

Bi-Flex Caribbean Limited

Appellant

v.

The Board of Inland Revenue

Respondent

FROM

THE COURT OF APPEAL OF TRINIDAD
AND TOBAGO

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL, DELIVERED THE
23RD JULY 1990

Present at the hearing:-

LORD KEITH OF KINKEL
LORD TEMPLEMAN
LORD GRIFFITHS
LORD LOWRY
SIR ROBIN COOKE

[Delivered by Lord Lowry]

The appellant Bi-Flex Caribbean Limited ("the company"), which manufactures and sells ladies' foundation garments, was by virtue of section 3(c) of the Corporation Tax Act and sections 2(1) and 5 of the Unemployment Levy Act liable, as a company resident in Trinidad and Tobago, to corporation tax and unemployment levy on the profits of its trade. In 1977 the respondent Board of Inland Revenue ("the Board") undertook an audit of the company's tax affairs for the years 1971 to 1974 ("the relevant years") and informed the company that it could trace no tax returns by the company in respect of those years. The company stated that its records had been destroyed by fire in 1975 but furnished to the Board duplicate copies of the returns which it claimed to have made in respect of each of the relevant years. Their Lordships were told at the Bar that copies of the returns had been in the possession of Mr. Paul Roopsingh, since deceased, the company's financial director (who had an independent practice as an accountant). No other material relating to the relevant years was available.

The Board, being dissatisfied with the figures contained in the returns, which showed a trading loss of \$5,977, \$2,586, \$1,154 and \$2,793 respectively in the relevant years, proceeded to assess the company in

respect of its income for the relevant years in accordance with sub-section (2)(b) of section 39 of the Income Tax Ordinance. This section was applied by section 19 of the Corporation Tax Act and has since been re-enacted as section 83 of the Income Tax Act which, so far as material, provides as follows:-

- "83.(1) The Board shall proceed to assess every person chargeable with the tax as soon as may be after the day prescribed for delivering the returns.
- (2) Where a person has delivered a return, the Board may -
- (a) accept the return and make an assessment accordingly; or
- (b) refuse to accept the return and, to the best of its judgment, determine the amount of the chargeable income of the person and assess him accordingly.
- (3) Where a person has not delivered a return and the Board is of the opinion that such person is liable to pay tax, it may, according to the best of its judgment, determine the amount of the chargeable income of such person by reason of his refusal, failure or neglect to deliver a return.
- (4) Subject to section 89(2) and (3), if at any time within the year of income or within six years after the expiration thereof, the Board makes an assessment which results in a person being charged to tax for the year of income in respect of a total chargeable income in excess of the chargeable income disclosed in the return of income rendered by such person, the Board may (unless the person assessed proves to the Board's satisfaction that the omission or incorrectness of the return did not amount to fraud, covin, art or contrivance, or gross or wilful neglect) charge such person, in addition to the total tax otherwise charged in the assessment, further tax not exceeding the amount of tax charged in respect of the excess."

The Board charged the company further tax under sub-section (4) in addition to the tax which it charged under sub-section (2)(b), assessed the company to additional tax on the basis that there had been an understatement of rents received by the company and disallowed deductions claimed by the company in respect of mortgage interest and travel expenses. The company appealed to the Tax Appeal Board ("the Appeal Board") against all the assessments and disallowances.

The Appeal Board found no evidence of fraud, covin, art or contrivance or gross or wilful neglect on the part of the company and allowed the appeals with regard to the further tax charged under sub-section (4), but found in favour of the Board with regard to the rents received, mortgage interest and travel expenses. By a majority the Appeal Board found in favour of the company with regard to the assessments to corporation tax and unemployment levy under sub-section (2)(b) and returned the assessments back to the Board for reassessment on the basis that the company had correctly returned its income from sales for the relevant years. The Board appealed by case stated under section 9(1) of the Tax Appeal Board Act against the decision reached on the assessments of the company's income from sales in each of the relevant years and that decision became the only matter in issue before the Court of Appeal, since the company did not appeal further in regard to the rents, mortgage interest or travel expenses and the Board did not appeal the decision reached upon the assessments under sub-section (4). The Court of Appeal (Persaud, McMillan and Warner JJ.A.) allowed the Board's appeal and restored the sub-section (2)(b) assessments. It is from that decision that the company has now appealed.

