

INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D75/91

Profits tax – assets betterment statement – onus of proof.

Panel: Ronny Wong Fook-hum QC (chairman), Paul Tong Hon-to and Vincent Lo Wing-sang.

Dates of hearing: 15, 16, 17 and 25 January 1992.

Date of decision: 11 March 1992.

The taxpayer was assessed to tax for three years of assessment. The assessments were based on a revised assets betterment statement. The taxpayer challenged the three assessments and the assets betterment statement. He claimed that certain substantial sums should be deducted from the assets betterment statement. At the hearing of the appeal the taxpayer himself gave evidence and called a witness to support one of the claims which he made.

Held:

After analyzing the evidence before it the Board dismissed the appeal because the Board was not satisfied on the balance of probabilities that the taxpayer had discharged the burden of proof.

Appeal dismissed.

Case referred to:

D30/89, IRBRD, vol 4, 346

Chiu Kwok-kit for Commissioner of Inland Revenue.
Paul Kwong of Paul Kwong & Co for the taxpayer.

Decision:

I. BACKGROUND OF THIS APPEAL:

1. This is an appeal by the Taxpayer against the following profits tax assessments raised on him for the years of assessment 1986/87 to 1988/89.

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<u>YEAR OF ASSESSMENT</u>	<u>DATE OF CHARGE</u>	<u>REVISED ASSESSABLE PROFITS</u> \$	<u>REVISED TAX PAYABLE</u> \$
1986/87	20-1-1989	1,627,046	276,597
1987/88	20-1-1989	3,838,456	633,345
1988/89	20-1-1989	13,445,026	2,083,979

2. The above assessments are based on a revised assets betterment statement forwarded by the Inland Revenue Department to the Taxpayer on 16 February 1990. According to that revised assets betterment statement the net assets of the Taxpayer and his wife were as follows:

<u>DATE</u>	<u>NET ASSETS</u> \$
1 April 1986	1,074
31 March 1987	1,508,979
31 March 1988	5,317,856
28 February 1989	15,803,442

It is common ground that the Taxpayer's wife was at all material times a housewife and all her assets came from the Taxpayer.

3. The principal ground of appeal relates to the Inland Revenue Department's wrongful refusal to deduct from the revised assets betterment statement three sums:
- (a) a sum of HK\$15,000,000 allegedly due from the Taxpayer to one Mr Z;
 - (b) a sum of US\$468,835 allegedly due by the Taxpayer to one Mr H; and
 - (c) a sum of HK\$620,000 allegedly due from the Taxpayer to L Enterprises, a concern operating in a province of China (Province T).

II. THE APPLICABLE PRINCIPLES:

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4. An assets betterment statement is a recognised method of assessing a taxpayer's income or profits by showing the increases in his assets and his expenses on the one hand and his returned income or profits on the other and the excess, if any, of the former over the latter. The excess or discrepancy, unless satisfactorily accounted for, is taken to be the taxpayer's understated income or profits. On appeal, the onus is on the taxpayer to prove that the assessment is excessive or wrong. This principle can be gleaned from D30/89, IRBRD, vol 4, 346.
5. The onus therefore rests on the Taxpayer to satisfy us on a balance of probabilities that the above assessments are excessive or wrong.

III. ARGUMENT THAT THE TAXPAYER DID NOT CARRY ON BUSINESS IN HONG KONG:

6. Mr Kwong, solicitor for the Taxpayer argued in his closing submission that the Taxpayer did not carry on any business in Hong Kong with the result that no profits tax was payable by the Taxpayer at all.
7. Quite apart from the fact that this is not a ground relied on in the notice of appeal dated 22 October 1991, the objection is unsupported by the evidence of the Taxpayer given before us. On 30 March 1989, the Taxpayer submitted three profits tax returns for the years of assessment 1986/87 to 1988/89 wherein he declared assessable profits as follows:

	1986/87 YEAR ENDED <u>31-3-1987</u> \$	1987/88 YEAR ENDED <u>31-3-1988</u> \$	1988/89 YEAR ENDED <u>31-3-1989</u> \$
Assessable Profits	68,134	151,626	490,882

8. We therefore reject the argument of the Taxpayer on this basis.

IV. ALLEGED INDEBTEDNESS OF THE TAXPAYER TO MR Z IN THE SUM OF HK\$15,000,000

9. The Taxpayer's case:
 - (a) By an agreement dated 1 January 1987 between Mr Z and the Taxpayer, Mr Z agreed to provide the Taxpayer with \$100 million in a certain currency (the Currency) which shall be used by the Taxpayer 'in construction of , purchase and disposal of real estate, and money-lending business in Hong Kong'. By Clause 2, Mr Z was to pay the Taxpayer the Currency \$15,000 per month as travelling expenses and the Currency \$35,000 per month as salaries and wages. By Clause 3, Mr Z and the

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Taxpayer agreed to settle accounts on 31 December each year. 2% of the profits 'shall be given to [the Taxpayer] per year as remunerations'. By Clause 5, the agreement was to last 'from 1 January 1987 to 31 December 1991'.

