

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D50/00

Profits tax – understatement of income – whether sufficient business record – section 51C of the Inland Revenue Ordinance.

Panel: Terence Tai Chun To (chairman), Berry Hsu Fong Chung and William E Mocatta.

Dates of hearing: 10 November 1998, 16 December 1998, 3, 4 March 1999, 2 June 1999
and 21, 22, 23, 24 February 2000.

Date of decision: 14 August 2000.

The taxpayer is a general medical practitioner and started his private practice in 1985.

It was suspected that there was an understatement of income by the taxpayer for the year of assessment 1991/92. As a result, books and records of the taxpayer were seized for the years of assessment 1985/86 to 1993/94.

After investigation, the IRD raised on the taxpayer profits tax assessment for the year of assessment 1985/86 and additional profits tax assessments for the years of assessment 1986/87 to 1993/94 (except for the year of assessment 1988/89 which has been separately assessed on 20 March 1995) amounting to \$21,863,198 assessable profits which was adjusted subsequently.

Held:

Having heard all the evidence, the Board found the taxpayer failed to prove that the adjusted assessments are excessive or incorrect.

Obiter:

When the income received is mainly in the form of cash, it is necessary for the taxpayer to have daily income sheets to satisfy the duty to keep sufficient records under section 51C.

Appeal allowed in part.

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Cases referred to:

Gamini Bus Company Ltd v CIR Colombo (1952) AC 571
Mok Tsze Fung v CIR (1962) HKTC 166
CIR v The Board of Review ex parte Herald International Ltd (1964) HKLR 224
G Deacon & Sons v CIR (1952) 33 TC 66
Argosy Co Ltd v Guyana CIR (1971) ATC 49
Anderson v IRC 18 TC 320

Herbert Li of Department of Justice for the Commissioner of Inland Revenue.
McCoy Counsel instructed by Messrs K W Cheung & Co for the taxpayer.

Decision:

1. This is an appeal by the Taxpayer against the determination of the Commissioner dated the 27 December 1997 in respect of profits tax assessments as follows:
 - (1) Additional profits tax assessment for the year of assessment 1988/89 under charge number 2-8430942-89-7, dated 20 March 1995 showing additional assessable profits of \$3,200,000 with additional tax payable thereon of \$496,000 is hereby reduced to additional assessable profits of \$2,567,286 with additional tax payable thereon of \$397,929.
 - (2) Additional profits tax assessment for the year of assessment 1989/90 under charge number 2-8471364-90-1, dated 9 August 1995, showing additional assessable profits of \$3,300,000 with additional tax payable thereon of \$495,000 is hereby reduced to additional assessable profits of \$2,696,400 with additional tax payable thereon of \$404,460.
 - (3) Additional profits tax assessment for the year of assessment 1990/91 under charge number 2-8471366-91-2, dated 9 August 1995, showing additional assessable profits of \$3,300,000 with additional tax payable thereon of \$495,000 is hereby reduced to additional assessable profits of \$2,690,943 with additional tax payable thereon of \$403,641.
 - (4) Additional profits tax assessment for the year of assessment 1991/92 under charge number 2-8471368-92-3, dated 9 August 1995, showing additional assessable profits of \$3,500,000 with additional tax payable thereon of \$525,000 is hereby reduced to additional assessable profits of \$2,779,741 with additional tax payable thereon of \$416,961.

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- (5) Additional profits tax assessment for the year of assessment 1992/93 under charge number 2-8471370-93-6, dated 9 August 1995, showing additional assessable profits of \$3,600,000 with additional tax payable thereon of \$540,000 is hereby reduced to additional assessable profits of \$2,689,021 with additional tax payable thereon of \$403,353.
- (6) Additional profits tax assessment for the year of assessment 1993/94 under charge number 3-9450420-94-1, dated 9 August 1995, showing additional assessable profits of \$2,400,000 with additional tax payable thereon of \$360,000 is hereby reduced to additional assessable profits of \$1,407,578 with additional tax payable thereon of \$211,136.
- (7) Profits tax assessment for the year of assessment 1994/95 under charge number 3-1291151-95-2, dated 23 October 1995, showing assessable profits of \$5,500,000 with tax payable thereon of \$825,000 is hereby reduced to assessable profits of \$3,022,165 with tax payable thereon of \$453,324.

2. The parties have presented a statement of agreed facts, which is set out in full as follows:

1. Mr A (the Taxpayer) trading as Dr A (the Practice) has objected against the profits tax assessments for the years of assessment 1985/86 and 1994/95, and the additional profits tax assessment for the years of assessment 1986/87 to 1993/94 raised on him. The Taxpayer claims that all the assessments are excessive and that the assessments for the years of assessment 1985/86 to 1987/88 are invalid by virtue of section 60(1) of the Inland Revenue Ordinance (the Ordinance).
2. The Taxpayer is a medical practitioner and established the Practice on 15 August 1985.
3. The profits tax returns in respect of the Practice for the years of assessment 1985/86 to 1991/92 submitted by the Taxpayer showed the following particulars:

Year of assessment	Basic period	Consultancy income reported	Returned profits/(loss)
		\$	\$
1985/86	15-8-85 to 31-3-86	76,170	(63,189)
1986/87	Year ended 31-3-87	299,940	39,002

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1987/88	Year ended 31-3-88	625,265	348,989
1988/89	Year ended 31-3-89	789,855	401,571
1989/90	Year ended 31-3-90	1,048,830	573,526
1990/91	Year ended 31-3-91	1,341,090	825,360
1991/92	Year ended 31-3-92	1,714,725	1,009,822

A computation of the assessable loss for the year of assessment 1985/86 and profits tax assessments for the years of assessment 1986/87 to 1991/92 were raised in accordance with the returns submitted, save for the year of assessment 1987/88 where a minor technical adjustment was made. The Taxpayer did not object to these assessments. He elected to be assessed under personal assessment for the years of assessment 1985/86 and 1986/87.

