



**PRACTICE  
STATEMENT No. 1**

**2<sup>nd</sup> Release**

<b>SUBJECT</b>	<b>FIJI ISLANDS REVENUE AND CUSTOMS AUTHORITY: PRACTICE ON THE IMPOSITION AND REMISSION OF PENALTIES</b>
<b>DATE OF EFFECT</b>	1 April 2003 (Note: This Practice Statement replaces the 1 <sup>st</sup> Release dated 1 May 2002)
<b>CONFIDENTIALITY STATUS</b>	May be released to the public
<b>LEGISLATIVE REFERENCES</b>	<i>Income Tax Act 1974</i> Sections 44,45,46,47,48,86, 92,93,94, 95,97, 99,100,108 <i>VAT Decree 1991</i> Sections 9,31,60,70,76,76A, 80
<b>PRACTICE CO-ORDINATOR</b>	General Manager - Risk and Compliance Division

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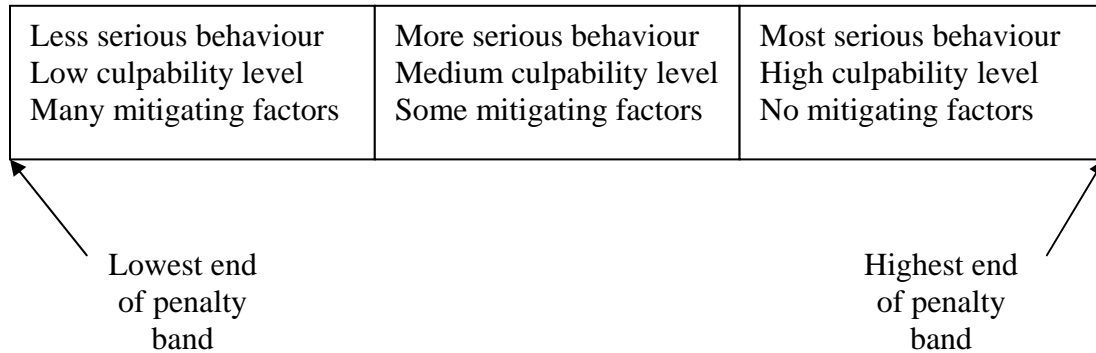
## INTRODUCTION

1. This statement sets out the practice of the Fiji Islands Revenue and Customs Authority (FIRCA) in relation to the application of various administrative penalties under the taxing acts. It is issued with the authority of the Chief Executive Officer of the Fiji Islands Revenue and Customs Authority, who is also Commissioner of Inland Revenue.
2. The penalties covered by this statement are **administrative penalties**, i.e., those which are imposed by the legislation, or by FIRCA officers under an authority provided for in the tax law. They are distinguished from **court-imposed penalties**, which a magistrate imposes following the conviction of a taxpayer for an offence provided for in the law.
3. The purpose of penalties is to impose a financial cost on a taxpayer as a consequence of a particular behaviour by the taxpayer, so that the taxpayer (and taxpayers generally) will be deterred from engaging in that type of behaviour in the future. Administrative penalties are generally considered one of the main enforcement tools of a tax compliance process, and will be used by FIRCA to improve compliance levels with the tax law.
4. Some penalties are imposed by the law automatically as a consequence of a person's action or inaction. In these cases the penalty is not imposed by the Commissioner - the law makes the person liable for a penalty at the maximum amount specified in the statutory provision, and the Commissioner has the discretion to remit all or part of the penalty. Other penalties are initially imposed at a level set by the Commissioner. In both cases consistent outcomes are required for taxpayers with the same degree of culpability.
5. The Commissioner's general power to remit penalties are found in subsection 100(2) of the *Income Tax Act 1974* and subsection 70(1) of the *VAT Decree 1991*. There are some specific remission powers such as subsection 92(2) of the *Income Tax Act*. The specific remission powers override the general remission power, and they may provide limited grounds to remit the penalty.
6. The use of these guidelines by FIRCA officers is mandatory, not optional. As there are numerous officers within FIRCA authorised by the Commissioner to apply the penalty provisions on a daily basis, this practice statement is necessary to give guidance in the setting of rates for each penalty applied to a taxpayer. It is important that all taxpayers are treated in a similar way for similar breaches of the law. It is also important that taxpayers have access to this document, to understand the basis on which the penalty imposition and remission powers have been applied to them.

