Inland Revenue
Te Tari Taake

CASE SUMMARY

Lack of complete financial records secures TCRA win for the Commissioner in major income suppression case

Decision date: 13 December 2024

CSUM 25/09

CASE:

Disputant 1, Disputant 2, Disputant 3, Disputant 4, Disputant 5, Disputant 6 v The Commissioner of Inland Revenue [2024] NZTRA 004

LEGISLATIVE REFERENCES

Tax Administration Act 1994, ss 15B, 22, 89AB(5), 89C(eb), 89D(1)(b), 89N, 89P, 108, 114, 138E(1)(e)(iv), 141(1), 141E(1), 143B(1), 148(1) and 149A(2)

Evidence Act 2006, section 92

Lawyers and Conveyances Act (Lawyers: Conduct and Client Care) Rules 2008, rule 13.8

CASE LAW REFERENCES

Buckley & Young Ltd v Commissioner of Inland Revenue [1978] 2 NZLR 485 (CA)

Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue [2008] NZSC 115, [2009] 2 NZLR 289 (SC)

R v Soutar [2009] NZCA 227 (CA)

R v Dewar [2008] NZCA (CA)

Jones v Dunkel (1959) 101 CLR 298 (High Court of Australia)

Edwards v Commissioner of Inland Revenue [2016] NZHC 1795 (HC)

Great North Motor Co Ltd (in receivership) v Commissioner of Inland Revenue [2017] NZCA 328 (CA)

Babington v Commissioner of Inland Revenue [1957] NZLR 861 (New Plymouth SC)

Cross & Goulding v Commissioner of Inland Revenue [1987] 1 NZLR 498 (1987) 9 NZTC 6,101, (CA)

Tannadyce Investments Ltd v Commissioner of Inland Revenue [2011] NZSC 158 [2012] 2 NZLR 153 (SC)

Case Y14 (2008) 23 NZTC 13,137 (TRA)

LEGAL TERMS

Suppressed income, income tax, underreported income, contemporaneous documentation, unexplained sources of income, unexplained deposits

Summary

The Commissioner of Inland Revenue (**CIR**) assessed the 6 Disputants (four brothers and their two brothers-in-law) on numerous deposits into bank accounts they controlled. The Disputants were involved, in different ways, with two companies involved in exporting vehicle parts from New Zealand to the United Arab Emirates (**UAE**). A related company received the vehicle parts in the UAE and sold them there. Funds were remitted to the Disputants from the UAE. The CIR considered these deposits were taxable and the Disputants had underreported their income for tax purposes.

The Disputants contended that the funds came from private and non-taxable sales of land and timber and related loan instruments in Afghanistan and Pakistan. They claimed the funds were correctly remitted to private bank accounts and were correctly not returned as income by two New Zealand based companies and themselves.

The Taxation and Charities Review Authority (**TCRA**) dismissed the Disputants challenges to the CIR's assessments and upheld the assessments without alteration. The TCRA concluded

that the best measure of the Disputant's probable income were the deposits into the various bank accounts they each controlled. The discrepancy between the amounts they had reported and what was deposited into the accounts were both so great that it was not plausible that the Disputants were unaware of the true source of funds. As such, any material lack of knowledge is implausible.

The TCRA was satisfied that it was probable that each of the Disputants were aware of their true income, knew that it was not all reported to the CIR and intended to evade the assessment or payment of tax by filing returns that were false and misleading. The assessments by the CIR stand.

Impact

The judgment upheld well established principles and made distinct rulings in relation to ss 89C, 89M and 108 of the Tax Administration Act 1994 (**TAA**) and Inland Revenue's Disputes Review Unit (**DRU**) as follows:

- A challenge proceeding is not a judicial review, and the authorities give no encouragement to judicial review processes as a preliminary or parallel process with a challenge proceeding.
- Section 89C(eb) is not grounds for, or part of, a challenge proceeding.
- There is nothing in s 89M or related provisions in the TAA that requires an independent reviewer.
- It is apparent that from the terms of s 89M(4), that it is not necessary to provide evidential material with a SOP; it is sufficient to outline the facts and evidence.
- The first limb of the time bar exceptions is s 108(2)(a), based on a return being fraudulent or misleading. The second limb is s 108(2)(b), based on failing to mention income of a particular nature or source. It is important to recognise that the second limb does not require the return to be fraudulent or misleading. It is enough that the return omitted the income of that nature or source.
- The TAA does not establish any procedural step in a dispute that the DRU is required or directed to undertake. The TAA does not refer to the DRU by name or identity. The published guidelines relating to the administration and decision-making in disputes do not and cannot override the provisions in the TAA or other tax legislation. The TCRA has no jurisdiction to review the CIR's practice statements, only the effect of legislation.

