not satisfied that the Appellant has discharged his burden in showing that the ABS is wrong in regard to his various deduction claims such as to require any adjustment.

Appeal dismissed.

Cases referred to:

D30/89, IRBRD, vol 4, 346
D28/88, IRBRD, vol 3, 312
D20/89, IRBRD, vol 4, 285

Leung Siu Yin of Messrs S Y Leung & Co, Certified Public Accountants and a nominee secretary of a secretarial services company for the taxpayer.

Tang Yiu Fai, Tai On Kee and Chan Wai Hong Steven for the Commissioner of Inland Revenue.

Decision:

1. This is an appeal by the Appellant against the determination ('the Determination') of the Deputy Commissioner made in respect of the additional profits tax assessments for the years of assessment 1994/95 to 1998/99, and also the profits tax assessment for the years of assessment 1999/2000 to 2000/01 raised on the Appellant. As revised by the Determination, the amounts of revised additional assessable profits and revised assessable profits for the various years of assessment in question are as follows:

<u>Year of Assessment</u>	<u>Additional Assessable Profits</u>	<u>Assessable Profits</u>	<u>Tax Payable</u>
1994/95	\$1,422,813		\$213,422
1995/96	\$3,484,234		\$522,635
1996/97	\$68,929		\$10,340
1997/98	\$4,705,762		\$635,278
1998/99	\$7,837,271		\$1,175,591
1999/2000		\$2,924,888	\$438,733
2000/01		\$3,827,249	\$574,087

2. The revised additional assessable profits for the years of 1994/95 to 1998/99

and the revised assessable profits for the years of 1999/2000 to 2000/01 were computed or assessed by the Commissioner using what is sometimes called the method of Assets Betterment Statement ('ABS'). The method is a 'Capital Computation Method of Estimating Profits', as mentioned in Accounting Guideline 1 – Preparation and Presentation of Accounts from Incomplete Records issued by the Hong Kong Institute of Certified Public Accountants.

Background

3. The parties were unable to agree to the facts upon which the Determination was arrived at, as set out in paragraph 1 of the Determination. The major areas of disagreement were, firstly, on the adoption of the ABS method in assessing the profits of the Appellant in the relevant years of assessment; and secondly, on various items that the Commissioner had taken into account in the ABS.

4. We set out below the background facts leading to this appeal, which are based on the evidence adduced at the appeal hearing and also on the undisputed documents before this Board.

5. The Appellant was the sole-proprietor of a business ('the Business') known by the name Company A, which was a business engaged in the retailing of second-hand diesel engines and parts used in boats and ships. Apart from this, Company A also acted as a commission agent for its Mainland customers. The Business commenced its operation on 1 April 1961 and was terminated on 1 April 2001.

6. In September 2000, the Commissioner commenced a tax audit of the tax returns filed by the Appellant. In the course of investigation, the Commissioner requested the Appellant to supply the accounting books and records of the Business covering the period from 1 April 1994 to 31 March 2001. The books and records from 1 April 1996 to 31 March 2001 were supplied but those for the two years from 1 April 1994 to 31 March 1996 were alleged to have been damaged by water and excrement, and were not made available to the Commissioner.

7. It was discovered from the accounting records that there were some receipt vouchers recording sales proceeds from customers in the Mainland which had been deposited into the bank account of the Business ('Business Bank Account'). The Business Bank Account was the only bank account of the Business. Upon enquiries with the bank where the Business Bank Account was held ('the Bank'), it was further discovered that the persons who made the deposits into the Business Bank Account did not in fact correspond to the names of Company A's customers.

8. It was also discovered that the wife of the Appellant ('Wife') was involved in the operation of the Business. She had signed cheques and remittance applications of the Business Bank Account, and had been involved in liaising and dealing with customers and suppliers of Company A.

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9. After the Wife had refused to attend a meeting with the tax assessor handling the tax audit ('the Assessor'), the Assessor, by 2 letters both dated 31 May 2001, made written enquires on the Wife's personal assets and liabilities covering the period from 1 April 1994 to March 2000. In a reply letter dated 22 June 2001 issued by Messrs SY Leung & Co ('the Representative') on behalf of the Appellant, it was alleged that the Wife had indirect investment in the Mainland ('Mainland Business') although no records had been kept for it.

10. The Assessor also noticed that deposits and withdrawals of substantial amounts were made into and from the personal bank accounts of the Wife. Further it was found out that various sums were transferred from the Wife's bank account (being account no XXX-XXX-X-XXXXXX-X) to the Business Bank Account from late 1997 to early 2000, which were purportedly recorded in the accounts of the Business as sales of the Business.

11. The Commissioner took the view that the accounting books and records kept by the Appellant were either unreliable or unavailable, and considered that the ABS method is the appropriate method to ascertain the assessable profits for the years from 1994/95 to 2000/01. A draft ABS ('the 1st ABS') was prepared which, amongst other things, included or took into account the Wife's assets. The 1st ABS showed an overall discrepancy of \$32,076,315 for the years in question. On 30 May 2003 the draft ABS was sent to the Appellant for his comments.