- (b) Pursuant to this agreement the Taxpayer allegedly received from Mr Z the following sums in HK-dollars as evidenced by divers receipts signed by the Taxpayer.

<u>DATE OF RECEIPT</u>	<u>AMOUNT RECEIVED IN HK-DOLLAR</u>
	\$
10 March 1987	1,500,000
3 July 1987	2,500,000
7 June 1988	3,000,000
3 September 1988	4,000,000
1 November 1988	<u>4,000,000</u>
Total:	<u>\$15,000,000</u> =====

- (c) There is a further receipt dated 31 March 1988 for HK\$30,000 said to be bonus given to the Taxpayer in respect of the year 1987.
- (d) It is the Taxpayer's case that the total sum of HK\$15,000,000 depicted in the receipts summarised in sub-paragraph (b) above should be deducted from his net assets as shown in the revised assets betterment statement.
10. The Taxpayer gave evidence before us. He told us that it was sometime in 1987 that he started business connection with Mr Z. Mr Z appointed the Taxpayer as his agent in Hong Kong to entertain Mr Z's customers from Mr Z's home city (Region A). Those customers needed cash to gamble in Macau. Mr Z would telephone the Taxpayer the requirements of each customer and the Taxpayer would act on those instructions. Upon the customers' return from the Macau casino, the winning customers might return the principal borrowed directly to the Taxpayer. The losing customers would settle and repay the money directly to Mr Z. The Taxpayer in turn would 'off-set' his account with Mr Z. He accepted that in those circumstances there should be a reduction from the figure of HK\$15,000,000 as presently claimed. The Taxpayer said that he could not produce any record because his book of record was found missing after the police raided his flat in place S in late 1988. He further told us that about half a

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year after the raid, Mr Z 'had unilaterally terminated the agreement and then step by step, [Mr Z] withdrew his money. By now he is still chasing after me for the outstanding balance'.

11. The evidence given by the Taxpayer before us is inconsistent with the explanations that he preciously furnished to the Inland Revenue Department ('the Revenue'):
 - (a) In a statement given in an interview held on 14 February 1989 with the Revenue and admitted by the Taxpayer, he told the assessors at that interview that 'the money held by [the Taxpayer] on [Mr Z's] behalf was estimated to be in the region of HK\$2,000,000 to HK\$3,000,000'. This is far short of the figure of HK\$15,000,000 as now contended.
 - (b) In a letter dated 2 June 1989, the Taxpayer told the Revenue that:
 - (i) The total loans of HK\$15,000,000 'have not been repaid to date'.
 - (ii) In relation to sums received from Mr Z 'no detailed accounting record is maintained, the date and the amount of deposit placed [in bank] cannot be accurately stated'.
 - (iii) In relation to accounts receivable from the customers, accounting records for the same cannot be made available because '(1) no accounting books are maintained and (2) the loan agreements with lenders were either returned to the lenders or destroyed by the lenders when the loans were repaid'.
 - (c) In a letter dated 23 October 1989, the Taxpayer told the Revenue that despite the requirement in Clause 3 of the agreement dated 1 January 1987, no account statement was made and the HK\$30,000 bonus as evidenced by the receipt of 31 March 1988 'was considered as a gift from [Mr Z] ...'.
 - (d) In a letter received by the Revenue on 15 January 1990, the Taxpayer told the Revenue that: 'There is no formal account statement, but I and [Mr Z] ... had confirmed the balance of the transactions informally by phone verbally. Since the Inland Revenue Department started to investigate, we didn't confirm the balance any more because the project had been disturbed'.
12. We are not satisfied on a balance of probabilities that the sum of HK\$15,000,000 should be deducted from the Taxpayer's net assets. Apart from the receipts signed by the Taxpayer himself, there is no other evidence to indicate that the provisions of the 1 January 1987 agreement were genuine. No computation as at 31 December each year was produced for our consideration.

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If accounting records had not been kept, the police raid in late 1988 is wholly irrelevant. If accounting records had been kept, we are not satisfied that the police raid resulted in the disappearance of such records. Even if the records maintained by the Taxpayer were disturbed, we see no reason why corresponding records from Mr Z cannot be obtained. The Taxpayer admitted two types of repayments to Mr Z. Firstly, by the losing gamblers direct to Mr Z and secondly, repayments by virtue of pressure exerted by Mr Z after the police raid. Both types of repayments would drastically reduce the figure of HK\$15,000,000. Even accepting for one moment the genuineness of the 1 January 1987 agreement (which we do not), the Taxpayer has not discharged his onus in demonstrating that the alleged indebtedness had not been obliterated by those repayments which he conceded himself. We therefore reject this ground of appeal.