Facts

This is an income suppression case. Between 1 April 2006 and 31 March 2018, the CIR considered identified 237 disputed deposits were taxable and the Disputants had, through the filing of falsified income tax returns, intentionally suppressed their income. The Disputants returned minimal income and claimed working for family tax credits (**WfFTC**).

The CIR issued amended assessments for the years in dispute to include, as income, the disputed deposits. The Disputants were also paid WfFTC for the children in their care and because of the amendments, the CIR issued amended assessments to include the amounts of WfFTC each of the six Disputants were required to repay.

The primary determination the TCRA had to make was whether the Disputants had proved that all the disputed funds were from the sale of family assets or otherwise were non-taxable; and, if not, whether part of the funds were not subject to tax.

The Disputants contended that the funds came from private and non-taxable sales of land and timber and related loan instruments in Afghanistan and Pakistan (disputed transactions) – transactions which were private capital sales and not taxable in New Zealand. The CIR considered the explanations as to how the money from the transactions were remitted from Afghanistan a false narrative constructed for this case and concluded that the disputed funds were likely derived from the Disputants' offshore business activity.

In addition to the central issue, the TCRA was also required to determine five ancillary issues: issuing assessments without the CIR issuing a **NOPA** (Notice of Proposed Adjustment), tax evasion shortfall penalties and the abuse of process, the validity of the CIR's **SOP** (Statement of Position) and the failure to refer the SOPs to the DRU. These are discussed below.

Decision

The TCRA in summary concluded

The TCRA concluded that the evidence does not establish on the balance of probabilities, in relation to the income tax assessments and WfFTC, that any of the assessments were wrong. Furthermore, that for any of the assessments, the TCRA could not find with reasonable clarity that some lesser amount of taxable income was a more accurate amount to assess for tax.

The TCRA held that the explanations provided by the Disputants to establish their propositions about their taxable income were false, and the best available measure of taxable income was the receipts the CIR had assessed.

Ancillary issues:

Assessment without the CIR issuing a NOPA – s 89C(eb)

The TCRA was tasked with determining whether the disputed assessments were invalid on the grounds that the CIR failed to issue a NOPA before issuing assessments.

The material exception relied on by the CIR is s 89C(eb) that applies if the CIR "has reasonable grounds to believe that the taxpayer has been involved in fraudulent activity". The CIR said s 89D(1)(b) provides that the remedy for a breach of s 89C is the taxpayer may issue a NOPA and that s 138E(1)(e)(iv) excludes s 89C from challenges. The Disputants said the CIR incorrectly relied on section 89C(eb), which is not able to be cured by s 114. Section 114 provides that an assessment made by the CIR is not invalidated through failure to comply with a provision of the tax legislation.

The TCRA was satisfied that it is sensible to recognise the exception in s 89C(eb) applied and the CIR was not required to issue a NOPA before issuing the assessment. Due to the shortfall penalties assessments, the issue has essentially been determined and the TCRA concluded that all 6 Disputants had intended to evade tax which is fraudulent.

Independent reviewer

The Disputants argued that the CIR's review of their SOPs was inadequate as the case officer could not undertake the review which required "independent consideration". They alleged that the team leader of the investigator working on the investigation lacked sufficient independence and did not have enough time (three days) for an adequate review.

The TCRA held:

> There is nothing in s 89M or related provisions in the TAA that requires an independent reviewer. Indeed, it could raise questions of unauthorised delegation. The structure of the TAA is that assessments, NOPAs, SOPs and other similar processes with legal significance are issued by the CIR or an authorised delegate. There is no justification in the legislation for challenging the appropriateness of the person leading the team of investigators making decisions regarding the issue of SOPs in this matter. On the contrary, it would appear to be an unexceptional and appropriate approach. There has been no suggestion that the prescribed form was not used, or that the issuer of the SOPs lacked delegated authority.

Time bar constraints

Section 108(1) enacts the time bar, which is relevantly four years after the end of a tax year in which the taxpayer provides a tax return, and an assessment has been made. An exception is contained in s 108(2), which the CIR relied on. The first limb of the exceptions is s 108(2)(a), based on a return being fraudulent or misleading. The second limb is s 108(2)(b), based on failing to mention income of a particular nature or source. It is important to recognise that the

second limb does not require the return to be fraudulent or misleading. It is enough that the return omitted the income of that nature or source.