4. The Taxpayer's Practice was located at a flat at Building B (the Premises). On 18 and 26 June 1993, a tax inspector of the Inland Revenue Department (IRD) visited the Taxpayer's Practice at the Premises. The tax inspector recorded his observations and made enquiries with the Taxpayer as to his conduct of the Practice.
5. The IRD later commenced an audit on the profits tax return for the year of assessment 1991/92 submitted by the Taxpayer in respect of the Practice and, by a letter dated 12 July 1993, invited the Taxpayer to attend an interview. The Taxpayer attended an interview with a senior assessor (Mr LAU Fu-wah) and an assessor (Mr GO Shun-yuk) on 15 September 1993 during which he provided, inter alia, the following information about the accounting/recording system of the Practice:
 - (a) the Practice income was received mainly in the form of cash and normally no receipts were issued to the patients, unless requested;
 - (b) the medical fees charged to his patients consisted of consultation and medication;
 - (c) a daily income sheet (showing the patient numbers and the medical charges) was prepared by him and the daily total was then given to his wife for compiling the Income Book;
 - (d) the Income Book was passed to his father-in-law at the end of the accounting year to prepare the General Ledger;

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- (e) the General Ledger was then handed over to his tax representative, Company C, for preparing the financial statements in support of the profits tax returns;
- (f) he did not keep the daily income sheets.

The Taxpayer showed to the assessors a daily income sheet which recorded the patient numbers and the respective amounts paid for the morning session of 15 September 1993. He also handed to the assessors business records of the Practice for the year of assessment 1991/92, including an Income Book, a General Ledger, Bank Statements and Income Statements from Hospital D, which was the hospital he stationed.

- 6. By arrangement, assessor Mr GO Shun-yuk and an assistant assessor Mr IP Chun-chiu visited the Practice at the Premises on 23 November 1993 with a view to conducting a field audit.
- 7. The Taxpayer submitted profits tax returns in respect of the Practice for the year of assessment 1992/93 and tax return – individuals for the year of assessment 1993/94 on 11 November 1993 and 28 July 1994 respectively. The returns showed the following particulars in respect of the Practice:

Year of assessment	Basic period	Consultation income reported	Returned profits
		\$	\$
1992/93	Year ended 31-3-1993	2,451,475	1,411,176
1993/94	Year ended 31-3-1994	3,075,530	1,742,377

- 8. Pursuant to section 51B of the Ordinance, authorised officers of the IRD obtained search warrants and carried out a search at the Premises and the Taxpayer's home on 30 November 1994. The following books and records were among the documents seized during the search at the Premises and the Taxpayer's home (the Search):
 - (a) Patient cards with serial numbers ranging from 0 to 9056 (about 7,600 records);
 - (b) Income Books for the years of assessment 1985/86, 1986/87, 1988/89, 1989/90, 1992/93 and 1993/94.

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- (c) General Ledgers for the years of assessment 1985/86 to 1990/91, 1992/93 and 1993/94;
- (d) Loose sheets of drug charges records (125 sheets, each bearing a stamped date);
- (e) Registration Book (January 1994 to March 1994);
- (f) Invoices of medial supplies and drug purchases;
- (g) Bank Statements.

The daily income sheets mentioned by the Taxpayer during the interview on 15 September 1993 [Fact (5)] for the relevant years were not found during the Search. At the request of the Taxpayer, the patient cards were sealed to enable the Taxpayer to apply for a judicial review on the matter.

9. On 9 December 1994, the Court granted to the Taxpayer leave to apply for judicial review of the IRD' s seizure of the patient cards and meanwhile, the IRD made an arrangement with the Taxpayer to allow him to make copies of the patient cards.
10. On 13 January 1995, the Taxpayer' s tax representatives, Company E, went to the IRD to review all the documents seized except the patient cards.
11. On 20 March 1995, the IRD raised on the Taxpayer the following additional profits tax assessment for the year of assessment 1988/89 in respect of the Practice:

Additional assessable profits	<u>\$3,200.00</u>
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12. By letter dated 7 April 1995, Company C lodged objection against the additional profits tax assessment for the year of assessment 1988/89 on the ground that the estimated additional profits were grossly excessive and not in accordance with the tax return previously submitted.
13. By virtue of a Court Order by consent dated 12 April 1995, the IRD was permitted to unseal the patient cards seized and to make copies of the patient cards on condition that certain confidential information of patients would not be copied. Entries of dates, charges and codes for charges paid by the patients and particulars of patients including names and addresses were not covered up when the copies of the patient cards were made.

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14. On 21 April 1995, the IRD returned to the Taxpayer those patient cards which were opened after 31 March 1994.
15. On 1 May 1995, the IRD issued to the Taxpayer a tax return for individual for year of assessment 1994/95.
16. The IRD raised on the Taxpayer the following profits tax assessment for the year of assessment 1985/86 and additional profits tax assessments for the years of assessment 1986/87 to 1993/94 (except 1988/89) in respect of the Practice on 9 August 1995:

Year of assessment	Assessable profits	
\$	\$	
1985/86	1,363,189	
1986/87	1,700,000	(Additional)
1987/88	2,700,000	(Additional)
1989/90	3,300,000	(Additional)
1990/91	3,300,000	(Additional)
1991/92	3,500,000	(Additional)
1992/93	3,600,000	(Additional)
1993/94	2,400,000	(Additional)

The IRD claimed that these estimated assessments were based on information obtained mainly from patient cards. The additional liability for tax under the said assessment and additional assessments amounted to \$3,412,802.

