INLAND REVENUE BOARD OF REVIEW DECISIONS

Case No. D93/03

Profits tax – assets betterment statement – sections 51C, 60 and 68(4) of the Inland Revenue Ordinance ('IRO').

Panel: Ronny Tong Ka Wah SC (chairman), Herman Fung Man Hei and Anthony So Chun Kung.

Dates of hearing: 3 and 4 November 2003.
Date of decision: 5 February 2004.

In 1996, the Revenue started an investigation of the income and profits of the restaurant business ('Business') of Mr A and Mr B. There were various meetings with Mr A and Mr B but neither was able to produce comprehensive evidence to explain certain discrepancies found as regards the income of the Business. The Revenue then produced an Assets Betterment Statement ('ABS') itemizing income which Mr A and Mr B alleged to be income generated by overseas trading. Additional profits of the Business were assessed.

Counsel for the taxpayers raised two issues:

a) whether as a matter of law, the Revenue was justified in assessing the alleged understated profits of the Business by the use of ABS;

b) on the evidence, the understated profits were shown to have been generated by overseas trading which were not susceptible to tax under the IRO.

Held:

1. The legal challenge of the use of ABS is without substance. The statement of Bokhary J (as he then was) in Lee Ma Loi v Commissioner of Inland Revenue confirmed the power of the Revenue to make estimated assessments. In case no D69/02, this Board held that while ABS could be challenged and its use must not be abused, its use had been approved in a number of decisions of this Board over many years. In particular, it was said that while the Revenue should not harass taxpayers by indiscriminate use of ABS, it would be failing in its duties if it had not thoroughly investigated the taxpayer's tax affairs.

2. The Board has no hesitation in rejecting Mr A and Mr B's evidence. The Board is by no means satisfied that the additional profits which were not disputed by the taxpayers were profits earned from overseas trading and thus not liable for tax. The Board finds that the taxpayers had not discharged their burden under section 68(4) of the IRO.

Appeal dismissed.

Cases referred to:

Lee Ma Loi v Commissioner of Inland Revenue (1992) 1 HKRC 90-063
Hudson v Humbles 42 TC 380
D28/88, IRBRD, vol 3, 312
D69/02, IRBRD, vol 17, 916
Luu v Deputy Commissioner of Taxation 34 ATR 516 AAT Case 8650

Wong Wing Yu for the Commissioner of Inland Revenue.
Ho Chi Ming Counsel instructed by Messrs C B Wong & Company for the taxpayers.

Decision:

Background facts

1. Before us are three appeals involving the same facts.

2. Case 1

In about 1984, Mr A entered into a partnership with his brother-in-law, Mr B and operated a restaurant business under the name or style of Restaurant C ('the Business') in the Islands.

3. The Business was prosperous and in 1993, the Business was transferred to and thereafter carried on by a limited company under the same name or style.

4. In 1996, the Inland Revenue Department ('the Revenue') started an investigation of the income and profits of the Business. There were various meetings with Mr A and Mr B but neither was able to produce comprehensive evidence to explain certain discrepancies found as regards the income of the Business. We will refer to the limited evidence produced by Mr A and Mr B in more detail later on.

5. On 13 August 2001, the Revenue produced an Assets Betterment Statement ('ABS') itemizing the following income which Mr A and Mr B alleged to be income generated by overseas trading:

Year	**Amount**
1990	$1,800,000
1991	$2,360,000
1992	$2,520,000
1993	$2,870,000
1994	$1,960,000
1995	$1,330,000
1996	$960,000
Total:	$13,800,000

6. There were further meetings but neither Mr A nor Mr B was able to further substantiate their assertion that the income in question was generated overseas.

7. On 5 November 2002, the following additional profits of the Business were assessed:

Year	**Additional profits**
1990/91	$680,000
1991/92	$2,060,000
1992/93	$3,340,000
1993/94	$560,000

8. Additional profits tax was raised on the Business accordingly.

9. Case 2 & Case 3

In these appeals, additional salaries tax was raised on Mr A and Mr B respectively on the basis that their drawings as partners and later on as directors of the Business were correspondingly understated by reason of the understated profits assessed in relation to the Business. We will refer to Mr A, Mr B and the Business collectively as 'the Taxpayers'.