The TCRA concluded that for each Disputant of which the time bar issue was relevant, each of the relevant returns was false and misleading and they did not mention income from Company 3 (or other material sources). The TCRA held that it necessarily follows that on all the evidence, it is satisfied that the exception to the time bar in s 108(2)(a) applies, as does the exception in s 108(2)(b). Therefore, none of the assessments against Disputant 1 through to Disputant 6 were subject to the time bar.

Tax evasion shortfall penalties – Abuse of process

As the criminal proceedings brought against the Disputants were stayed, the Disputants with little specificity said the assessments were an abuse of process and lacked validity. The Disputants contended the assessments were demonstratively unfair and the application of s 89C(eb) by immediate assessments is obviously flawed. They argued that crippling late payment and interest charges could not be mitigated, when they resulted from the assessments made without the full tax dispute process. They said it was necessary to follow the tax dispute process until the conference stage to avoid unfairness and the CIR chose to delay the tax dispute process until the prosecution of the Disputants was stayed.

The TCRA was tasked with determining whether that was correct, and if so, the consequences.

For all Disputants, the TCRA held that there was no element of invalidity or abuse that could be regarded as vitiating its conclusions regarding the assessments made and it appears this ground is an invitation to change the effects of legislated processes that are outside the TCRA's jurisdiction. The TCRA concluded that that cannot be a justification for failing to determine whether the assessments are correct, being the issue that is within the TCRA's jurisdiction.

The TCRA noted that the Disputants appeared to complain that the "Commissioner delayed the tax disputes process until after his prosecution collapsed". The TCRA held that the prosecutions were stayed because the tax disputes process had advanced sufficiently to be inconsistent with the right to silence that applied to the defendants in a prosecution.

Completing the SOPs in time

The Disputants say the CIR's SOPs did not issue in time. The Disputants issued their SOPs on 21 or 22 November 2019. That triggered a two month response time under s 89AB(5), ending on 21 January 2020. The Commissioner issued SOPs on 17 January 2020 with paper copies delivered on 17 January 2020. Accordingly, those processes were within the mandated response period. However, evidence the CIR relied on was not provided to the Disputants until after 23 January 2020.

The TCRA held that it was apparent that under s 89M(4), it is not necessary to provide evidential material with a SOP; it is sufficient to outline the facts and evidence. The Disputants did not deny the SOPs achieved that, and the TCRA was satisfied that they do. Accordingly, there was no basis to identify any lack of validity of the SOPs.

SOP's and the Disputes Review Unit

The Disputants said the assessments they challenge are invalid because the truncated disputes process by the CIR meant that the SOPs were not referred to the DRU in Inland Revenue before the assessments were made and the DRU wasn't able to consider the issues before the assessments were issued. They argued that consideration of a taxpayer's SOP, where the dispute will not be considered by the DRU, cannot be satisfactorily completed by a case officer simply issuing an SOP; a suitably independent case officer should undertake a review with the aim of reproducing the independence of the DRU.

The TCRA noted that:

a) The DRU is part of Inland Revenue.
b) The DRU is not a statutory body, its officers are part of the Public Service, and operate under delegations like any structure created as part of Inland Revenue.
c) Accordingly, as the DRU is intended to be independent of the investigators and other decision-makers within Inland Revenue, it is not separate from Inland Revenue or able to act in any truly independent way, its decisions are necessarily the decisions of the CIR under delegation.
d) The TAA does not establish any procedural step in a dispute that the DRU is required or directed to undertake. The TAA does not refer to the DRU by name or identity.

The TCRA held that the published guidelines relating to the administration and decision-making in disputes do not and cannot override the provisions in the TAA or other tax legislation. The TCRA has no jurisdiction to review the CIR's practice statements only the effect of legislation. The CIR's evidence and the relevant documents show that the team leader approved a request that none of the disputes in these proceedings be referred to the DRU. To the extent the TCRA has any jurisdiction in relation to that decision and its consequences, it turns on whether the subsequent processes were lawful. The TCRA held:

> The Disputants had not identified any element of invalidity in the statutory process under s 89P. I have not identified any element of the statutory process that was not met when reviewing the oral evidence and documents. Accordingly, I find no merit in this aspect of the Disputants' claims the assessments are invalid.

About this document

These are brief case summaries, prepared by Inland Revenue, of decisions made by the Taxation and Charities Review Authority, the District Court, the High Court, the Court of Appeal or the Supreme Court in matters involving the Revenue Acts. For Taxation and Charities Review Authority matters, names have been anonymized. The findings of the court described in a case summary will no longer represent current law where the matter has been successfully appealed or subsequent amended legislation has been enacted.