Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

Suppressed cash sales, GST and evasion shortfall penalties

Decision date | Rā o te Whakatau: 22 November 2023

Issue date | Rā Tuku: 12 April 2024

TDS 24/07

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Subjects | Kaupapa

Income tax: Suppressed income; GST: Input tax deductions, taxable activity; TAA: Shortfall penalties.

Facts | Meka

1. The Taxpayer is a company that carried on a restaurant business. It was registered for income tax and GST.
2. Following an investigation, Customer Compliance Services, Inland Revenue (CCS), formed the view that:
    - The Taxpayer was involved in fraudulent activity through suppressing cash sales.
    - The Taxpayer had under-returned GST and income tax.
    - The Taxpayer ceased to carry on a taxable activity in later GST periods, as another company (Company B) took over the restaurant business.
3. CCS reassessed the Taxpayer's GST and income tax returns for the relevant periods, accounting for suppressed cash sales based on an analysis of the point of sale (POS) data, the Taxpayer's bank statements and an industry benchmark. CCS also issued a default assessment in respect of one income year. Evasion shortfall penalties of 150% were applied, reduced for previous behaviour by 50%.
4. For later GST periods, CCS assessed the Taxpayer's GST returns as nil, disallowing input tax deductions claimed.
5. The Taxpayer filed a Notice of Proposed Adjustment (NOPA) rejecting the Commissioner's reassessments and disputing CCS's default assessment.
6. The matter was referred to the Tax Counsel Office, Inland Revenue (TCO) for adjudication.

Issues | Take

7. The main issues in dispute were:
    - Did the Taxpayer under-report its cash sales and, if so, what is the amount of the under-reported cash sales?
    - Is the Taxpayer entitled to offset the cost of fresh produce purchased with cash against unreported cash sales where it does not hold records?

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- Has the Commissioner correctly reassessed GST for the later periods disallowing input tax deductions claimed?
- Is the Taxpayer liable to pay a shortfall penalty for evasion?

8. There were also preliminary issues raised by the Taxpayer concerning:
   - Whether the Commissioner was entitled to issue assessments under s 89C(eb) of the Tax Administration Act 1994 (TAA).
   - Was the outcome of the investigation pre-determined?

Decisions | Whakatau

9. TCO decided that:
   - The Commissioner validly assessed the Taxpayer without issuing a NOPA.
   - The outcome of the investigation of the Taxpayer was not predetermined.
   - The Taxpayer under-reported its cash sales.
   - The Taxpayer was not entitled to offset the cost of fresh produce purchased with cash, as no supporting evidence was provided.
   - The Commissioner correctly assessed the Taxpayer's GST and income tax assessments for the disputed periods.
   - For later GST periods, the Commissioner correctly reassessed the Taxpayer's GST disallowing input tax deductions claimed.
   - Evasion penalties were correctly imposed for the GST and income tax shortfalls.

Reasons for decisions | Pūnga o ngā whakatau

10. All legislative references in relation to the preliminary issues are to the TAA.

Preliminary Issue 1 | Take tōmua tuatahi: Whether the assessments were valid

11. The Commissioner's decision to make assessments without issuing a NOPA cannot be disputed by the Taxpayer. Relying on s 89C(eb), the Commissioner formed the view that he had reasonable grounds to believe that the Taxpayer has been involved in fraudulent activity through suppressing sales and under-returning GST and income tax.

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A matter which s 89C(eb) leaves to the Commissioner's discretion is not a "disputable decision" and s 138E provides there is no right of challenge.

12. However, the Taxpayer can dispute the resulting assessments by issuing its own NOPA (s 89D). As such, the Taxpayer is not denied dispute rights and other issues may be considered and dealt with under the statutory disputes process.