Issues

10. Counsel for the Taxpayers raised two issues:

(a) Whether as a matter of law, the Revenue was justified in assessing the alleged understated profits of the Business by the use of ABS;

(b) On the evidence, the understated profits were shown to have been generated by overseas trading which were not susceptible to tax under the Inland Revenue Ordinance, Chapter 112 ('IRO').

The law

11. There is no doubt that a taxpayer is obligated to keep proper business records to enable the assessable profits of his business be readily ascertained and that such records must be kept for a period not less than seven years. This is provided in section 51C of the IRO.

12. There is also no dispute that the records kept by the Business were neither complete nor accurate. For example, the Taxpayers accepted that at one stage, service charges were not recorded in the accounts produced. The investigation had been going on for a long time. Mr A and Mr B were first interviewed in 1996 when they were asked to assist by producing proper records of the profits of the Business.

13. Indeed, throughout this dispute, the Taxpayers did not strongly object to either the use of ABS or the figures contained therein. In a separate computation, they themselves had produced similar figures as regards the 'profits of the overseas trade'. The crux of the dispute is thus not so much as the use of ABS or what was the magnitude of the understated profits but rather whether the profits were profits of overseas trade or profits which could not be explained by the Taxpayers.

14. The legal challenge of the use of ABS at the hearing by Counsel appearing for the Taxpayers was thus somewhat surprising. In any event, we are of the view that such challenge is without substance.

15. Mr Ho, appearing for the Taxpayers referred us to the case of Lee Ma Loi v. Commissioner of Inland Revenue (1992) 1 HKRC 90-063 where Bokhary J (As he then was) was reported to have said this about the assessments in that case:

> *'... I have no doubt that the revenue's power to make estimated assessments was not conferred on them for the purpose of working background in that way. Nor was it conferred on them to enable them to confiscate property or to take it as security for the payment of tax.'*

16. That was said in the context of the facts of that case which was an appeal from a Judicial Review. The Court of Appeal came to the view that it could not interfere with what was essentially an exercise of discretion by the trial Judge. The statement quoted above was not meant to be of general application. Quite the contrary, it confirmed the power of the Revenue to make estimated assessments.

17. In Hudson v Humbles 42 TC 380, Pennycuick J said (at page 387):

'The taxpayer knows the full facts, and the Revenue does not. In the nature of things, it must often be the case that, even if the Revenue can show a prima facie case that receipts have not been satisfactorily accounted for, it has no material upon which to set up a prima facie case for bringing the receipts in question under one or other source of income. On the other hand, it is always open to the taxpayer to challenge the assessment, not only on the ground that there has been no wilful default but also on the ground that the receipts did not represent income from the particular source selected by the Revenue.'

18. In case no D28/88, IRBRD, vol 3, 312, this Board said (at page 317):

'An assets betterment statement is not the best way of ascertaining the assessable profits of a business or of an individual. It is a last resort when all else fails. It is important to bear in mind that, when a return of income is not made or is not accepted by an assessor or a case arises under section 60 of the Ordinance, the assessor is entitled and indeed has a duty to make an estimated assessment. In default of accurate information, it is customary for the assessor to protect the public revenue by issuing an assessment which is not less than whatever profit the taxpayer might have made. This imposes the obligation or burden on the taxpayer to come forward with what is his true taxable income. It forces the taxpayer to cooperate either by producing acceptable accounts or by assisting in the preparation of a meaningful assets betterment statement.

An assets betterment statement in its final or revised form is nothing more than an account of how the assessor has arrived at estimating the taxable profits of a taxpayer. It is not and does not pretend to be accurate or precise. It is merely a calculation of a taxpayer's income on a "net assets basis" in default of any other available information. If a taxpayer is aggrieved by an assessment founded on such a statement, it is for him to show how and to what extent it is incorrect or excessive. If he fails to do that, the assessment will be confirmed. It is for the taxpayer to displace the assessment. The taxpayer can blame no one except himself for such a state of affairs having arisen and can blame no one except himself if he finds it difficult to discharge the burden and prove that the betterment profit revealed by the assets betterment statement is wrong. The onus is not discharged by the taxpayer simply appearing before the Board and saying that the assets betterment statement is wrong. The onus is not discharged by the taxpayer if he leaves the Board in a state of conjecture by his failure to give evidence on matters peculiarly within his knowledge. If

he elects to remain silent or is unable to give detailed and acceptable evidence or is unable to obtain independent acceptable documentary evidence and to call witnesses to substantiate the truth of what he say, then he leaves the Board with no alternative but to uphold the assessments based on the assets betterment statement because, like the Commissioner before it, the Board has no better means of ascertaining the true profits of the taxpayer.

