

# Income Tax – Omitted income and liability for shortfall penalties

Decision date | Te Rā o te Whakatau: 26 May 2023

Issue date | Te Rā Tuku: 29 November 2023

TDS 23/17

## DISCLAIMER | Kupu Whakatūpato

This document is a summary of the original technical decision so it may not contain all the facts or assumptions relevant to that decision.

This document is made available for **information only** and is not advice, guidance or a “Commissioner’s official opinion” (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner’s position more generally or in relation to your own circumstances or tax affairs.** It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

For more information refer to the [Technical decision summaries guidelines](#).

## Subjects | Kaupapa

INC: Omitted employment income; TAA: Shortfall penalties, onus and standard of proof

## Facts | Meka

1. The Taxpayer was a trust with X and Y being settlors, trustees and beneficiaries. The Taxpayer was involved in property investment. Both X and Y were signatories of the Taxpayer's bank accounts. X was also the sole director and shareholder of Company B.
2. The Taxpayer returned only rental income for income tax purposes.
3. Customer Compliance Services, Inland Revenue (CCS) investigated the Taxpayer's income tax affairs and formed the view that:
  - Money from Company B had been deposited in the Taxpayer's bank accounts and retained by the Taxpayer and was used to fund the purchase of properties.
  - Money from Company B deposited and used in this way was not:
    - recorded as capital drawings or loans in the Taxpayer's financial statements, or
    - returned by the Taxpayer for income tax purposes.
4. CCS issued a Notice of Proposed Adjustment (NOPA) to the Taxpayer proposing:
  - Income tax adjustments for the applicable income years to include the money it considered the Taxpayer had received from Company B as unimputed dividends or, alternatively, income under ordinary concepts.
  - A shortfall penalty for evasion for each income year, reduced by 50% for previous behaviour.
5. The 4-year time bar periods for amending the Taxpayer's income tax assessments had expired in respect of some of the income years and in dispute. However, CCS considered that exceptions applied to allow the assessments to be amended at any time.
6. The Taxpayer rejected the proposed adjustments, and the matter was referred to the Tax Counsel Office, Inland Revenue (TCO) for adjudication.

## Issues | Take

7. The main issues in dispute were:
  - Whether money the Taxpayer received from Company B was assessable as dividends or, alternatively, income under ordinary concepts (ss CD 1 and CA 1(2) of the ITA 2007).
  - Whether the Commissioner could increase the Taxpayer's income tax assessments (ss 108(2) of the TAA).
  - Whether the Taxpayer was liable for shortfall penalties for evasion, reduced by 50% for previous behaviour (ss 141E and 141FB of the TAA).
8. There was also a preliminary issue on the onus and standard of proof.

## Decisions | Whakatauranga

9. TCO decided that:
  - Money the Taxpayer received from Company B was assessable to the Taxpayer as dividend income. If the dispute proceeded to challenge stage and it was found the amount was not the Taxpayer's dividend income, the amount was assessable to the Taxpayer as income under ordinary concepts.
  - CCS's position that the time bar exception in s 108(2) of the TAA applied was accepted. The Commissioner could increase the Taxpayer's income tax assessments.
  - The Taxpayer was liable for evasion shortfall penalties, reduced by 50% for previous behaviour.

## Reasons for decisions | Pūnga o ngā whakatau

### Preliminary Issue | Take tōmua: Onus and standard of proof

10. The onus of proof in civil proceedings<sup>1</sup> is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.<sup>2</sup> The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.<sup>3</sup>
11. The standard of proof in civil proceedings is the balance of probabilities.<sup>4</sup> This standard is met if it is proved that a matter is more probable than not. Whether the Taxpayer had discharged the onus of proof was considered in the relevant issues.
12. An assessment made by the Commissioner cannot be arbitrary. He must make the best judgement 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.<sup>5</sup>

### Issue 1 | Take tuatahi: Whether money received from Company B was assessable to the Taxpayer

#### Dividends

13. Under s CD 1 a dividend derived by a person is income of the person. Under s CD 4, a dividend is a “transfer of value” from a company to a person if the cause of the transfer is a shareholding in the company.
14. Section CD 5 provides that a transfer of value occurs when a company provides money or money’s worth to a person.

---

<sup>1</sup> Challenge proceedings (ie, the proceedings that would follow if a dispute proceeds to the Taxation Review Authority or a court) are civil proceedings.

<sup>2</sup> Section 149A(2) of the TAA.

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

<sup>4</sup> 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.

<sup>5</sup> *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).

15. Under s CD 6 a transfer of value to a person is caused by a shareholding in the company:
  - if the person:
    - holds shares in the company, or
    - is associated with a shareholder, and
  - the company makes the transfer because of the shareholding of the relevant person.
16. Associated persons include:
  - A company and a person (not a company) with a 25% or more interest in the company.
  - Two persons connected by marriage.
  - A trust and a person who is a beneficiary in the trust.
  - A trust and its settlor.
  - Two persons associated to the same third person.
17. Case law shows that company money taken and retained by a shareholder, whether deposited in their bank account or used for their personal expenditure, can be dividends under s CD 1.

