Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

Assessability of unexplained amounts, interest deductions and shortfall penalties

Decision date | Rā o te Whakatau: 21 October 2022

Issue date | Rā Tuku: 29 March 2023

TDS 23/02

Subjects | Kaupapa

Income tax: unexplained amounts; assessable income; interest deductions.

Shortfall penalties: evasion; obstruction.

Abbreviations | Whakapotonga

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner or CIR	Commissioner of Inland Revenue
ITA	Income Tax Act 2007
NOPA	Notice of Proposed Adjustment
SOP	Statement of Position
PTS	Personal Tax Summary
TAA	Tax Administration Act 1994
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ture tāke

This summary refers to the Income Tax Act 2007 **(ITA**) and the Tax Administration Act 1994 (**TAA**).

Facts | Meka

1. The Taxpayer, an individual, had a business. The dispute concerns the tax treatment of several deposits made to bank accounts owned by the Taxpayer and associates of the Taxpayer in the 2010, 2011, 2012 and 2016 income years.
2. The Taxpayer also owned rental properties. The Taxpayer proposed to include an amount of interest on a mortgage as a deduction for the 2016 income year, but the parties disagreed as to the nature of this interest. Customer & Compliance Services,

Inland Revenue (**CCS**) argued the interest claimed was in relation to the Taxpayer's family home.

3. The Taxpayer filed tax returns for the 2010 and 2011 income years but there was no mention of rental income or income from the business. The Taxpayer also requested a personal tax summary (**PTS**) for the 2012 income year. The Taxpayer filed a tax return for the 2016 income year. The return recorded a rental income loss.

4. The Taxpayer did not return any business income until 2016. The Taxpayer stated that income relating to the 2015 and 2016 income years for the business was fully returned by a company (**the Company**). The sole director and shareholder of the Company was the Taxpayer's spouse.

Issues | Take

5. The main issues considered in this dispute were:

   - whether the deposits were assessable income to the Taxpayer;
   - whether the Taxpayer was entitled to interest deductions under ss DA 1 and DB 6 of the ITA;
   - whether the Taxpayer was liable for an evasion shortfall penalty;
   - whether the Taxpayer was liable for an increase in the shortfall penalty for obstruction.

6. A preliminary issue of whether the Commissioner was entitled to amend the Taxpayer's assessments to increase the amounts outside the four-year period in s 108 of the TAA was also considered.

Decisions | Whakatau

7. The Tax Counsel Office (**TCO**) concluded that:

   - the deposits made in the 2016 income year were assessable income to the Taxpayer, but not the deposits made in the 2010 income year;
   - the Taxpayer was not entitled to the interest deductions;
   - evasion penalties should be applied as proposed for the 2012 and 2016 income years, but not for the 2011 income year (the gross carelessness penalty should be imposed for the 2011 income year);
   - all penalties should be increased by 25% for obstruction.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: Time bar

8. All legislative references in this issue are to the TAA unless otherwise stated.

9. Subject to some exceptions, s 108(1) prevents the Commissioner from amending an income tax assessment so as to increase the amount assessed or decrease 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.

10. However, if an exception applies, the Commissioner may amend an otherwise time-barred assessment.

11. For this dispute, all disputed periods would be time barred under s 108(1) unless an exception applies.

12. The relevant exceptions are in s 108(2), which provides that the Commissioner may amend an assessment at any time so as to increase its amount if the Commissioner is of the opinion that a tax return provided by a taxpayer:

   - is fraudulent or wilfully misleading; or
   - does not mention income of a particular nature or derived from a particular source.

13. It is sufficient that the Commissioner honestly believes, on the available evidence and on the correct application of the law, that the tax return meets the requirements for the time bar exception to apply.[1] A challenge to the Commissioner's opinion can only succeed if the taxpayer shows that:[2]

   - the Commissioner did not honestly hold the opinion, or
   - the Commissioner misdirected himself as to the legal basis on which the opinion was to be formed, or

[1] See *Wire Supplies Ltd v CIR* [2007] NZCA 244, (2007) 23 NZTC 21,404 at [87].