The assets betterment statement method of estimating the income of a taxpayer provides the taxpayer with the opportunity, if he is aggrieved by the assessment raised on that basis, of satisfying the Board that the increase in his wealth did not arise from his business activities. If at the end of the Board hearing there is no acceptable evidence or insufficient evidence to warrant a conclusion that the assessments are excessive, then the same must stand.'

19. In case no D69/02, IRBRD, vol 17, 916 this tribunal held that while ABS could be challenged and its use must not be abused, its use had been approved in a number of decisions of this Board over many years. In particular, it was said that while the Revenue should not harass taxpayers by indiscriminate use of ABS, it would be failing in its duties if it had not thoroughly investigated the taxpayer's tax affairs. We entirely agree.

20. Mr Ho further relied on two cases: Luu v Deputy Commissioner of Taxation 34 ATR 516 and AAT Case 8650. In both cases, the taxpayers gave evidence explaining about the discrepancies in the records of the taxpayers and their evidence was accepted by the tribunals in question.

21. We have no doubt that is the question we have to determine: whether the Taxpayers had adduced cogent evidence in explaining the considerable discrepancies as to the recorded and actual earnings of the Business. We do not understand the Revenue to be contending otherwise. So to that question we now turn.

Evidence of Mr A

22. We were surprised by the incredibility of Mr A's testimony. His story is essentially this. In 1986, Mr A and Mr B came to know two Chinese fishermen, one Mr D and one Mr E while carrying on a business of buying and selling fish. Both Mr D and Mr E resided at the Islands.

23. Mr D and Mr E suggested that the four of them should start a business of selling fish to Taiwanese and Japanese fishermen. Mr A and Mr B were to and did invest a total of $1,000,000 but were not to be involved in the running of the business. Mr D and Mr E were to do all the work but provide no capital. They agreed that for their work, Mr D and Mr E were entitled to 30% of the net profits of the fish selling business.

24. The business was extremely profitable but inexplicably, Mr A originally said in evidence that for five years, he and Mr B did not collect their share of profits. No credible explanation was given other than that 'they did not need the money' and that the profits were lent out to various fishermen. Nothing was in writing.

25. Mr A's evidence on this was very confusing. He originally said they made $2,000,000 in 1987 but then said he could not really remember how much they made. He said they did not care about the money. He said Mr B would report to him at the end of each year how much money was made in that year and while at the time he remembered how much profit was made he did not write it down. He did not care if either side of the partnership might make a mistake as to how much profit was available to be shared. In the detailed accounts prepared by the Taxpayers at page 114 of Bundle B1 in Case 1, they showed a total of $6,500,000 was collected between 1986 and 1989. These accounts were apparently prepared in 2001 at the request of the Revenue.

26. In his signed statement (it was in English although there was no interpreter's clause and Mr A did not know English), he said he and Mr B collected profit 'from time to time since 1986'. There was also annexed to the statement an Appendix 1 which showed money was collected from July 1989 onwards.

27. Throughout the years, Mr A only met Mr D and Mr E five or six times. That averaged out to be about once a year. All dealings with Mr D and Mr E were carried out by Mr B who met the former 'on average two to three times a week'. The profits were paid in large sums of Hong Kong dollars which were all deposited into the account of the Business.

28. Again, inexplicably, there was no record of any kind. There was apparently a running account between the two sides but there was never anything in writing. According to Mr A, when they started drawing from the business in 1990 or 1991 because the Business needed cash, he never bothered to find out how much was profit earned over the past years, how much was profit currently earned or how much was return of capital, if any.

