

Liability for shortfall penalties

Decision date | Te Rā o te Whakatau: 29 June 2021

Issue date | Te Rā Tuku: 4 November 2021

TDS 21/03

Refer to related TDS 21/04

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Subjects | Ngā kaupapa

TAA: Shortfall penalties, onus and standard of proof

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

Commissioner	Commissioner of Inland Revenue or CIR
GST	Goods and services tax
CCS	Customer and Compliance Services, Inland Revenue
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture take

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

Facts | Ngā meka

1. The taxpayers were shareholders of Company X. One was the sole director of Company X (the subject of TDS 21/04) and the other managed the businesses of Company X.
2. The GST returns of Company X were reassessed by Customer and Compliance Services (**CCS**), Inland Revenue on the basis that unexplained deposits made into bank accounts of the taxpayers and a family trust are undisclosed cash sales of Company X for GST purposes. These assessments have been confirmed by the Tax Counsel Office of Inland Revenue.
3. CCS reassessed the income tax returns of the taxpayers to include additional shareholder salary amounts. The amount of additional shareholder salary was calculated based on an equal share of the undisclosed cash sales of Company X.

4. CCS also imposed on each of the shareholders a shortfall penalty for evasion. The taxpayers have accepted the assessment of the additional shareholder salary but dispute the imposition of the shortfall penalty.

Issues | Ngā take

5. The issue considered in this dispute is:
 - Whether the taxpayers are liable for a shortfall penalty for evasion or, in the alternative, for gross carelessness or not taking reasonable care.
6. There was also a preliminary issue on the onus and standard of proof.

Decisions | Ngā whakatau

7. The Tax Counsel Office decided that:
 - The taxpayers of the company are liable for a shortfall penalty for evasion. Alternatively, the shareholders are liable for shortfall penalties for gross carelessness or not taking reasonable care. Any shortfall penalties for which the shareholders are liable are reduced by 50% for previous behaviour.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary Issue | Take tōmua: Onus and standard of proof

8. The onus of proof in civil proceedings¹ is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.² The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.³

¹ Challenge proceedings (ie, the proceedings that would follow if this dispute proceeds to the TRA or a court) are civil proceedings.

² Section 149A(2).

³ *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA); *Beckham v CIR* (2008) 23 NZTC 22,066 (CA).

9. The standard of proof in civil proceedings is the balance of probabilities.⁴ This standard is met if it is proved that a matter is more probable than not. Whether the shareholders have discharged the onus of proof is considered in the relevant issues.

Issue 1 | Take tuatahi: Shortfall penalties

Shortfall penalty for evasion

10. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:⁵
- The taxpayer has taken a tax position.
 - Taking the tax position has resulted in a tax shortfall.
 - 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.
11. The penalty payable for evasion or similar act is 150% of the resulting tax shortfall.
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.⁶ 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.⁷

Shortfall penalty for gross carelessness

13. Section 141C of the TAA imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:⁸
- The taxpayer has taken a tax position.
 - Taking the tax position has resulted in a tax shortfall.

⁴ Section 149A(1); *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC); *Case X16* (2005) 22 NZTC 12,216; *Case Y3* (2007) 23 NZTC 13,028.

⁵ 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). Further detail is included in the related TDS 21/04 for Company X.

⁶ Section 149A(2) of the TAA.

⁷ Section 149A(1) of the TAA.

⁸ The shortfall penalty for gross carelessness is considered in the Interpretation Statement: Shortfall Penalty for Gross Carelessness as published in *Tax Information Bulletin* Vol 16, No 8 (September 2004). Further detail is included in the related TDS 21/04 for Company X.

- The taxpayer has been grossly careless in taking the taxpayer's tax position.
14. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

Shortfall penalty for not taking reasonable care

15. Section 141A imposes a shortfall penalty for not taking reasonable care on a taxpayer if the following requirements are satisfied:⁹
- The taxpayer has taken a tax position.
 - Taking the tax position has resulted in a tax shortfall.
 - The taxpayer has not taken reasonable care in taking the taxpayer's tax position.
16. The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.

Application of the penalties

17. The taxpayers took tax positions that resulted in tax shortfalls. The taxpayers are liable for evasion shortfall penalties because:
- In the income years in dispute the taxpayers received shareholder salaries from Company X which they both included in their tax returns. Accordingly, they knew that they were required to include amounts received from Company X for their personal benefit in their income tax returns.
 - The taxpayers filed their income tax returns without including any of the undisclosed cash sales of Company X paid into their joint private bank account and into the bank account of a family trust knowing that the returns were incorrect and misleading and in breach of their tax obligations. Even if the taxpayers did not know the amounts were income, at the very least, they were inadvertent to that probability and recklessly filed their returns without including the amounts, not caring whether the returns were correct or not. There is no evidence that they made enquiries to determine whether the amounts were income or not.
18. If it is concluded that the requirements of the evasion shortfall penalty are not satisfied the shareholders are liable for shortfall penalties for gross carelessness. Filing their income tax returns without including any of the undisclosed cash sales of Company X

⁹ The shortfall penalty for not taking reasonable care is considered in the Interpretation Statement: Shortfall penalty for not taking reasonable care as published in *Tax Information Bulletin* Vol 17, No 9 (November 2005). Further detail is included in the related TDS 21/XX for Company X.

paid into their joint private bank account and into the bank account of a family trust shows a complete disregard by the taxpayers for the consequences of their actions. This factor created a high risk of the tax shortfalls occurring. That risk and its consequences would have been foreseen by a reasonable person in the circumstances.

19. Further, if it is concluded that the requirements of the gross carelessness shortfall penalty are not satisfied the shareholders are liable to shortfall penalties for not taking reasonable care. A reasonable person would have foreseen as a reasonable probability of not including amounts received from Company X for their personal benefit in their income tax returns, that a tax shortfall would arise.
20. Any shortfall penalties for which the shareholders are liable are reduced by 50% under s 141FB for previous behaviour.