## **PRACTICE FOR PENALTIES GENERALLY**

7. In deciding whether to remit penalties in whole or in part, consideration has to be given to the degree of culpability of the taxpayer, and whether any mitigating factors exist. “Culpability” is synonymous with “blame” or “guilt”, and refers to the level of responsibility the taxpayer bears for the legal requirement not having been met. “Mitigating factors” are factors which may warrant a reduction in a penalty and which are **not** related to the degree of culpability of the taxpayer. Both these concepts are discussed further below.
8. The degree of culpability would be in the lower end of the range if an event occurred which prevented the taxpayer from fulfilling their obligation under the tax law, such as the taxpayer contracting a serious illness or a fire destroying business premises. Not only must such an event have occurred, but it must have been impossible for the taxpayer to have arranged for another person such as a tax agent to have carried out the legal obligation for the taxpayer. An excuse by a taxpayer that they were too busy with their business affairs to fulfil their obligations, or that they were unaware of their obligations, would not reduce culpability.
9. Lower culpability would also be indicated by the taxpayer contacting FIRCA prior to the due date for lodgement to inform FIRCA that the obligation would not be met. If FIRCA is the initiator of contact with the taxpayer this would indicate a higher level of culpability. If FIRCA issues a demand notice for an outstanding obligation to be complied with, a slow response by the taxpayer or no response would indicate higher culpability.
10. Mitigating factors may warrant a reduction in penalty no matter what the culpability level. These may include:
  - whether the taxpayer has an otherwise good record of tax compliance. If this is the first occurrence of non-compliance, a lesser penalty combined with a warning may be more effective in ensuring the taxpayer improves their future compliance;
  - whether the taxpayer suffers from ill health or is of old age; or
  - whether the taxpayer has a low literacy level or level of education.
11. Mitigating factors do **not** include:
  - the taxpayer’s status in the community: or
  - the extent to which the taxpayer has exhibited contrition for the breach of their statutory obligations.

12. Where these guidelines call for penalty to be set within a particular band or range, the penalty percentage will be fixed taking into account the comparative degree of seriousness of the non-compliant behaviour within that band, the degree of culpability and whether there are mitigating factors. This can be summarised as:



13. The degree of culpability and mitigating factors may result in a penalty reduction, but it is rarely the case that a penalty remission to nil is justified. Even where low culpability is indicated on the part of the taxpayer, the revenue needs to be compensated for the taxpayer having use of the money at the revenue’s expense.

14. This rate of compensation is currently estimated at 10%. This rate may change, but should be based on what the State has to pay to borrow money to fund its operations (in the absence of having the revenue to do so because of the taxpayer’s non-compliance), and the costs to the State in administering the taxpayer’s non-compliance. Some penalties, such as income tax incorrect return penalties, have a specific “interest” component to achieve this outcome, but the principle should apply across all penalties.

15. In setting penalties it has been the usual practice to peg the penalty at a multiple of 5%. While this is helpful in providing consistency across a range of taxpayers it is not mandatory in all cases, and an odd amount penalty such as 27.5% or 28% may be warranted in some cases.

16. It is also acceptable to reverse calculate a penalty from a dollar amount into a percentage, as long as the percentage is calculated in accordance with these guidelines and rounded down by less than 5%. A penalty amount which is calculated this way as an even amount has the advantage of being easier to administer if it is to be paid in equal instalments under an arrangement to pay. For example, a penalty amount of \$3,000 representing 24.18% of the discrepancy may be selected, rather than \$3,101.25 being 25% of the discrepancy calculated under these guidelines.

