

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D6/92

Profits tax – assets betterment statement – onus of proof – whether expenses deductible.

Panel: T J Gregory (chairman), Alexander Au Siu Kee and Stephen Lau Man Lung.

Dates of hearing: 10, 11 and 12 September 1991.

Date of decision: 27 April 1992.

The taxpayer was carrying on business either in partnership or as sole proprietor. An investigation was conducted into the tax affairs of the taxpayer and an assets betterment statement produced. The taxpayer was assessed to tax on the basis of the assets betterment statement and the taxpayer appealed to the Board of Review. The taxpayer submitted that certain expenses should be deducted from the business profits and that other errors had been made in the assets betterment statement. Part of the blame was put upon the former tax representatives of the taxpayer.

Held:

Save to the extent that the Commissioner had conceded the matters under appeal the Board dismissed the appeal. The onus of proof is upon the taxpayer. Where a taxpayer wishes to claim expenses to be deducted from business income it is necessary to keep proper and full records to justify the same. Where it is sought to place blame upon former professional advisers it is necessary that this be substantiated by evidence.

Appeal dismissed.

Cases referred to:

D28/88, IRBRD, vol 3, 312

D30/89, IRBRD, vol 4, 346

Chiu Kwok Kit for the Commissioner of Inland Revenue.
Frank Wong of Messrs Frank Wong & Co for the taxpayer.

Decision:

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1. THE SUBJECT MATTER OF THE APPEAL

The Taxpayer appealed against the determination of the Commissioner issued on 8 June 1991 ('the determination') rejecting his objections to:

- 1.1 An additional tax assessment for the year of assessment 1981/82 and a profits tax assessment for the year of assessment 1982/83 raised on a business ('the business') in which, during those two years, he was a partner;
- 1.2 Additional profits tax assessments for the years of assessment 1983/84, 1984/85 and 1985/86 and a profits tax assessment for the year of assessment 1986/87 which were raised on him as a sole proprietor of the business.

2. THE FACTS

The following facts were not in dispute:

- 2.1 In July 1976 the business commenced as a partnership of two equal partners, the Taxpayer being one. From 28 December 1982 the business was a sole proprietorship of the Taxpayer.
- 2.2 For the years of assessment 1981/82, 1983/84 and 1984/85 profits tax assessments (loss computations) were raised on the basis of profits tax returns submitted, as follows:

<u>Year of Assessment</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>
Assessable Profits/ (Losses)	\$78,631 =====	(\$57,790) =====	\$75,922* =====	\$17,260 =====

* (before loss set-off)

- 2.3 For the year of assessment 1985/86 a profits tax assessment was raised on estimated assessable profits of \$60,000 as a result of the failure of the Taxpayer to submit a profits tax return in accordance with section 51(1).
- 2.4 The Taxpayer did not object to the assessments referred to in paragraphs 2.2 and 2.3 above and, accordingly, they became final and conclusive under section 70.
- 2.5 An investigation by the assessor into the tax affairs of the Taxpayer was undertaken from some time in 1986. On 14 December 1987 the Taxpayer together with a partner of firm of Certified Public Accountants was interviewed by officers of the Inland Revenue Department. A copy of the Note of Interview

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was subsequently sent by the assessor to the Taxpayer for confirmation of its accuracy but no response was received from the Taxpayer.

2.6 In the course of the investigation the assessor identified from the accounting records of the business and the accounting records of a limited company (Company A), a company of which the Taxpayer was a director, that sums had been withdrawn from them by the Taxpayer for unidentified purposes. Additionally, the assessor identified that the balances of the Taxpayer's current account with the business, as recorded in its ledger, did not reconcile with the balances as stated in financial statements of the business.

2.7 On 9 November 1988 another firm of Certified Public Accountants (the tax representatives) submitted an assets betterment statement ('ABS-1') together with supporting schedules. ABS-1 showed a negative discrepancy of \$1,246,641 for the period 1 April 1981 to 31 March 1987. After examination the assessor was of the opinion that ABS-1 did not correctly compute the Taxpayer's betterment profit and, accordingly, ABS-1 was rejected.

2.8 On 24 February 1989 the assessor forwarded a revised assets betterment statement ('ABS-2') to the Taxpayer, with a copy to the tax representatives, which reflected the information provided by the Taxpayer, the information obtained from ABS-1 and the information obtained during the investigation, including those matters referred to in paragraph 2.6 above.

