

Standard practice statement

SPS 16/03

Notification of a pending audit or investigation

INTRODUCTION

Standard Practice Statements describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This statement sets out the Commissioner's practice for notifying taxpayers of a pending audit or investigation or advising them that one has begun. For many taxpayers, notification of an audit will be by letter without any prior contact by Inland Revenue on the matter.

For the purposes of this statement, the words "audit" and "investigation" have the same effect. Inland Revenue may undertake a variety of tasks to review a taxpayer's compliance with their tax obligations, but these will all be referred to here as "audits".

Not all contact by Inland Revenue officers with a taxpayer, or the taxpayer's agent, relates to an audit or will necessarily lead to one. An officer may contact a taxpayer (or their agent) for information where no decision has been made to audit them. General enquiries by Inland Revenue officers are not considered part of an audit unless the taxpayer has been clearly notified that an audit is pending or that one has begun. Taxpayers will be encouraged to voluntarily disclose any errors or omissions.

Section references are to the Tax Administration Act 1994 (the TAA) unless otherwise stated. The relevant provision is s 141G. It is reproduced in the appendix to this statement.

APPLICATION

This statement applies from 17 June 2016 and replaces SPS 07/02 *Notification of a pending audit or investigation*, which was issued in April 2007.

This statement should be read with SPS 09/02 *Voluntary Disclosures* (or any subsequent statement issued in replacement).

STANDARD PRACTICE

Summary

1. Inland Revenue makes a variety of enquiries of taxpayers that may or may not be related to a pending or existing audit.
2. Inland Revenue will clearly notify a taxpayer when they are about to be audited or advise them when an audit has begun. This notification will specifically use the word "audit" or "investigation".
3. Notification of pending or existing audits will meet the requirements of sections 14 to 14G of the TAA and will be in writing and communicated by post, by facsimile, by personal delivery, or by electronic means.

Detailed Discussion

4. A number of situations have arisen where it was disputed whether the taxpayer was entitled to a reduction of a shortfall penalty. These situations show a need for Inland Revenue to communicate clearly when notifying taxpayers of a pending audit or that one has begun.
5. This statement also clarifies when notification is expected to be given. It clarifies when enquiries made by Inland Revenue are likely to be for information gathering purposes only and when the enquiry is likely to be part of a pending or existing audit.
6. Modern tax administration practices recognise that taxpayers have the best information about their own activities. Taxpayers are generally better placed than the Commissioner to assess their tax liabilities by making the appropriate calculations and furnishing their returns.
7. The voluntary disclosure rules provide an incentive to taxpayers to determine their tax liability correctly. The incentives in those rules reflect the savings to Inland Revenue from auditing taxpayers where a voluntary disclosure has been made. They also acknowledge the co-operation of those taxpayers who have made a voluntary disclosure.
8. The voluntary disclosure rules are based around the timing of notification by the Commissioner that an audit is pending or that one has begun. Where a voluntary disclosure is made before that notice is given, a taxpayer qualifies for the greatest reduction in shortfall penalties for which they may be liable. The reductions can be 100% or 75% of the shortfall penalty, depending on the relevant type of penalty.
9. However, a person can still qualify for a lesser reduction of 40% where a voluntary disclosure is made after that notification but before the time specified in s 141G(5). That section provides that an audit starts at the earlier of (a) the end of the first interview, and (b) the time when an officer inspects information and the taxpayer is notified of the inspection. This is known as a post-notification disclosure. Note, in relation to s 141G(5)(b), that Inland Revenue will give written notice that the records are being inspected upon the commencement of that inspection. It is not necessary that the records being inspected have been collected subsequent to the initial notification of audit. Until the notification of inspection is given, or the first

interview has ended, a taxpayer will still qualify for a post-notification disclosure reduction of shortfall penalties.

10. It is therefore important to clarify when it is expected that notices will be given and how to recognise them.

What is an audit or investigation?

11. The words "audit" and "investigation" are not specifically defined in the tax legislation. The Concise Oxford English Dictionary (11th ed, Oxford University Press, New York, 2004) defines "audit" as "an official inspection of an organisation's accounts, typically by an independent body", and "investigate" as to "carry out a systematic or formal inquiry into (an incident or allegation) so as to establish the truth."
12. In a tax context, Inland Revenue views an audit as an examination of a taxpayer's financial affairs to verify that they have paid the correct amount of tax and complied with their tax obligations as required by law.
13. For further information about audits, please see Inland Revenue's guide, IR297 *Inland Revenue audits - Information for taxpayers*. This is available on our website at <http://www.ird.govt.nz/forms-guides/number/forms-200-299/ir297-guide-ir-audits.html>

When will notification be given?