The company's grounds of appeal were:-

- (1) That the Court of Appeal misdirected itself in finding that the assessments were made to the best of judgment as required by section 83(2)(b).
- (2) That the Court of Appeal erred in finding that there was no evidence upon which the Tax Appeal Board could come to the conclusion that the company had made a true return of its taxable income or profits from its business.

As to the first ground, their Lordships, like the Court of Appeal, start by considering the principles on which a best of judgment assessment should be made and should be reviewed by the Court. Section 83 is one of many similar statutory provisions which have been enacted in different Commonwealth jurisdictions permitting the Revenue in given circumstances to make a best of judgment assessment and the principles applicable thereto have been discussed in a number of cases, including *C.I.T. v. United and Central Provinces v. Badridas Ramrai Shop* (1937) LR. 64 Ind. App. 102, *Argosy Co. Ltd. v. Inland Revenue Commissioner* [1971] 1 W.L.R. 514 (two decisions of this Board), *N. Ltd. v. Commissioners of Taxes* (1962) 24 S.A.T.C. 655, a decision of the High Court of Nyasaland, and *Trautwein v. Federal Commissioner of Taxation* (1936) 56 C.L.R. 63, a decision of the High Court of Australia, the judgments in which were cited by the Court of Appeal. The corresponding provision in United Kingdom legislation is section 29(1)(b) of the Taxes Management Act 1970:-

"(1) Except as otherwise provided, all assessments to tax shall be made by an inspector, and -

...

(b) if it appears to the inspector that there are any profits in respect of which tax is chargeable and which have not been included in a return under Part II of this Act, or if the inspector is dissatisfied with any return under Part II of this Act, he may make an assessment to tax to the best of his judgment."

There appear to be no reported cases dealing with that provision, but Mr. Mathew, for the company, reminded their Lordships of the similar provision relating to value added tax, namely, section 31(1) of the Finance Act 1972 (now superseded by paragraph 4(1) of Schedule 7 to the Value Added Tax Act 1983) and referred to the helpful judgment of Woolf J. in *Van Boeckel v. Customs and Excise Commissioners* [1981] 2 All E.R. 505. He also cited *Gamini Bus Co. Ltd. v. C.I.T. Colombo* [1952] A.C. 571 (also decided by their Lordships' Board) in which the Commissioner had made a best of judgment assessment against the taxpayer by reference to the average operating costs of a number of other transport undertakings.

Persaud J.A. and Warner J.A. selected the same three passages to exemplify the principles as follows:-
N. Ltd. at page 658

"The onus is upon the appellant, by satisfactory evidence, to show that the assessment ought to be reduced or set aside, that is, the appellant has to attain the standard of proof in a civil suit to prove his case. When the evidence of the appellant and his books are satisfactory, which is an identical standard of proof, the burden of proof is shifted from the appellant to the Commissioner. The circumstances that the facts are peculiarly within the knowledge of one party is a relevant matter in considering the sufficiency of evidence to discharge a burden of proof. Obviously, the facts in relation to his income are facts peculiarly within the knowledge of the taxpayer or, in a company, of its agents. In the absence of some record in the mind or in the books of the taxpayer, it would more often than not be quite impossible to make a correct assessment. The assessment would necessarily be a guess to a more or less extent and almost certainly inaccurate in fact. There is every reason to assume that the legislature did not intend to confer upon a potential taxpayer the valuable privilege of disqualifying himself in that capacity by the simple and relatively unskilled method of losing either his memory or his books. The application of section 41 is not excluded as soon as it is shown

that an element of the assessment is a guess or that it is very probably wrong. It is prima facie right and remains right until the appellant shows it is wrong. The taxpayer must, as a general rule, show not only negatively that the assessment is wrong but also, positively what correction should be made to make it right or more nearly right."