Preliminary Issue 2 | Take tōmua tuarua: Whether the outcome of CCS's investigation was predetermined

13. The Taxpayer argued that the basis of CCS's assessments was prejudicially and constructively reached with the outcome of CCS's inquiries having been predetermined from the start of their investigation.
14. TCO considered the outcome of the investigation was not predetermined and the Taxpayer did not provide any evidence in support of this allegation. The approach the Commissioner took to obtaining and analysing the Taxpayer's bank statements and POS data was a genuine attempt to calculate the Taxpayer's GST, income tax and shortfall penalty liabilities fairly and impartially.
15. The Taxpayer has not provided any evidence that the Commissioner ignored any information that was available to him or declined to pursue relevant lines of enquiries open to him.
16. Even if there had been a breach of natural justice (and it is not considered there has been) the Taxpayer can dispute the validity of an assessment through the disputes and challenge procedures. In addition, if this dispute proceeds to challenge stage the Taxpayer will have another opportunity to be heard (in the Taxation Review Authority or a court, as the case may be) and for a decision to be made free from bias. Similarly, TCO's review is independent from CCS and considers the dispute afresh on the basis of the evidence submitted by the parties.

Issue 1 | Take tuatahi: Whether the Taxpayer under-reported cash sales

17. The Commissioner assessed the Taxpayer with additional cash sales in the relevant GST periods and income years, resulting in GST and income tax shortfalls.
18. The Taxpayer argued that the Commissioner had no basis for the assessments and that the maximum/sales revenue was lower than the amount the Commissioner assessed.

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Onus and standard of proof

19. The onus of proof in civil proceedings is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction. The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[1]

20. The standard of proof in civil proceedings is the balance of probabilities.[2] This standard is met if it is proved that a matter is "more likely than not".

21. 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.[3]

Application

22. The Commissioner's methodology relied on the Taxpayer's bank statements and the Taxpayer's POS system data to determine as best he could with the information available, the amount of omitted income of the Taxpayer.

23. The Commissioner established that not all cash received from the restaurant business had been deposited into the Taxpayer's bank accounts. He made a reasonable assumption based on the available evidence that only the cash banked had been returned for GST purposes and that other cash takings recorded by the POS system had not been included in the returns. Using the information available to him, he recalculated the gross sales and determined the amount of omitted income in the Taxpayer's GST and income tax returns in the relevant periods.

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[1] Section 149 of the TAA. Case law confirms this approach: *Case V17* (2002) 20 NZTC 10,192; *Accent Management Ltd v CIR* (2005) 22 NZTC 19,027 (HC); *Vinelight Nominees Ltd v CIR (No 2)* (2005) 22 NZTC 19,519 (HC).

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

[3] *Lowe v CIR* (1981) 5 NZTC 61,006 (CA) at 61,015; *CIR v Canterbury Frozen Meat Co Ltd* (1994) 16 NZTC 11,150.

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Did the Taxpayer prove that the Commissioner's assessments were arbitrary or demonstrably unfair?

24. The Taxpayer asserted that CCS's assessments were demonstrably unfair, arguing that:
    - The benchmark comparison used to calculate the amount of cash sales was inaccurate for the business.
    - The amount of undeclared income could be nil.
    - Cash from the business was deposited sporadically because banking required travel to the nearest banking facility.
25. TCO concluded that the above arguments did not support the Taxpayer's position that the assessments were arbitrary or demonstrably unfair, noting that:
    - The industry benchmark did not affect CCS's assessments, as the assessments were based on the Taxpayer's own POS data.
    - It was not possible for CCS to be more precise about the suppressed cash sales as the Taxpayer did not maintain good records and did not provide most of the information requested by CCS.
    - Without further explanation or analysis by the Taxpayer, its reason for sporadic banking did not explain why the cash sales percentage used by the Commissioner was unfair.

Did the Taxpayer prove that the Commissioner's assessments were wrong?

26. The Taxpayer also argued that the Commissioner overestimated the maximum sales/revenue for a particular period, stating that the sales/revenue could not have exceeded the gross sales recorded by the restaurant's POS system.
27. However, the figure for the maximum sales/revenue that the Taxpayer provided related to a different period than the Commissioner's assessments, and the Commissioner's assessments did not exceed the gross sales recorded by the restaurant's POS system.
28. Following receipt of the Taxpayer's Statement of Position, CCS accepted the Taxpayer's arguments regarding cancelled sales and reduced the cash sales ratio and the assessments of income tax, GST and shortfall penalties accordingly.
29. TCO concluded that the Taxpayer had not established that CCS's assessments were wrong.