17. Some tax provisions give the Commissioner the power to extend the time for a taxpayer to meet their obligations, such as section 48 and subsection 76(5) of the *Income Tax Act*, and section 9 of the *VAT Decree*. The granting of such an extension by the Commissioner relieves the taxpayer from the imposition of penalties for not carrying out the obligation within the time the law requires.
18. Penalties are to be assessed in the same manner as normal tax, that is, they are to be notified to the taxpayer in the notice of assessment or other notice as appropriate. In the case of income tax and VAT penalties, these should be notified in the notice of assessment for the income year or period to which the penalty relates. The *VAT Decree* in subsections 76(3) and 76A(3) require that the penalties in those sections be assessed separately from the deficient tax. This can be achieved by including a penalty amount in a notice of assessment but identifying it as a separate amount from the normal tax or deficient tax. If any penalty is subsequently reduced, this must be done by way of an amended assessment and not a journal entry on the taxpayer's account.
19. Taxpayers have the right to object against an assessment on the grounds that the amount of penalty is excessive. After an audit, taxpayers should be given a period of 28 days in which they can informally apply to have a penalty reduced. Any agreement by a taxpayer to a penalty amount under such an arrangement does not remove the taxpayer's right to object to the penalty during the statutory period for doing so. Any informal request or formal objection by a taxpayer to have a penalty reduced must be considered in accordance with this practice statement.
20. All decisions on the imposition and remission of penalties by FIRCA officers are required to be documented, or stored electronically if appropriate. The name of the decision-maker and the basis of the decision should be explained, with reference to the relevant parts of these guidelines.

## **LATE LODGEMENT PENALTY**

21. The penal provisions which affect the late lodgement of returns are section 94 of the *Income Tax Act 1974* and section 60 of the *VAT Decree 1991*.

22. Section 94 of the *Income Tax Act* states:

“Every person required to make a return under the provisions of section 44 who fails to make a return within the time limited therefor shall be subject to a penalty of 50 per cent of the amount of the tax payable, and every other person who is required to make a return under the provisions of section 44, 45, 46 or 47 who fails to do so within the time limited therefor shall be subject to a penalty of \$10 for each day during which the default continues, and all such penalties shall be assessed and collected from the person liable to make a return in the same manner in which taxes are assessed and collected.”

23. The returns referred to are returns of persons liable to taxation (section 44), returns of corporations (section 45), returns by guardians or legal representatives (section 46) and returns by employers of salary and by companies of dividends etc (section 47). Note that the Regulations to Section 81 require reporting by employers, which relieve employers from complying with section 47, and so section 94 cannot be used to penalise an employer for failing to lodge a return in accordance with section 47. In such cases there is the option of prosecution using the offence provision of subsection 93(2) of the *Income Tax Act*.

24. The section 94 penalty has two limbs:

- \$2 per day or part of a day if the failure to lodge continues after the due lodgement date to a date of up to three (3) months after the due lodgement; \$7 per day or part of a day if the failure to lodge continues after three months to a date up to six (6) months; \$15 per day or part of a day if the failure continues after six (6) months under the provisions of section 44, 45, 46 or 47.
- a fine of \$400 and treble the amount of tax for which the person is liable under the *Income Tax Act* for the year of assessment, in respect of or during which the offence was committed or to imprisonment for six (6) months; and

The first limb applies only where the return involves an amount of tax payable. Where the return discloses that no tax is payable or would result in a refund, or is a return of a reporting nature (such as a return of company dividends paid), the second limb would apply.

25. If a person lodges a return due under sections 44, 45 or 46 later than the due date, which discloses that no tax is payable or the taxpayer is entitled to a refund, the

second limb of section 94 would apply. However, for the purpose of encouraging voluntary lodgement of such returns, penalties shall be remitted to nil automatically. If the assessment is subsequently amended to result in a taxable situation, penalty should be applied under the first limb of section 94.