17. By letter dated 4 September 1995, Company E lodged objections on behalf of the Taxpayer against the above assessments [Fact (16)] on the following grounds:

“(i) all these assessments are excessive and not in accordance with the tax returns previously filed by our client; and (ii) the assessments for the years of assessment 1985/86 to 1987/88, both inclusive, are invalid by reason that all these years concerned have become statute-barred by virtue of section 60(1) of the Inland Revenue Ordinance and there has not been any non-assessment or under assessment of our client due to fraud or wilful evasion such that proviso (b) of section 60(1) could be applied.”

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18. On 25 September 1995, the Taxpayer wrote to the IRD saying that he could not file his tax return for the year of assessment 1994/95 because his accounting records had been seized by the IRD.
19. On 6 October 1995, the Taxpayer was advised to contact the IRD for access of the documents seized.
20. Since the Taxpayer's tax return – individuals for the year of assessment 1994/95 issued on 1 May 1995 had not been forthcoming, the IRD raised on the Taxpayer the following estimated profits tax assessment in respect of the Practice, under section 59(3) of the Ordinance, on 23 October 1995 for the year of assessment 1994/95:

Assessable profits	<u>\$5,500,000</u>
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21. On 30 January 1996, the Taxpayer authorised his wife to go to the IRD to examine the documents seized.
22. On 12 March 1996, the Taxpayer filed the tax return – individuals for the year of assessment 1994/95. The tax return showed the following particulars in respect of the Practice:

Year of assessment	Basis period	Consultation income reported \$	Returned profits \$
1994/95	Year ended 31-3-1995	3,283,370	1,917,951

23. The Taxpayer's notice of objection dated 20 November 1995 which was stamped "Received" by the IRD on 22 November 1995 in respect of the profits tax assessment issued on 23 October 1995 [Fact (20)] had been misplaced; the objection was brought to the IRD's awareness by the Taxpayer, vide a fax message of 16 September 1996, enclosing a copy of the letter dated 20 November 1995. The letter was accepted as a valid notice of objection against the estimated profits tax assessment for the year of assessment 1994/95. In July 1996, the IRD started recovery actions for tax charged under estimated assessment 1994/95 of \$5,500,000.
24. By a letter dated 23 October 1996, the IRD informed the Taxpayer that, having analysed all the available patient cards and the numeric markings thereon, the IRD proposed to settle the objections against the assessments for the years of assessment 1985/86 to 1993/94 as follows:

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Year of assessment	Revised assessable profits	
	\$	
1985/86	1,142,982	
1986/87	1,390,950	(Additional)
1987/88	2,241,944	(Additional)
1988/89	2,567,286	(Additional)
1989/90	2,696,400	(Additional)
1990/91	2,690,943	(Additional)
1991/92	2,779,741	(Additional)
1992/93	2,689,021	(Additional)
1993/94	1,407,578	(Additional)

25. Having made copies of the seized patient cards (last on August 1995) in accordance with the Court Order dated 12 April 1995, the IRD returned all the patient cards to the Taxpayer on 25 November 1996.
26. In response to a letter dated 17 December 1996 from the Taxpayer's tax representative, Company F, the IRD, on 20 December and 23 December 1996, supplied the tax representative with five computer diskettes containing the data files of the numeric markings extracted from the patient cards seized.
27. By letter dated 26 March 1997, the chief assessor requested the Taxpayer to confirm a statement of facts. The Taxpayer, by a letter dated 5 May 1997, contended that the numeric codes which were marked on the patient cards denoted the total amount charged and that the actual amount charged was five times the numeric value of the codes, but might be less or waived in cases where the patients had financial difficulties.
28. By letter dated 25 June 1997, the Taxpayer contended that the assessments raised on him for the years of assessment 1985/86 to 1987/88 pursuant to proviso (b) to section 60(1) of the Ordinance were invalid on the ground that there was no proof that the under-assessment was due to fraud or wilful evasion on his part.
29. By letter dated 3 July 1997, the IRD requested the Taxpayer to produce the books and records of the Practice for the year ended 31 March 1995. In reply, the Taxpayer, on 10 July 1997, submitted copies of the Income Book of the Practice for the year ended 31 March 1995. The Income Book recorded the Practice income on a daily total basis. An extract of the monthly total Practice income is as follows:

Number of	Monthly income
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Year	Month	consultation days	from practice \$	
1994	April	22	202,025	
	May	26	227,975	
	June	23	216,020	
	July	26	247,460	
	August	19	202,230	
	September	25	236,580	
	October	25	228,765	
	November	26	236,050	
	December	21	319,900	
	1995	January	20	333,275
		February	14	208,240
		March	27	377,690

30. By another letter dated 18 July 1997, the IRD requested the Taxpayer to supply further documents and information in support of the income records submitted on 10 July 1997. The Taxpayer, by a letter of 26 July 1997, contended that the income records produced on 10 July 1997 would constitute sufficient records as required by the law before the introduction of the amendment to section 51C of the Ordinance on 30 June 1995.
31. The IRD was of the view that the monthly income for the period after the search, that is, from December 1994 to March 1995, recorded in the Income Book better reflected the actual position of the operating results of the Practice for the year of assessment 1994/95. The IRD, by a letter dated 24 September 1997, made a proposal to the Taxpayer to settle the objection against the profits tax assessment for the year of assessment 1994/95 at a revised assessable profit which was arrived at by projecting from the recorded income for the last four months ended 31 March 1995.
32. By a fax of 8 October 1997, the Taxpayer contended that the tax return he filed for the year of assessment 1994/95 was “true, valid and in accordance with the legal requirements of the time”.
33. By another fax message of 8 October 1997, the Taxpayer forwarded to the IRD copies of the bank statements of his bank accounts with Bank G and Bank H. The statements of the Bank G account, numbered XXXXXXXXX, covered the period from May 1994 to September 1994 while the statements of the Bank H account, numbered XXXXXXXXX, covered the period from March 1994 to June 1994.