[2] *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) at [102].

- the opinion was one that was not reasonably open to the Commissioner on the information available to him.

14. The decision to rely on s 108(2) is a disputable decision.[3] This means that any challenge to this decision may have regard not only to the validity of the Commissioner's opinion but also to the correctness of the opinion itself.[4]

15. Even if the Commissioner has validly formed his opinion, this will not prevent a court or a hearing authority from considering the requirements of s 108(2) anew. The burden of proof, however, rests with the taxpayer to show, on the balance of probabilities, that the decision made by the Commissioner is wrong and that the statutory requirements are not met.[5]

16. TCO considered it appropriate to adopt a similar approach to that which a hearing authority would follow in respect to the onus of proof. Therefore, TCO considered the issue of the time bar anew, using the evidence available to TCO.

Fraudulent or wilfully misleading

17. For the exception in s 108(2)(a) to apply, the Commissioner must be of the opinion that the tax return is fraudulent or wilfully misleading.

18. For a return to be fraudulent, the person filing it must have known that it was incorrect and nevertheless dishonestly or deceitfully filed it that way. [6] In the case of a company, fraudulence is imputed via a responsible officer or officers of the company.[7]

19. TCO considered the meaning of "wilfully misleading" and concluded the following:

- Whether or not a return is misleading is a question of fact.[8]

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[3] Definition of "disputable decision" in s 3(1).

[4] *Edwards v CIR* [2016] NZHC 1795, (2016) 27 NZTC 22-064; *Great North Motor Company Limited (in receivership) v CIR* [2017] NZCA 328, (2017) 28 NZTC 23-022. See also *Van Uden v CIR* [2018] NZCA 487, (2018) 28 NZTC ¶23-081 at [69].

[5] *Great North Motor* (CA) at [32] and [34]; *Auckland Institute of Studies* at [102].

[6] Definition of "fraudulent" in *Concise Oxford English Dictionary* (12th ed, Oxford University Press, Oxford, 2011). The meaning of "fraudulent" was considered in *R v Coombridge* [1976] 2 NZLR 382 (CA) at 387.

[7] *Meulen's Hair Stylists v CIR* [1963] NZLR 797 (SC) at 799.

[8] *Great North Motor* (CA) at [37]

- Whether or not a return is wilfully misleading concerns the "state of mind" of the person filing the return.[9] There must be evidence that the act complained of was deliberate and intentional, not accidental or inadvertent.[10]
- An omission, as well as an act, may be wilful.[11]
- Subjective recklessness is sufficient as proof of wilfulness if the person had no reasonable grounds for believing the returns were correct and was reckless in the sense of not caring whether they were correct.[12]

20. Therefore, a return will be "fraudulent or wilfully misleading" when the taxpayer:
    - filed it knowing that it did not reflect their true income tax position, or
    - was recklessly careless as to whether or not the return was wrong.
21. The burden of proof rests with the taxpayer to show that a return is not fraudulent or wilfully misleading. The standard of proof is the civil standard, ie on the balance of probabilities.[13]
22. TCO considered that the knowledge requirement for s 108(2)(a) is consistent with the consideration of the evasion shortfall penalty under s 141 (discussed in Issue 3 below), which requires determining whether the Taxpayer knowingly evaded the assessment of tax. The knowledge element of evasion can be satisfied through actual knowledge that an action or omission would breach a tax obligation or through subjective recklessness.
23. In Issue 3, in the context of the evasion shortfall penalty under s 141E, TCO concluded that the Taxpayer evaded assessment or payment of tax when they took the tax positions for the 2012 and 2016 income years for these reasons:
    - Based on the evidence presented in this dispute, TCO concluded that the Taxpayer knew they were breaching their tax obligations by not returning rental income and business income. This knowledge can also be inferred from the Taxpayer's business experience. The Taxpayer failed to disclose the information

[9] *R v Senior* [1899] 1 QB 283; *Great North Motor* (CA) at [40].

[10] *Case W26* (2003) 21 NZTC 11,263 at [110]. See also *CIR v Parisienne Gown Company Limited*; *CIR v Gold* [1956] NZLR 442 (NZSC) at 444.