Badridas (per Lord Russell of Killowen) at page 115:-

"The officer is to make an assessment to the best of his judgment against a person who is in default as regards supplying information. He must not act dishonestly or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee, and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that sense, too, the assessment must be to some extent arbitrary."

Argosy (per Lord Donovan) at page 516:-

"Once a reasonable opinion that liability exists is formed there must necessarily be guess-work at times as to the quantum of liability. A resident may be known to be living well above the standard which his declared income would support. The commissioner must make some estimate, or guess, at the amount by which the person has understated his income. Or reliable information may reach the commissioner that the books of account of some particular taxpayer have been falsified so as to reduce his tax. Again the commissioner may have to make some guess of the extent of the reduction. Such estimates or guesses may still be to the best of the commissioner's judgment - a phrase which their Lordships think simply means to the best of his judgment on the information available to him. The contrast is not between a guess and a more sophisticated estimate. It is between, on the one hand, an estimate or a guess honestly made on such materials as are available to the commissioner, and on the other hand some spurious estimate or guess in which all elements of judgment are missing."

Two of the points made by the judgment in *N. Ltd.* are, as Warner J.A. indicated, derived from the judgment of Latham C.J. in *Trautwein*, where he said at page 87:-

"In the absence of some record in the mind or in the books of the taxpayer, it would often be quite impossible to make a correct assessment. The assessment would necessarily be a guess to some extent, and almost certainly inaccurate in fact. There is every reason to assume that the legislature did not intend to confer upon a potential taxpayer the valuable privilege of disqualifying himself in that capacity by the simple and relatively unskilled method of losing either his memory or his books.

The application of sec. 39 is not, in my opinion, excluded as soon as it is shown that an element in the assessment is a guess and that it is therefore very probably wrong. It is prima facie right - and remains right until the appellant shows that it is wrong. If it were necessary to decide the point I would, as at present advised, be prepared to hold that the taxpayer must, at least as a general rule, go further and show, not only negatively that the assessment is wrong, but also positively what correction should be made in order to make it right or more nearly right. I say 'as a general rule' because, conceivably, there might be a case where it appeared that the assessment had been made upon no intelligible basis even as an approximation, and the court would then set aside the assessment and remit it to the commissioner for further consideration."

Relying on the statements of principle noted above, their Lordships would also endorse and adopt the observations of Woolf J. in the following passage from his judgment in *Van Boeckel* at page 511C:-

"The second contention which was made before the tribunal was that the commissioners made no real investigations into the manner in which the Hop Pole was run, either by interviewing a manager or by visiting the public house when it was open. In view of the taxpayer's state of health and the fact that the officers well knew that he played no active part in the actual running of the Hop Pole this was an omission so serious as went to the root of the whole assessment.

With regard to that second contention, the approach to the provisions of s 31 which I have indicated earlier in this judgment again, in my view, makes it clear that the criticisms of the commissioners were not justified. In fact, quite clearly on the material which was before the tribunal the commissioners had made substantial investigations in this case. As I have indicated, unless the situation is one where no material is before the commissioners on which they can reasonably base an assessment, the commissioners are not required to make investigations. If they do make investigations then they have got to take into

account the material disclosed by those investigations. Obviously, as a matter of good administrative practice, it is desirable that the commissioners should make all reasonable investigations before making an assessment. If they do that it will avoid, in many cases, the necessity of appeals to the tribunal. However to try and say that in a particular case a particular form of investigation should have been carried out is a contention which, in my view, as a matter of law, bearing in mind the wording of s 31(1), is difficult to establish."

Against this background their Lordships have considered how the best of judgment assessments were made.