12. The Appellant objected to the use of ABS method and by a letter dated 9 June 2003, the Representative informed the Assessor that the Appellant could not agree to the 1st ABS as most of the assets belonged to the Wife. It was claimed that the Appellant had no obligation or duty to explain the Wife's assets or the movement of funds and that the Wife had the right not to disclose her private affairs according to human rights legislation.

13. However, in an interview on 3 July 2003, the Appellant disclosed, among other things, the following:

- (a) the Wife beneficially owned the Mainland Business, which was registered in the name of a Mainland citizen;
- (b) the Mainland Business was engaged in the trading of engines and goods, some of which were purchased through the Business;
- (c) payments made by the Mainland Business to the Business might be made through underground channels or third parties accounts;
- (d) the Mainland Business could earn several millions dollars each year and the profits would either be transferred back to Hong Kong or reinvested in the Mainland.

14. On 7 July 2003, the Appellant furnished to the Assessor copies of the business licences and the tax registration certificates of the alleged Mainland Business. As shown on

both of the aforesaid documents, the Mainland Business was a business operated by a Mr B. No further documentary evidence on the Mainland Business was provided.

15. By a letter dated 25 July 2003, the Assessor explained to the Appellant the reasons for adopting the ABS method. For the years of assessment 1994/95 and 1995/96, it was pointed out that in the complete absence of books and records provided by the Appellant, a direct method could not be applied. For the years 1997/98 to 2000/01, the Assessor further stated, *inter alia*, that:

‘...certain deficiencies were also detected upon examination, like:

- (a) The transactions were not recorded on a double-entry basis.
- (b) The sales invoices were not issued in serial order and several invoice books were used concurrently.
- (c) No cash sale invoices were retained by [the Appellant].

In view of the above, an indirect method is considered to be more appropriate in this particular case. Among the indirect methods of quantification, the preparation of an [ABS] is generally considered as the most comprehensive indirect means of quantifying an understatement of profits.....’

16. Apart from maintaining that the use of the ABS method was inappropriate, the Appellant further argued in subsequent correspondences that various deductions should be made in the ABS. Despite various adjustment made to the ABS by the Commissioner, no final agreement could be reached. Eventually the Deputy Commissioner issued the Determination confirming the assessments and additional assessments as set out in paragraph 1 above.

17. The Appellant now appeals to the Board of Review.

The appeal and the issues

18. In this appeal, Mr D of a secretarial services company representing the Appellant called the Appellant, the Wife and Mr C, an employee of the Business, to give evidence. The Commissioner called no witness. The evidence given by the witnesses concern various matters. We would discuss the relevant evidence when we deal with the various specific matters that we are concerned in this appeal.

19. Mr D essentially raised two issues. Firstly he submitted that the ABS method should not have been adopted. This issue raises the question as to the circumstances under which it may be appropriate to employ the ABS method.

20. Secondly and alternatively, Mr D argued that even if it was justified to adopt the ABS, a number of deductions, including in particular the alleged cash dividends that the

Wife received from the Mainland Business, should have been, or should be, made to the ABS.

21. In considering these issues, the methodology and the principles underlying the ABS method need to be examined.

The ABS method

22. The ABS method is explained in the case of D30/89, IRBRD, vol 4, 346 at page 347 as follows:

‘ 4. *An assets betterment statement (ABS) is a recognised method of assessing a Taxpayer’s income or profits by showing his increases in assets and his expenses on the one hand and his returned income or profits on the other, and the excess, if any, of the former over the latter. The excess, or discrepancy as is commonly called, unless satisfactorily accounted for, is taken to be the taxpayer’s understated income or profits. On appeal, the onus is on the Taxpayer to prove that the assessment is excessive or wrong. This means that in the case of an assessment or additional assessment based on an AHBS, the Taxpayer has to prove that the ABS is excessive or wrong.*’

23. In terms of the circumstances which render the ABS method appropriate, the Inland Revenue Department Interpretation and Practice Notes No.11 (Revised) entitled ‘Field Audit and Investigation’ (‘PN 11’) explains as follows:

‘ 56. *In view of the multiplicity of circumstances, under which understatements occur, it is not practicable to lay down hard and fast rules as to the computation of understatements that could be applied to all field audit and investigation cases.....*

57. *A key element in determining the appropriate method of quantification to be used is the reliability of the taxpayer’s books and records. If they are reliable, a “direct” approach can be used, whereas if they are incomplete or unreliable, an “indirect” method will be called for.*

.....

61. *The Department’s experience had been that, because of the inadequacy or even complete absence of records, it is often not possible to construct revised accounts on conventional lines. For such cases, the back duty assessments generally have to be based on indirect methods. Indirect methods are founded on an investigation of the taxpayer’s personal affairs. There is no single “best” indirect method of quantification; the method used depends on the circumstances of the case. One commonly used method involves the preparation of an [ABS]....’ (underline added)*

24. As explained in PN 11, whether the ABS method should be adopted depends on the circumstances of each case. Where the books and records are available and found to be reliable, the accounts of the taxpayer could be reconstructed directly from its books and records. However, where the books and records are not available, or are shown to be unreliable, the use of the direct approach is not possible, and the use of the ABS method may be appropriate. We agree. We would further hold, in this regard, that it must be shown that there is a possible understatement of the profits by the taxpayer before consideration would be given to the use of the ABS method to quantify the taxpayer's assessable profits. Further, merely because some isolated errors or omissions are found in the books and records do not necessarily mean that the same are unreliable. Whether the books and records are unreliable is a matter of degree, and need to be judged as a whole. The question is whether the books and records, judged as a whole, are capable of producing an account that is reasonably correct in showing the profits and loss of the taxpayer's trade or business. If the errors and omissions are merely isolated instances, and could be rectified or remedied by available information from other sources, they may not affect the reliability of the books and records as a whole.