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34. The Commissioner of Inland Revenue by his determination dated 27 December 1997:
- (i) annulled the profits tax assessment for the year of assessment 1985/86 and additional profits tax assessment for the years of assessment 1986/87 and 1987/88;
 - (ii) reduced the assessable profits in the additional profits tax assessments for the years of assessment 1988/89 to 1993/94 to the respective revised amounts as shown in Fact (24) above;
 - (iii) reduced the assessable profits in the profits tax assessment for the year of assessment 1994/95 to \$3,022,165.
35. The Taxpayer lodged an appeal on 23 January 1998 to the Inland Revenue Board of Review against the Commissioner's determination in respect of the additional profits tax assessment for the years of assessment 1988/89 to 1993/94 and the profit tax assessment for the year of assessment 1994/95.'

The Taxpayer's **grounds of appeal** are, in essence, that

- (i) The method of computation used by the assessor in computing the income of his practice was completely flawed and incorrect;
- (ii) The total of markings observed on the patient cards and computed by the assessor as well as the multiple of 10 used by the assessor to arrive at the consultation charges were incorrect;
- (iii) The assessor should have accepted the assessable profits reported in his tax returns as correct in the light of the records kept by him, which he considered as sufficient for the purposes of section 51C;
- (iv) The Commissioner wrongly took into account without prejudice correspondence from him dated 25 June 1997 in reaching his assessment [Additional ground with leave of the Board].

The law

3. In the course of the hearing, we were referred to the following authorities:

Gamini Bus Company Ltd v CIR Colombo (1952) AC571 at 577
Mok Tsze Fung v CIR (1962) HKTC 166
CIR v The Board of Review ex parte Herald International Ltd

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(1964) HKLR 224 at 227

G Deacon & Sons v CIR (1952) 33 TC 66 at 74

Argosy Co Ltd v Guyana CIR (1971) ATC 49 at 51

Anderson v IRC 18 TC 320

Several sections of the Inland Revenue Ordinance (‘IRO’) were also drawn to our attention, namely section 51C, section 59(2), section 59(3), section 60(1), section 68(4) and section 80.

Findings and conclusion

4. At the hearing of this appeal, the Commissioner was represented by Mr Herbert Li, Senior Government Counsel. The Taxpayer appeared in person for the first two days and thereafter was represented by Mr McCoy SC with Mr Victor Luk.

5. Counsel for the Commissioner put in evidence three witness statements respectively made by Mr Go, assessor, Miss Ngan, assessor and Nurse I, the Taxpayer’s nurse.

6. Miss Ngan made a supplemental statement which was also put in evidence.

7. Both Mr Go and Miss Ngan gave evidence under oath.

8. The Taxpayer made altogether three statements which were also put in evidence. He and his wife also gave evidence under oath.

9. Counsel for the Taxpayer made a preliminary application to the effect that the Board should recuse itself and that a newly constituted Board should hear the case de novo mainly on the ground that without prejudice communication made by the Taxpayer had been appended to the Commissioner’s determination.

10. We rejected the Taxpayer’s application for the following two reasons:

Firstly, the Commissioner’s determination was the subject matter of appeal before the Board. If there was anything inherently objectionable in the determination, it would be up to the Taxpayer to raise it as a ground of appeal. There is no question of a hearing de novo. In any event, it has been drawn to our attention that it was in fact the Taxpayer who lodged with the Board the Commissioner’s determination without any reservation or objection in the first instance.

Secondly, we have not been prejudiced by the without prejudice communication and we find that no substantial wrong had been done.

11. Counsel for the Taxpayer then went on to apply for leave, which we granted, to put in an additional ground of appeal which was subsequently reduced in writing in the following form:

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‘ That the Commissioner of Inland Revenue wrongly took into account without prejudice correspondence from the Taxpayer dated 25 June 1997 in reaching his assessment. The without prejudice correspondence was highly prejudicial to the Taxpayer, wrongly and materially influenced the Commissioner and ought not to have been taken into consideration in reaching the Commissioner’ s determination.’

12. At this juncture, it is convenient to deal with the additional ground of appeal.
13. In determining an objection the Commissioner does not perform the function of a judicial or quasi-judicial tribunal deciding an issue between contesting parties, for example, the assessor and the taxpayer. The Commissioner’ s role is an administrative one. He puts himself in the shoes of the assessor reviewing and determining afresh what ought to be the proper assessment. In the course of discharging his original and administrative functions, the Commissioner inevitably came across all documents, including without prejudice correspondence. For these reasons we reject the Taxpayer’ s additional ground of appeal.
14. We now turn to the essential facts of the case.
15. The Taxpayer is a general medical practitioner, having his clinic at a commercial complex at Building B. He started his private practice in 1985.
16. On 18 June 1993 and 23 June 1993, a tax inspector conducted a site inspection of the Taxpayer’ s clinic. The purpose was to collect relevant information relating to the Taxpayer’ s practice for the year of assessment 1991/92.
17. The following matters were noted by the tax inspector.
18. The average daily income from the Taxpayer’ s clinic was over \$10,000 and the monthly hospital income was about \$27,000. On the basis of these figures, the Taxpayer’ s annual income should have been over \$3,000,000. However, the income reported by the Taxpayer was \$1,700,000. It was therefore suspected that there was an understatement of income by the Taxpayer for the year of assessment 1991/92.
19. The Taxpayer only kept a record book showing the daily total of the cash received. He did not keep any accounting record showing how the daily total was arrived at and therefore in the opinion of the IRD, the Taxpayer did not keep sufficient records within the meaning of section 51C of the IRO.
20. By prior appointment, the Taxpayer called on the 15 September 1993 at the office of the IRD for an interview. A senior assessor (Mr Lau Fu Wah) and an assessor (Mr Go Shun Yuk) informed the Taxpayer that the IRD would conduct a tax audit of his tax return for the year of assessment 1991/92.

