

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

# Deemed acceptance of shortfall penalties and liability to evasion shortfall penalty

Decision date | Rā o te Whakatau: 6 May 2022

Issue date | Rā Tuku: 12 October 2022

TDS 22/17

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## Subjects | Kaupapa

Deemed acceptance of shortfall penalties; Liability to evasion shortfall penalty

## Abbreviations | Whakapotonga

The abbreviations used in this document include:

<b>CCS</b>	Customer & Compliance Services, Inland Revenue
<b>Commissioner</b>	Commissioner of Inland Revenue
<b>TSOP</b>	Statement of Position issued by the Taxpayer
<b>CSOP</b>	Statement of Position issued by the Commissioner
<b>TNOPA</b>	Notice of Proposed Adjustment issued by the Taxpayer
<b>AAA</b>	Agreement to Amend Assessment
<b>TCO</b>	Tax Counsel Office, Inland Revenue

## Taxation laws | Ture tāke

All legislative references are to the Tax Administration Act 1994 (**TAA**) unless otherwise stated.

## Facts | Meka

1. In September 2020, Customer and Compliance Services, Inland Revenue (**CCS**) issued a series of default income tax and GST assessments to the self-employed Taxpayer and imposed associated evasion shortfall penalties. The shortfall penalties were reduced by 50% for previous behaviour under s 141FB. The default income tax assessments related to the 2007, 2008, 2015, and 2018 income years. The GST assessments covered the 6-month GST periods occurring during the 2014, 2015, 2017 and 2018 income years.
2. CCS also issued an Agreement to Amend Assessment (**AAA**) form to the Taxpayer in which they proposed to adjust the Taxpayer's tax assessments for the 2014 and 2017

income years and impose an evasion shortfall penalty in each year, reduced by 50% under s 141FB for previous behaviour. In December 2021 the Taxpayer signed the AAA form and returned it to CCS.

3. The Taxpayer issued a Notice of Proposed Adjustment in January 2021 (**TNOPA**), and CCS issued a Notice of Response in March 2021. During the conference stage of the dispute the Taxpayer agreed that they would no longer dispute the core tax that was in issue, but they would continue to dispute the shortfall penalties. The Taxpayer issued a Statement of Position in January 2022 (**TSOP**), and CCS issued a Statement of Position in March 2022 (**CSOP**). In the CSOP, CCS argued that the Taxpayer was deemed to have accepted the default assessment shortfall penalties and, if they were wrong in this respect, the Taxpayer's liability for the penalties was proved by the available evidence. The Taxpayer disputed these arguments.

## Issues | Take

4. To determine whether the Taxpayer was liable to pay the evasion shortfall penalties CCS imposed in relation to the default assessments, the Tax Counsel Office, Inland Revenue (TCO) considered the following issues:
  - Was the Taxpayer deemed to have accepted the shortfall penalties?
  - Was the Taxpayer liable under s 141E of the TAA for evasion shortfall penalties? This involved consideration of the following sub-issues:
    - Did the Taxpayer take tax positions in respect of which shortfall penalties could be imposed?
    - The onus and standard of proof.

## Decisions | Whakatau

5. TCO decided that:
  - The Taxpayer was prohibited from challenging the default assessment shortfall penalties in a hearing authority. Therefore, in practical effect, the Taxpayer is deemed to have accepted the default assessment shortfall penalties.
  - The Taxpayer took tax positions in respect of which shortfall penalties could be imposed and CCS met the onus of proving to the required standard of the balance of probabilities that the Taxpayer is liable for the default assessment shortfall penalties under s 141E.

- If the Taxpayer had disputed the AAA form penalties in a NOPA and raised the same arguments that they did in the TSOP, the arguments would not have succeeded.

