

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D53/94

Profits tax – appeal without merit – order for costs – section 68(9) of the Inland Revenue Ordinance.

Panel: Kenneth Kwok Hing Wai QC (chairman), Audrey Eu Yuet Mee QC and Robert Kwok Chin Kung.

Dates of hearing: 8 and 9 August 1994.

Date of decision: 25 November 1994.

The taxpayer was carrying on business and claimed as deductible expenses sums of money stated to have been paid to the mother and father of the taxpayer by way of salary/commission. The assessor did not accept that the sums had been paid and further maintained that if any money had been paid it was not paid as an expense of the business. The taxpayer appealed to the Board of Review and gave evidence which was rejected by the Board.

Held:

The taxpayer had not discharged the onus of proof placed upon him and the appeal was dismissed. The Board considered the appeal to be an abuse of the process and ordered the taxpayer to pay the sum of \$1,000 as costs.

Appeal dismissed with \$1,000 awarded being costs of the Board.

Tse Yuk Yip for the Commissioner of Inland Revenue.

Taxpayer in person.

Decision:

1. This is an appeal against the determination dated 22 March 1994 by the Deputy Commissioner of Inland Revenue, confirming the profits tax assessment for the year of assessment 1991/92.

The Facts

2.1 The Taxpayer has been carrying on a business since 1 August 1986.

2.2 The accounts of the Taxpayer are made up to the end of February each year.

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2.3 Mr A ('the Father') is the father of the Taxpayer. According to his identity card, the year of birth of the Father is 1915. In 1991, the Father was 76 years old.

2.4 Ms B ('the Mother') is the mother of the Taxpayer. According to her identity card, the year of birth of the Mother is 1925. In 1991, the Mother was 66 years old.

2.5 At all material times, the Taxpayer resided with his parents at Place X. That was also the business address of the Taxpayer, at least until August 1991. We reject the evidence of the Taxpayer that the business moved to Place Y in August 1991 because, inter alia, the return for the year of assessment 1991/92 contains no claim for rent paid in respect of Place Y. However, we attach no weight to this rejection. Whether or not the move took place in August 1991 is not relevant to the issues which we have to decide on this appeal.

2.6 In the return for the year of assessment 1986/87, the total income was \$54,123 and a deduction of 2 sums of \$14,500 was claimed as salary/commission paid to each of the parents of the Taxpayer. Although there is no evidence whether the assessor accepted such claim for deduction, we are prepared to assume that the assessor did allow such deduction. The total sum of \$29,000 paid to the parents represented 53.58% of the total income. Married person's personal allowance (for the parents) for the year was \$60,000.

2.7 In the return for the year of assessment 1987/88, the total income was \$139,907 and a deduction of 2 sums of \$30,000 was claimed as salary/commission paid to each of the parents of the Taxpayer. The claim for deduction was accepted by the assessor. The total sum of \$60,000 paid to the parents represented 42.88% of the total income. Married person's personal allowance for the year was \$70,000, subject to 10% claw back on additional personal allowance.

2.8 In the return for the year of assessment 1988/89, the total income was \$153,346 and a deduction of 2 sums of \$34,500 was claimed as salary/commission paid to each of the parents of the Taxpayer. The claim of deduction was accepted by the assessor. The total sum of \$69,000 paid to the parents represented 45% of the total income. Married person's personal allowance for the year was \$74,000, subject to 10% claw back on additional personal allowance.

2.9 In the return for the year of assessment 1989/90, the total income was \$157,238 and a deduction of 2 sums of \$35,100 was claimed as salary/commission paid to each of the parents of the Taxpayer. The claim for deduction was accepted by the assessor. The total sum of \$70,200 paid to the parents represented 44.65% of the total income. Married person's personal allowance for the year was \$80,000, subject to 10% claw back on additional personal allowance.

2.10 In the return for the year of assessment 1990/91, the total income was \$37,387 and a deduction of 2 sums of \$35,100 was claimed as salary/commission paid to each of the parents of the Taxpayer. The claim for deduction was not initially accepted by the assessor. The total sum of \$70,200 said to be paid to the parents represented 187.76% of the total income. Married person's personal allowance for the year was \$80,000.

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2.11 By a letter dated 14 August 1992, the assessor wrote to the Taxpayer about the claim of the payment of the total sum of \$70,200 to the parents during the year of assessment 1990/91. The assessor wrote in these terms:

‘The amount of tax involved is insignificant, but we could not overlook the basic principle. The so-called salaries and commission in the sum of \$70,200 were actually paid to your parents. There is no commercial justification to employ two persons to answer telephone calls for you with emoluments amounted to 187% of your gross income (even in the year of assessment 1989/90, the ratio is still as high as 45%). The lack of commercial justification strongly suggests that these payments to your parents were not incurred for the production of profits.