The figures in the company's returns showed:

	(1) <u>Gross Sales</u>	(2) <u>Discount</u>	(3) <u>Net Sales</u>	(4) <u>Cost of Sales</u>
1971	\$543,545.94	\$68,388.55	\$475,157.39	\$411,083.05
1972	564,371.31	57,485.29	506,886.02	422,597.65
1973	494,536.24	48,838.09	445,698.15	374,391.52
1974	466,638.87	52,595.35	414,043.52	350,856.29

This enabled Mr. Barry Chang, the Board's tax auditor, to make the following calculation:

	<u>Gross Profit on Sales</u>	<u>Gross profit on cost of sales</u>
1971	13.48%	15.59%
1972	16.63%	19.95%
1973	16.00%	19.05%
1974	15.26%	18.01%

In this table, to take 1971 as an example, "gross profit on sales" is the difference between the proceeds of sales (after discount) \$475,157.39 and the cost of sales \$411,083.05 (that is, \$64,074.34) expressed as a percentage (that is, 13.48%) of the sales (column (3) above), whereas "gross profit on cost of sales" is the same difference (\$64,074.34) expressed as a percentage (that is, 15.59%) of the cost of sales (column (4) above). The same calculation yields similar results for the other years.

Mr. Chang considered that the gross profit margins indicated by the company's returns were understated and

refused to accept the returns. He prepared analyses of information relating to other garment manufacturers in Trinidad with a view to ascertaining the average gross profit on sales for the relevant years and produced this table:

Year	1971	1972	1973	1974
Percentage gross profit on sales	26.77%	27%	28%	26.4%
Number of returns examined	10	12	20	22

Then, on the basis of these averages, he rounded down the percentages to 26, 27, 28 and 26 and, in the absence of documentary evidence supporting the figures in the company's returns, substituted the average figures relating to gross profit on sales for those indicated by the returns. To take 1971 again as an example, the deduction of 26% from \$475,157.39 yields by inference a new cost of sales figure of \$351,616.46, which is less than the cost of sales figure in the return by \$59,466.59. The same calculation for 1972, 1973 and 1974, using the percentages of 27, 28 and 26 respectively, results in differences from the company cost of sales figure of \$52,570.86, \$53,488.86 and \$44,464.09. If one accepts the average gross profit of other garment manufacturers for the relevant years as a basis of calculation and assumes that all the company's other figures are correct, then the company's gross profits (and hence its assessed net profits) for each of the relevant years should be increased by \$59,466, \$52,570, \$53,488 and \$44,464. This is what Mr. Chang did when making his assessments.

Before the Appeal Board the company attacked the assessments on the grounds that they were arbitrary, capricious and unreasonable and that they were made without proper investigation and, while accepting that the Revenue need not have given any basis for its assessments, contended that, once having done so, it must incur the risk of the basis being undermined. In particular, the company criticised the method used by Mr. Chang to arrive at an assessment figure. The majority of the Appeal Board accepted this contention, saying:-

"... we consider that on the evidence no reliance can be placed on Chang's analyses as being a basis for determining the appellant's income. We have noted the vast variations in figures used to arrive at average percentages of gross profit on sales and have not been able to undertake a comparison of the figures of any known manufacturer of garments with those of the appellant. Even as a statistical exercise, Chang's analyses cannot stand up to the test of having been prepared on a basis comparable with that followed by the appellant. It is not

known whether there was any similarity between the operations of the appellant with any of those whose figures have gone into the make up of his averages."

The Chairman, however, dissented. He was of the opinion that, in the absence of the books and records, the method used by Mr. Chang was proper and the best he could have adopted. Referring to the passage already cited from the judgment delivered by Lord Russell of Killowen in *Badridas*, he continued:-

"On appeal, the onus of proving that the assessment was excessive or wrong was on the appellant. To discharge that burden it must show, not negatively that the assessment was wrong, but also positively what correction should be made to make it right or more nearly right. That would obviously require the appellant to show, not only that its sales figures were correct, but also that its cost of sales figures were correct in order to establish its true profits. However, no evidence had been adduced in regard to its cost of sales figures. It should also be noted that Hernandez had stated in cross-examination that he was not in a position to verify figures for cash and other sales in exhibit P.H.3. The figures attributed thereto represent the difference between the aggregate of sales to D & M and Ozzie Khan and the total sales reflected in the financial statements of the appellant.

Accordingly, the appellant has failed to discharge the burden of showing that the increases in the gross profits were wrong."