25. In terms of the methodology of the ABS method, PN11 provides a specimen format of an ABS at Appendix A. Paragraphs 63 and 64 of PN 11 explains the methodology as follows:

‘63. *In essence, the function of an ABS is to disclose the correct taxable profits or income of a person by adding to the person's yearly asset increase (i.e. the excess of net assets in any one year over the previous year) all expenditure of a non-allowable nature. Receipts which are of a capital nature or otherwise not assessable are deducted from the sum of these items to arrive at the betterment profits (adjustments are also made if necessary in respect of any applicable depreciation allowances or balancing charges). This can be summarized simply by the following formula:*

$$\textbf{Betterment Profits} = \textbf{Increase in Net Assets} + \textbf{Disallowable Expenditure} - \textbf{Non-taxable Receipts}$$

64. *The preparation of an ABS entails making a detailed analysis of the taxpayer's Drawings Account or company Current Account, Loan Accounts, and bank accounts (or accounts held with similar institutions) which show deposits or withdrawals of money. The accounts of the taxpayer's immediate family members, such as his spouse and dependent children, should also be reviewed and analysed if appropriate.*’
(underline added)

26. Finally, it is well established that the burden is on a taxpayer to prove that the assessment based on the ABS is incorrect or excessive. This has been emphasized in D30/89, cited above. In another decision of the Board, namely, D28/88, IRBRD, vol 3, 312,

the Board observed at pages 316-317 as follows (See also D20/89, IRBRD, vol 4, 285 at page 303):

‘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.

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.’ (underline added)

Unreliability of the accounting records

27. Mr Tang, representing the Commissioner, contended that the ABS method should be adopted because the accounting records of the Business for the year of 1994/95 to 1995/96 were not available at all, and for the rest of the years the records produced by the Appellant were unreliable in such a way that affect the reported profits of the Business. In support of his contention, Mr Tang drew our attention to the following:

(i) The errors or omissions in the accounting records

28. The trust receipt account of the Business as shown on the balance sheet as at 31 March 1995 was \$663,875 as opposed to \$927,910 of the bank confirmation from the Business Bank Account. However, we are not persuaded that, in itself, the same would have a real impact on the overall accuracy of the profits. This error can be easily rectified without affecting the overall reliability of the accounting records.

29. The Appellant alleged that two withdrawals of \$800,000 respectively on 24 January 1995 and 12 June 1995 from the Business Bank Account were loans to one Company E, which loans were repaid on 3 March 1995 and 20 November 1998 respectively. It is admitted by the Appellant during cross examination that these loans were not recorded in the books in the relevant years. Mr Tang submitted that during the 3-year period when the second loan was not repaid and was not recorded in the books, other hidden omissions in the balance sheet could be possible which might have affected the profit. In our view, the omissions involved two transactions only, and can be easily taken into account by a proper audit. In themselves and without more, these omissions do not justify the adoption of the ABS method.

30. Mr Tang pointed out that the borrowings of the Business from the Wife were not accurately recorded. The Wife gave evidence that she had advanced monies to the Business, which were not recorded as borrowings but simply as sole-proprietor's injection of funds. It seems to us that these borrowings by the Wife were not recorded as borrowings simply because they were not intended as such. In any event, we cannot see how these borrowings (or injection of funds) would affect the profits of the Business.

31. Mr Tang also relied on the fact that the Appellant had reported to the Commissioner various errors made in the accounts for the year of assessment 1999/2000. We note that the disclosures of errors were made in January 2001, that is, shortly after the tax audit was commenced. We are not prepared to draw any adverse inference from this.

(ii) Bank Loan of \$1,400,000 omitted from balance sheet

32. The Commissioner has made enquiries with the Bank which confirmed that it had granted a loan of \$1,400,000 to the Business on 17 July 1993. The loan was repaid on 16 September 1994. However, on examining the relevant balance sheet submitted by the Appellant, the loan was found omitted.

33. Mr Tang submitted that an omission of the bank loan on the liability side must have been balanced by a corresponding omission on the asset side. In this case, the asset

omitted might well be trade debtors, which would suggest that the turnover of the Business might have been understated.

34. If one conceals the trade debtors and the trade debtors subsequently make payment of the trade debts, unless payments were paid into some other bank accounts unknown to the revenue (or paid by cash and pocketed secretly), the concealment would be revealed. We do not see how this could be done without somebody deliberately manipulating or handling the receipt of the payments from the trade debtors in such a way that these payments would not feature at all in the banking records of the Business.