[11] *In Re City Equitable Fire Insurance Co Ltd* [1925] 1 Ch 407 at 434. See also *Babington v CIR* (No. 2) [1958] NZLR 152 (NZSC) at 156–157.

[12] *Great North Motor* (CA) at [36].

[13] *Great North Motor* (CA) at [34].

to Inland Revenue, going so far as to proactively provide misleading information about their requirement to file in their phone calls with Inland Revenue.

- Even if the Taxpayer did not know they were in breach of their tax obligations, TCO considered the evidence indicated that facts actually known to the Taxpayer were such that they must have put them on inquiry that a tax obligation may not be met but they made the conscious decision to proceed by filing returns excluding rental and business income.

24. CCS formed the opinion that the Taxpayer's returns (including their PTS for the 2012 income year) were fraudulent or wilfully misleading. There was nothing to indicate that:

- this opinion was not honestly held, or
- the Commissioner misdirected himself as to the legal basis on which the opinion was to be formed, or
- the opinion was one that was not reasonably open to the Commissioner on the information available to him.

25. For the above reasons, it was concluded that the exception to the time bar under s 108(2)(a) applied to allow the Commissioner to assess the 2012 and 2016 income years. However, the exception in s 108(2)(a) did not apply to allow the Commissioner to assess the 2011 income year.

26. The Commissioner could assess the 2011 income year if the exception in s 108(2)(b) applies. This is discussed next.

Does not mention income

27. For the exception in s 108(2)(b) to apply, the Commissioner must be of the opinion that the tax return does not mention:

- income which is of a particular nature, or
- income derived from a particular source,

and in respect of which a tax return is required to be provided.

28. In respect of this exception, TCO came to the following conclusions:

- Income of a particular nature is income that has a basic or inherent feature, quality or character. The source of the income is where it is from.[14]

[14] The definitions of "nature" and "source" in the *Concise Oxford English Dictionary*. See *Case T52* (1998) 18 NZTC 8,378 at 8,400–8,401.

- Income must be mentioned in or with the return of the taxpayer seeking the protection of the time bar. The disclosure of income at some other time, or in another taxpayer's return, will not suffice.[15]
- The omission of income does not need to be fraudulent or deliberate.[16]
- Once it is determined that the time bar exception applies, the Commissioner is not confined to the omitted sums but may amend the whole assessment.[17]
- Section 108(2)(b) is not directed at the failure to characterise a gain as income. Rather, it is directed at the failure to mention the gain at all.[18]

29. The Taxpayer acknowledged that they derived rental income in all the disputed periods, and business income in the 2011 and 2012 income years. The Taxpayer did not return any of this income in their returns (including the PTS for the 2012 income year) for the disputed periods.

30. Rental income and business income are distinct categories of income that are required to be returned, and they are also types of income derived from particular sources (tenants and business clients respectively). The Taxpayer, by failing to return any of this income, failed to return income of a particular nature or derived from a particular source.

31. Therefore, s 108(2)(b) applied to allow the Commissioner to assess the Taxpayer for the periods in dispute, including the 2011 income year.

Issue 1 | Take tuatahi: Whether deposits were assessable income

32. All legislative references in this issue are to the ITA unless otherwise stated.

33. This issue concerns whether deposits made to bank accounts owned by or accessible by the Taxpayer in the 2010 and 2016 income years were taxable income of the Taxpayer, either as business income under s CB 1 or income under ordinary concepts under CA 1(2).

34. CCS considered cash deposits and substantial business expenses showed the Taxpayer derived income from their business in the 2010 income year. CCS also considered

[15] *Miller v CIR* (1998) 18 NZTC 13,961 (HC) at 13,975.

[16] *Babington v CIR* [1957] NZLR 861 (NZSC).

[17] *Babington* at 869.

[18] *Cross v CIR* (1987) 9 NZTC 6,101 (CA); *Case Z19* (2009) 24 NZTC 14,217.

deposits paid into the bank accounts of the Taxpayer's relatives were income of the Taxpayer.