2.9 By letter dated 9 March 1989 the tax representatives submitted their observations on ABS-2.

2.10 On divers dates the assessor raised on the Taxpayer:

2.10.1 the following additional profits tax assessments:

<u>Year of Assessment</u>	<u>1981/82</u> (Add'l)	<u>1983/84</u> (Add'l)	<u>1984/85</u> (Add'l)	<u>1985/86</u> (Add'l)
Assessable Profits	\$400,000 =====	\$336,333 =====	\$300,000 =====	\$300,000 =====

2.10.2 the following profits tax assessments:

<u>Year of Assessment</u>	<u>1982/83</u>	<u>1986/87</u>
Assessable Profits	\$242,210 =====	\$500,000 =====

2.11 The Taxpayer objected to these assessments and additional assessments.

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- 2.12 A further interview with the tax representative took place on 28 April 1989. A minute of the meeting was sent to the Taxpayer and was returned signed on 16 May 1989.
- 2.13 On 5 May 1989 the assessor sent a further revised assets betterment statement ('ABS-3') to the Taxpayer for agreement. By letter dated 16 May 1989 the tax representative submitted representations in respect of ABS-3.
- 2.14 On 9 June 1989 the assessor issued a further revised assets betterment statement ('ABS-4') to the Taxpayer. By letter dated 15 June 1989 the tax representative submitted representations in respect of ABS-4. By this time there were four issues which were under contention, namely whether or not:
- 2.14.1 Certain bank interest should be added back in the assets betterment statement;
- 2.14.2 An unidentified withdrawal from the Taxpayer's current account with the business was a withdrawal to settle a trade debt;
- 2.14.3 An unidentified withdrawal from the Taxpayer's current account with Company A should be added back in the assets betterment statement;
- 2.14.4 Inadmissible items adjusted in the tax computations of the business were incurred for business purposes.
- 2.15 Subsequently, the assessor recomputed the additional profits tax assessments and profits tax assessments as follows:

<u>Year of Assessment</u>	<u>Revised Assessable Profits (from ABS-4)</u> \$	<u>Assessable Profits refer paragraph 2.2 and 2.3</u> \$	<u>Recomputed Additional Assessable Profits</u> \$
1981/82	82,787	78,631	4,156
1982/83	155,939	Nil	155,939
1983/84	210,690	75,922	134,768
1984/85	92,066	17,260	74,806
1985/86	303,009	60,000	243,009
1986/87	<u>(89,057)</u>	<u>Nil</u>	<u>(89,057)</u>
	755,434	231,813	523,621

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- 2.16 The matter was referred to the Commissioner who, by his determination, confirmed the re-computed additional profits tax assessments and profits tax assessments set out in paragraph 2.15 above and rejected the objections submitted by the tax representative as set out in his letter of 15 June 1989.
- 2.17 On 5 July 1991 the tax representative gave notice of appeal against the determination. The issue are those set out in the tax representative's letter of 15 June 1989, refer paragraph 2.14 above.

3. CASE FOR THE TAXPAYER

The Taxpayer's case was put by the tax representative.

- 3.1 In an opening submission, having accepted the statement of facts, he stated that during the course of the investigation of the Taxpayer four assets betterment statements had been prepared, namely:

3.1.1 On 9 November 1988, showing a negative discrepancy of \$1,246,641;

3.1.2 On 24 February 1989, showing a discrepancy of \$2,744,249;

3.1.3 On 5 May 1989, showing a discrepancy of \$883,343; and

3.1.4 On 9 June 1989, showing a discrepancy of \$593,363.

- 3.2 The Taxpayer's former tax representative had agreed certain arbitrary apportionments of expenses which should be ignored and more rational apportionments adopted.

- 3.3 The representative then informed the Board that whilst the appeal originally was to be concerned with four issues, refer 2.14 above, the second of these had been subject matter of agreement with the Revenue and therefore the Board would not be concerned with it. He then outlined his reasons why the appeal should be allowed with respect to the other three items.

3.4 First Witness

The Taxpayer having been sworn in Punti then gave evidence. He stated that:

- 3.4.1 He did not divert money from the business and that the money withdrawn from Company A was spent to purchase materials for the business and also to cover his living expenses. Withdrawals of \$1,000 and \$2,000 were withdrawals to cover the cost of entertaining customers.

