Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTOTANGA WHAKATAU Ā-TURE> WHAKAWĀ

"Negative income" adjustment, RWT credit, time bar

Decision date | Te Rā o te Whakatau: 1 February 2022

Issue date | Te Rā Tuku: 16 June 2022

TDS 22/11

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Subjects | Ngā kaupapa

Income Tax: Whether the Taxpayer is entitled to a "negative income" adjustment as a consequential adjustment to avoid double taxation. Whether the time bar applies. Whether the Taxpayer is entitled to the resident withholding tax (RWT) credit it claimed. Whether the net loss amount should be adjusted.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
ITA 2007	Income Tax Act 2007
RWT	Resident withholding tax
SOP	Statement of Position
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture tāke

All legislative references are to the Income Tax Act 2007 (**ITA 2007**) unless otherwise stated.

Facts | Ngā meka

1. The Taxpayer is a company.
2. The dispute concerns amounts that the Taxpayer included in an assessment of income tax:
   - A negative income amount included by the Taxpayer as a purported adjustment of previous year income.
   - A resident withholding tax (**RWT**) credit.

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- A net loss. The parties agree that the correct net loss amount is less than the amount claimed. The inclusion of a larger figure appears to have been a keying error by Inland Revenue.

3. Customer & Compliance Services, Inland Revenue (**CCS**) proposed adjustments to remove the first two and reduce the third of these amounts in the Taxpayer's assessment. The Taxpayer rejected the proposed adjustments and argued the time bar applied preventing the Commissioner from making the adjustments.

4. The Taxpayer filed three documents purporting to be income tax returns for the income tax year in question (the income year).

5. The first document (using a paper IR4 Company income tax return form) was received by Inland Revenue five months before the end of the income year. The IR4 form was completed by the Taxpayer's director and included the three disputed amounts.[1]

6. The first document was rejected by Inland Revenue's FIRST computer system because it was received before the end of the income year.

7. The second document was filed eight months after the end of the income year. This document was accepted by Inland Revenue as an income tax return and led to an assessment being recorded in Inland Revenue's FIRST computer system.

8. The amounts claimed in the second document were the same as in the first document, except the net loss was recorded in Inland Revenue's FIRST computer system as the larger amount rather than the correct (smaller) amount.

9. The third document was filed almost a year after the second document. It is not known why the third document was filed.

10. The third document was treated as a duplicate return. Inland Revenue contacted the Taxpayer about the return and was advised by its director that the original return filed (which was taken to mean the second document) was the correct return.

11. One of the issues in dispute (relevant to the time bar) was whether the first document referred to above was a valid return that resulted in an assessment. The Taxpayer argued it was valid and it did result in an assessment. CCS argued it did not. CCS argued only the second document resulted in an assessment.

12. Shortfall penalties were not pursued as part of this dispute.

[1] See above at [2]. In the first document the correct (smaller) "net loss" amount was shown.

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Issues | Ngā take

13. There were two main issues in this dispute:

- Whether it was correct for the Taxpayer to include a negative income amount in the Taxpayer's assessment for the income year as a consequential adjustment to avoid double taxation.
- Whether the time bar applied to prevent CCS from making its proposed adjustments.

14. The secondary issues in dispute both depended on whether the time bar applied:

- Whether it was correct for the Taxpayer to include the RWT credit in its return for the income year.
- Whether CCS was entitled to reduce the net loss from the larger amount down to the smaller amount.

Decisions | Ngā whakatau

15. The Tax Counsel Office reached the following decisions on the issues:

- It was not correct for the Taxpayer to include the negative income amount in its return.
- The time bar in s 108 of the Tax Administration Act 1994 (**TAA**) did not prevent the Commissioner from amending the assessment for the income year.
- It was not correct for the Taxpayer to include the RWT credit in its return.
- The correct net loss was the smaller amount.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Negative income adjustment

16. The Taxpayer argued the negative income amount related to its participation in a tax avoidance arrangement. The Taxpayer argued that in response to the arrangement income derived by the Taxpayer had been assessed to another taxpayer under s GA 1. The Taxpayer argued the income must be reversed out of its assessments under s GA 1(6) to avoid double taxation.

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17. The Taxpayer argued that by including the negative income amount in its return for the income year it had applied the rule in s GA 1 to exclude the income returned by it in previous income years (13-15 years ago) (the previous income years).

18. Where an arrangement is void under s BG 1, s GA 1(2) gives the Commissioner the power to adjust the taxable income of a person affected by the arrangement.

19. If, under s GA 1(2) the Commissioner includes an amount of income in calculating the taxable income of the person, the income must not be included in calculating the taxable income of another person. Therefore, s GA 1(6) may require the Commissioner to make consequential adjustments to ensure that income is not included in the taxable income of more than one person.

20. CCS argued that:

    - The Taxpayer had not satisfied the onus of proving that an adjustment is required under s GA 1(6).
    - No evidence was held or provided to show that the Taxpayer returned income in the previous income years.