I agreed with you that we should not waste our time over such trivial issue. Therefore, in future, you should refrain from making such claim and for this year under objection, I am prepared to accept that you have no assessable profit, but no loss will be allowed.

If you still wish to pursue the issue further of this year or in future years, please submit a list of your clients showing full name and address together with your claim, so that we can ascertain how and to what extent your parents have assisted you in earning your commission.’

2.12 The return for the year of assessment 1991/92 was dated 15 June 1992 but the receipt chop of the Revenue was dated 3 August 1992. The return declared a total income of \$179,552 and a deduction of 2 sums of \$41,000 was claimed as salary/commission paid to each of the parents of the Taxpayer. The total sum of \$82,000 said to be paid to the parents represented 45.67% of the total income. Married person’s personal allowance for the year was precisely \$82,000.

2.13 There is no evidence on whether the assessor’s offer to compromise by allowing the deduction for the year of assessment 1990/91 but without carrying forward any loss for the subsequent year of assessment 1991/92 was accepted by the Taxpayer. However, we note that no loss carried forward has been claimed in the return for the year of assessment 1991/92.

2.14 The assessor did not accept the deduction claim for the year of assessment 1991/92, added the sum of \$82,000 to the profits per return and assessed accordingly.

2.15 The Taxpayer objected. By his determination, the Deputy Commissioner did not accept that the claimed expenses of \$82,000 were actually incurred; did not accept that the sum, if incurred, was incurred in the production of the Taxpayer’s chargeable profits; and confirmed the assessment.

This Appeal

3. The Taxpayer appealed from the determination.

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Relevant Provisions

4.1 Section 68(4) of the Inland Revenue Ordinance (the IRO), chapter 112, provides that the onus of proving that the assessment appealed against is excessive or incorrect is on the Taxpayer.

4.2 Section 16(1) provides that:

'16(1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period ...'

4.3 Section 17(1) provides that:

'17(1) For the purpose of ascertaining profits in respect of which a person is chargeable to tax under this Part no deduction shall be allowed in respect of:

- (a) domestic or private expenses, including the cost of travelling between residence and place of business;*
- (b) any disbursements or expenses not being money expended for the purpose of producing such profits ...'*

Our Decision

5. The Taxpayer gave evidence on oath before us. We have carefully considered what he said in correspondence, in evidence and by way of submission. The Taxpayer impressed us as an unreliable and evasive witness who had scant respect for the truth.

6.1 Under cover of his letter dated 7 December 1992 to the assessor, the Taxpayer enclosed a receipt dated 29 February 1992 signed by the Father acknowledging receipt of \$41,000 'being in payment of salary and commission for the year from 1 March 1991 to 29 February 1992', and an identical receipt signed by the Mother.

6.2 Under cover of his letter dated 27 January 1993 to the assessor, the Taxpayer enclosed 12 undated receipts signed by the Father. Each acknowledged receipt of the sum of \$3,416.66 as salary and commission for March 1991 respectively to February 1992. This letter also enclosed 12 receipts signed by the Mother, identical to those signed by the Father. In response to the assessor's request for a copy of ledger account to prove the recording of such payment of salary, the Taxpayer replied in this letter stating that the receipts 'act as a form of ledger accounting or accounting record'. We do not see how the 24 receipts could serve the purpose of being 'a form of ledger or accounting record' for the Taxpayer unless they were contemporaneous documents and were not created after 7 December 1992 when the Taxpayer enclosed 2 other receipts for \$41,000 each.

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6.3 When cross-examined by the representative for the Commissioner about the 24 receipts, the Taxpayer said that the receipts were all typed 'in one go' and claimed that he 'maintain records'.

'Q: Who typed those receipts?

A: My wife.

Q: According to your knowledge, were those receipts typed monthly or twelve at one go?

A: They were typed in one go.

Q: When were they signed?

A: They were all signed at the same time but I can't recall when.

Q: Why those receipts were in odd cents?

A: Well since all these receipts were signed in one go, so we just treated the sum of \$41,000 to be divided into twelve, therefore there were odds and ends.

Q: Are they prepared retrospectively to satisfy the Revenue?

A: No, not so, because we maintain records.'

6.4 What the Taxpayer conveniently overlooked was the statement in his letter of 27 January 1993 to the effect that these 24 receipts were the 'records'. No other 'records' (apart from the 2 receipts for \$41,000 each) have been produced by the Taxpayer.