35. Accordingly, unless there is evidence to show that there had been some deliberate concealment or manipulation of payments received by the Business in the ways mentioned above, we would not be satisfied, on this point alone, that the omission of the bank loan of \$1,400,000 would justify the use of ABS. However, as will be seen from the discussion below, there is in fact evidence that payments by customers in Mainland China have been channelled into the Wife's bank accounts. This will be discussed in greater detail in the paragraphs below.

(iii) Payments into the Wife's accounts

36. On the evidence before this Board, Company A did regularly use the Wife's personal account to receive payments from customers in Mainland China from as early as 1994. The major customer was the Mainland Business which was alleged to be solely owned by the Wife.

37. The Wife gave evidence that she was the sole beneficial owner of the Mainland Business which also traded in second-hand motor car engines and engines parts. The Mainland Business was one of the major customers of Company A in respect of the latter's commission business. According to the Wife, she would share 70% of the profits of the Mainland Business as her dividend payments and the rest of the profits would be divided amongst the managing staffs (some of which were the relatives of the Wife). However, the frequency of these dividend payments was allegedly irregular.

38. It was the evidence of both the Appellant and the Wife that when the Mainland Business settled the invoices in respect of purchase of goods through Company A, the Mainland Business would sometimes remit the purchase monies together with dividends payable to the Wife in one lump sum. The remittances would be made through some underground channels into the Wife's personal bank accounts. The Appellant explained that this was done in order to save cost and time as remitting money out of China was not convenient. Sometimes (when no dividend payments to the Wife were involved) the Mainland Business would make remittances directly to Company A to settle its invoices.

39. Mr Tang submitted that because the same payers had made deposits into both the Business Bank Account and the Wife's personal accounts, it could be inferred that the money received by the Wife were the sale proceeds of the Business. In other words, Mr Tang asked us to infer from this that monies properly belonging to the Business had been

siphoned off the Business into the Wife's bank accounts.

40. Remitting money through the underground channel explained why the names of the persons making the remittances did not correspond with the names of the customers. However, as can be seen from above, remittances made to the Wife's personal accounts – according to the evidence of the Appellant and the Wife – included monies which were sale proceeds payable to the Business as well as dividend payments which were intended to be received by the Wife. In other words, monies properly belonging to the Business were mixed up with monies allegedly belonging to the Wife. Unless the monies so mixed up are properly accounted for, a big question mark is casted on the reliability of the books and records of the Business.

(iv) Transfer of funds from the Wife to the Business

41. It is therefore relevant to consider how the Wife accounted for the part of remittance she received on behalf of the Business. During his cross-examination, when the Appellant was asked how the Wife would know what part of the remittance was intended for the Business, the Appellant gave evidence to the effect that the Wife would transfer that part of remittance in the exact amount of an outstanding invoice in order to settle the invoice, though the figures would not necessarily square. The Appellant further claimed that it was the Wife's discretion to decide how much would be transferred back to the Business, which depended on her view as to the cash flow situation of the Business.

42. The Wife claimed in her evidence that whenever a remittance was made to her bank account, a Mr F working for the Mainland Business would phone her and tell her the amount payable to the Business and the amount payable to her as her dividends. The Wife would then transfer the money to the Business and pass the deposit slip to the bookkeeper. It was pointed out by Mr Tang there were sometimes delay of up to one and a half month in transferring the funds back to the Business.

43. We find the evidence of the Appellant and the Wife very unsatisfactory in this regard. Their evidence does not sit well together. Moreover, if what the Appellant said in evidence was true, the Wife did not properly account to the Business the monies received by her on its behalf, and it was up to her own discretion as to how much of the money received by her would be paid back to the Business.

44. When the ledgers prepared by the Representative are examined, it can be readily seen that over the years, the total amount that was paid by the Mainland Business did not tally with the amount of the invoices. For example, in the year 1996/97, there was an overpayment of over \$2,200,000. There was then an underpayment of around \$200,000 in the year 1997/98. This was followed by an underpayment of around \$300,000 in the year 1998/99. In the next year (1999/2000) there was again an underpayment of around \$200,000 and in the year 2000/01 was an overpayment of some \$1,600,000.

45. Mr D tried to explain the discrepancies by submitting that the Business maintained a running trade debtors account with the Mainland Business so that the latter did

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not pay in accordance with the invoice billed. It was argued that when there was an overpayment made in a particular year there must have been a corresponding underpayment during the previous years.

46. There may be some force in Mr D's contention if a running account was in fact operated. However, as pointed out above, the books for the years 1994/95 and 1995/96 were not available for verification. Moreover, one would expect that any underpayment of customers in a previous year would be reflected in the opening balance of trade debtors account in the next year. As Mr Tang pointed out, the opening balance of trade debtors for the year 1996/97 was only about \$970,000. Assuming that the entire opening balance was wholly owed by the Mainland Business, after the said overpayment of over \$2,200,000 in the year 1996/97 was made, the net overpayment was still well over \$1,200,000.