21. The Taxpayer argued it maintained a full schedule of the amounts of the Taxpayer's income that were attributed to another taxpayer by the Commissioner under s GA 1(6). The Taxpayer argued that the schedule was relied upon to support the Taxpayer's compensating adjustment under s GA1(6) Income Tax Act 2007.

22. This schedule was not included in the evidence for this dispute.

23. In response to a request by CCS, the Taxpayer provided some additional income information for the previous income years. However, as argued by CCS, the amounts were considerably less than the negative income amount claimed by the Taxpayer.

24. Based on the information provided, the Tax Counsel Office concluded that the Taxpayer has not shown it was correct to include the negative income adjustment in its return for the income year. The Taxpayer has not shown its assessments for the previous income years included such an amount.

25. Even if a consequential adjustment was required to remove income from the taxable income of a person, the Tax Counsel Office considered the adjustment would need to be made in the periods in which the income was originally included. This was because the allocation of income to a particular year and, by extension, the reversal of such allocation, has important implications within the scheme of the income tax legislation. For example, tax rates may be different between different years and the availability of losses or imputation credits can differ between different years. An adjustment in a different income year may not have the same effect. There is also no provision

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authorising the making of adjustments in a later income year. This is a further reason why it was not correct for the Taxpayer to include the negative income adjustment in its 2017 income tax return.

26. In summary, the Tax Counsel Office concluded:

- The Taxpayer had not shown the negative income adjustment that it claimed was necessary.
- Even if such an adjustment was necessary, the adjustment would need to be made in the previous income years, not the income year.
- The negative income amount should be removed from the Taxpayer's assessment for the income year, as proposed by CCS.

Issue 2 | Take tuarua: Whether the time bar applies

27. Legislative references in Issue 2 are to the TAA unless otherwise stated.

Time bar

28. The issue is whether the time bar in s 108 prevented CCS from amending the Taxpayer's income tax assessment for the income year. This depends on when the Taxpayer filed its return for the income year.

29. As discussed above in the facts, the Taxpayer provided three different documents which purported to be income tax returns for the income year. The Taxpayer argued the first of these documents was a valid return and it resulted in an assessment. If this was true, the timing of this return would mean that the time bar would apply (subject to time bar exceptions).

30. CCS argued the first document was not a valid return. CCS argued only the second document was a valid return. The time of filing the second document would mean that the time bar would not apply.

31. Subject to time bar exceptions, s 108(1) prevents the Commissioner from amending an assessment, by increasing the amount assessed or decreasing the amount of a net loss, if:

- the taxpayer has filed an income tax return, and
- an assessment has been made, and
- four years have passed from the end of the tax year in which the taxpayer provides the tax return.

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Section 33

32. CCS argued the first document filed by the Taxpayer was not a valid income tax return because it was filed before the end of the tax year. CCS argued this view was supported by the wording of s 33 of the TAA.

33. Section 33 states that "in each tax year" a taxpayer (other than certain taxpayers to whom other rules apply) must furnish a return of income "for the preceding tax year".

34. The wording of s 33 requires an income tax return for a particular tax year to be filed in the subsequent tax year.[2] The Taxpayer did not do this. The Taxpayer filed the first document almost five months before the income year had ended.

35. The Tax Counsel Office noted that s 33(1) of the TAA was subsequently amended and in the later version there is no reference to a preceding tax year.[3] The Tax Counsel Office considered that the change in wording does not support the Taxpayer's argument (that a return can be filed before the end of an income year) because:

    - the amendment does not apply to the income year; and
    - there is no indication in the commentary to the amending legislation that the removal of the words "for the preceding tax year" was intended to result in any change in meaning.

A return must be definitive

36. CCS argued filing an income tax return early could result in income or expenses not being included or law changes not being accounted for, resulting in incorrect tax positions.

37. An income tax assessment is important because it quantifies the liability for tax that is imposed on a taxpayer for an income year under the legislation. The importance of the assessment process means that an assessment cannot be tentative, provisional, subject to adjustment, or conditional. The quantification of liability must be definitive

[2] Note that this wording would not prevent a taxpayer who has elected and received consent to file returns to a late balance date (under s 38) from filing before the end of their income year, but after 31 March of the corresponding tax year. It would still be questionable whether this return was valid based on a potential lack of certainty.

[3] For more information on the changes made at this time see *Tax Information Bulletin* Vol 31, No 4 (May 2019).

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at the time it is made and final subject only to challenge through the objection process.[4]

38. It is noted *CIR v Canterbury Frozen Meat Co Ltd* was decided before the introduction of taxpayer self-assessment and was concerned with an assessment made by the Commissioner. Nevertheless, the Tax Counsel Office considered that the same principle would apply to taxpayer self-assessments. The assessment process is no less important because the assessment is made by a taxpayer rather than the Commissioner. Taxpayer assessments will often be the only assessment made for a period. It follows that a taxpayer self-assessment must also be definitive.