V. THE ALLEGED INTEREST OF MR H IN THE SUM OF US\$468,685

13. THE TAXPAYER'S CASE:

- (a) In July/August 1988, the Taxpayer and Mr H agreed to go into a jade joint venture.
- (b) In late 1988, Mr H came to Hong Kong with US\$600,000 in cash. He obtained the US-dollars by changing the currencies of Region A from his own resources with underground operators in Region A.
- (c) A day later Mr H handed over the cash to the Taxpayer in Hotel A. Mr H and the Taxpayer arranged for this meeting in a telephone conversation on 25 October 1988.
- (d) Out of the US\$600,000, the Taxpayer exchanged US\$131,365 into RMB through L Enterprises. He obtained the RMB so exchanged on 13 November 1988 in Province T and deposited the same with a company in a province of China (Province U) by way of deposit for the acquisition of jade.
- (e) At the police raid referred in paragraph 10 above the balance of the US\$600,000 amounting to US\$468,685 was seized. The police subsequently returned this sum of US\$468,685 to the Taxpayer and he used it in part of the payment of the profits tax assessed by the Revenue.
- (f) In his letter dated 23 October 1989 to the Revenue, the Taxpayer told the assessor that:

‘The US\$600,000 was repaid to [Mr H], except the deposit US\$131,365 and the tax deducted by Inland Revenue Department. The repayment was in cash and during March 1989.’

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- (g) In the letter received by the Revenue on 15 January 1990, the Taxpayer told the assessor that the deposit of US\$131,365 'was got back from the company in [Province U] and send (sic) back to Mr H in June 1989'.

14. Mr H gave evidence before us. He told us that:

- (a) Since 16 April 1986, he had maintained a deposit of US\$272,080.50 in his US-dollar savings account with Bank N.
- (b) He owns beneficially 93% of a company in Region A called I Ltd whose net equities in 1988 stood at the Currency \$9,000,000.
- (c) He produced for our consideration statements dated 30 December 1989 and 28 February 1990 of his bank account with Bank A. He told us that this account was opened in 1987. The two statements indicate:

<u>DATE OF STATEMENT</u>	<u>ADDITIONAL INVESTMENT/ DEPOSITS THIS MONTH</u>	<u>INVESTMENTS RETIRED OR DEPOSITS REDEEMED</u>	<u>CHECKING ACCOUNTS</u>	<u>SAVINGS ACCOUNTS</u>
30-12-1989	3,613,073.06	2,195,012.00	57,221.18	1,366,960.73
28-2-1990	6,666,757.73	6,616,045.93	84,533.36	Nil

- (d) In his evidence-in-chief, he initially told us that in late 1988 his worth was over US\$400,000 odd. After further questions by Mr Kwong, he revised his estimate to US\$700,000/US\$800,000.
- (e) He said he brought the money from Region A and instructed the Taxpayer 'to use the same in jewellery business'. He said 'we want to buy raw gem stones such as ruby stones in the raw form to be brought back to say Hong Kong for cutting'. The profit would be distributed according to capital contributed. He didn't know exactly the Taxpayer's contribution. The Taxpayer only told him that the capital required would be around US\$1,000,000.
- (f) He was responsible for exchanging in Region A the Currency into US\$. The US-dollars so exchanged were in big denominations '\$50 or bigger denominations' and the exchange rate applicable 'was 28:50'.
- (g) He accepted that he had been repaid by the Taxpayer but can't remember exactly how much nor when the repayments were made.

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15. The evidence of Mr H differs in several respects from the statement given by Mr H to the police on 15 December 1988. He told the police that the joint venture with the Taxpayer was in respect of 'our jade business'. There was no mention at all of a 'ruby' joint venture. The denomination of the US-currency and the exchange rate adopted were the precise reverse of what he told us in evidence.
16. The Taxpayer's case rests essentially on the financial strength of Mr H. This case is however considerably weakened by Mr H's difficulties in stating his net worth in 1988. If the Taxpayer's case is to be believed, Mr H's net worth in late 1988 should well exceed the figure of US\$700,000 to US\$800,000 which he so grudgingly accepted. On Mr H's evidence, his net worth in late 1988 should at least amount to the following:

<u>NATURE</u>	<u>AMOUNT</u> US\$
Deposit with Bank N	272,080.50
Joint Venture with the Taxpayer	600,000.00
93% interest in I Ltd	293,684.21 (being 93% of [the Currency] 9 million at <u>US\$1:[the Currency] 28.5)</u>
TOTAL:	US\$1,165,764.71 =====

Both the Taxpayer and Mr H accept that Mr H had been repaid in full the sum of US\$600,000 after the raid in late 1988. Given the numerous requests for supporting evidence by the Revenue, it is surprising that no record whatsoever is produced before us in support of such repayment. In particular, there is no document tendered before us in support of the repayment of US\$131,365 said to be the initial deposit returned from Province U.