26. Section 60 of the *VAT Decree* states:

“Subject to this Section, additional tax shall be, and be deemed to be, added to any tax remaining unpaid, and shall be payable accordingly, as follows:

(a) where any return for any taxable period is not furnished or any tax remains unpaid on the expiry of the due date then notwithstanding anything contained in any other section of this Decree, additional tax of ten percent of the tax payable in respect of that taxable period;

(b) on the amount of so much, if any, of the tax, (being the tax referred to in paragraph (a) of this subsection and the additional tax added thereto in accordance with the provisions of paragraph (a) of this subsection) as remains unpaid at the expiry of the day on which there expires the period of one month immediately following the due date referred to in paragraph (a) of this subsection, additional tax of two and a half percent;

(c) on the amount of so much, if any, of the tax, (being the tax referred to in paragraph (a) of this subsection, the additional tax added thereto in accordance with the provisions of paragraphs (a) and (b) of this subsection, and the additional tax added thereto in accordance with the provisions of this paragraph) as remains unpaid at the expiry of any of the periods of one month that, consecutively, succeed the period of one month referred to in paragraph (b) of this subsection, additional tax of two and a half percent.”

Section 60 covers both late lodgment of returns and late payment of tax. Penalties for the late payment of tax are covered in the next section of this statement.

27. The penalty components in paragraphs (b) and (c) of section 60 should be remitted to nil automatically. This is done having regard to the social and business difficulties currently being experienced in Fiji (Refer to the later section on automatic penalty remissions). The penalty component in paragraph (a) should be initially imposed at the fixed rate of 10% in all cases of late lodgement of VAT returns, and remitted in part or in whole in accordance with the following guidelines, as appropriate.

28. The imposition of late lodgement penalty under section 94 of the *Income Tax Act* is the subject of an automatic remission. The penalty for late lodgement of all types of returns is 12% p.a. of net tax payable times the number of days late, where:

“net tax” means tax on chargeable income minus (tax deducted at source + advanced company tax or provisional tax paid + payments in advance); and

“number of days late” means the number of days between the actual lodgement date and the later of the due date or extended due date.

29. If the late lodgement penalty calculated per the rules in the preceding paragraph is greater than 50% of the net tax, it will be set at 50%. That is, there will be no remission in such cases. The new standard rate of 12% p.a. will be used for all late lodgments on or after 1 April 2003, irrespective of which year is being lodged.
30. Penalty imposed for the late lodgement of VAT and income tax returns at the above rates may be further remitted upon request or objection by the taxpayer providing valid reasons for such further reduction. A further remission may be justified based on the degree of culpability of the taxpayer, the seriousness of the breach of obligation, and whether any mitigating factors exist. The diagram in paragraph 12 gives guidance on the further remission of late lodgement penalties. For example, if a 10% return had been imposed for late lodgement of a VAT return, the lower and upper ends of the penalty range in the diagram would be 0% and 10% respectively.

## **INSUFFICIENT ADVANCE PAYMENT PENALTY & UNDERESTIMATED PROVISIONAL TAX PENALTY**

31. The penal provisions for insufficient advance payment of company tax are found in subsection 92(1) of the *Income Tax Act*:

“(1) If the amounts of the advance payments of tax required to be paid under the provisions of subsection (1) of section **91** are less by more than 20 per cent, at the expiry of 3 months after the last day of a company’s fiscal year, of 66.67 per cent of the tax for that year of assessment as finally assessed by the Commissioner in accordance with the provisions of section **55**, then the company shall be liable to pay to the Commissioner, by way of additional tax, an amount equal to 10 per cent of the difference between the amount of the advance payment made and 66.67 per cent of the liability to tax as finally assessed.”

32. The section provides a mitigation power in subsection (2):

“The Commissioner may, where it is shown to his satisfaction that the failure to make an advance payment or a sufficient advance payment was due to circumstances which were not or could not reasonably have been foreseen by the company at the time such payments were due, remit the whole or any part of the penalty provided for in this section.”