47. We find it unreasonable that a customer would overpay so excessively even assuming that it was operating under a running account. Moreover, if one adds up the opening balance of the trade debtors account in 1996/97 to the over and underpayments made in the subsequent years by the Mainland Business (as stated in paragraph 44 hereinabove), there was still an overall net overpayment of over \$2,100,000.

48. Why would a customer make such overpayments (that is, to pay more than the amounts of the invoices)? In the absence of a satisfactory explanation, the inference is that probably the trade debtors of the Business had been understated in the books of the Business. Whether the understatement was made deliberately or inadvertently is not the concern of this appeal. The fact is that such discrepancies and possible understatement of the trade debtors could very well affect the accuracy of (that is, by understating) the reported profits of the Business.

49. In the light of the matters mentioned above, we are of the view that there is a possible understatement of the profits of the Business. Moreover, the books and records of the Business, when judged as a whole, are unreliable, and cannot be relied upon to construct an account which is reasonably correct in showing the profits and loss of the Business. We find that the adoption of the ABS method is appropriate in the present case.

Alleged deductions to the ABS

50. We now turn to the second issue in this appeal: whether the list of items contended by Mr D should be deducted from the ABS. The making of these deductions, if allowed, would have the effect of reducing the assessable profits of the Appellant.

51. In computing the ABS, the Commissioner had included the assets of the Wife. Many of the items of deductions claimed by the Appellant relate to the assets of the Wife. Accordingly, it is necessary for us to deal with the question whether the Wife's assets should be taken into consideration for the purpose of the ABS.

The Wife's assets

52. It is the Commissioner's contention that since the Wife was actively involved in the Business, her assets should be included in the ABS. We do not agree. We are of the view that unless there is evidence to show that the profits of the Business had been channeled away to the Wife's pocket, the mere fact that the Wife had been heavily involved in the operation of the Business is not *per se* a sufficient justification for including her assets in the ABS.

53. As pointed in PN No.11, the preparation of an ABS involves a detailed analysis of the taxpayer's accounts which show deposits or withdrawals of money. Where appropriate, the accounts of the immediate family members should also be reviewed.

54. In the present case, there were substantial payments from the Mainland Business made into the Wife's personal bank accounts. Moreover, on the evidence monies of the Business had been mixed up with the personal monies of the Wife. The Wife's personal accounts were used as a receiving account of the Business (that is, for receiving payments from customers). The onus is on the Appellant to satisfy us that the money kept by the Wife was indeed the personal monies properly belonging to the Wife.

Alleged dividend payments received by the Wife

55. Mr Tang argued that the evidence did not support the contention of the Wife that she was the sole beneficial owner of the Mainland Business. He invited the Board to hold that the sums retained by the Wife allegedly as dividends were in fact the sale proceeds of the Business.

56. The Wife gave evidence that she was born in Guangzhou and came to Hong Kong in 1980. She had previously worked in the automobile parts industry and had assisted her father in his clothing business. Her aunt in Hong Kong had regularly transferred money to support her living expenses. So when she moved to Hong Kong, she left some money (of about RMB200,000) to his father.

57. In 1990 her brother-in-law set up a motor parts business in another county in Guangdong and she contributed the capital of the business (in the sum of around RMB500,000). As her brother-in-law was not a native of the county, the business was operated by him without a business licence, as it was difficult for a non-native to apply for one. In 1994 they decided to apply for a business licence and agreed that a native of the county, namely one Mr B, would be the holder of the business licence. The licensed business became the Mainland Business. The capital of the Mainland Business was RMB1,000,000 and it was financed from funds derived from the original non-licensed business. On this basis, it is claimed that the Wife was the sole beneficial owner of the Mainland Business.

58. The Appellant claimed that the Mainland Business paid a fixed tax at RMB6,500 per month in China irrespective of the actual profits made by the Mainland Business. For this reason the Mainland Business did not prepare any financial statements at all. During cross-examination the Wife was asked how she would know the performance of

the Mainland Business without any financial statements prepared. Her reply was that the Mainland Business was a sure winner and as the staff shared the profits they would monitor each other to safeguard anyone from committing fraud.

59. As to the frequency of the dividend payments, the Wife gave evidence to the effect that it varied – sometimes the dividend payments would be made every two months, but sometimes they would be made as frequently as twice in a month – depending on whether the staff had time to make the remittances. The Wife also claimed that she would not make inquiry with her brother-in-law as to the amount of profits made by the Mainland Business. She did not know, and would not bother to calculate the profit margin of the Mainland Business.

60. We find the evidence of the Wife in this regard very unsatisfactory. Not only did she not know the profits made by the Mainland Business, she did not even know, and apparently did not bother to find out, whether the dividends allegedly remitted to her corresponded to her 70% share in the profits of the Mainland Business. It is hard to believe that an owner of a business would manage the affairs of her business in this way, even assuming that she has trust on those who manage the business on a day to day basis. Moreover, her total ignorance of the Mainland Business was a complete contrast to her thorough understanding of the Business (during her evidence, she could vividly explain the logistics of the Business), which she claimed she only gave assistance when she was free.

