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Failing to File Tax Returns: Criminal Prosecution

The global financial crisis has meant an increased number of businesses suffering hardship and failing to meet the expectations of creditors, including the IRD. All too often, businesses in trouble have directors that are under extreme stress. This means that some things can fall by the wayside, including filing of tax and GST returns. Some businesses may use the IRD as a “bank”, paying trade creditors in preference to the IRD. The consequences of failing to meet your tax obligations can be serious.

In the event an individual or a business fails to file tax returns, the IRD may calculate tax payable by the business or person on the basis of previous returns – commonly called a default assessment. It is imperative that any person subject to a default assessment immediately contact the IRD, firstly to ensure the default assessment is accurate and secondly, to avoid criminal charges being laid. Putting one’s head in the sand is not a wise option. The Tax Administration Act 1994

(“TAA”) contains a complicated process for disputing a default assessment, and it is a process on which you may wish to seek legal advice.

If the dispute resolution process fails, or the taxpayer does not engage with the IRD, the IRD may lay criminal charges for failing to file tax returns and therefore failing to pay tax.

Section 143B(1)(b) of the TAA provides that it is an offence to knowingly fail to file an income tax return when required, with the intention of evading the assessment or payment of tax. Similarly, it is also an offence under the TAA to aid and abet any company or other entity to knowingly fail to file income tax returns when required, with the intention of evading the assessment or payment of tax. The maximum penalty in relation to each offence is five years imprisonment, a fine not exceeding \$50,000.00, or both.

A person can be prosecuted for failing to file both personal tax returns and the tax returns of a company for which they are a director. A separate charge can be laid for each year for which a tax return has not been filed.

These charges are very difficult to defend. The act of failing to file a tax return will usually be considered sufficient proof of an intention to evade tax. More often than not, the accused will plead guilty to the offences and then their lawyer will present a plea in mitigation. Any guilty plea should be entered at the earliest possible opportunity as it will reduce the sentence imposed by 33%.

You should always talk to your lawyer about whether a guilty plea is the most appropriate step to take, or whether the circumstances suggest that the charges can be defended.

If a guilty plea is entered, the matter can be adjourned so your lawyer can approach the IRD to discuss the amount of tax the IRD says is payable in the default assessment. Ideally you will reach agreement with the IRD that a lesser sum is actually owed, and this will reduce the sentence the Court may impose.

You can approach the IRD with any material or evidence that you may have to support a position that a lesser sum is payable than is set out in the default assessment. The IRD may also agree to remove penalty fines imposed and penalty interest accrued, and simply deal with the core tax payable.

Charges can be laid for each year a tax return is omitted. If it is accepted by the IRD that no tax is payable by the taxpayer in any of the disputed years, the charge can no longer stand.

If the parties are unable to agree on how much tax would be payable (had tax returns been filed), the matter will go to a formal proof hearing. You should always discuss the cost effectiveness of this approach with your lawyer.

Morrison Kent Wellington recently conducted a plea in mitigation for an individual who faced eight charges of failing to file tax returns, both personally and on behalf of his company. During the process of negotiation with the IRD, the core tax payable was reduced by several hundred thousand dollars, and penalties and interest were excluded. Two charges were also withdrawn. This had a significant impact on the severity of the penalty for our client. The negotiation process took the taxpayer out of the sentencing range of imprisonment and he was instead sentenced to a small amount of reparation, community work and a short period of community detention.

It was central to the plea in mitigation and our submissions on sentencing that our client was a “clumsy businessman” under extraordinary pressure, both in his business life and his personal life. The District Court Judge considered it a mitigating factor that he had not acted fraudulently or in a calculated manner to evade tax.

In the District Court, the IRD sought to rely on a series of previous decisions where the defendant had set out to avoid tax by the use of company structures, falsifying documents and failing to properly calculate GST. The Judge stated that the IRD’s submissions, which were based on these cases, were not fitting to the case of the “clumsy businessman”.

On appeal to the High Court, the IRD submitted that the Judge had erred on the basis that there was no difference between the clumsy businessman and an actively fraudulent individual. The IRD said that this resulted in a sentence that was manifestly inadequate.

The High Court agreed with our submission that it was a mitigating factor that the taxpayer was a clumsy businessperson, rather than an actively fraudulent individual. The High Court held that the sentence imposed in the District Court was not manifestly inadequate and it was upheld.

While it is never ideal to end up in the criminal courts in relation to tax matters, it is avoidable. Filing tax returns, engaging with the IRD early, or appointing an accountant to do your returns are ways to manage your tax obligations.

If you ever have any doubts about your tax returns or you are involved in the dispute process with the IRD, contact your accountant or your lawyer to ensure that the process is followed correctly and criminal proceedings are avoided.



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