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Issue 2 | Take tuarua: Offset for Cash Purchases of Fresh Produce

30. The Taxpayer argued that it was entitled to offset the cost of fresh produce purchased with cash against unreported cash sales where it did not hold records.

31. TCO considered whether the Taxpayer was entitled to claim input tax deductions under the Goods and Services Tax Act 1985 (GSTA) and deductions under the Income Tax Act 2007 (ITA) for the cash purchases.

GST input tax deduction

32. The calculation of GST payable by a registered person is set out in s 20 of the GSTA. In brief, the input tax that a registered person has paid when acquiring goods and services may be offset against the GST output tax charged on supplies made by the person in the same period (s 20(3) of the GSTA).

33. For a taxpayer to claim input tax, the applicable requirements must be met:

    - The taxpayer must be a GST registered person. Registration for GST is dependent on the person carrying on a taxable activity.
    - Goods or services must have been acquired. It is not enough that a payment to a registered person is identified, it must have sufficient connection to the supply of goods and services.
    - The goods and services must have been used for, or available for use in, making taxable supplies.
    - The taxpayer holds a tax invoice when they furnish the return.

Tax Invoice Requirements

34. TCO noted that the requirement to hold a tax invoice is an important and deliberate feature of the GSTA. The information provided by invoices is essential for the administration of the GSTA and helps a registered person to know whether they can claim an input tax deduction.

35. A tax invoice is not required for supplies made for a consideration of $50 or less (s 24(5) of the GSTA).

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Application

36. TCO decided that the Taxpayer was not entitled to an input tax deduction because:
    - The Taxpayer had provided no basis for the value of fresh produce it acquired.
    - The Taxpayer's argument that its financial statements included little reference to purchases of fresh produce was not meaningful without further analysis and context.
    - The Taxpayer did not provide any tax invoices to support its claim for input tax deductions in relation to purchases of fresh produce with cash, and they did not claim that any of the purchases were less than $50.

Income tax deductions

37. Section DA 1 of the ITA sets out the general permission. To establish that a deduction for expenditure or loss is allowable under the general permission a taxpayer must show that:
    - they have incurred the expenditure or loss; and
    - there is a sufficient nexus or connection between the expenditure or loss and the derivation of income by the taxpayer, or the carrying on of a business for that purpose.
38. Determining whether there is a sufficient nexus or connection between expenditure and the derivation of income requires identifying the relationship between the advantage gained or sought to be gained by the expenditure and the income earning process. Whether a sufficient relationship exists is a question of fact.[4]
39. While a taxpayer's entitlement to an income tax deduction cannot be disallowed merely because no invoice is provided, s 22 of the TAA requires taxpayers who carry on an activity or business for the purpose of deriving assessable income to keep sufficient records.

Application

40. TCO concluded that the Taxpayer had not provided sufficient evidence to show that it incurred expenditure on fresh produce using cash for the value that it claimed. Therefore, it was not entitled to the income tax deduction.

[4] *Cox v CIR* (1992) 14 NZTC 9,164 (HC) at 9,168; *CIR v Banks* (1978) 3 NZTC 61,236 at 61,240.

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Issue 3 | Take tuatoru: Taxable activity

41. In this issue, all legislative references are to the GSTA unless stated otherwise.

42. CCS reassessed the Taxpayer's GST returns as nil in several GST periods, having formed the view that Company B had taken over the Taxpayer's taxable activity.

43. The Taxpayer accepted that Company B became the new operating entity for the business for the relevant GST periods, but argued that the Taxpayer remained an active entity as:

   - It paid expenses incurred by it before the first relevant GST period.
   - It purchased materials and paid accounts for the establishment of Company B.

44. CCS argued that the Taxpayer no longer had a taxable activity from the GST period in which Company B took over the business, and that the Taxpayer could therefore no longer claim input tax. It also argued that:

   - The Taxpayer had not provided any documentation to support its input tax claims.
   - The Taxpayer could only claim expenses for goods and services bought for use in its own taxable activity.