29. The Taiwanese and Japanese fishermen paid in United States dollars but they were converted into Hong Kong dollars in the Islands. He did not inquire about the exchange rates or whether the money he collected represented all the money paid by the fishermen.

30. It was apparently a matter of pure coincidence that he very often only paid the large sums of money collected from Mr D and Mr E into the Bank on a Monday or Tuesday irrespective of when the money was collected together with the earnings from the Business over the weekend which was the busiest time of the week as far as the Business was concerned.

31. What is most amazing is that despite the large sums involved, Mr A insisted there was no attempt to verify the profits allegedly made from the business of selling fish overseas. He would not even count or check the money received. 'It was entirely based on trust', he said. He also said

he trusted Mr B completely. Mr B would hand over all the money collected to him, Mr A insisted. He said he never asked for a record of the sums involved but in 1996 when investigation started, he did try to obtain some documentary evidence from Mr D and Mr E. He produced two sheets of paper which are now at pages 96 and 97 of Bundle B1 in Case 1. On the other hand, he claimed in paragraph 12 of his statement that Mr D and Mr E were illiterate. And yet, Mr A said in a signed letter to the Revenue [page 169 of Bundle B1 in Case 1] Mr D and Mr E were so angry with him and Mr B for asking for records that all records were destroyed by Mr D and Mr E.

32. Pages 96 and 97 of Bundle B1 in Case 1 showed dates of 28 October 1993 and 4 November 1993 respectively. They appeared to be a record (or part of a record) of sale of fish but there is nothing to show who was the seller and who was the buyer or what was the profit arising out of these transactions. If the documents show a record was kept by Mr D and Mr E as to the business of selling fish, there was no explanation as to why only two sheets in 1993 were produced. In our opinion, the probative value of these two sheets is practically nil.

33. Mr A concluded by saying that as a result of the investigation by the Revenue, he and Mr B pressed Mr D and Mr E for documents and the latter were unhappy about the request for assistance. They eventually dissolved the partnership. Mr A claimed some money was still not collected but he was unclear as to exactly how much. When asked how he knew there was money outstanding when he kept no record, he claimed he just knew. He, of course, took no step to recover the money. Neither Mr D nor Mr E was called to give evidence.

34. We have no hesitation in rejecting Mr A' s evidence.

Evidence of Mr B

35. Mr B did not fare any better. He was equally vague. He said he left everything to Mr A and he was just a runner. He received the money often in a large bundle and he just threw it into the hull of his boat. He never bothered to count the money let alone ask for documents or records. He gave no receipt. Sometimes, he said, he even forgot about the money in the boat and let the money lying in the boat overnight.

36. It was nothing short of remarkable that so much money was made and yet the parties were so relaxed about how they should account to each other over such a long period of time.

37. We also reject the evidence of Mr B.

Trading volume of the Business

38. There was also a feeble attempt to demonstrate that the Business just could not physically generate so much profit as to include the money allegedly made from overseas trading. Various tables were produced as regards areas and tables and chairs of the eight restaurants and

the number of employees and their earnings over the year of 1995.

39. These are all self-serving documents. In any event, they are inconsistent with the contemporaneous documents. For example, the inventory kept by the Business showed in 1990, there were 228 chairs. In 1991 [at page 32 of Bundle B1 of Case 1] there were 48 more chairs. That translated into over 25 large tables (assuming each large table sitting 10). In 1993 [at page 61 of Bundle B1 of Case 1], there were 30 tables. In 1996, the inventory showed at least a further 30 large tables were acquired [R1 page 21]. There was a reference to further 14 tables being acquired at the same time. All these simply do not square with the figure of 38 tables set out in Appendix 2 to Mr A's statement. Counsel for Mr A later submitted that the figure 38 only referred to large tables but even then these figures do not even begin to show the additional profits could not have been made from the Business. Even if they do, there is still no credible evidence that the additional amounts were profits made from overseas trading.

Conclusion

40. In these circumstances, we are by no means satisfied that the additional profits which were not disputed by the Taxpayers were profits earned from overseas trading and thus not liable for tax. We find that the Taxpayers had not discharged their burden under section 68(4) of the IRO. All three appeals must be dismissed and the corresponding Commissioner's determinations confirmed.