35. The Taxpayer asserted that they did not derive income in relation to the business until the 2011 income year. The Taxpayer also considered that all income derived in the 2016 income year had been returned by the Company.

Onus and standard of proof

36. The onus of proof in civil proceedings[19] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[20] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[21]

37. The standard of proof in civil proceedings is the balance of probabilities.[22] This standard is met if it is proved that a matter is "more likely than not".[23]

38. An assessment made by the Commissioner cannot be arbitrary. He must make the best judgment he can on the information in his 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.[24]

Assessability of unexplained amounts

39. The law concerning the assessability of unexplained amounts received by a taxpayer is well settled. It is for the taxpayer to prove that the Commissioner's proposed adjustments are wrong and by how much they are wrong.[25] The standard of proof is the balance of probabilities.[26]

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[19] Challenge proceedings (ie, the proceedings that would follow if this dispute proceeds to the Taxation Review Authority (**TRA**) or a court) are civil proceedings.

[20] Section 149A(2) of the TAA.

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

[22] 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.

[23] *Miller v Minister of Pensions* [1947] 2 All ER 372, 374.

[24] *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).

[25] *Buckley & Young Ltd* at 61,283.

[26] *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Case Y3* (2007) 23 NZTC 13,028; *Case X16* (2005) 22 NZTC 12,216.

40. The taxpayer can meet the onus of proof if the taxpayer provides specific details of other sources of funds that are capital or non-taxable in nature.[27] This requires the taxpayer to do more than simply provide a credible possible alternative explanation for the amounts.[28] The taxpayer must establish that the Commissioner's assessment is incorrect and by how much it is incorrect.[29]

41. 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. The courts will normally test statements made by taxpayers against the surrounding circumstances.[30] This generally means that the taxpayer must provide evidence in support of their claims, including corroborative evidence, in particular contemporaneous evidence and records.[31] If the taxpayer has provided no such evidence, and there is no compelling reason for disallowing the Commissioner's assessment, a court is likely to uphold the assessment.[32]

Taxation of unexplained amounts

42. It is in the nature of unexplained income that the exact tax character of the income may be unknown. Generally, the unexplained amounts are treated as income under s CA 1(2) (income under ordinary concepts).

Income under ordinary concepts

43. Section CA 1(2) provides that an amount is income of a person if it is their income under ordinary concepts.

44. Some key principles derived from case law on income under ordinary concepts are:

- Income is something that "comes in".[33]

[27] *Case L40* (1989) 11 NZTC 1,249.

[28] *Case E69* 5 NZTC 59,378 at p 59,380.

[29] *Case S30* (1995) 17 NZTC 7,207; *Case 2/2017* [2017] NZTRA 02, (2017) 28 NZTC 4-001.

[30] *National Distributors Ltd v CIR* (1989) 11 NZTC 6,346 (CA) at 6,351. See also *Buckley & Young* at 61,283 and *Case E69* at 59,380.

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

[32] *Alexander v CIR* (1996) 17 NZTC 12,543 (HC) at 12,544. This decision was appealed to the Court of Appeal in *Alexander v CIR* (1998) 18 NZTC 13,921 (CA) where it was confirmed that the taxpayer had not discharged the onus of proof.

[33] *Tennant v Smith* (1892) 3 TC 158; *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA) at 13,355.

- Whether or not a particular receipt is income depends on its quality in the hands of the recipient.[34]
- The periodic nature of payments made is the major determinant in many cases. Regularity or recurrence indicates that payments may become part of the receipts on which the recipient may depend for their living expenses.[35]
- Consideration must be given to the relationship between the payer and the payee.[36]
- The purpose of any payments made must be taken into account.[37]

Business income

45. CCS also argued that the deposits were business income of the Taxpayer.

46. *Grieve v CIR*[38] is the leading case that considers the definition of business.[39] The key principles from *Grieve* are:

- Determining whether a business exists involves a twofold inquiry comprised of analysing the nature of the activities carried on and the intention of the taxpayer in engaging in those activities.
- Underlying the term "business" in the context of tax law is the fundamental notion of the exercise of an activity in an organised and coherent way, and one which is directed to an end result.[40] Factors for determining the nature of a taxpayer's activities include:
  - The period over which it is engaged in.
  - The scale of operations and volume of transactions.
  - The commitment of time, money and effort.
  - The pattern of activity.