39. The Taxpayer filed its return almost five months before the end of the income year. Filing the return early raises doubt about whether the first document provided a definitive quantification of the Taxpayer's liability to tax for the income year.

40. In hindsight, it appears that the company was not actively carrying on a business during the income year. Four years after the end of the income year the Taxpayer's director provided a copy of the Taxpayer's financial accounts for the income year showing no income and a small claim for expenses (accounting fees). However, at the time the first document was filed (almost five months before the end of the income year), it was not necessarily certain that the particulars of the return would not change further. The Taxpayer has not explained how it could have certainty about the assessment when the return was filed.

41. The onus of proof is on the Taxpayer. The Tax Counsel Office concluded that the Taxpayer had not satisfied the onus of proving that the first document provided a definitive quantification of the Taxpayer's liability to tax for the income year.

The overriding effect of s 108

42. The Taxpayer argued s 108 has overriding effect and that even if there was a technical breach of s 33, s 108 overrides s 33 and prevents CCS from making the proposed adjustments.

43. The Taxpayer referred to s 108(3), which provides that s 108 overrides every other provision of the Act, and any other rule of law, that limits the Commissioner's right to amend assessments. The Taxpayer also referred to s 108(4) which states that subs (1) applies to all returns filed on or after 1 April 1997. The Taxpayer argued this wording clearly applied to the first document that it filed.

[4] *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150 (CA).

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44. Section 108 does have overriding effect, but for s 108 to override anything, it must first apply. For section 108 to apply as argued by the Taxpayer, the first document must have been a valid return. Whether the return was valid will determine whether s 108 applies.

45. Further, s 108(3) states that it overrides any rule of law that limits the Commissioner's right to amend assessments. As argued by CCS, s 33 does not limit the Commissioner's right to amend assessments. Section 33 requires a person to file a return.

46. Section 108(4) does not assist the Taxpayer. The effect of subs (4) is that s 108 does not apply to returns filed before 1 April 1997. For s 108 to apply to returns filed on or after 1 April 1997, the other requirements of s 108 must also be satisfied. Unless these requirements are satisfied, the overriding effect of s 108 will not be engaged.

Conclusion – the first document was not a valid return

47. The Tax Counsel Office concluded that the first document filed by the Taxpayer was not a valid return. This is because:

    - The wording of s 33 requires an income tax return for a particular tax year to be filed in the subsequent tax year.
    - The subsequent amendment to s 33 does not support the Taxpayer's position.
    - The Taxpayer has not satisfied the onus of proving that the first document provided a definitive quantification of the Taxpayer's liability to tax for the income year.
    - The overriding effect of s 108 does not support the Taxpayer's position because s 108 does not apply.

48. This means that a valid return was not filed, and an assessment was not made, until the second document was provided. Consequently, the Tax Counsel Office concluded that the income year was not time barred.

Issue 3 | Take tuatoru: RWT credit and net loss

49. The secondary issues in dispute both depended on whether the time bar applies. Since the time bar did not apply, it was necessary for the Tax Counsel Office to consider:

    - Whether it was correct for the Taxpayer to include the RWT credit in its return for the income year.

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- Whether CCS was entitled to reduce the net loss from the larger amount down to the smaller amount.

RWT adjustment

50. CCS proposed to remove the RWT credit from the Taxpayer's assessment for the income year.

51. Although the Taxpayer has not explicitly conceded this issue, the Taxpayer had stated that the amount that it included in the return as RWT related to imputation credits, not RWT. Therefore, it was clear that the Taxpayer was not entitled to a RWT credit in the income year because no evidence was provided to the Tax Counsel Office to show that a RWT credit was available.

52. It follows that the Taxpayer was not entitled to the refund that resulted from the RWT credit. The Tax Counsel Office noted there is no mechanism in the legislation where excess imputation credits can be paid to a taxpayer as a refund. This was not disputed by the Taxpayer.

53. The Taxpayer's only apparent objection to the proposed adjustment to remove the RWT credit was based on its argument that the time bar prevents CCS from making the adjustment.

54. As noted above, the time bar did not apply. Therefore, the Tax Counsel Office concluded the assessment should be adjusted to remove the RWT credit claimed. As a consequence of the RWT credit adjustment, the Taxpayer will also be liable to repay the refund and use of money interest that it received as a result of the RWT credit claimed.

Net loss adjustment

55. CCS also proposed to reduce the net loss from larger (incorrect) amount down to smaller (correct) amount.

56. The Taxpayer agreed the smaller amount is the correct figure. The entry of the larger amount appeared to have been a keying error by Inland Revenue.

57. Again, the Taxpayer's only apparent objection to the proposed adjustment is based on its argument that the time bar prevents CCS from making the adjustment. Since the time bar does not apply, the Tax Counsel Office concluded the assessment should be adjusted to reduce the net loss as proposed by CCS.

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