The words “failure to make an advance payment or a sufficient advance payment” cover all situations where such a failure occurs. It includes situations where:

- a taxpayer deliberately does not pay;
- where the taxpayer does not have the funds to pay; and
- where the taxpayer makes a genuine attempt to estimate their final tax but this later proves incorrect.

33. The penal provision for underestimated provisional tax is subsection 86(1) of the *Income Tax Act*, which says:

“Where, in accordance with the provisions of subsection (2) of section **84**, the Commissioner has accepted from any person an estimate of income as the basis of payment of provisional tax and that estimate proves to be less than 80 per cent of the actual income derived during the income year, that person shall, subject to the provisions subsection (2), be liable to pay to the Commissioner, by way of additional tax, an amount equal to 10 per cent of the difference between—

(a) the amount of tax calculated on 80 per cent of his actual income for the year; and

(b) the amount of tax calculated on the basis of the full amount of the aforesaid estimate:

Provided that, where emolument income is derived in that year, any deductions made therefrom in accordance with the provisions of section **80** shall be deducted from (a) and (b).”

34. The section provides a mitigation power in subsection (2):

“Where the Commissioner is satisfied that any person has become liable to pay additional tax under this section by reason of his income for that year being affected by circumstances of which he was not or could not reasonably have been aware at the time of making the estimate referred to in subsection (2) of section **84**, the Commissioner may, in his discretion, remit the additional tax or any part thereof.”

35. Both subsections 92(2) and 86(2) are specific mitigation powers and therefore, under the *ejusdem generis* principle of statutory interpretation, take precedence over the Commissioner’s general remission power in subsection 100(2). The specific grounds of mitigation preclude any other grounds of mitigation. For example, insufficient advance payment penalty cannot be remitted for a taxpayer with arrears, on the grounds that the taxpayer agrees to pay their arrears more promptly.

36. The grounds of remission in both subsections are limited to whether the shortfall arose “due to circumstances which were not or could not reasonably have been foreseen” by the taxpayer. In the case of section 86 the circumstances must have affected the taxpayer’s income. For example, a taxpayer may have an expectation of imminent migration, which would lead to the taxpayer to believe they would have no income in the following year. The taxpayer might therefore estimate their provisional tax as zero. Events may then happen which delay the migration, such as a family illness or longer time taken than anticipated to sell a business, which increase the taxpayer’s income beyond the estimation. The issue is whether the taxpayer could reasonably have foreseen these events.

37. The imposition and remission of these penalties is usually handled by the Revenue Collection and Risk and Compliance Divisions of FIRCA. There are three steps in the decision-making process for remitting this penalty. Firstly, the cause of the shortfall of advance company tax or provisional tax needs to be ascertained. In the case of provisional tax, the statement of reasons given by the taxpayer in their application under subsection 84(2) to estimate their provisional tax needs to be examined. In the case of advance company tax, this is self-assessed and the reasons for variation will have to be determined by questioning the taxpayer. In either case, the taxpayer must explain:

- why they believed their provisional tax estimation or company tax instalments would be lesser than the final tax payable; and
- what circumstances arose which made their estimation incorrect.

38. Secondly, it must be determined whether the events, which occurred subsequent to the provisional tax estimation or company tax variation, could have been reasonably foreseen by the taxpayer. The “reasonableness test” required by the legislation relates to the taxpayer’s foresight of the circumstances which gave rise to the shortfall. “Foresee” is synonymous with “anticipate” and “predict”. The taxpayer’s ability to foresee will depend on their intellectual and educational level, their knowledge of business and economic conditions, and their ability to make judgements about future possibilities. What is “reasonable” for a large company with skilled staff, and represented by a leading accounting firm, will be different from a sole trader who handles his or her own tax affairs.

39. Thirdly, the extent to which it was reasonable to foresee the circumstances needs to be determined. The legislation calls for a remission in whole or *in part*, and therefore anticipated a situation of partial reasonableness. If a determination of partial reasonableness is made, the penalty is remitted to the extent of that reasonableness. If there was more than one factor, which gave, rise to the shortfall, and some of the factors are reasonable and some are not, it is appropriate that the penalty be remitted in part, in proportion to those factors, which are reasonable.