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21. During the interview, the Taxpayer provided the following information:
22. He kept about 8,000 patient cards in his clinic.
23. His fees consisted of charges for consultation and medicine. Since his consultation charges varied according to the duration of the consultation, only charges for medicine were recorded in the patient cards.
24. Code numbers were used to record the medicine charges that is, 10, 12, 12.5 would represent \$100, \$120 and \$125 respectively.
25. After each consultation, he would hand to his nurse the patient card with prescription together with a slip indicating the fee to be charged. His nurse would then collect the fee from the patient. Income received at the clinic was mainly in the form of cash.
26. Then on a separate sheet of paper, he would jot down the individual fees charged in respect of all his patients who came in for the day.
27. For the sake of easy identification, this separate sheet of paper was referred to as the daily income sheet.
28. At the end of each day, the Taxpayer would hand over to his wife all the cash received from the clinic together with the daily income sheet so that his wife could enter the daily total in a daily income book.
29. Thereafter the daily income sheets were not retained.
30. During the interview, it was pointed out to the Taxpayer that the patient cards would have to be examined in order to verify the fees received.
31. The Taxpayer stated that he maintained an account with Bank G and Bank H respectively. The bank statements of these accounts were handed to the IRD officers.
32. As a follow up to the interview and by prior arrangement, Mr Go Shun Yuk and Mr Ip Chun Chiu (assistant assessor) visited the Taxpayer's clinic for a field audit on 23 November 1993.
33. At this visit, the Taxpayer stated that he charged his patients by reference to the cost of drugs given plus an amount of consultation fee ranging from \$80 to \$200 depending on the time taken.

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34. The Taxpayer confirmed that the daily income sheets were disposed of after the tax returns for the year of assessment were submitted.

35. The IRD officers tried to obtain information directly from the patient cards regarding the fees charged to patients but the Taxpayer would not allow the IRD officers to have direct access to them on the ground that he was obliged to protect the privacy of his patients.

36. Before the field audit ended, Mr Go of the IRD informed the Taxpayer that according to Mr Go's calculation, the Taxpayer's bank deposits amounted to \$5,800,000 for the year which obviously exceeded his reported income and reminded the Taxpayer that he would have to give an explanation of the \$5,800,000 deposits at a later stage.

37. Shortly after the visit, on 23 November 1993, Miss Ngan, an assessor took charge of the investigation of the profits tax affairs of the Taxpayer.

38. Such was the sequence of events leading to the execution of a search warrant of the Taxpayer's clinic and his home in November 1994 for the purpose of obtaining, examining and taking possession of the books and records of the Taxpayer for the years of assessment 1985/86 to 1993/94.

39. The books and records seized included the following:

- (a) Patient cards approximately 7,600 in number;
- (b) Income book for the years of assessments 1985/86, 1986/87, 1988/89, 1989/90, 1992/93 and 1993/94;
- (c) General ledgers for the years of assessment 1985/86 to 1990/91, 1992/93 and 1993/94;
- (d) 125 loose sheets of drug charge records;
- (e) Registration book;
- (f) Invoices of medical suppliers and drug purchases;
- (g) Bank statements.

40. The Taxpayer strongly protested that the IRD was abusing its power in obtaining a search warrant because he firmly believed that he had kept sufficient records as required by law.

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41. A good deal of arguments were advanced by both Counsel for the Taxpayer and Counsel for the Commissioner on the issue as to what records were required to be kept. It would be helpful if the relevant provisions of section 51C of the IRO were reproduced here in full.

Section 51C –

‘Business records to be kept

- (1) Subject to subsection (2), every person carrying on a trade, profession or business in Hong Kong shall keep sufficient records in the English or Chinese language of his income and expenditure to enable the assessable profits of such trade, profession or business to be readily ascertained and shall retain such records for a period of not less than 7 years after the completion of the transactions, acts or operations to which they relate. (Amended 7 of 1986s 12)*
- (2) Subsection (1) shall not require the preservation of any records –*
 - (a) which the Commissioner has specified need not be preserved; or*
 - (b) of a corporation which has been dissolved.*
- (3) For the purpose of this section, “records” (紀錄) includes –*
 - (a) books of account (whether kept in a legible form, or in a non-legible form by means of a computer or otherwise) recording receipts and payments, or income and expenditure; and*
 - (b) vouchers, bank statements, invoices, receipts, and such other documents as are necessary to verify the entries in the books of account referred to in paragraph (a). (Added 48 of 1995s 10)*
- (4) Without limiting the generality of subsection (3), the records required to be kept and retained pursuant to subsection (1) in respect of any trade, profession or business carried on during any year of assessment by any person, include –*
 - (a) a record of the assets and liabilities of the person in relation to that trade, profession or business;*
 - (b) a record of all entries from day to day of all sums of money received and expended by the person in relation to that trade,*

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profession or business and the matters in respect of which the receipt and expenditure take place;

(c) *where that trade, profession or business involves dealing in goods –*

(i) *a record of all goods purchased and of all goods sold in the carrying on of that trade, profession or business (except those sold in the course of cash retail trading customarily conducted in a trade, profession or business of the kind of which that trade, profession or business is one) showing the goods, and the sellers and buyers in sufficient detail to enable the Commissioner to readily verify the quantities and values of the goods and the identities of the sellers and buyers; and all invoices relating thereto; and*

(ii) *statements (including quantities and values) of trading stock held by the person –*

(A) *at the end of each year of assessment; or*

(B) *where the Commissioner is satisfied that the accounts of such trade, profession or business are made up to a day other than 31 March, on that day in the year of assessment,*

and all records of stocktakings from which any such statement of trading stock has been prepared; and

(d) *where that trade, profession or business involves the provision of services, records of the services provided in sufficient detail to enable the Commissioner to readily verify the entries referred to in paragraph (b). (Added 48 of 1995 s. 10)*

(Added 26 of 1969s. 28)'

42. It was the Commissioner's case that records in order to be sufficient must include the underlying source documents which would evidence the transactions, act or operations giving rise to the receipts or payments and which would enable the entries in the books of account to be readily ascertained, traced and verified. The daily income sheets in the present case would be such underlying source documents.