14. Not all contact that Inland Revenue has with taxpayers will relate to an audit.
15. Although the Commissioner is not required either to alert taxpayers when she is considering whether to audit them or to advise them that an audit has begun, the Commissioner's practice is that a taxpayer will generally be given notice, in writing, advising them that they have been selected for an audit, or that an audit is underway. The notice will set out which areas of their tax affairs are being audited. Taxpayers will also be informed of the direction and focus of an audit as it progresses. If the audit's scope widens during the audit and other tax types and/or periods are to be reviewed, the taxpayer will be promptly notified of this change.
16. Instances where no notice will be given will be limited but may include where:
 - the visit is intended to be unannounced, such as a spot check;
 - Inland Revenue holds anonymous information;
 - there are strong indications the taxpayer is involved in an aggressive tax practice;
 - it is impractical to send a letter due to time constraints.
17. Notwithstanding [8], where the Commissioner establishes a tax shortfall but no notice was given, a taxpayer will not qualify for a pre-notification or post-notification disclosure reduction in shortfall penalties. This is because a taxpayer cannot disclose a tax shortfall when Inland Revenue has already identified the shortfall and advised them of it.

Situations that are not audits

18. Inland Revenue often contacts taxpayers for information omitted or incorrectly entered on filed returns to enable the self-assessment process to be completed.

19. Inland Revenue officers often call taxpayers for background information on GST returns without having decided whether to carry out an audit. These situations are not considered part of an audit unless the taxpayer has been clearly notified that an audit is pending or that one has begun.
20. Inland Revenue officers routinely request information from various sources, including individual taxpayers, to research and prioritise tax compliance risk areas. This activity is often referred to as risk review. In these circumstances, the purpose of the Inland Revenue officer's enquiry is to collect information and their contact with taxpayers is neither an audit nor notification of a pending audit.
21. Information gathered through risk review activities allows Inland Revenue to consider the level of risk of a particular taxpayer, taking into account that taxpayer's approach to determining their tax position. Audit activity, on the other hand, involves examining the tax position itself, having already decided to audit that tax position.
22. As discussed earlier, a taxpayer will qualify for a pre-notification disclosure reduction of shortfall penalties up until the point that the taxpayer has been notified in writing that an audit is pending or is notified that one has begun.

Notice of Audit

23. Inland Revenue officers will clearly communicate the purpose of their contacts with taxpayers and their agents. When Inland Revenue contacts taxpayers or their agents to notify of a pending audit or to advise that one has begun, the communication will use the word "audit" or "investigation". That notification will only occur once a decision has been made to audit the taxpayer.
24. The communication will be in writing and is considered to be given when that written notification is received by the taxpayer. It will be communicated in terms of section 14C of the TAA by post, by facsimile, personal delivery, or by electronic means. Up until that time, a taxpayer can still qualify for a pre-notification disclosure reduction of shortfall penalties.
25. Audits sometimes involve considering compliance by other parties that are connected. For example, a partnership and the individual partners, a company and its shareholders. Notification of an audit will be made to each party subject to a pending audit.

This Standard Practice Statement is signed on 17 June 2016.

Rob Wells

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APPENDIX:

Tax Administration Act 1994

Section 141G – Reduction in penalty for voluntary disclosure of tax shortfall.

- (1) A shortfall penalty payable by a taxpayer under any of sections 141A to 141EB may be reduced if, in the Commissioner's opinion, the taxpayer makes a full voluntary disclosure to the Commissioner of all the details of the tax shortfall, either—
 - (a) before the taxpayer is first notified of a pending tax audit or investigation (referred to in this section as **pre-notification disclosure**); or
 - (b) after the taxpayer is notified of a pending tax audit or investigation, but before the Commissioner starts the audit or investigation (referred to in this section as **post-notification disclosure**).
- (2) The Commissioner may from time to time—
 - (a) specify the information required for a full voluntary disclosure; and
 - (b) the form in which it must be provided.
- (3) The level by which the shortfall penalty is reduced—
 - (a) for pre-notification disclosure is—
 - (i) 100%, if the shortfall penalty is for not taking reasonable care, for taking an unacceptable tax position, or for an unacceptable interpretation; or
 - (ii) 75%, if subparagraph (i) does not apply:
 - (b) for post-notification disclosure is 40%.
- (4) A taxpayer is deemed to have been notified of a pending tax audit or investigation, or that the tax audit or investigation has started, if—
 - (a) the taxpayer; or
 - (b) an officer of the taxpayer; or
 - (c) a shareholder of the taxpayer, if the taxpayer is a close company; or
 - (d) a tax adviser acting for the taxpayer; or
 - (e) a partner in partnership with the taxpayer; or

(f) a person acting for or on behalf of or as a fiduciary of the taxpayer,—
is notified of the pending tax audit or investigation, or that the tax audit or
investigation has started.

(5) An audit or investigation starts at the earlier of—

(a) the end of the first interview an officer of the department has with the
taxpayer or the taxpayer's representative after the taxpayer receives the
notice referred to in subsection (4); and

(b) the time when—

(i) an officer of the department inspects information (including books
or records) of the taxpayer after the taxpayer receives the notice
referred to in subsection (4); and

(ii) the taxpayer is notified of the inspection.