

GST – Undisclosed cash sales and liability for shortfall penalties

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

Issue date | Te Rā Tuku: 4 November 2021

TDS 21/04

Refer to related TDS 21/03

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Subjects | Ngā kaupapa

GST: Cash sales; 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
GST Act	Goods and Services Tax Act 1985
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. Company X owned and operated several retail establishments. Company X is registered for GST.
2. During the GST periods in dispute bank statement and vouching data showed unexplained cash deposits made into the joint private bank account of two shareholders of Company X and into the bank account of a family trust.

Issues | Ngā take

3. The issues considered in this dispute were:

- Whether the unexplained deposits made into the bank accounts of the shareholders and the family trust are undisclosed cash sales of Company X for GST purposes.
 - Whether Company X is liable for shortfall penalties for evasion under s 141E or, in the alternative, gross carelessness under s 141C or not taking reasonable care under s 141A.
4. There was also a preliminary issue on the onus and standard of proof.

Decisions | Ngā whakatau

5. The Tax Counsel Office decided that:
- The unexplained deposits made into the bank accounts of the shareholders and the family trust are undisclosed cash sales of Company X for GST purposes.
 - Company X is liable for evasion shortfall penalties for evasion. Alternatively, Company X is liable for shortfall penalties for gross carelessness or not taking reasonable care. Any shortfall penalties for which Company X is 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

6. 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 Taxation Review Authority or a court) are civil proceedings.

² Section 149A(2) of the TAA.

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

7. 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 Company X has discharged the onus of proof is considered in the relevant issues.
8. An assessment made by the Commissioner cannot be arbitrary. She must make the best judgement she can on the information in her possession as to the amount of taxable income and the amount of tax payable. In some cases, a taxpayer may be able to discharge the onus of proof by showing that the assessment is arbitrary or demonstrably unfair.⁵

Issue 1 | Take tuatahi: Whether the unexplained deposits are undisclosed cash sales of Company X for GST purposes

9. In relation to unexplained amounts received by a taxpayer it is for the taxpayer to prove that the Commissioner's assessment is incorrect. The taxpayer must do more than simply provide a credible possible alternative explanation for the amounts.⁶ It will depend on the facts of the particular case as to what evidence will be required to discharge a taxpayer's onus of proof.⁷
10. The taxpayer can meet the onus of proof if they provide specific details of other sources of funds that are capital or non-taxable in nature.⁸ In *Case 8/2017*, Judge Sinclair stated that it would "be necessary for there to be corroborative evidence, in particular contemporaneous evidence and records, in support of a disputant's ex post facto explanations".⁹
11. Company X did not discharge the onus of showing on the balance of probabilities that the unexplained cash deposits made into the bank accounts of the shareholders and the family trust were not undisclosed cash sales from its business for these reasons:
 - The GST assessments were not arbitrary. The GST assessments were based on bank deposit information and vouching data. Cash sales analysis supports the

⁴ Section 149A(1) of the TAA; *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 *Lowe v CIR* (1981) 5 NZTC 61,006 (CA); *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 (CA); *CIR v New Zealand Wool Board* (1999) 19 NZTC 15,476 (CA).

⁶ *Case S30* (1995) 17 NZTC 7,207 and *Case E69* (1982) 5 NZTC 59,378.

⁷ See *Case 2/2017* [2017] NZTRA 02, (2017) 28 NZTC 4-001 at [7] and [9];

⁸ *Case L40* (1989) 11 NZTC 1,249

⁹ *Case 8/2017* [2017] NZTRA 08, (2017) 28 NZTC 4-007 at [46].

view that the assessments were reasonable (being less than half of the industry average).

- Company X did not provide sufficient evidence to support its explanations regarding the source of any of the unexplained deposits or the additional business expenditure it said was incurred in generating additional cash sales from its business.

Issue 2 | Take tuarua: Shortfall penalties

Shortfall penalty for evasion

12. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:¹⁰
 - 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.¹¹
 - 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.¹²
 - 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.¹³

¹⁰ 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).

¹¹ Definitions of "tax position" and "taxpayer's tax position" in s 3 of the TAA.