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43. Counsel for the Taxpayer maintained that the Taxpayer was only obliged to keep the underlying source documents after June 1995 when subsection 3 and subsection 4 were introduced by way of amendment containing an exhaustive list of records required to be kept. We do not think that the list was intended to be exhaustive. Obviously, there might be cases in which more records would be required.

44. It is correct, though, that prior to June 1995, one was required to keep sufficient records to enable assessable profits to be readily ascertained. But has the Taxpayer done so? We think not. The Taxpayer's medical practice was such that the income received from his clinic was mainly in the form of cash. We do not think that it can be successfully argued that, in the absence of the daily income sheets, the Taxpayer had kept sufficient records to enable his assessable profits to be readily ascertained.

45. Counsel for the Taxpayer further submitted that Miss Ngan did not have a proper understanding of the provisions of section 51 because she kept using the word 'verify' instead of 'ascertain'. He drew a distinction between 'ascertain' and 'verify'. To him, 'ascertain' meant to find out; 'verify' meant to examine in order to establish the truth or correctness of contents.

46. We find the distinction canvassed by Counsel for the Taxpayer to be a distinction without a difference. According to the New Oxford Dictionary of English, 'ascertain' or 'verify' simply means to make sure. Miss Ngan should not be criticised for using these two words interchangeably.

47. We hold that the IRD was justified in obtaining a search warrant on account of (i) the Taxpayer's failure to keep sufficient records (ii) the suspected understatement of income by the Taxpayer (iii) the unavailability of the daily income sheets and (iv) the inaccessibility to the patient cards. There was no abuse of power on the part of the IRD.

48. In respect of the search warrant, the Taxpayer took out an application for judicial review.

49. In the judicial review proceedings, Mr Goh, the assessor, in his affidavit dated 16 February 1995 repeated his assertion, inter alia, that the Taxpayer's \$5,800,000 exceeded his reported income.

50. We are unable to ascertain from the evidence before us whether the Taxpayer made any response or indeed rendered any explanation of the \$5,800,000 bank deposits at any stage of the judicial review proceedings. At this point, it might be convenient to mention that subsequently the Taxpayer did make attempts to explain the \$5,800,000 bank deposits by the production of various bank accounts, bank statements and bank deposits which turned out to be totally unconnected with the \$5,800,000 referred to by Mr Go. The result was that the \$5,800,000 remained unexplained.

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51. Nor were we informed as to whether, in the judicial review proceedings, the Taxpayer persisted in his allegation of abuse of power by the IRD.

52. In any event, on 12 April 1995, a consent order was made in the judicial review proceedings whereby the IRD was allowed to make copies of all the patient cards seized.

53. On 9 August 1995, based on the transcription results from the patient cards and the estimated consultation charges, the IRD raised on the Taxpayer profits tax assessments for the year of assessment 1985/86 and additional profits tax assessments for the years of assessment 1986/87 to 1993/94 (except for the year of assessment 1988/89 which has been separately assessed on 20 March 1995) amounting to \$21,863,189 assessable profits.

54. It was common ground that numeric codes or markings appearing on the patient cards were related to the fees charged on the patients. Upon the analysis of the patient cards, Miss Ngan discovered that a considerable portion of the markings on the patient cards was altered by adding a plus (+) sign in between digits of a double number or triple number thereby significantly reducing the basic numeric value of markings, for example, 22 would become 2+2, 17 would become 1+7, 51 would become 5+1.

55. For the purpose of quantifying the incomes derived from the clinic, Miss Ngan removed all the artificially squeezed in plus (+) signs from the numeric markings.

56. The resultant figures (that is, with all the artificial plus (+) signs removed) were then multiplied by 10, which were taken to be the estimated income of the Taxpayer.

57. The multiple of 10 was used as the Taxpayer had indicated in his interview with the field audit officer on 15 September 1993 that the numeric markings on the patient cards represented a multiple of 10 in dollar value.

58. The selection of multiple of 10 was found to be compatible on account of the following:

- (i) it was consistent with a comparison between transactions recorded on one of the two available daily income sheets dated 15 September 1993 and the corresponding markings on the relevant patient cards.
- (ii) The markings on some of the patient cards confirmed that the 10-unit marking system was adopted.
- (iii) It was consistent with the records prepared by Nurse I. Out of a total of 837 visits, 555 visits confirmed the 10-unit coding system. 122 visits unveiled

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alterations in the form of a plus (+) sign being inserted in between digits, the pre-altered markings confirming the 10-unit coding system. 151 visits could not be verified because of missing records.

59. Counsel for the Taxpayer submitted that Miss Ngan was wrong in eliminating all the plus (+) signs which she judged to have been squeezed in artificially. Miss Ngan was not an expert of any kind and she was not qualified to say whether alteration had been made to the patient cards. A proper forensic examination of the patient cards should have been conducted. As there was no expert evidence and no forensic examination, Miss Ngan's judgment could not be relied on. Miss Ngan stated that the alterations were easily visible as the new ball pen markings of the plus signs contradicted conspicuously with the long existed pale markings. In the absence of any evidence to the contrary, we have no reason to doubt the reliability of Miss Ngan's statement.