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- 3.4.2 The basic living expenses for the family were met by his wife who had a job. The monies that he previously referred to were paid to her from time to time.
- 3.4.3 A car, [car number mentioned], was used either by the Taxpayer or by an employee whom he identified, 'Mr F'. The second car, [car number mentioned], was used by his wife and himself. His use included site visits. A third car, [car number mentioned], was used to take him for his morning exercise. These cars were owned by him at the same time and the third car was very rarely used to visit sites.
- 3.4.4 During the investigation tax totalling \$60,000 had been demanded and he had paid this out of money provided by his sons and daughters.
- 3.4.5 He is now living in a home for the sick and the elderly in a public estate in Place X. This cost \$3,000 or so a month, inclusive of food, and was discharged mainly out of social welfare assistance. His wife also lived with him there.
- 3.4.6 Under cross-examination by the Revenue he stated that:
- 3.4.6.1 He was sixty-two years of age. He was born in the People's Republic of China but came to Hong Kong when he was ten. He did not go to school but went to evening classes between his sixteenth and eighteenth birthdays to learn English.
- 3.4.6.2 His business experience which spanned twenty years was gained partly as an employee and partly as a self-employed person.
- 3.4.6.3 The business had employed an accountant, whom he identified, and whom he regarded as competent. For profits tax returns a tax representative, whom he also identified, 'Mr W', did the necessary work.
- 3.4.6.4 The Taxpayer was then referred to the profits tax return for the year of assessment 1984/85 and a financial statement for the business as at 31 March 1985. He confirmed that he had signed the profits tax return and he stated that he had not withheld any documents with respect to the financial statement from the accountant. When asked about discrepancies between the balances as stated in the accounts and in the ledgers the Taxpayer stated that his memory had deteriorated as a result of his illness. He confirmed that the tax computation for the year of assessment 1984/85 had been explained to him by his accountant and he had agreed with the explanation. He was unable to understand his current representative's argument as to the fact that certain of the deductions claimed in this tax computation should not have been made.

In answer to a question from the Board the Taxpayer stated that he understood the question generally but was not clear as to the details.

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- 3.4.6.5 The Taxpayer confirmed that the amount expended for living expenses was a vague impression.
- 3.4.6.6 He was then questioned as to unidentified withdrawals from the director's current account with Company A and reminded that he had said that this related to the entertainment of clients. When asked if he kept records he stated that he wrote out slips for his accountant. When asked why it was not charged as a business expenses he stated that that was the course adopted by his accountant.
- 3.4.6.7 He was then referred to an account from a firm of solicitors with respect to the preparation of a mortgage over premises in a factory building. He stated that the premises were used as a workshop for the business. It was not used by Company A.
- 3.4.6.8 He was then referred to the balance sheet accompanying the 1984/85 profits tax return and was asked why no figure for the property appeared. He was unable to give an answer.
- 3.4.6.9 The Board reminded the Taxpayer that he had attended an interview with the Revenue on 14 December 1987 during the course of which he had said that the property was owned by his wife. He was unable to recollect either the visit or that particular statement.
- 3.4.6.10 The Taxpayer was then questioned about two of the cars, [car numbers mentioned]. He stated that the cars were owned by him personally and were not business assets.
- 3.4.6.11 He was then referred to a schedule that had been put before the Board by his representative and referred to expenditure on telephone, cleaning expenses, and air-conditioning repair. He stated that the telephone and air-conditioning in question were located in an office in Street C. After the overnight adjournment the representative of the Revenue had reverted to these two items of expenditure at which stage the Taxpayer then stated that the office was in fact in an office building in Place S and that Company A occupied the same office.
- 3.4.6.12 He was then referred to the profits tax return of Company A for the year of assessment 1984/85 and confirmed that the address stated in that return was correct. When asked whether during that same period this address was shared by Company A and another company, Company B, the Taxpayer stated that at that time he was still hospitalised.
- 3.4.6.13 He confirmed that the telephone and air-conditioning were not exclusively used by the business.

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3.4.6.14 He was then referred back to the two motor cars and asked whether he used those cars to get to work. He answered in the negative and added that from time to time he did drive but on other occasions he went by bus or public light bus. He parked his car at the estate where he lived.

3.4.6.15 He had no records to show the places he visited or the purpose of the visit nor the dates of the visits to sites made by Mr F. However he denied the car would have been used for any purpose other than for the business.

3.4.7 The Taxpayer was not re-examined.

3.5 Second Witness

This witness, Madam X, who was affirmed in Puntí, was the accountant employed by the Taxpayer.

3.5.1 She completed her education on Form five. She obtained the LCC Intermediate Certificate in Accountancy. She studied LCC Higher Level Accountancy but did not do the examinations. She considered herself competent to keep double entry accounting records and she knew how to post such entries.