¹² Definition of "tax shortfall" in s 3 of the TAA.

¹³ *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.

- Recklessness can amount to evasion and involves the conscious taking of risk. Recklessness will be proven where:¹⁴
 - 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.
- 13. The penalty payable for evasion or similar act is 150% of the resulting tax shortfall.
- 14. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E.¹⁵ 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.¹⁶

Shortfall penalty for gross carelessness

- 15. Section 141C of the TAA imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:¹⁷
 - The taxpayer has taken a tax position.
 - Taking the tax position has resulted in a tax shortfall.
 - The taxpayer has been grossly careless in taking the taxpayer's tax position. Gross carelessness means doing or not doing something in a way that, in all of the circumstances, suggests or implies a complete or high level of disregard for the consequences (s 141C(3)):
 - Gross carelessness is characterised by conduct which creates a high risk of a tax shortfall occurring where that risk and its consequences would have been foreseen by a reasonable person in the circumstances.¹⁸

¹⁴ *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.

¹⁵ Section 149A(2) of the TAA.

¹⁶ Section 149A(1) of the TAA.

¹⁷ 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).

¹⁸ *Case W4* (2003) 21 NZTC 11,034 at [44].

- The test for gross carelessness is not whether the taxpayer actually foresaw the probability that their act or omission would cause a tax shortfall but whether a reasonable person would have foreseen that probability. Whether the taxpayer has acted intentionally is not a consideration.¹⁹
- A person who takes reasonable care is not grossly careless.²⁰

16. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

Shortfall penalty for not taking reasonable care

17. Section 141A imposes a shortfall penalty for not taking reasonable care on a taxpayer if the following requirements are satisfied:²¹

- 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:²²
 - The test of "reasonable care" is whether a reasonable person in the taxpayer's circumstances would have foreseen a tax shortfall as a reasonable probability. It is not a question of whether the taxpayer actually foresaw the probability.
 - Taking reasonable care includes exercising reasonable diligence to determine the correctness of a return. It also includes keeping adequate books and records to properly substantiate a return and generally making a reasonable attempt to comply with the tax law.
 - The "reasonable care" test does not require the commitment of unlimited time and money or other resources. The effort required of the taxpayer is

¹⁹ *Case W4* at [60]; *Case 9/2014* (2014) 26 NZTC 2-019 at [88].

²⁰ *Case W4*; *Re Carlaw and FCT* 95 ATC 2166 (AAT); *Re Sparks and FCT* [2000] AATA 28 and see also *Pech v Tilgals* [1994] ATC 4206.

²¹ 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).

²² *Case W4* (2003) 21 NZTC 11,034.

commensurate with the reasonable person in the taxpayer's circumstances.²³

18. The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.

Application of the penalties

19. Company X took a tax position that resulted in a tax shortfall. Company X is liable for evasion shortfall penalties because:
 - Company X had included some cash sales in most of its GST returns and accordingly knew that it was required to include cash sales in its GST returns.
 - Company X took deliberate steps to divert significant amounts of cash from the business by depositing cash into various bank accounts and ultimately into the bank accounts of the shareholders and the family trust.
 - Company X filed its GST returns without including an amount of cash sales knowing that the returns were incorrect, misleading and in breach of its tax obligations.
20. If it is concluded that the requirements of the evasion shortfall penalty are not satisfied, Company X is liable to shortfall penalties for gross carelessness. Depositing cash into bank accounts of persons other than Company X and not including these cash sales in its GST returns shows a complete disregard by Company X for the consequences of its 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.
21. Further, if it is concluded that the requirements of the gross carelessness shortfall penalty are not satisfied Company X is liable to shortfall penalties for not taking reasonable care. A reasonable person would have foreseen as a reasonable probability of not recording all income from its taxable activity, that a tax shortfall would arise.
22. Any shortfall penalties for which Company X is liable are reduced by 50% under s 141FB for previous behaviour.

²³ See also *Case W3* (2003) 21 NZTC 11,014 and *TRA 007/12* [2014] NZTRA 08, (2014) 26 NZTC 2-018.