61. Furthermore, it is hard to believe that the Mainland Business would make dividend payments in such random manner as alleged by the Wife. This is clearly at odds with the case of the Appellant that the Mainland Business operated a running trade debtor account with the Business. The complete lack of financial statements of the Mainland Business is, in our view, not properly explained. Moreover, the alleged ‘fixed tax’ paid by the Mainland Business (which was relied on as a reason of not keeping financial statements) was not supported by any actual receipts, and we have not been referred to any provision in the Tax Law of mainland China that provides for such a fixed tax irrespective of the amounts of profits.

62. The Appellant has not called the Wife’s brother-in-law to give evidence. The brother-in-law would have been the natural witness to be called to support the Wife’s allegations, particularly when there is no documentary evidence that lends support to her claim. We do not accept the reason purportedly given by Mr D that it was hard to travel from mainland to Hong Kong.

63. We do not accept the evidence of the Appellant and the Wife regarding the Mainland Business. In particular, the Wife’s evidence in this regard is inherently incredible, unsupported by any documentary evidence, and having observed her demeanour while giving evidence, we do not find her to be a credible witness. We hold that the Appellant had not discharged his onus in showing that the Wife was the beneficial owner of the Mainland Business, or that the alleged dividend payments made by the Mainland Business were in fact monies properly payable to the Wife.

64. In the premises, given the fact that there was no other known source of income of the Wife (except the rental income from a property which was solely owned by her) that could explain the Wife's assets, we are of the view that it is right for the Commissioner to include the Wife's Assets in the computation of the ABS.

65. We now turn to deal with the deduction claims made by the Appellant.

(i) Bank Loan of \$1,400,000 as at 31 March 1994

66. This is the same bank loan referred to in paragraphs 32 to 35 above. The ABS (as latest revised) included this amount as a liability in the opening balance of the year 1994/95, which has the effect of reducing the opening net asset value of that year. The effect of it is that there is a bigger net assets increase in the year 1994/95, and the betterment profit is correspondingly increased.

67. The Appellant contended that this bank loan had been doubly counted because it was already been accounted for in the balance sheet of the Business. However, when the balance sheet (as at 31 March 1994) is examined, there is nothing to show that this loan has been included. We are not satisfied that the Appellant has discharged his burden in showing that the ABS is wrong in this regard such as to require an adjustment.

(ii) Trust receipt balance as at 31 March 1995

68. This is the same trust receipt balance referred to in paragraph 28 above. The Appellant contended that the balance as at 31 March 1995 should be \$663,875 as shown on the balance sheet of the Business. However, this is contrary to the bank confirmation record which shows a balance of \$927,910. Apart from the base assertion of the Appellant, we have no evidence to show that the figure of \$663,875 is the correct figure. We do not think that any adjustment to the ABS is necessary in this regard.

69. In any event, we accept the submissions of Mr Tang that even if the balance was adjusted as suggested by the Appellant, it would have no effect on the overall betterment profits. This is because the betterment profit of 1994/95 is calculated from the net increase of assets during the year by deducting the net asset values ('NAV') of the Business as at the end of year from the NAV as at the opening of the year. If the closing liability as at the end of 1994/1995 is lowered as suggested by the Appellant, the closing NAV for the year 1994/95 and the opening NAV for the year 1995/96 would be increased. The result is that the betterment profits for the year 1994/95 would be enlarged but it would be offset by the corresponding amount of decrease in the betterment profits for the year 1995/96. We believe that Mr D accepted this in his subsequent submissions. Accordingly no adjustment is required.

(iii) Alleged loans to Company E in the years of 1994/95 and 1995/96

70. The alleged loans have already been referred to in paragraph 29 above. Our attention has been drawn to the deposit slips evidencing the transfer of \$800,000 to

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Company E both on 24 January 1995 and 12 June 1995. They were considered as disallowable withdrawal and were added up in the betterment profits.

71. As pointed out above, the transfers were alleged to be loans to Company E. However, the alleged loans were not evidenced by anything in writing. There were no loan agreements, receipts or anything else that documented the alleged loans. Nor were the alleged loans recorded as loans in the balance sheets. Apparently no interests were charged to these alleged loans. In the absence of books and records for the years of 1994/95 and 1995/96 and other supporting documents, the claim that the transfers were loans made to Company E is nothing but a bare allegation.

72. If these transfers were truly loans, one would expect that the loans would have to be repaid. As regards the first loan allegedly made on 24 January 1995, it had previously been alleged by the representative (in their letter dated 29 April 2004) that the alleged loan was repaid on 27 May 1997. However, by a letter dated 6 February 2008, the representative alleged that this loan was in fact repaid on 3 March 1995, more than 2 years earlier than the date of repayment previously alleged. How and why this discrepancy (regarding the date of repayment) arose has not been properly explained. For the second loan allegedly made on 12 June 1995, it was alleged that the loan was repaid by Company E on 20 November 1998. Curiously, however, the document that was furnished by the Appellant in support was a deposit slip which shows that on 20 November 1998 the Wife transferred a sum of \$800,000 into the Business Bank account. The Appellant claimed that this represented the repayment by Company E of the second loan. Allegedly Company E had previously made a deposit into the bank account of the Wife, and the Wife then transferred the money back to the Business Bank account. However, there is no evidence to show that the deposit of \$800,000 in the Wife's bank account on 19 February 1998 in fact originated from Company E, or that the Wife's deposit into the Business Bank Account was in fact money derived from Company E's alleged repayment.