3.5.2 She started work for the business in July 1982.

3.5.3 Over the years the account balances did not match the ledger balances. This was because she entered all the debits and credits into books but did not keep the opening balances. What records she kept were given to the Taxpayer's first accountant for the preparation of the accounts.

3.5.4 Over the years there was a big difference between the accounts profits and the assessable profits and she had asked the accountants for an explanation over the telephone. An employee of the accountants told her to pay the tax demand and not to get into trouble with the Inland Revenue Department.

3.5.5 She was referred to an appendix showing motor vehicle expenses of three cars over several years. She said that one of the cars was used by the manager of the company, Mr F. All expenses incurred, such as parking fees at his place of residence and costs of site visits, were included. Mr F produced accounts and receipts for petrol to her. The business had an account with Caltex. At the end of every month all expenditure on petrol and oil was directly debited to the business's bank account by Caltex.

3.5.6 She was able to apportion the sundry expenses between the business, Company A and Company B by analyzing the relevant accounts. She would also ask the Taxpayer, Mr F or any member of the staff who was concerned for particulars, for example which sites were visited. The expenses incurred by Company A

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and Company B were charged directly to them. At no time had she intentionally charged the bulk of the expenses to the business.

- 3.5.7 The Taxpayer periodically withdrew cash, \$1,000 or \$2,000. When he did this Madam X would debit the bank and credit the Taxpayer's account. The Taxpayer would bring back restaurant bills etc. whereafter she would credit his current account and debit expenses.
- 3.5.8 She produced a ledger sheet entitled 'building account'. All entries on his page were made by her. It related to the purchase of a workshop at a factory building. The cost was not included in the balance sheet of the business because, after enquiry with the auditors, she was told this purchase could not be included in the balance sheet as it was purchased in the Taxpayer's personal name. Accordingly, it was entered into his current account with the business. Effectively, the Taxpayer owned the business and all the money was his. This property was not included in the balance sheet of the business for the years ended 31 March 1984, 1985 and 1986 because she did not keep opening balances.
- 3.5.9 During her employment the office address in Street C was not used by Madam X. She had heard the Taxpayer mentioned this office address but it had been sold in 1979.
- 3.5.10 Madam X was no longer employed by the business.
- 3.5.11 Under cross-examination she said:
- 3.5.11.1 That she thought that the workshop in the factory building was purchased in 1983. She was then referred to the ledger sheet and stated that the year entered was 1982, but it was not in her handwriting. She confirmed that all entries on the original ledger sheet had been made by her with the exception of the numerals '1982' and the English. When asked who wrote '1982' her answer was that sometimes she did not put the year down on the ledger sheets. She had not produced this sheet to the Taxpayer's present accountants when they prepared the 1985/86 accounts as it was irrelevant to that year of assessment. She stated that to the best of her belief this property had been sold in mid-1986. When asked why she did not record the property as a business asset she repeated her previous evidence as to having consulted the then auditors and having been told that it was to be posted to the Taxpayer's current account.
- 3.5.11.2 Having been shown several profits tax returns and having answered that the relevant records had been maintained on the double entry system it was put to Madam X that she had used the single entry system to maintain the accounts, something which she denied.

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- 3.5.11.3 She was then referred to the second of the assets betterment statements prepared by the Revenue and was asked about certain amount of the cash withdrawals. She explained that occasionally the Taxpayer told her he wanted to withdraw money and occasionally he told her that it was for payment of rental. When asked if he produced bills or receipts she stated that on the occasions he took customers to restaurants he would produce the receipts to her. When asked how she satisfied herself that the withdrawals were genuine business expenses she answered that she was aware that a certain customer had visited the office and gone to a restaurant with the Taxpayer and that a few days later the Taxpayer would produce a receipt and the name of the customer was always written down on the receipt. When asked whether it was correct to say that she had recorded these as business expenditure because that was what the Taxpayer told her, she stated that if the receipt had a customer's name on it and she knew them, she would.
- 3.5.11.4 She was then shown a schedule of expenses which had been referred to by the Taxpayer's tax representative in the opening and confirmed that they were all related to the office in Place S. She confirmed that the offices were shared by the business, Company A and Company B and that she kept the books of Company A and Company B. She had joined the business in July 1982 and from November 1982 she had worked in Place S. Her salary was paid by Company A.
- 3.5.11.5 She was then shown a salaries tax return for the year of assessment 1983/84 and confirmed that the signature was that of her husband. She was then referred to the fact that in Part B it stated that her employer was Company A which she agreed was correct. She was then shown a salaries tax return for the year of assessment 1984/85 which she said had been signed by her husband and confirmed that her employer was stated correctly as Company A. The same facts pertained with respect to a salaries tax return for the year of assessment 1985/86.
- 3.5.11.6 She confirmed that other employees of Company A worked at the office in Place S. She also confirmed that the expenses set out in the schedule produced by the tax representative were not incurred exclusively for the business. She had made an analysis of sundry expenses and each company's expenses were maintained under separate accounts.
- 3.5.11.7 When asked why two of the cars [car numbers mentioned] were not recorded as business assets she stated that this was because the registration of the vehicles was not in the name of the business. When referred to the relevant account she confirmed that each expend item recorded was supported by a receipt which she had obtained from the Taxpayer and/or Mr F and that the receipt she obtained recorded details of clients and places visited.
- 3.5.12 In answering questions from the Board she stated that:

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- 3.5.12.1 She had assisted in extracting receipts and making photocopies to the Taxpayer for the purposes of the investigation.
- 3.5.12.2 If the Taxpayer had drawn cash and the receipt was for less than the amount withdrawn she would only set off the amount expended against the drawing.
- 3.5.12.3 It was pointed out that according to some of the documents before the Board in some of the months, no cash had been drawn. The witness disagreed with this.
- 3.5.13 Under re-examination the witness confirmed that the numerals '1982' did not appear on the original ledger sheet but were put on the photocopy produced to the Revenue.
- 3.6 The Board asked if evidence was to be adduced from the former tax representative about the apportionments referred to during the tax representative's opening submission. If not, was the tax representative seeking to reopen any assessments pursuant to section 70A. The tax representative undertook to respond to this.

4. SUBMISSION BY THE REPRESENTATIVE

Having identified the three issues before the Board the representative proceeded to address each issue in time.

- 4.1 Unidentified withdrawals from director's current account with Company A:
- 4.1.1 The representative produced a computer print-out of all entries in the Taxpayer's current account with Company A for the period 12 May 1983 to 30 January 1987. He had highlighted the sums which totalled \$51,310 which were claimed by the Revenue as withdrawals which had not been explained to their satisfaction. He reminded the Board that the evidence was that having made withdrawals the Taxpayer would return with invoices which established that the money had been expended on business related activities.
- 4.1.2 The Board was told that it was common practice for a director of a small business to withdraw small sums of money for business purposes or domestic expenses from time to time. Upon production of invoices the bills relating to the business would be credited to the current account and debited to the relevant expense account. The differences were treated as amounts owing by the director or vice versa. It was submitted that although money would be drawn without any specific explanation being given initially, the subsequent production of bills for expenditure of that money would mean that the part in question would not be classified as unidentified. The fact of the matter was that over the two years ended 31 March 1985 and 31 March 1986 the differences

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between the sums drawn and the vouchers produced were treated as salary of the Taxpayer and debited to his salaries account.

4.1.3 The Board should not treat this amount as unidentified.

4.2 The Board's enquiry as to section 70A of the Ordinance:

4.2.1 Having cited the section the representative stated that it was not the intention to apply for a section 70A or otherwise to amend the assessment.

4.2.2 There was no provision in the Ordinance governing the preparation of an assets betterment statement. This is mentioned in a departmental interpretation and practice note. This practice note gives guidance that disallowable items in accounts have to be added back as opposed to disallowable items in tax computations. The correct interpretation should be that disallowable items in accounts referred to those actually identified by the assessor during the course of a tax investigation. Nothing would prevent an assessor from adjusting newly discovered disallowable items even though they were not treated as such in the previous tax computations.

4.2.3 An assets betterment statement should be reviewed as a separate exercise to check whether a taxpayer had understated his reported income thereby paid lesser tax.

4.3 Disallowable items of \$529,519:

These fell under three heads: motor expenses, sundry expenses and legal fees.

4.3.1 Motor vehicle expenses:

These expenses were fully added back by the former auditors as disallowable items. Whilst there were three motor vehicles only two were owned and used at the same time. One was used exclusively by staff of the business for the purposes of the business. From the tax point of view no apportionment as to private use and business use is required as the vehicle was used by a staff member as opposed to the proprietor. Whether the motor vehicle was a business asset was irrelevant. The other two cars were used by the Taxpayer and, occasionally, to visit sites whereby a certain proportion should be allowable. He suggested that 50% would be reasonable apportionment.