## Reasons for decisions | Pūnga o ngā whakatau

### Issue 1 | Take tuatahi: Deemed Acceptance

6. Under s 138B(3) a disputant who does not propose an adjustment to an assessment within the response period for the assessment is prohibited from challenging the assessment. A taxpayer disputes an assessment by issuing a NOPA as provided in s 89D.
7. Section 89F requires a NOPA to be in the prescribed form (IR 770) and it must contain the information specified in ss 89F(3)(a) and (b). In summary a NOPA must:
  - identify the taxpayer's proposed adjustments;
  - state the facts and the law in sufficient detail to inform the Commissioner of the grounds for the taxpayer's proposed adjustments;
  - state how the law applies to the facts, and
  - include copies of significantly relevant documents.
8. In this dispute, the Taxpayer's NOPA did not meet the requirements of ss 89F(3)(a) and (b) because it did not mention the shortfall penalties. While it was arguable that a letter issued by the Taxpayer's agent on 27 January 2021 might meet the requirements of those sections, this ultimately did not assist the Taxpayer. This was because the letter is not in the prescribed form for a NOPA, and it was provided outside of the 4-month response period during which the Taxpayer was required to propose adjustments to the shortfall penalties. This meant that the Taxpayer was prohibited from challenging the assessments in a hearing authority. Therefore, in practical effect, the Taxpayer is deemed to have accepted the shortfall penalties.

### Issue 2 | Take tuarua: Liability for evasion shortfall penalty

9. Although it was considered that there was non-compliance with s 138B(3), the merits of the Taxpayer's claim that they were not liable for shortfall penalties was considered by TCO. This approach was taken in the event that the Taxpayer chooses to file a challenge under s 138B and the TRA or a Court holds that there has been compliance

with the statutory requirements and, as such, the challenge may be made and there is no effective deemed acceptance of the shortfall penalties.

10. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:<sup>1</sup>
- The taxpayer has taken a tax position. A tax position is a position or approach to tax under a tax law as taken in or in respect of a tax return, income statement, or due date.<sup>2</sup>
  - Taking the tax position has resulted in a tax shortfall. A tax shortfall is the difference between the tax effects of the correct tax position and the tax effects of the taxpayer's tax position.<sup>3</sup>
  - The taxpayer has evaded the assessment or payment of tax. Evasion requires an intention to avoid the assessment or payment of tax known to be chargeable:
    - The element of intention will be satisfied if the taxpayer knows that their action or omission will breach a tax obligation. There must be some blameworthy act or omission on the part of the taxpayer. The required intent for evasion can be inferred from surrounding circumstances and conduct.<sup>4</sup>
    - Recklessness can amount to evasion and involves the conscious taking of risk. Recklessness will be proven where:<sup>5</sup>
      - Facts actually known to the taxpayer were such that they must have put the taxpayer on inquiry that a tax obligation may not be met.
      - The taxpayer made a conscious decision to ignore the facts without making further inquiry.
11. The penalty payable for evasion or similar act is 150% of the resulting tax shortfall.

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<sup>1</sup> The shortfall penalty for evasion or a similar act is considered in the Interpretation Statement: Shortfall Penalty—Evasion as published in *Tax Information Bulletin* Vol 18, No 11 (December 2006).

<sup>2</sup> Definitions of "tax position" and "taxpayer's tax position" in s 3 of the TAA.

<sup>3</sup> Definition of "tax shortfall" in s 3 of the TAA.

<sup>4</sup> *Taylor v Attorney-General* [1963] NZLR 261 (SC); *Lloyds Bank Ltd v Marcan* [1973] 2 All ER 359; *Case H90* (1986) 8 NZTC 619; *Case N47* (1991) 13 NZTC 3,388; *R v G* [2013] NZCA 146.

<sup>5</sup> *Case H90* (1986) 8 NZTC 619; *R v Harney* [1987] 2 NZLR 576 (CA); *Case P29* (1992) 14 NZTC 4,213; *Case S100* (1996) 17 NZTC 7,626; *R v G* [2013] NZCA 146.

12. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E.<sup>6</sup> This is different from the other shortfall penalties where the onus of proof is on the taxpayer. The standard of proof is the balance of probabilities.<sup>7</sup>

## Tax position and tax shortfalls

13. The Taxpayer was required to file GST and income tax returns for the periods in respect of which shortfall penalties have been imposed. The Taxpayer's failure to meet this requirement means that they took tax positions regarding the provision or non-provision of the returns. Further, the Taxpayer's failure to pay any of the tax owing in each period means that they took tax positions regarding their liability for tax in those periods. As the Taxpayer's tax positions were "nil" tax positions, they resulted in tax shortfalls. The amount of the tax shortfall in each period is the amount of tax CCS assessed as payable for the period when they made the default assessment for the period.

## Knowledge and intentions

14. The Taxpayer argued that their non-compliance was attributable to unaddressed mental health problems. A person's health may be a relevant consideration when determining if the person is liable for shortfall penalties.<sup>8</sup> However, TCO concluded the Taxpayer did not provide medical evidence that showed their health issues rendered them incapable of exercising the sort of judgment that would have avoided the tax shortfalls that occurred in this case. Further, the Taxpayer's non-compliance occurred over a significant number of years that spanned beyond the periods in dispute, and during the years of non-compliance, the Taxpayer was able to earn significant amounts of income. These circumstances indicated that the Taxpayer was capable of exercising better judgement when dealing with their tax obligations including, obtaining and retaining the help of a tax professional.
15. The available evidence showed that the Taxpayer knew they were required to file income tax and GST returns by their due dates and that they knew they were required to include the income from their self-employed activities in the returns. The Taxpayer's knowledge was demonstrated by the fact they filed 3 GST returns and attempted to file one income tax return during the early periods of their self-employed activities. The

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<sup>6</sup> Section 149A(2) of the TAA.

<sup>7</sup> Section 149A(1) of the TAA.

<sup>8</sup> *Case Y21 (2008) 23 NZTC 13,227.*

Taxpayer's knowledge was also demonstrated by the fact they discussed their outstanding tax obligations with two tax accountants and had numerous contacts with Inland Revenue staff in which their tax obligations were also discussed. Further, in July 2016 the Taxpayer filed an income tax return for the 2016 income year.

16. The available evidence also supported an inference that the Taxpayer evaded tax. The inference arose because although the Taxpayer was aware of their filing obligations, they chose not to meet them and as a consequence of this, tax that should have been assessed was not assessed. In the alternative, at a minimum the available evidence supports a conclusion that the Taxpayer intended to evade tax in the sense that they acted recklessly. The Taxpayer's knowledge that they were required to prepare and file income tax and GST returns which included their income would have put them on notice that preparing the returns might show they had tax liabilities. This circumstance supports an inference that the Taxpayer did not file their returns because they did not want to pay the tax that they knew was owing or suspected was owing in each period and, as such, they acted recklessly.
17. A conclusion that the taxpayer intended to evade tax is also supported by the significant extent of the Taxpayer's non-compliance, their dealings with Inland Revenue staff, their dealings with the tax accountants, and their decision to file an income tax return for the 2016 income year in which they claimed a tax refund.

### **Shortfall penalties in the 2014 and 2017 income years**

18. If the Taxpayer wished to dispute the shortfall penalties in the AAA form, the appropriate course would have been for the Taxpayer to issue a NOPA proposing adjustments to the penalties within the applicable response period. The Taxpayer did not do this. It was observed that even if the Taxpayer had disputed the penalties and in doing so raised the same arguments that they did in the TSOP against the default assessment shortfall penalties, the same result would have applied. This was because the tax shortfalls that relate to the penalties in the AAA form were in all material respects the same as the tax shortfalls that related to the default assessment shortfall penalties. As such, the matters that supported a conclusion the Taxpayer was liable to pay the default assessment shortfall penalties also supported a conclusion that the Taxpayer was liable to pay the AAA form shortfall penalties.