73. We are unable to accept the Appellant's allegations regarding the nature of these transfers to Company E. We hold that the Appellant has not discharged his burden in showing that an adjustment is required to be made to the ABS (as revised) in this regard.

(iv) Repayment of \$5,000,000 to Mr G in the year of 1995/96

74. On 26 February 1996, there were two payments made to a person named Ms H in the sum of \$2,000,000 and \$3,000,000 respectively. These two payments were treated by the Commissioner as disallowed expenditures and were added into the betterment profit. The Appellant gave evidence that a Mr G wanted to do business with him and requested him to accept a cheque of \$5,000,000, which was deposited into the Business Bank Account on 7 February 1996. Subsequently the business negotiation broke down and the Appellant was told to return the \$5,000,000 to a third party, namely the said Ms H.

75. Upon cross examination the Appellant was unable to condescend into any particulars at all on the nature of the business deal that was the alleged subject of negotiation between him and Mr G. All he was prepared to say was that it was some kind of trading. He

was unable to tell us what was being traded, and who he was supposed to trade with. He told us that he did not know, and had not even asked, why the \$5,000,000 was transferred to him.

76. The Appellant's evidence in this regard is less than convincing, and we do not accept his evidence. In the absence of books and records for the years 1995/95 and 1995/96, and other documents that may go to support the Appellant's allegations, the true nature of the payment of the \$5,000,000 and the identity of the payer are not known. On its face, the 2 payments made on 26 February 1996 were made to Ms H, not Mr G. There is nothing, except the bare allegations of the Appellant (which we do not accept), to link these 2 payments to the \$5,000,000 deposit on 7 February 1996.

77. Accordingly, we hold that no adjustment is required in respect of the sums of \$2,000,000 and \$3,000,000, which are rightly disallowed by the Commissioner as expenditures of the Business.

(v) Unidentified withdrawal of \$50,000 on 29 May 1995

78. A sum of \$55,100 was deposited into the Business Bank Account on 29 May 1995. The Appellant claimed that part of that sum, namely \$50,000, was in fact his personal monies. He claimed that on the day in question he closed his personal account at the Hong Kong Bank and drew out a cheque in the sum of \$50,000, which made up part of the deposit of \$55,100 into the Business Bank Account.

79. We note that in fact the Appellant's account with the Hong Kong Bank was not closed until 2000. The amount of deposit of \$55,100 does not match the amount withdrawn from the Hong Kong Bank account and apart from the bare allegation of the Appellant, there is nothing on the face of the documents to link the withdrawal to the deposit (save for the fact that the 2 transactions were on the same day). We also note that the date written on the cheque stud had apparently been amended. We accept the submission of Mr Tang that there is insufficient evidence to prove that part of the said deposit is derived from the withdrawal from the Appellant's personal account. We reject the Appellant's claim for deduction under this head.

(vi) Loan of \$300,000 to Mr J in the year of 2000/01

80. A withdrawal of \$300,000 on 23 September 2000 was treated by the Commissioner as disallowed expenditure and was added into the betterment profits. The Appellant claimed that the sum was lent to Mr J when he came to Hong Kong to purchase some second-hand motor engines. The relevant bank advice however shows that the sum was paid to one person named K and not Mr J. The document, therefore, does not support the Appellant's claim that the sum was a loan to Mr J.

81. The transaction was not recorded in the books. There was no loan agreement nor other documents supporting the alleged loan, nor is there any evidence (other than the Appellant's bare allegations) that Mr J had received the money in question. It was alleged that a transfer deposit on 26 May 2001 was a repayment of the loan. Again, apart from a

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bare allegation, there is nothing to link the said transfer deposit with the withdrawal on 23 September 2000.

82. The Appellant has failed to prove his claim and we reject his claim for deduction under this head.

(vii) Alleged loan of \$488,660 from Mr L

83. The Appellant complained that the Commissioner has failed to include a loan, allegedly in the sum of \$488,660 from one Mr L (said to be the brother-in-law of the Appellant), as part of the Appellant's liabilities. It is alleged that the loan was advanced by Mr L to the Business in mid-1993 and repayment was made to him on 26 March 2001 before the Business ceased operation. A withdrawal of \$488,660 on 26 March 2001 was alleged to be the repayment of this loan.

84. Again this transaction was not recorded in the books. There is no loan agreement nor was any interest charged. Apart from the bare allegations of the Appellant, there is no evidence to prove the alleged loan. There is no explanation as to why, if the loan was made by Mr L to the Business as long ago as in 1993, it had taken so many years for the loan to be repaid – and why it was only repaid only a few days before the Business ceased operation. There is also no explanation as to why a loan of such an odd amount was made.

85. We do not accept the Appellant's evidence on the alleged loan. In the premises, deduction claimed under this head is disallowed.