4.3.2 Sundry expenses totalling \$59,215:

50% had been added back by the former auditors as disallowable. Upon a detailed review it was concerned that this was purely arbitrary. The accountant of the business had screened and analyzed all expenses before posting. It was pointless for the accountant to charge all the expenses to the business only.

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There were also sundry expenses in the accounts of Company A and Company B. Accordingly, the assessor's claim that these expenses which might be shown by these others could not be established.

4.3.3 Legal fees \$2,630:

These were incurred during the year ended 31 March 1983 and related to a charge for preparing a mortgage of the workshop in the industrial building. This was an allowable expense as defined in section 16(1) of the Inland Revenue Ordinance.

4.4 Interest apportionment of non-income producing assets:

It was the usual practice that part of the interest paid by a company if the company has non-income producing assets at the balance sheet date. Loans/Advances to directors which were not interest bearing and investments are common non-income producing assets, trade debtors and fixed assets were not treated as such. The formula for apportionment was given to the Board and thereafter the Board was reminded as to the balances of the Taxpayer's current account with the business in each of the years ended 31 March 1982 to 1987, both inclusive. The balances which did not reconcile with the ledger balances between the accountants did not bring forward opening balances. At the request of the Revenue by letter dated 22 November 1988 certified copies of the ledgers were submitted by the representative on 5 December 1988. Because the ledger balances did not reconcile with the account balances a reconciliation had been prepared and sent to the assessor. Although they could not be reconciled exactly the differences were small. The Board was then taken through the reconciliations as provided by the representative to the Revenue and the Board was referred to a schedule handed to them during the course of the representative's opening submission with respect to this.

4.5 Capital cost of the property in the factory in the industrial building:

4.5.1

This had been used as workshops by the business. Although it was purchased in the name of the Taxpayer it were recorded and treated as fixed assets in the ledger. The previous auditors had misclassified this in the accounts. This incorrect treatment should not affect the reality of the situation. The representative said the property had not been shown in the accounts prepared by his firm as it had not been drawn to their attention. It was his opinion that the Taxpayer's current account should be reduced by the cost of the properties, namely \$311,200. If this was done, by the year of assessment 1982/83 the debit balance of \$525,772.66 would result in a credit balance of \$53,060.20 and the representative then proceeded to state what the revised balances should be in each of the remaining years.

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4.5.2 If this was done the bank interest apportionment for the years of assessment would be revised as follows:

	<u>Adjusted in tax computation</u> \$	<u>Should be revised to</u> \$	<u>Difference</u> \$
1982/83	32,415	Nil (1)	32,415
1983/84	125,332	Nil (1)	125,332
1984/85	113,651	6,885(2)	106,766
1985/86	44,019	10,000(3)	34,019
1986/87	<u>8,578</u>	<u>Nil</u>	<u>8,578</u>
	323,995 =====	16,885 =====	307,110 =====

(1) Amount due from the Taxpayer revised to credit balance, therefore no adjustment is required.

$$(2) \quad 189,077 \times \frac{28,713}{1,016,139 - 227,585^*} = \$6,885$$

$$(3) \quad 77,792 \times \frac{133,247}{1,264,128 - 227,585^*} = \$10,000$$

*Amount due from a corporate customer should be written off as bad debts as that company had closed down.

4.6 His firm's examination of the records of the Taxpayer disclosed that he had not understated his assessable profits for the relevant period. Although a small discrepancy was noted this was not the Taxpayer's fault it was the fault of time. As time passed memory faded and withdrawals which ought to have been capable of being identified could not be identified for that reason.

4.7 The representative concluded by saying that the Taxpayer had suffered a stroke during the course of the investigation and is now without savings and income. He is living in an old people's home and being supported by the social welfare department. He has been penalised not only on his own statement of income but on the failure of his memory as well as having placed reliance on an incompetent tax representative.