As already stated, the judgments in the Court of Appeal agreed with that of the Chairman. The Appeal Board, accepting the company's arguments, had noted the wide variations of gross profit and turnover indicated by the accounts of the other undertakings which Mr. Chang had collated in order to strike an average for comparison with the company's figures. When cross-examined he admitted that he had not been able to distinguish between firms which did their own selling and those which had employed agents, nor had he known which firms had offered credit or how discounts had affected the company's figures compared with those of other firms. The members of the Court of Appeal considered that to rely on such a microscopic examination, as Warner J.A. put it, of Mr. Chang's figures conflicted with the principles on which a best of judgment assessment should be approached and pointed out that Mr. Chang had, in the absence of any books from the company, used an acceptable accounting method to make the best assessment he could on the sparse material available. There must necessarily be a large element of guess-work in an assessment made in such circumstances and their Lordships on this point are in complete agreement with the Court of Appeal. So

far as the company's first ground of appeal is concerned, they are of the opinion that the best of judgment assessment was a proper one in the circumstances of this case.

The element of guess-work and the almost unavoidable inaccuracy in a properly made best of judgment assessment, as the cases have established, do not serve to displace the validity of the assessments, which are *prima facie* right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessments right or more nearly right. It is also relevant, when considering the sufficiency of evidence to displace an assessment, to remember that the facts are peculiarly within the knowledge of the taxpayer. Against that background their Lordships pass to the second ground of appeal, that the Court of Appeal erred in finding that there was no evidence on which the Appeal Board could conclude that the company had made a true return of its income.

As the wording of that ground suggests, the Appeal Board had found "on the balance of probabilities that the [company] had correctly returned its income from sales in the relevant years" and had reduced the company's chargeable income for those years by the amounts of \$59,466, \$52,571, \$53,488 and \$44,464 which Mr. Chang had added into its returns. Whether there is evidence to support a finding is, of course, a question of law and, as such, suitable for decision on a case stated. The crucial material for the decision of such a question is the evidence adduced and this was set out in the Appeal Board's judgment which was annexed to and formed part of the case stated (see paragraph 8).

Five witnesses were called on behalf of the company. Alim Khan Juman had been the managing director since 1959 when the company was incorporated. He gave evidence of sales made and discounts allowed by the company and deposed to various difficulties experienced by the company in the course of its business. Richard Ian Gill had once worked for D & M, one of the company's main customers, and he gave evidence concerning the company's sales to D & M in the relevant years and also referred to discounts, identifying figures for 1971 and deposing that the discounts were similar in the other years for which he had no records. Gary Cedeno had been a director of Trade Promotions Ltd., which from August 1974 to June 1978 had been the company's selling agent for the Port-of-Spain and San Fernando areas. He testified that the net sum paid to the company for the period August to December 1974, after deducting 10% commission, was \$53,109.77. Ozzie Khan was a main customer of the company during the relevant years. He purchased mostly seconds and obtained various

commissions and discounts for which he bargained from time to time. He put in evidence delivery notes for the relevant years which show quantities supplied, prices, discounts and commissions.

Peter Hernandez was an accountant who testified that he had worked with Paul Roopsingh, the company's financial director, since deceased, in reconciling the sales figures of the company by analysing invoices. He produced a number of tables and summaries of figures, all of which related to sales, and also stated that he had used the gross sales figures to arrive at a cost of sales comparison, having obtained the cost of sales from the company's tax returns and applied thereto a 33% mark up which yielded a figure that approximated very closely to the gross sales figure for each of the relevant years. In cross-examination Hernandez stated that he was not in a position to verify figures for cash and other sales. The figures attributed thereto represented the difference between the aggregate of sales to D & M and Ozzie Khan and the total sales reflected in the financial statements of the company. He pointed out that he had not examined the books of the company and that he could not verify the sales figures of \$475,157.39 for 1971 or say how discounts had been reflected in the accounts. There was, accordingly, no evidence from any witness as to the cost of sales and no evidence (which might have at least gone some way to fortify the cost of sales figures in the returns) that a 33% mark-up was customary in the trade.