[34] *Reid v CIR* (1985) 7 NZTC 5,176 (CA) at 5,183.

[35] *Reid v CIR*; *A Taxpayer*; *FCT v Hyteco Hiring Pty Ltd* 92 ATC 4694 at 4,700.

[36] *Reid v CIR*.

[37] See for example in *Reid* where the payments were contractual and received in return for performing student obligations.

[38] *Grieve v CIR* [1984] 1 NZLR 101 (CA)

[39] The definition of "business" in s YA 1 includes any profession, trade, or undertaking carried on for profit.

[40] At 61,689.

- The financial results.

Deposits in the 2010 income year

47. CCS considered the Taxpayer derived business income in the 2010 income year as shown by deposits included in the Taxpayer's credit card statements. However, this proposed adjustment was made in a letter after a Statement of Position (**SOP**) was issued and were not included in the Commissioner's Notice of Proposed Adjustment (**NOPA**).

48. TCO considered that these deposits were outside the scope of the dispute and it would be inconsistent with the requirements of s 89C of the TAA for the Commissioner to make an assessment relating to the credit card deposits without first issuing a NOPA.

49. Therefore, TCO concluded that the adjustment proposed by CCS in its post-SOP letter should not be made at this time. If the Commissioner wishes to propose adjustments relating to deposits in the 2010 income year, he will need to issue a new NOPA.

Deposits in the 2016 income year

50. CCS asserted that several deposits made into the accounts of the Taxpayer's relatives were not returned by the Company in the 2016 income year. The Taxpayer asserted that all income and expenses relating to the business were accounted for by the Company for the 2016 income year. The Taxpayer also asserted that CCS's inclusion of deposits into the relatives' accounts was arbitrary.

51. The onus of proof is on the Taxpayer to show the adjustments proposed by the Commissioner were wrong and by how much they were wrong. Further, to prove on the balance of probabilities that unexplained amounts were not income, the Taxpayer was required to do more than simply provide a credible possible alternative explanation for the amounts. The Taxpayer must establish that the Commissioner's assessment was incorrect.

52. The information available to CCS, including bank statements and vouching information of the relatives' bank accounts, indicated that the Taxpayer was making deposits into these accounts for the purpose of concealing income from the business. The information also showed that the Taxpayer had access to these accounts during the 2016 income year and that several payments were transferred to the Taxpayer's personal account.

53. The Taxpayer argued that the transfers to the Taxpayer's account related to expenses incurred by the relative's family. While this might be a credible explanation for some

of the transfers or deposits, the Taxpayer did not provide sufficient evidence to prove on the balance of probabilities that the deposits were not income of the Taxpayer, despite multiple requests from CCS to the Taxpayer for further explanations of the deposits. Nor did the Taxpayer provide any evidence to indicate that CCS's proposed adjustments were arbitrary or demonstrably unfair.

54. The Taxpayer acknowledged that they were carrying on a business in the 2016 income year, although maintained the income was returned by the Company. It was therefore not necessary for TCO to determine whether the Taxpayer was carrying on a business during the relevant period.

55. As the Taxpayer did not satisfy the burden of proof to show that the amounts were not income, it was considered that the Commissioner was empowered to tax these deposits as business income under s CB 1 or as income under ordinary concepts, based on the information available to the Commissioner.

Issue 2 | Take tuarua: whether the Taxpayer was entitled to interest deductions

56. All legislative references in this issue are to the ITA unless otherwise stated.

57. This issue concerns whether a deduction proposed by the Taxpayer for the 2016 income year in relation to interest on a mortgage is deductible under s DB 6.[41]

58. The Taxpayer asserted that the interest related to a rental property. However, the Commissioner considered that the relevant loan facility was used to pay the balance of the loan for the family home. Accordingly, CCS considered the expenditure was of a private or domestic nature and was therefore not deductible in accordance with the private limitation.