5. SUBMISSION BY THE REVENUE

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- 5.1 The representative stated that the Taxpayer had not kept proper accounts. Sums had been withdrawn from the business and from Company A for purposes which could not be identified. Additionally the balances of the Taxpayer's current account with the business per ledger did not reconcile with the balances stated in the financial statements. The Taxpayer failed to give any explanation as to why this had occurred during his evidence. It was also to be noted that in the 1980/81 to 1984/85 profits tax returns the Taxpayer declared that he had adopted the single entry bookkeeping system, a system which was far less reliable than the double entry system.
- 5.2 Because of these facts the assessor had resorted to the compilation of an ABS to estimate the assessable profits of the business covering the years of assessment commencing with that for 1981/82 to and including that for the year of assessment 1986/87.
- 5.3 Although the Taxpayer had lodged an appeal claiming that the betterment profits shown in the ABS should be further reduced, the amount he had specified would have reduced the ABS to a negative discrepancy. However, at the appeal the Taxpayer had agreed:
- 5.3.1 Bank interest:
- That the amount that should be allowed for deduction amounted to \$212,000 as stated in ABS-4 and he withdrew his claim for further deduction of that interest.
- 5.3.2 Inadmissible items:
- The amount to be added back in the ABS should be reduced by an amount of \$319,308 to \$212,211.
- 5.4 At the appeal the Commissioner had conceded that the unidentified withdrawal of \$50,000 was used to settle a trade debt.
- 5.5 Assuming that the Taxpayer were to succeed on the remaining issues the discrepancy in the ABS would still have a positive figure of \$191,185. The effect of the Taxpayer's submissions was that he had omitted profits of at least \$191,185. Accordingly, the question was not whether the Taxpayer had omitted profits but the quantum of his omitted profits.
- 5.6 In arriving at the assessable and additional assessable profits in his determination the Commissioner did not accept the Taxpayer's claim that:
- 5.6.1 Bank interest for \$424,475 was incurred wholly in the production of chargeable profits of the business.

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- 5.6.2 A sum of \$50,000 drawn from the business was applied to settle a trade debt.
- 5.6.3 Sums totalling \$33,200 drawn from Company A were not unidentified withdrawals.
- 5.6.4 Sums totalling \$529,519 previously omitted by the Taxpayer as non-deductible expenses should not be added back in the ABS.
- 5.7 The Board was then referred to D28/88, IRBRD, vol 3, 312, in which the Board had made certain relevant comments on an ABS. The Board was requested to apply that observation to the present case.
- 5.7.1 As to the specific grounds of appeal, they continued to be relevant:
- 5.7.2 Bank interest of \$424,475:
- The Board was informed, and this was confirmed, that this claim was no longer being pursued. It had been accepted that the amount to be allowed was \$212,000 as stated in ABS-4.
- 5.7.3 The unidentified withdrawal of \$33,000:
- The Taxpayer had failed to establish this sum which had been expended for the purposes of generating taxable profits.
- 5.7.4 Inadmissible items in the tax computation:
- The profits tax assessments for the years of assessment 1981/82, 1983/84, 1984/85 and 1985/86 were final and conclusive in terms of section 70. No section 70A application had been lodged within the prescribed time limit and, in any event, there were no errors or omissions as contemplated by section 70A.

6. Reasons for the Decision:

- 6.1 Onus of Proof:
- Section 68(4) of the Inland Revenue Ordinance places the onus of proof in an appeal on the taxpayer. Accordingly, it was for the Taxpayers to satisfy the Board, on balance of probabilities, that the assessment to tax which is under appeal was excessive or incorrect.
- 6.2 Evidence:

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- 6.2.1 The Board is entitled to administer oaths and, for the purposes of proof, applies the same principles as are applied in a court of law.
- 6.2.2 If a person disputing the refusal of the Revenue to admit a deduction of an item which is claimed to have been incurred for the purposes of generating a profit, it is for that person to produce evidence. In a simple case, business entertainment, the Board is entitled to hear evidence from the person who claims the deduction as to how the expenditure was incurred and, if for a meal, not only the taxpayer's internal voucher for bookkeeping purposes but also the receipt from the restaurant or other establishment at which the meal was eaten. It is not sufficient for him to make a bald statement that on a specific day he took an identified businessman to an identified restaurant and incurred a bill for an identified amount. Even if the businessman was called as a witness to confirm that he was entertained on the day claimed, that would not be evidence as to the amount expended. A voucher prepared by the witness to claim reimbursement from the taxpayer would not necessarily establish the amount. It is for the taxpayer to produce all the documents.
- 6.2.3 With his closing submission the Taxpayer's tax representative produced a computer print-out which he said listed all withdrawals by the Taxpayer from the business throughout the relevant period. This was a five-page document and a number of the items listed were highlighted and were said to have been justifiable business expenses. That was the extent of the information given to the Board. No other documents were produced to support the claims made with respect to these highlighted items.
- 6.2.4 A submission by a Taxpayer's representative is not evidence. Accordingly, the Board is unable to take this print-out or the explanations given during the submission into account when considering the evidence. This comment applies equally to other statements made during the tax representative's submissions which were not addressed by evidence from the two witnesses.
- 6.2.5 The Board has stated on prior occasions that whilst it may be extremely tedious for a taxpayer to have to establish that the claimed expenditure was incurred and how it was incurred, whereby the validity of the claim for deduction may be considered, that is the only way in which the Board can be satisfied that a claim is justified.
- 6.3 The ABS:
- 6.3.1 In the absence of any or any proper accounts, an ABS is a well established and fully recognised method of assessing the benefit that has accrued to a taxpayer from his trading profits by showing the increases in his assets after allowance for his expenses. The excess, or discrepancy, unless satisfactorily accounted for, is taken to be the taxpayer's understated profits. On appeal, the onus is on