The Appeal Board's judgment records that Mr. Procope S.C., the leading counsel for the company, accepted that the burden of proof was on the appellant and that he asked the court to find that, in the absence of books and records, the company had produced the best evidence available and had thus satisfied this burden. His junior, Mr. Shivarattan, submitted that there had been no burden of proof on the company in regard to the expenses incurred in arriving at gross profit as that had never been in issue in the documents filed with the court or at the trial. While accepting the law as laid down in *C.I.T. v. Badridas*, which had been cited by Mrs. Robinson-Walters for the Board, and also conceding that Mr. Chang had adopted the best means available to him, he contended that *Badridas* was not an authority for holding that, if no fault was found with the approach taken by a revenue officer, the court must accept the assessment made when a taxpayer has appealed against it.

The judgment (described on the following page as a majority decision) continued:-

"We now proceed to assess the evidence as it relates to the additional income attributed to the appellant on the basis of Chang's analyses. In so doing, we bear in mind that the evidence was that the books and records had been destroyed in a fire and,

accordingly, the appellant had been obliged to obtain the best evidence it could in the absence of those basic records. It is therefore vital to the case that we should be satisfied on that score in making a finding on the balance of probabilities.

In this regard, evidence was forthcoming to corroborate the major portion of the appellant's sales - those to D & M and Ozzie Khan. These were accepted by Chang, who also accepted other sales as having been normal. The numerous exhibits on which we have commented earlier in the judgment and the evidence establish that the appellant's method of operation had occasioned considerable sales at sizeable discounts and commissions. The appellant did not adhere to a rigid mark-up, as it had been faced with a situation that it had had to take what the market would bear. The evidence of Ozzie Khan, which was not controverted, supports such a finding.

We consider that there has been a vast amount of evidence to support a conclusion that the sales receipts were correctly returned."

After referring to Mr. Chang's evidence in the passage which their Lordships have already quoted, the majority judgment went on:-

"Mrs. Robinson-Walters had submitted that there has been a lack of evidence regarding the expenditure items which would affect the figure for gross profit on sales or cost of sales. In this regard, we agree with the submission made by Mr. Shivarattan in his reply that there was no burden of proof on the appellant in respect of that matter, as it had not been an issue in the determinations leading up to the appeals or at the hearing.

For the foregoing reasons, we find on the balance of probabilities that the appellant had correctly returned its income from sales for the relevant years."

The Chairman's dissent from this conclusion has been noted above and the judges in the Court of Appeal were united in the view that the company, not having proved the cost of sales, had consequently failed to prove its gross profits and the correctness of its returns. Their observations can conveniently be subsumed in their Lordships' conclusions on this part of the case.

Mr. Procope's concession as to the burden of proof was of course correct, as the Appeal Board seem to have accepted. Where, with respect, the majority went astray was in accepting Mr. Shivarattan's submission that there was (in fact) no burden of proof on the company in respect of the cost of sales. If that item was "not in issue", it was simply because the company

never attempted to prove it by evidence, as Mrs. Robinson-Walters's submission makes abundantly clear. The majority made no legal error as to the burden of proof, but they made a crucial mistake (which in law would be enough to invalidate their conclusion) in assuming that the burden of proof in relation to the cost of sales did not need to be discharged.

But in any event it is plain that the submission of Mrs. Robinson-Walters referred to above was right. The correctness of the cost of sales in the returns was the very thing which was not accepted by Mr. Chang and was therefore put in issue by his assessments. Either the cost of sales figure in the return or an alternative cost of sales figure had to be proved before the best of judgment assessment could be displaced, and the company completely failed to prove any cost of sales figures either directly or by reasonable inference. The Appeal Board accordingly erred in law in the following respects:

- (1) By condemning the best of judgment assessments contrary to the established principles;
- (2) By wrongly holding in the circumstances that no burden of proof lay on the company in regard to the cost of sales;
- (3) By finding, in the absence of evidence, that the company had proved the correctness of its returns and thereby substituting assessments based on those returns for the best of judgment assessments.

Their Lordships accordingly dismiss the appeal with costs.