7.1 The Taxpayer claimed that the payments were made in cash. The Taxpayer's business income was by way of cheques and his business maintained only 1 bank account, a current account with Bank M. Despite repeated invitations made in the correspondence and in the course of the hearing of the appeal, the Taxpayer has not produced any bank statement or passbook evidencing the source of the cash from which he made any of the alleged payments to his parents.

7.2 At the end of his evidence in chief and before being cross-examined by the representative for the Commissioner, the Taxpayer was invited by the Chairman to deal with the payments, and he responded in these terms:

'Chairman: Now I believe the Inland Revenue, the Revenue is going to suggest that you never in fact paid \$82,000 per year or \$3,000 per month to them, that they are going to suggest that there is in fact no such payment. Would you like to deal with that in any way?

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A: Well in our firm they are not paid at regular periods; sometimes they might be paid at three months period, six months period or even annually. I don't think I have other things to explain.'

7. When cross examined by the representative for the Commissioner, his version was:

'Q: Can you tell us the dates and the amounts of the individual payments that make up a total of \$41,000 to Mr A during the year ended 29 February 1992?

A: Well in actual fact I really just can't remember at all as they are my parents, it would not be surprising that at certain stage they got sums of \$30,000, \$50,000 or \$70,000.

Q: Can you tell us the dates and individual amount of each payment made to Ms B, that make up the total of \$41,000 during the year ended 29 February 1992?

A: Well I am saying that during that year the sum of \$41,000 was in fact paid to Ms B, however I cannot recall the date of payments.

Q: How the payments were made, by cheque or cash or?

A: By cash.

Q: Can you show us the passbook or bank statements from which you withdraw the money for the payments?

A: Well usually I withdraw monies from savings account through bank passbooks. As it had been about two years from now, after a bank passbook was run out then it was just simply discarded.

Q: What accounting records had you kept for you company?

A: I myself have never been in the accounting field so for the present things being kept I just treated as some sort of account record of our firm.

Q: Based on what information did you arrive at the figure of \$41,000?

A: In actual fact, the monies paid by me were in excess of this figure, however sometimes I make enquiries from the Inland Revenue Department and I was told that that would be the limit of allowances extended to them so that they were still exempted from any tax payment.'

7.4 In answer to questions from a member of the Board, the Taxpayer came up with yet another version:

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‘Q: I just want to find out when actually this forty-one odd thousand dollars was paid?

A: It, the payment falls within that year.

Q: And can you remember when during that year payments were made?

A: Mostly those payments were made at the beginning of the calendar months.

Q: Sorry I don't follow, what do you mean by the beginning of those calendar months, do you mean it was per calendar month or do you mean paid at the beginning of the financial year?

A: In fact payments were made each and every month.

Q: Each and every month for all the twelve months in the financial year, is that right?

A: Yes, at the beginning of every month.

Q: And who determines the amount to be paid at the beginning of every month?

A: I determine it.

Q: And on what basis did you determine the amount?

A: Depending on the business, if the business was good more money was paid, if the business was poor less money was paid.

Q: Does the amount therefore vary from month to month?

A: That's right. Yes, the amount paid out did vary.

Q: Was there any fixed percentage that you adopted for the purpose of calculating the amount to be paid every month?

A: No, there was no fixed percentage to be based on for calculation but for each payment it ranged about three thousand odd dollars.

Q: And how did you pay this three thousand odd dollars?

A: Just handed out the cash.

Q: And did you draw the cash from any particular account?

A: No, not from any specific bank account.

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Q: I presume from the nature of your business that your income would be by way of cheques paid into your bank account, is that right?

A: Yes, that's right.

Q: Do you have a particular bank for your business?

A: Yes. Yes, there has.

Q: Can you tell us which account that is?

A: It is a current account maintaining with Bank M.

Q: Is there any other account apart from this current account?

A: No this company, this firm does not maintain any other bank accounts, however I myself have my personal banking accounts.

Q: And this three thousand odd dollars cash that was drawn out every month, is it possible for you to produce to this Board any particular bank account or bank statement from time to time to show this withdrawal?

A: I think I have to check the bank statements.

Q: Which bank statements are you referring to?

A: Bank M.

Q: That is the current account?

A: Yes.'

8. The Taxpayer progressed from 2 receipts for \$41,000 each to 24 receipts for \$3,416.66 each. The payments changed from version one which was that they might be paid quarterly, bi-annually or annually to version two which was that it would not be surprising that at certain stage they got sums of \$30,000, \$50,000 or \$70,000, and then to version three which was that payments were made at the beginning of each and every month of the 12 months in the basis period and that each payment ranged about three thousand odd dollars.