(viii) Initial provident fund deduction of \$31,480 in the year 2000/01

86. The Appellant had taken out a provident fund scheme at the cost of \$157,401 in the year of 1997/98 (which was reflected in the tax return for that year submitted to the Commissioner). The initial contribution to provident fund is tax deductible. This is governed by Section 16A(2) of the Inland Revenue Ordinance (Chapter 112):

'(2) For the purpose of making the deduction provided for in subsection (1), one fifth part of the payment shall be deemed to have been expended during the basis period in which the payment was actually made and the remaining 4 parts shall be deemed to have been expended at the rate of one part in the basis period for each of the succeeding 4 years of assessment: Provided that in no case shall the total amount of the deductions exceed the amount of the payment.'

87. Accordingly, the initial contribution to provident fund may be deducted in 5 equal parts over a period of 5 years. One-fifth part of the payment is deemed to have been expended during the basis period in which the payment was actually made and the remaining 4 parts are deemed to have been expended at the rate of one part in the basis period for each of the succeeding 4 years of assessment.

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88. In the year of 2000/01 when the Business ceased, it was the 4th year since the initial contribution was made and there was a remaining balance of \$31,480 yet to be deducted. If the Business had continued, the Appellant may of course claim deduction of the remaining balance in the next basis period. However, the Appellant argued that when the Business ceased operation in 2000/01, it was entitled to claim deduction of the remaining balance of \$31,480 in the basis period when the Business ceased.

89. Mr Tang is clearly right. Section 16A(2) is clear in its provision. Only one-fifth of the initial contribution payment is deemed to have been expended in each of the year of assessment succeeding the initial payment. If a business ceases operation in the 4th year after the initial contribution was made, there is nothing in section 16A(2) to allow the taxpayer to claim deduction for the one-fifth part of the contribution that is only deductible in the 5th year. If the taxpayer no longer carries on business in the 5th year, the deduction that is otherwise available in that year simply could not be claimed.

90. We also agree with Mr Tang that Mr D's reference to section 15D(2) is wholly irrelevant as the subsection concerns post-cessation payments only.

91. Mr D however argued that an employer was obliged to pay severance payment when the business came to an end. In the Appellant's case, it was alleged that the severance payment was made out from the provident fund. Mr D therefore argued that contribution to the provident fund was in effect an advance payment of the severance pay to the employee.

92. We cannot accept Mr D's argument, it is clearly stated in Section 16A (1) that any initial contribution '*shall be allowed as a deduction therefrom in accordance with subsection (2)*'. In other words, no deduction other than that in accordance with section 16A (2) is allowed. Accordingly, it is not open to the Appellant to claim deduction on any basis other than that allowed by section 16A (2). In any event, there is no evidence to show that the severance payments were in fact paid out from the provident fund. The submission of Mr D is devoid of legal and factual basis.

93. In the premises, the deduction is not allowed.

(ix) Estimated living expenses for the year 1994/95 to 2000/01

94. The Commissioner estimated that the monthly living expenses of the Appellant's family during the relevant years were \$15,000. The yearly figure of \$180,000 was therefore added into the betterment profits as disallowable expenditure. The Appellant argued that his monthly household expenses were \$10,000 only (\$120,000 yearly). There is therefore an annual discrepancy of \$60,000 in each relevant year between the Appellant's and the Commissioner's estimates. The Appellant claims that the ABS should be adjusted in each of the relevant year by deducting this amount from the betterment profits.

95. The Appellant gave evidence that he paid the Wife, from money earned from the Business, \$10,000 per month in cash for household expenses. However, his evidence was contradicted by the Wife's evidence who claimed that the Appellant did not give her

any specific sum of money on a regular basis for household use.

96. We find that a monthly expense of \$10,000 only is quite unbelievable in the present case. At all material times, the Appellant was living with the Wife and their daughter (she was still going to school) in an apartment of around 900 square feet in a private estate. They hired a domestic helper. On top of the salary of the domestic helper and the living expenses of the family, there were regular management fees and utility fees (which would not be minimal given the size of the flat and it being a private estate). The Appellant also said in his evidence that he would normally stay 4 days every month either in Macau or Mainland China to visit the customers. There were transport expenses to be paid, and other expenses for entertainment or accommodation.

97. We therefore hold that the Appellant has not discharged his burden in showing that the Commissioner's estimate was wrong in this regard. In the premises, the deduction is disallowed.

(x) Withdrawals by the Wife

98. The Appellant also claimed, in a letter dated 18 March 2008 sent by the Representative to the Commissioner, that a list of withdrawals by the Wife should not be included in the ABS.

99. However, the Appellant and the Wife had not, in their testimony before this Board, given any evidence at all on the items in the list of withdrawals. Nor is the Representative's contention supported by any documentary evidence. We would not allow deduction for these items of withdrawals.

(xi) Alleged Dividend Payments to the Wife

100. As pointed out above, it is the Appellant's case that part of the remittances made by the Mainland Business was dividend payments payable to the Wife. On this basis, the Appellant argued that these dividend payments should be deducted from the ABS. We have already dealt with the evidence relating to these alleged dividend payments in the discussion above. For the reasons set out in paragraphs 55-64 above, the deduction claimed under this head is not allowed.

Conclusion

101. For the reasons given above, the appeal is dismissed in its entirety.