59. Section DB 6(1) provides that a person is allowed a deduction for interest incurred. Section DB 6(1) overrides the capital limitation, but the general permission must still be satisfied, and the other general limitations still apply (s DB 6(2)). Section DB 6(1) is subject to the limitations in s DB 1, however that provision is not relevant for the purposes of this dispute.

60. The test for interest deductibility, commonly referred to as the "use test", is whether the borrowed funds on which the interest is incurred have been used in deriving income, or in a business carried on to derive income. The test is whether the capital

[41] This issue was not affected by changes to deductibility of interest for residential rental properties as the relevant provisions did not yet apply during the disputed periods.

lent was used or employed in the process of deriving assessable income during the period in which the interest was incurred. It is not relevant how the capital was previously or subsequently employed.[42]

61. As stated above, s DB 6 is still subject to the general limitations (other than the capital limitation). The private limitation denies a deduction for expenditure or loss to the extent it is of a private or domestic nature.

62. An outgoing is of a private nature if it is exclusively referable to living as an individual member of society and domestic expenses are those relating to the household or family unit.[43] Private or domestic expenditure is often expenditure that is not of a business nature.[44]

63. In this dispute, the information available to CCS showed that the relevant loan facility related solely to the Taxpayer's family home. The Taxpayer did not provide any evidence to show that the loan facility was used for a rental property activity and not the family home as argued by CCS. Therefore, the Taxpayer has failed to satisfy the onus of proving that CCS's proposal to deny the deduction for the interest expenditure was wrong and by how much.

64. TCO concluded that the Taxpayer was not allowed a deduction for the interest expenditure relating to the relevant loan facility.

Issue 3 | Take tuatoru: whether the Taxpayer was liable for an evasion shortfall penalty

65. All statutory references in this issue are to the TAA unless otherwise stated.

66. The issue is whether the Taxpayer is liable under s 141E for a shortfall penalty for evasion or a similar act.

67. If the Taxpayer is liable for an evasion shortfall penalty, CCS accepts that the shortfall penalty will be reduced by 50% under s 141FB for previous behaviour.

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[42] *Pacific Rendezvous Ltd v CIR* (1986) 8 NZTC 5,146 (CA); applied in *Eggers v CIR* (1988) 10 NZTC 5,153 (CA) and *CIR v Brierley* (1990) 12 NZTC 7,184 (CA). It is noted that these cases considered the application of s 106(1)(h) of the Income Tax Act 1976. Despite the change in the words of the legislation, subsequent decisions in the TRA have continued to rely on the "use test". Therefore, it is considered that the "use test" as formulated by the Court of Appeal in *Pacific Rendezvous* continues to be good law.

[43] *CIR v Haenga* (1985) 7 NZTC 5,198 (CA) at 5,207.

[44] *Reid v CIR* (1990) 12 NZTC 7,153 (HC).

68. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:[45]

- 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.
- 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.
- 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.[46]
  - Recklessness can amount to evasion and involves the conscious taking of risk. Recklessness will be proven where: [47]
    - 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.

69. The penalty payable for evasion or similar act is 150% of the resulting tax shortfall.

70. The penalty may be:

- apportioned between the taxpayer and an officer of the taxpayer under s 141F.
- reduced for previous behaviour under s 141FB.
- reduced for voluntary disclosure under s 141G.
- reduced for temporary shortfall under ss 141I and 141J.

[45] 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).

[46] *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.

[47] *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.

- increased for obstruction under s 141K.

71. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E.[48] 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.[49]

72. In this dispute, the Taxpayer took a "tax position" by filing returns for the 2010, 2011, and 2016 income years, and through their PTS for the 2012 income year. A tax shortfall arose for the 2011 and 2012 income years as accepted by the Taxpayer, and for the 2016 income year as TCO concluded above. However, no tax shortfall arose in the 2010 income year as TCO concluded that the adjustments proposed by CCS should not be made at this time.