60. Counsel for the Taxpayer further submitted that it was wrong for Miss Ngan to use the multiple of 10 which was mentioned to Mr Go during the interview of 15 September 1993. Other multiples might have been discussed and Mr Go could have forgotten or omitted to make a note of the discussion.

61. We find that it was not until 5 May 1997 when the Taxpayer mentioned, for the first time, the multiple of 5, and not until at the hearing before the Board when the Taxpayer mentioned, for the first time, the set of special circumstances in which the multiple of 10 was to be used, namely (i) for patients visiting on a Wednesday afternoon (ii) for patients asking for a brand name medication instead of a generic substitution and (iii) for patients having medical insurance and asking for a receipt.

62. We are satisfied that Mr Goh was a reliable witness. He had given cogent evidence and had made a full note of the interviews on 15 September 1993 and 23 November 1993. If the multiple of 5 or the special circumstances had been mentioned on the occasions of the interviews, Mr Go would have recorded the same in his notes of interviews.

63. It might well be that the figures produced by Miss Ngan's methodology lacked scientific precision. Nevertheless, they represented estimates honestly made by Miss Ngan on the materials available to her and according to her judgment and they were neither capricious nor spurious.

64. It was argued by Counsel on behalf of the Taxpayer that Miss Ngan had a vested interest in seeing the case to be resolved in favour of the Commissioner because she had been working on it for approximately five years. We find it difficult to follow the logic of this argument and we have no hesitation in rejecting it.

65. Miss Ngan found numerous discrepancies in the Taxpayer's books of accounts the accuracy of which was highly questionable:

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- (1) The average charge based on returned clinical income was much lower than that based on Nurse I's records as well as lower than that based on the markings of the patient cards.
- (2) The daily income recorded in the income book (\$4,750) for 15 September 1993 was much lower than that recorded on the daily income sheet (\$6,895) for the same day.
- (3) The daily income recorded in the income book (\$4,460) for 16 August 1992 was lower than that deduced from Nurse I's records (\$8,575) for the same day.
- (4) For 10, 11 and 21 of April 1992, the daily income recorded in Nurse I's records were \$4,602, \$3,715 and \$1,328 respectively. There was no corresponding entry of any of these amounts in the income book.

66. We also find that the Taxpayer failed to give an adequate explanation of (i) the missing patient cards relating to older patients who paid a significant number of visits to the clinic during the relevant years of assessment and (ii) the duplicate set of consultation records as evidenced by the visits shown on the daily income sheet dated 15 September 1993 and the corresponding markings on the patient cards.

67. As regards the year of assessment 1994/95, Miss Ngan confirmed that the Taxpayer continued to use, in the majority of cases, the coding system adopted prior to 15 September 1993 despite being advised to record the actual amount charged on the patient cards. The Taxpayer firmly believed that he had produced all the documents and records as required by law. He was adamant that he was not required to produce the daily income sheets despite the IRD's advice given to him during the interview on 15 September 1993 that it would be difficult to verify the Taxpayer's reported income in the absence of the daily income sheets.

68. The IRD then proceeded to estimate the assessable profits for the year of assessment 1994/95. The IRD found that there was an abrupt surge of income after the search warrant was executed on 30 November 1994. The reported income from the clinic for the four months from December 1994 to March 1995 was found to be much higher than the preceding months.

69. The Taxpayer suggested that the increase was due to patients coming in to check what happened after the search on 30 November 1994. If this suggestion was plausible, it would imply that the Taxpayer was charging those who came to make enquiry. We find this highly improbable.

70. The Taxpayer further suggested that the increase was due to seasonal fluctuation which, in our view, he failed to substantiate with convincing evidence.

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71. We have no doubt that the IRD was correct in its view that the incomes for these four months better reflected the operating results of the clinic. We are satisfied that in the absence of the daily income sheets it was reasonable for the IRD to estimate by projection the income of the Taxpayer's clinic for the year of assessment 1994/95. There was nothing capricious, arbitrary or spurious about the projection.

72. Complaint has been raised in respect of the three different versions of diskettes supplied to the Taxpayer at various times. We find that this was the result of an error made in the preparation of the sorted data files to be saved in the hard disk of the computer for the purpose of compiling the aggregate annual total income of the Taxpayer. There was no evidence of bad faith on the part of the IRD officers and there was no question that the right sorted data files were placed before the Commissioner which formed the basis of his determination.

73. The Taxpayer alleged that the IRD had been manipulating the figures as there were four different assessments made by the IRD for the years of assessment 1985/86 to 1993/94.

74. Upon closer scrutiny, the real circumstances surrounding the four different assessments emerged.

Date	Assessment	Years of assessments	Tax payable \$
9-8-1995	First	For 1985/86 to 1993/94 (excluding 1988/89 which was separately assessed) This assessment was based on transcription results and estimated consultation charges.	3,412,802
23-10-1996	Second	For 1985/86 to 1993/94 This assessment was based on the markings of the patient cards and was proposed to the Taxpayer for settlement who did not accept the same.	3,060,132
24-9-1997	Third	For 1985/86 to 1993/94 This assessment was made in response to the Taxpayer's offer for settlement. The Taxpayer did not accept the assessment.	650,001

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27-12-1997	Fourth	For 1988/89 to 1993/94	2,237,480
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This is the assessment determined by the Commissioner, the assessments for 1985/86, 1986/87 and 1987/88 having been annulled.

75. We find that the four different assessments had been honestly made with good reason and according to the best judgment of the assessor.

76. The Taxpayer produced several reports on doctors' fee survey and submitted that his income was within the range of industrial averages obtained from these surveys.

77. The survey was initially conducted by the Hong Kong Medical Association in 1990 for the purpose of deciding whether a fee schedule should be set up and the exercise was repeated in subsequent years.