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the taxpayer to prove that the assessment is excessive or wrong. The foregoing can be extracted from D30/89, IRBRD, vol 4, 346.

6.3.2 ‘An ABS forces the taxpayer to cooperate either by producing acceptable accounts or by otherwise assisting the IRD in its enquiries.’ - D28/88, IRBRD, vol 3, 312. If a taxpayer who has not maintained any or any proper accounts is able to produce the necessary documents to enable accounts to be prepared or revised, as the case may be, to disclose the true position, one purpose of the preparation of an ABS has been achieved. If he is unable so to do, and whether wholly or in part, the ABS is the only method by which the Revenue is able to obtain the nearest approximation possible to what would and ought to have been disclosed.

6.3.3 The Taxpayer had been unable to construct or reconstruct proper accounts to establish that ABS-4 was misconceived whereby, at the appeal from the determination of the Commissioner, the onus was on the Taxpayer to satisfy the Board that, on balance of probabilities, the assessments appealed against were excessive or wrong.

6.4 Matters before the Board:

By the time the appeal hearing had concluded the matters before the Board had been reduced from four to two namely those summarised by the representative of the Revenue, refer paragraph 5.7 above, namely the unidentified withdrawals of \$33,200 and the inadmissible items in tax computations.

6.5 The former tax representatives:

6.5.1 Criticism was made of the Taxpayer’s former representative, particularly with respect to what were effectively categorised as unilateral and arbitrary adjustments with respect to deductions. The Board was asked to accept that his agreements on these matters were wrong and that they should be ignored.

6.5.2 As the Board has said in the past, it is all too easy to lay the blame for a state of affairs on a third party in his absence. Such, when it relates to matters which do not stand out as obvious errors or mistakes, it can only have substance if each person or persons on whose shoulders the blame is laid appears as a witness and either acknowledges his error or mistake or is afforded an opportunity to explain why he adopted the course criticised.

6.5.3 No witness was called and, accordingly, the Board cannot be certain whether the action in question was unilateral or was taken after full consultation with the client.

6.5.4 The Board notes that when cross-examined as to his former tax representative’s treatment of deductions, refer paragraph 3.4.6.4 above, he said that he was

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unable to understand his current representative's argument and when the Board sought clarification of this, he stated that he understood the question generally but was not clear as to the details.

6.6 First Witness:

Reluctantly, the Board is unable to attach any credence to the evidence of this witness. Although sixty-two is not considered a great age today, he had the appearance of a person older than this age and was not a convincing witness. Even his representative suggested he was being punished for the failure of his memory. It is probable that his illness is to blame for this.

6.7 Second Witness:

This witness was not a convincing witness. Although identified as the 'Accountant', the Board's view is that she ought to have been described as a 'Book Keeper'. The impression left on the Board was that she was not a person who would take any initiative and that she would keep the books as they had been kept without question.

6.8 But for the acceptance by the Revenue that the unidentified withdrawal of \$50,000 was withdrawn to meet a business expense, refer paragraph 5.4 above, and the decision by the Taxpayer not to pursue the claim with respect to bank interest of \$424,475, refer paragraph 5.7.2 above, the Board would have been obliged to reject the Taxpayer's claims with respect thereto.

6.9 As the Taxpayer has not discharged the onus imposed on him by section 68(4) the Board has no alternative but to dismiss this appeal.

7. Decision

7.1 The Board orders that the assessments be adjusted to recognise the agreement of the Commissioner to accept that the \$50,000 was expended to discharge a trade debt but that subject thereto the assessments appealed against are confirmed.

7.2 There shall be liberty for the parties to apply if they are unable to agree the effect on the assessments of the Board's order.