17. In these circumstances, we are not satisfied on a balance of probabilities that the Taxpayer had discharged his onus in demonstrating that the sum of US\$468,685 should be deducted from his net assets as depicted in the revised assets betterment statements.

VI. THE ALLEGED LOAN OF HK\$620,000 FROM L ENTERPRISES

18. THE TAXPAYER'S EVIDENCE BEFORE US:

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- (a) The Taxpayer told us that he dealt with one Mr B of L Enterprises. Mr B instructed the Taxpayer to buy a consignment of beach umbrellas. The Taxpayer was entitled to 5% commission on the profit should the transaction go through.
- (b) The Taxpayer contacted a manufacturer in Region A. Initially, he could not recall in his evidence before us the name of this manufacturer but after consulting the Business Yellow Page Directory of Region A overnight, the Taxpayer told us that the manufacturer was S Ltd.
- (c) A quotation was obtained from S Ltd. This was conveyed to L Enterprises who indicated that the prices were acceptable. Three days later, L Enterprises pointed out to the Taxpayer that the custom duties for the umbrellas would be very high and the proposed purchase was therefore cancelled.
- (d) Before the Taxpayer telephoned S Ltd for the quotation, L Enterprises paid the Taxpayer RMB \$460,000. This is said to amount to '50% of the purchase price'. The Taxpayer obtained the RMB in Province T and he exchanged that into HK\$620,000 which he personally brought back to Hong Kong.
- (e) After the proposed purchase of beach umbrellas had fallen through, he kept the sum of HK\$620,000 in Hong Kong. Mr B and his associates regularly visited Hong Kong and on those visits, sums ranging between HK\$10,000 and HK\$100,000 were released to Mr B and his colleagues. The Taxpayer allegedly made entries in his accounts of those repayments until sometime in 1991. By 1991, he returned all monies back to L Enterprises.
- (f) The Taxpayer relies on a loan agreement dated 28 April 1987 signed by him and Mr B on behalf of L Enterprises. The loan agreement recites the payment in 1986 of HK\$620,000 to the Taxpayer as deposit for the purchase of umbrellas. The loan agreement goes on to provide that:

‘Due to the change of situation, the transaction has not been concluded. Upon negotiation of both parties, [L Enterprises] ... has agreed to lend this sum of money to [the Taxpayer] at an annual rate of 8%. Interest should be paid half-yearly until 28 April 1990, the date of expiration ...’.
- (g) The Taxpayer told us that the loan agreement was ‘back-dated as a matter of fact’. It was ‘prepared some time in 1987 having regarded to the fact that a sum of HK\$50,000 was paid to me in 1986’.

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19. The present case of the Taxpayer differs from the explanations he previously furnished to the Revenue:
 - (a) At the interview on 14 February 1989, he told the assessors that the loan borrowed from Mr B 'was given in one lump sum ... The money was borrowed to boost his liquidity and occasionally allowed him to bet on horses in the casino'.
 - (b) In his letter dated 23 October 1989 to the assessor, the Taxpayer told the assessor that the money was advanced to him 'on 28 April 1987 in [Province T]'.
 - (c) In the letter received by the Revenue on 15 January 1990, the Taxpayer told the Commissioner that 'HK\$620,000 was carried back to Hong Kong by myself on 28 April 1987'.
 - (d) The Taxpayer produced before us his re-entry permit and relied on entries at page 18 of that permit indicating his return from Province T to Hong Kong on 28 April 1987. In view of his own admission that the 28 April 1987 loan agreement was not contemporaneous, reliance on those entries only serves to highlight the contradictions of the Taxpayer's case.
20. No evidence has been adduced before us in support of the repayments to L Enterprises. The Taxpayer himself pointed out that Mr B and his colleagues regularly visited Hong Kong. No attempt was made to have their evidence placed before us. Given the contradictions outlined above we are not satisfied on a balance of probabilities that the Taxpayer has discharged his burden in relation to this alleged loan.
21. For these reasons, we would confirm the Commissioner's determination of 21 September 1991 and dismiss the Taxpayer's appeal.

VII. THE OTHER GROUND OF APPEAL IN RELATION TO ASSESSMENTS DIRECTED AGAINST THE TAXPAYER'S WIFE

22. The Revenue accepted that the assessments in question are protective assessments and will be rescinded upon confirmation of the Commissioner's determination. We have not taken into account this intimation in our deliberation of the main appeal.