73. The next question is whether the Taxpayer had the necessary intent for the evasion penalty to apply.

74. As the burden of proof for an evasion shortfall penalty is on the Commissioner, CCS must demonstrate on the balance of probabilities that, in taking these tax positions, the Taxpayer evaded the assessment of tax. The element of intention required for evasion will be satisfied if the taxpayer knows that an action or omission will breach a tax obligation. Subjective recklessness can also amount to evasion.

75. CCS argued that the intention element of evasion was satisfied as the Taxpayer's behaviour was deliberate, or alternatively the Taxpayer was subjectively reckless as to whether their actions or omissions would breach a tax obligation.

76. As mentioned in paragraph 23 above, TCO concluded that the Taxpayer evaded assessment or payment of tax when they took the tax positions for the 2012 and 2016 income years for the reasons summarised in that paragraph.

77. However, the evidence supported a finding of evasion for the tax positions taken for the 2012 and 2016 income years only. Some of the evidence presented in the dispute was not supportive of evasion for the 2011 income year. This included evidence of phone calls with Inland Revenue, which occurred after the Taxpayer took the tax position for the 2011 income year.

78. It was concluded that CCS satisfied the burden of proving that the Taxpayer evaded the assessment or payment of tax when they took the tax positions for the 2012 and 2016 income years. However, CCS did not satisfy the burden of proving evasion in

[48] Section 149A(2) of the TAA.

[49] Section 149A(1) of the TAA.

relation to the 2011 income year. The gross carelessness shortfall penalty will apply for the 2011 income year instead, as accepted by the Taxpayer.

79. Therefore, the Taxpayer is liable for shortfall penalties for gross carelessness under s 141C for the 2011 income year and evasion under s 141E for the 2012 and 2016 income years, reduced by 50% for previous behaviour.

Issue 4 | Take tuawhā: whether shortfall penalty should be increased for obstruction

80. All legislative references in this issue are to the TAA unless otherwise stated.

81. This issue concerns whether it is appropriate to increase the shortfall penalties the Taxpayer is liable to pay by 25% for obstruction in accordance with s 141K.

82. CCS considered that the Taxpayer was liable for an increase for obstruction on the basis that they had been uncooperative and impeded CCS's ability to carry out its lawful duties

83. Section 141K provides a shortfall penalty under any of sections 141AA to 141EB may be increased by 25% if the taxpayer obstructs the Commissioner in determining the correct tax position in respect of the taxpayer's tax liability.

84. Obstruction occurs when a taxpayer takes actions that make it more difficult for the Commissioner or an officer of the Commissioner to carry out their lawful duties. Words alone can constitute obstruction, including actions like lying at an interview or deliberately delaying Inland Revenue enquiries. Actions such as exercising legal rights, contesting an assessment, or maintaining an opinion contrary to the Commissioner are not obstruction. For conduct to be obstruction it must also be made without justification or lawful excuse.[50]

85. As with evasion, the onus of proof rests with the Commissioner to show that a taxpayer is liable for an increase in a shortfall penalty for obstruction (s 149A(2)(a)). The standard of proof is the balance of probabilities (s 149A(1)).

86. TCO acknowledged that this issue was finely balanced as there may have been justifications or explanations for some of the Taxpayer's actions. Nevertheless, on balance, TCO considered that the Taxpayer's continual and undue delays, misleading statements, diversion of income into other relatives' bank accounts and repeated failure to be forthcoming with information about deposits and bank accounts, delayed and made it more difficult for the Commissioner to carry out his audit of the Taxpayer's

[50] See Tax Information Bulletin Vol 8, No 7 (October 1996) at 24.

affairs. These factors affected the 2011, 2012 and 2016 income years, in respect of which it has been concluded shortfall penalties apply.

87. Accordingly, it was concluded that CCS has satisfied the onus of proving on the balance of probabilities that the Taxpayer obstructed the Commissioner in determining the correct tax position in respect of the Taxpayer's tax liabilities. Further, it was considered that these actions were done without justification or lawful excuse.

88. Therefore, the Commissioner may increase the shortfall penalties that the Taxpayer is liable to pay for the 2011, 2012 and 2016 income years by 25%.