### **Income under ordinary concepts**

18. Section CA 1(2) provides that an amount is income of a person if it is their income under ordinary concepts.
19. The phrase “income under ordinary concepts” is not defined in the ITA 2007. However, income has been described as a flow of money or money’s worth arising from the ownership of property or capital, from labour, or from a combination of those things.<sup>6</sup>
20. Regular recurrent payments on which the recipient depends to meet living expenses may be income under ordinary concepts.<sup>7</sup>

---

<sup>6</sup> *A Taxpayer v CIR* (1997) 18 NZTC 13,350 (CA) at 13,355. See also *Tennant v Smith* [1892] AC 150 (HL) and *CIR v Parson (No 2)* [1968] NZLR 574 (CA).

<sup>7</sup> *Reid v CIR* (1985) 7 NZTC 5,176 (CA) at 5,183.

## Application

21. TCO concluded that the money received from Company B was assessable to the Taxpayer as dividend income. This was because:
- Company B made transfers of value when it deposited and otherwise made available money to the Taxpayer.
  - The transfers of value were caused by a shareholding in Company B:
    - X held shares in Company B.
    - The Taxpayer was associated with X as they were a settlor of the Taxpayer.
    - There did not appear to be any reason for Company B to have made the transfers of value other than because of X's shareholding.
22. If the dispute proceeded to challenge stage and it was found the amount received from Company B was not the Taxpayer's dividend income, the amount was assessable to the Taxpayer as income under ordinary concepts:
- The money was made available to the Taxpayer recurrently over the income years in dispute, and regularly for a period of one income year.
  - The Taxpayer and X and Y used the money for their own purposes.
  - The Taxpayer did not explain the reason why it received the money or otherwise disproved that it arose from the ownership of property or capital, from labour, or from a combination of those things.

## Issue 2 | Take tuarua: Whether the Commissioner could increase the Taxpayer's income tax assessments

23. Generally, under s 108 TAA the Commissioner may not amend an assessment to increase the amount assessed if:
- the taxpayer has furnished an income tax return;
  - 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.
24. However, under s 108(2) TAA, the Commissioner may amend an assessment at any time 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.

25. An income tax return is misleading if:
  - it includes something which gives the Commissioner a wrong impression, or
  - it does not include something, the omission of which gives the Commissioner a wrong impression as to the taxpayer's true income tax position.
26. An income tax 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 the return was wrong.
27. To be "fraudulent or wilfully misleading", the filing of the incorrect return must be deliberate and intentional. Inadvertently filing an incorrect return or filing a return which the taxpayer honestly believes to be correct will not constitute filing a "fraudulent or wilfully misleading" return.

## Application

28. CCS argued that s 108(2) of the TAA allowed the Commissioner to amend the Taxpayer's income tax assessments. CCS argued that it was of the opinion that the Taxpayer's income tax returns for the income years in dispute were fraudulent or wilfully misleading.
29. TCO concluded that the Commissioner could increase the Taxpayer's income tax assessments. This was because
  - CCS was of the opinion the Taxpayer's income tax returns did not mention dividend income which was of a particular nature or was derived from a particular source and in respect of which a tax return was required to be provided.
  - There was support for CCS's opinion:
    - The income was of a particular nature, namely dividend income. It was derived from a particular source, namely Company B.
    - The Taxpayer's income tax returns for the income years in dispute did not include any dividend income from Company B.

- There was nothing to suggest CCS did not hold the opinion or that the opinion was not honestly held.

### Issue 3 | Take tuatoru: Whether the Taxpayer was liable for shortfall penalties for evasion

30. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:<sup>8</sup>

- 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.<sup>9</sup>
- 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.<sup>10</sup>
- 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.<sup>11</sup>
  - Recklessness can amount to evasion and involves the conscious taking of risk. Recklessness will be proven where:<sup>12</sup>
    - 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.

---

<sup>8</sup> 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).

<sup>9</sup> Definitions of "tax position" and "taxpayer's tax position" in s 3 of the TAA.

<sup>10</sup> Definition of "tax shortfall" in s 3 of the TAA.

<sup>11</sup> *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.

<sup>12</sup> *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.

- The taxpayer made a conscious decision to ignore the facts without making further inquiry.
31. The penalty payable for evasion or similar act is 150% of the resulting tax shortfall.
  32. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E.<sup>13</sup> 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.<sup>14</sup>

## Application

33. TCO concluded that the Taxpayer was liable for evasion shortfall penalties (reduced by 50% for previous behaviour) because:
  - They took tax positions that resulted in tax shortfalls.
  - In taking the tax positions, the Taxpayer evaded the assessment or payment of tax. There was evidence a trustee of the Taxpayer, X, knew that omitting to include the income the Taxpayer received from Company B in the income tax returns was in breach of the Taxpayer's tax obligations.
34. The imposition of shortfall penalties for evasion was appropriate given the seriousness of the Taxpayer's non-compliance. This occurred recurrently over the income years in dispute, involved substantial amounts and was not voluntarily disclosed.

---

<sup>13</sup> Section 149A(2) of the TAA.

<sup>14</sup> Section 149A(1) of the TAA.