9. The evidence of the Taxpayer gave the impression that the Taxpayer never in fact paid any of his parents, but claimed \$41,000 as salary/commission to each of his parents in order to get away with the maximum allowance (both for himself and for his parents who would not have to pay salaries tax as the married person's personal allowance for that year was precisely \$82,000). When queried by one of us whether this was the case, the Taxpayer's answer was 'Sir, it may be contemplated in the way as suggested ...'.

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10.1 We find on a balance of probabilities that the Taxpayer did not pay or incur the sum of \$41,000 or any other sum, whether to the Father or the Mother.

10.2 This finding is fatal to the Taxpayer.

11.1 In view of our finding, it is, strictly speaking, unnecessary for us to decide whether payments to the parents were expenses which were not domestic or private expenses, but were expenses incurred in the production of profits.

11.2 However, we would state that we do not accept that any payment which might have been made to any of the parents was not a domestic or private expense. Nor do we accept that such expense was incurred in the production of profits.

11.3 The Taxpayer's evidence on the terms of employment of his parents was vague and unconvincing.

11.4 The Taxpayer shifted his grounds as to what work was allegedly done by the 2 alleged employees.

11.5 By letter dated 27 January 1993, the Taxpayer would have the assessor believe that his aged parents; besides dealing with, consulting, and advising on his business affairs, administration works, handling client enquiry & complaint, customer relationship etc.; also inspected sites.

11.6 A few months later, the Taxpayer claimed in his letter dated 23 August 1993 that:

‘Mr A and Ms B deal with administration work, answering telephone enquiry and take care of the company affair. They may not necessary (sic) involve directly in property transaction or business of the company.’

11.7 In evidence, the Taxpayer said that they ‘do assist in answering telephone calls and also in other work in the firm’; that is was ‘not necessarily’ that the Father or the Mother was required to meet the clients; and that neither the Father nor the Mother concluded any successful business transaction during the basis period, although neither had a basic salary and both were to be paid on commission basis. The Taxpayer claimed that the parents gave advice but was unable to give us any concrete example of any advice said to be given by either parent.

Ground of Appeal

12. We do not consider that there is any merit in any of the Taxpayer's grounds of appeal.

13. As for ground (1), the fact that the Revenue accepted the deduction claims for the years of assessment 1986/87, 1987/88 and 1988/89 (we interpose here to note that the evidence tendered by the Taxpayer covered the years of assessment 1987/88, 1988/89 and 1989/90) is irrelevant to the question of fact whether the Taxpayer incurred the expense or

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outgoing claimed for the year of assessment 1991/92. That is a question of fact which we have found against the Taxpayer. Significantly, neither this ground of appeal nor the evidence tendered by the Taxpayer included the immediately preceding year of assessment 1990/91. By the time he lodged this appeal, the Taxpayer had received the letter referred to and quoted in paragraph 2.11 above. Whether or not the assessor had power to do so, the assessor did tell the Taxpayer that:

‘... in future, you should refrain from making such claim...’.

14. We do not think any of the questions asked by the assessor in correspondence was misleading, as allegedly in ground (2). So far as this appeal is concerned, the task of the Taxpayer is to satisfy us, not the Commissioner, that the assessment appealed against is excessive or incorrect.

15. Whether or not it is difficult to operate his business with only 1 person, as contended by the Taxpayer in ground (3), is beside the point. The questions are whether the Taxpayer paid his parents the sums claimed and whether the payments were made for the purpose of producing the profits and were not domestic or private expenses. We have found against the Taxpayer on all these points.

16. As for the compromise offer repeated in ground (4), that is to settle for one deduction of \$41,000 instead of 2 deductions, that was a matter entirely for the Commissioner. Our task is to adjudicate on the appeal. As we have found that neither of the alleged payments had been made, we cannot criticise the Commissioner for not accepting the Taxpayer's offer.

Appeal Dismissed

17. The Taxpayer has not discharged the onus under section 68(4) of proving that the assessment appealed against is excessive or incorrect. We dismiss the appeal and confirm the assessment appealed against.

Order under Section 68(9)

18. We are further of the opinion that this appeal is an abuse of the process. Pursuant to section 68(9), we order the Taxpayer to pay the sum of \$1,000 as costs of the Board, which \$1,000 shall be added to the tax charged and recovered therewith.

Postscript

19. Before we part with this appeal, we would like to record our gratitude to the representative for the Commissioner for her able to assistance. Her cross-examination was crisp and her submission precise and concise, taking full note of the evidence given on the first day of the hearing.