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Gross Carelessness Shortfall Penalties

There has been a noted increase in the number of cases where the Inland Revenue Department (IRD) has imposed shortfall penalties for gross carelessness. We therefore consider it timely to review the application of the gross carelessness penalty.

Section 141C (3) of the Tax Administration Act 1995 defines gross carelessness to mean:

“Doing or not doing something in a way that, in all the circumstances, suggests or implies a complete or high level of disregard for the consequences.”

In Tax Information Bulletin Vol 16, No 8 issued in September 2004 the Commissioner finalised an interpretation statement on the gross carelessness shortfall penalty. This statement replaced Standard Practice Statement INV 210 but covers much the same ground as INV 210. It also reflects amendments to legislation and case law since INV 210 was issued. Based on this case law the IRD considers there are a number of relevant factors that are present in situations where gross carelessness penalties are applied.

Case W24 (2003) 21 NZTC 11,034 concerned a property speculator who prepared his own GST returns. He acquired a property in December 1997 and claimed an input tax deduction. The property was sold in an agreement entered into in May 1998 (less than six months later) with settlement that November. Output tax was not returned. The error was picked up during an IRD audit. The Court held a gross carelessness penalty applied. There were inadequate systems in place and given his experience with

preparing GST returns and previous warnings he should have known to return the output tax. Barber considered gross carelessness must be something similar to recklessness. He noted the degree of negligence must be of greater magnitude than that required for not taking reasonable care.

Various other case law was considered including *R v Howe* [1982] 1 NZLR 618 where *R v Caldwell* [1981] all ER 961 was cited. In *Howe* the determination of whether behaviour was reckless was described as follows:

“As to recklessness there has been a line of cases in England of high authority affirming that this word has no separate legal meaning. And that, although including more than mere carelessness, it is not limited to deliberate risk taking but includes failing to give any thought to obvious and serious risk.”

Judge Barber considered that “gross carelessness” refers to a high level of disregard for the consequences which would have been foreseen by a reasonable person in the circumstances.

In the recent cases we have seen we do not consider the test of gross carelessness has been met. We believe only few cases would fall within this category and are surprised at the level being imposed. If you have cases of such penalties being applied we would recommend contacting us to determine whether the IRD have applied its policy correctly.

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New Tax Rules for Offshore Investments in Shares in Foreign Companies

As you may know, the Government has introduced new rules that impact on shares held in foreign companies and units in unit trusts. The FIF rules for superannuation schemes and life insurance policies remain the same.

What was originally sold by the Government as a relatively straightforward way to simplify the FIF rules for 'smaller' investors has been made unduly complicated.

The new rules come into effect for income years beginning on or after 1 April 2007.

The rules contain a number of exemptions including a de minimus exemption for natural persons, shares in companies tax resident in Australia and which are listed on the ASX, 10% or more shareholdings in companies tax resident in grey list countries, GPG shares and certain start-up companies. There is also a concession for natural persons and family trusts if their return is less than 5%. The grey list exemption no longer applies for shareholdings of less than 10%.

The new rules add two new methods to the existing four methods for calculating

FIF income, with restrictions on which methods can be used.

The new method that has generated most publicity is the 'fair dividend rate' ("FDR") method. In its simplicity, this method taxes 5% of the market value of the share portfolio (excluding any shares exempt from the FIF rules) at the start of the year. However the legislation has introduced a complex set of formulae for calculating income if shares are bought and sold within the same income year.

For your clients with a 31 March balance date these rules will apply from 1 April 2007, and will need to be taken into account for 2008 provisional tax estimates.

There may be tax planning opportunities to minimise the impact of the new rules at least for the 2008 income year if action is taken by 31 March 2007.

Please contact one of our tax team for more information on how the new rules will impact on your clients. And look out for our seminars that will cover these rules coming soon.

Gavin Stewart

Changes Announced to Penalties Regime

The Hon Peter Dunne recently announced changes to the penalty regime that are proposed to be introduced in the next Tax Bill expected in May of this year.

The proposed changes include:

- Penalties for not taking reasonable care or taking an unacceptable tax position will not be imposed where a voluntary disclosure is made prior to audit notification.
- The penalty for taking an unacceptable tax position will be limited to income tax. This will relieve taxpayers from being

harshly treated in respect of GST returns filed. In most cases such returns are prepared by taxpayers rather than their agent.

- First time late payers will not be penalised. They will instead receive notification that payment is due giving them time to pay.

These amongst other changes are aimed at promoting voluntary compliance. We welcome these changes as it will make it easier for taxpayers to comply with the tax laws. These changes will also make it easier for advisors to put their clients on notice as to whether or not certain penalties will apply should an error arise.

Lisa Murphy