Requirements for a taxable activity

45. GST is imposed on taxable supplies of goods and services made by a registered person in the course or furtherance of a taxable activity carried on by the registered person. Establishing that there is a taxable activity is crucial to whether a person should be registered for GST and subject to the GSTA.

46. Taxable activity is defined in s 6 of the GSTA. There are four requirements that must be satisfied to show there is a taxable activity (s 6(1)(a)):

   - There must be an activity.[5]
   - The activity must be carried on continuously or regularly by a person.[6]

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[5] *Newman v CIR* (1994) 16 NZTC 11,229 (HC) at 11,233; *CIR v Bayly* (1998) 18 NZTC 14,073 (CA) at 14,078; *Case 14/2016* at [63].

[6] *Newman* (CA) at 12,100; *Smith v Anderson* (1880) 15 Ch D 277 at 278; *Premier Automatic Ticket Issues Ltd v FCT* (1933) 50 CLR 268 (HCA) at 298; *Case 14/2016* at [67];

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- The activity must involve, or be intended to involve, the supply of goods and services to another person.[7]
- The supply or intended supply must be made for a consideration.[8]

47. Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity (s 6(2)).

Application

48. For the following reasons, TCO decided that CCS had correctly reassessed the Taxpayer's GST returns in the relevant periods as nil:
    - The onus of proof is on the Taxpayer.
    - The Taxpayer has not shown that it continued to carry on a taxable activity after Company B took over its restaurant business.
    - It has not shown that the expenses incurred were something done in connection with the ending of its taxable activity and it has not provided any tax invoices or other supporting documentation.

Issue 4 | Take tuawhā: Shortfall penalties for evasion

49. In this issue, all legislative references are to the TAA unless stated otherwise.

50. Section 141E(1)(a) imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:
    - 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 position.

[7] Definition of "supply" in s 5(1); *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213 (HC) at 6,223; *Pacific Trawling Ltd v Chief Executive of the Ministry of Fisheries* (2005) 22 NZTC 19,204 (HC); *Case S77* (1996) 17 NZTC 7,483; *Case L67* (1989) 11 NZTC 1,391.

[8] Definition of "consideration" in s 2(1).

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- 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.[9]
  - 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.
  - Wilful blindness may be equivalent to actual knowledge. A finding of knowledge can be based on evidence that a taxpayer has deliberately shut their eyes to the obvious or refrained from inquiry because they did not want to have their suspicions confirmed.[10]
  - Recklessness can amount to evasion and involves the conscious taking of risk.[11] Recklessness will be proven where:[12]
    - Facts known to the taxpayer were such that they must have put the taxpayer on inquiry that a tax obligation may not be met, and
    - the taxpayer made a conscious decision to ignore the facts without making further inquiry.
  - In the case of a company, the knowledge of a responsible officer or officers of the company can be attributed to the company.[13]

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

52. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E (s 149A(2)(a)). 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 (s 149A(1)).

[9] *Taylor v Attorney-General* [1963] NZLR 261 (SC).

[10] *R v Chahine-Badr* [2006] 2 CTC 243; 79 OR (3d) 671 and see also *Westminster City Council v Croyalgrange Ltd* [1986] 2 All ER 353, 359 (CA).

[11] *Case N47* (1991) 13 NZTC 3,388 at 3,393; *R v Harney* [1987] 2 NZLR 576 (CA) at 579 and 581.

[12] *Case P29* (1992) 14 NZTC 4,213.

[13] *Meulen's Hair Stylists Ltd v CIR* [1963] NZLR 797 (SC).

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Application

53. TCO concluded that the Taxpayer was liable for evasion shortfall penalties (reduced by 50% for previous behaviour) because the Commissioner has proven on the balance of probabilities that the Taxpayer evaded the assessment or payment of tax:

   - There was evidence that the Taxpayer's responsible officers knew that not all the restaurant's sales income was banked, yet they prepared the GST and income tax returns from the bank statements without any adjustment for unbanked sales income.
   - By not using the data from the Taxpayer's own POS system which would have provided a more accurate picture of the restaurant's total sales (even after being put on notice by Inland Revenue's investigation) the responsible officer who prepared the tax returns was being wilfully blind. Wilful blindness is equivalent to actual knowledge.

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