78. No evidence was adduced relating to the format and contents of the questionnaires sent out to the doctors whose response was purely voluntary.

79. An average of about 300 general practitioners responded to the surveys over the years. Sixty-five per cent of the general practitioners involved in the survey came from the peripheral areas such as the New Territories and Tuen Mun where the normal charges were at least 50% lower than that in the city area. And the Taxpayer was a general practitioner having his clinic in the city area. Consequently, the Hong Kong Management Association survey of charges was not reliable for the purpose of estimating the profits of the Taxpayer.

80. It was submitted by Counsel for the Taxpayer that the assessor and the Commissioner should have made use of the industrial averages easily generated from the information stored in the database of the IRD to ascertain if the assessable profits of the Taxpayer were within the industrial average. We find that the assessor and the Commissioner cannot be blamed for this because, as Miss Ngan explained, such information was not sorted out as industrial averages which were not a safe guide as doctors' charges varied greatly due to differences in location and their clientele base and might not have a direct bearing on the charges which a particular doctor chose to make on a particular patient.

81. The Taxpayer claimed that his cash deposits in banks and other assets were in line with his reported income.

82. However, the IRD could not find the trail of cash deposits into the banks of the Taxpayer as would be expected in a business where the income was received mainly in cash. Cash receipts from the clinic were found not to have been fully reflected in the bank accounts which the Taxpayer chose to disclose. Further, the Revenue was not able to trace some of the cheques

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received from the hospital, which could have been deposited in bank accounts other than those disclosed by the Taxpayer.

83. Under cross-examination, the Taxpayer admitted that he had interest in an aquarium, Aquarium J, which he started in 1991 with a partner. His initial contribution to capital was \$30,000. As the business involved placing orders abroad, he would use his own money to finance the orders and in this connection the Taxpayer's wife said in evidence that she was totally unaware of the aquarium business.

84. The Taxpayer also disclosed, under cross-examination, that he had a substantial interest in another company, Company K operating a fish shop called Shop L. With financial assistance from his aunt in the sum of Can\$66,000, he started the company in 1994 with a capital of \$800,000. Company K served individual customers as well as corporate clients. The Taxpayer had difficulty in recalling that he had advanced a sum of \$1,100,000 to the company, but his wife confirmed that he had made such a loan and that the \$1,100,000 came from his clinic income. The Taxpayer owned a membership debenture in a cricket club costing \$300,000, through a company called Company M, in addition to a membership with another club costing \$75,000. The residential property was held in the name of Company N. Despite the Taxpayer's earlier insistence that he never bought Hong Kong stocks, the Taxpayer admitted that he started to trade in Hong Kong stocks through a company some ten years ago with an initial investment of \$200,000 and subsequently through another company with an average of about \$100,000 investment a year for the last eight years. The investment in stock was handled by the Taxpayer's wife although the Taxpayer was aware of the general portfolio.

85. At different times during the relevant years of assessment, the Taxpayer owned a number of cars. Among them was an expensive car, a NSX sports car costing \$1,300,000, though the Taxpayer claimed that the purchase price was covered by the trade-in-value of his BMW 5 series and monthly instalment payments.

86. The financial assets which were extracted from the Taxpayer under cross-examination immediately refuted his claim that he did not speculate in stocks and seldom bought stocks and that his only possessions were two cars and a 34-year old flat. It was quite plain that this refutation cast a serious doubt on the credibility of the Taxpayer. We find that the financial assets hitherto disclosed were incomplete and could not be relied on to show that they were in line with the Taxpayer's reported income or to form the basis of his assessment.

87. The Commissioner conceded that mistakes were made in the schedules of consultation charges of the clinic which the determination confirmed. As a result, the assessable profits for the years of assessment 1989/90, 1991/92, 1992/93 and 1993/94 should be adjusted as follows:

Year of assessment

Assessable profits

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1989/90	Be increased by \$5
1991/92	Be reduced by \$36,120
1992/93	Be reduced by \$5
1993/94	Be reduced by \$173,668.5

88. In view of the enormous amount of details to be worked out in the schedules, we hold the view that the mistakes discovered were not serious enough as to undermine the overall reliability of the methodology employed by the IRD in estimating the charges from the markings on the patient cards.

89. Under section 68(4) of the IRO, the burden of proving that the assessments appealed against are excessive or incorrect falls on the Taxpayer.

90. We have carefully considered all the facts and matters put before us, including those to which we have not referred in our decision. We have also considered Mr McCoy's submissions, the submissions of Mr Herbert Li and the authorities to which they referred us.

91. Having regard to all the circumstances of this case, we are not satisfied that the Taxpayer has discharged his onus of proving that the additional profits tax assessments for the years of assessment 1988/89, 1989/90 and 1990/91 and the profits tax assessments for the year of assessment 1994/95 as determined by the Commissioner were excessive or incorrect. We would dismiss the Taxpayer's appeals relating to these years of assessments and confirm the additional profits tax assessments and profits tax assessments therefor respectively save and except that for the year of assessment 1989/90, we would increase the Commissioner's additional assessable profits by \$5 to \$2,696,405.

92. To the extent of errors conceded by the Revenue to have been made to the schedule of consultation charges for the years of assessments 1991/92, 1992/93 and 1993/94, we would accordingly allow the appeals in respect of these years of assessments as follows:

- (i) the Commissioner's additional assessable profits for the year of assessment 1991/92 be reduced by \$36,120 to \$2,743,621;
- (ii) the Commissioner's additional assessable profits for the year of assessment 1992/93 be reduced by \$5 to \$2,689,016; and
- (iii) the Commissioner's additional assessable profits for the year of assessment 1993/94 be reduced by \$173,668.5 to \$1,233,909.5.

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95. It remains for us to thank Mr Herbert Li and Mr McCoy SC for supplying their helpful written submissions to the Board.