## **LATE PAYMENT PENALTY**

40. The penal provisions which concern the late payment of tax are sections 97 and 99 of the *Income Tax Act 1974* and section 60 of the *VAT Decree 1991*.

41. Subsection 97(1) of the *Income Tax Act* states:

“If any person fails to pay any tax on an assessment or any instalment thereof on or before the date when such amount or instalment should be paid, he shall pay in addition to any other penalties, a penalty of \$2 or one-quarter of the amount of tax unpaid, whichever is the greater sum.”

42. The penalty found in section 99 of the *Income Tax Act* relates to late payment of provisional tax or of the insufficient advance payment penalty. Section 99 states:

“(1) If any person fails to pay the amount of provisional tax or any instalment thereof by the times required by the provisions of section 85 or within such extended time as may be granted by the Commissioner, then such person shall pay, in addition to any other penalties, a penalty of \$2 or one-quarter of the amount unpaid, whichever is the greater sum, and such penalty shall be assessed and recovered in the same manner as tax.

(2) If any company shall fail to make payment of tax in advance, in accordance with the provisions of sections 91 and 92, then it shall be liable to the like penalty as that to which it would have been liable if 25 per cent of the tax as finally assessed upon the income for that fiscal year had become due and payable on the last day of its fiscal year and 66.67 per cent had become due and payable 3 months after the end of its fiscal year and either or both amounts had not then been paid.”

43. Section 60 of the *VAT Decree* has been discussed in the above section of this statement concerning late lodgement penalties. As with late lodgement penalty, the penalty components in paragraphs (b) and (c) of section 60 should be remitted to nil automatically in cases of late payment. This is done having regard to the social and business difficulties currently being experienced in Fiji. The penalty component in paragraph (a) of 10% should be initially imposed in all cases of late payment of VAT liabilities, and remitted in part or in whole in accordance with the following guidelines, as appropriate.

44. The remission of penalties imposed under sections 97 and 99 of the *Income Tax Act*, and section 60 of the *VAT Decree* as it applies to late payment, are covered by the same practice.

45. The administration of late payment penalty remission is handled by FIRCA’s Debt Management Service (DMS). The DMS case manager will attempt to secure payment of all outstanding tax and penalties in full. The DMS case manager decides if any time-to-pay arrangement is to be entered into, and if any remission of penalty is warranted. It is a DMS requirement that mitigation of late payment penalty is not considered until the principal tax debt is paid in full, or becomes subject to a time-to-pay arrangement. This is the case even if the principal tax debt is in dispute.
46. Late payment penalties relating to VAT and PAYE debts will never be remitted, as these are in the nature of trust funds. If the remission of income tax late payment penalties is to be remitted, this remission will be allowed on a sliding scale, depending on the length of time agreed to in the arrangement to pay. If the taxpayer pays within 2 months, the penalty may be remitted in full. If the taxpayer pays within 12 months, no remission of penalty will take place. The sliding scale gives taxpayers an incentive to pay their debt as quickly as possible. Under DMS procedures no arrangement agreed to will exceed a 12-month period. Note that the percentage in the sliding scale is a maximum amount, and the DMS case manager may decide on a lesser amount.
47. The sliding scale referred to in the above paragraph is:

<b>Number of months agreed to pay</b>	<b>Percentage of total Late Payment Penalty to be remitted</b>
2	100%
3	90%
4	80%
5	70%
6	60%
7	50%
8	40%
9	30%
10	20%
11	10%
12	0%

It should be noted that the rates in the sliding scale do not apply automatically. They should only be agreed to by the DMS case manager after a thorough interview with the taxpayer, in which the taxpayer demonstrates their inability to pay and good faith in intending to pay off the debt within the time frame arranged. Note that the percentage in the table is not the rate of penalty, but the percentage of the total dollar amount of the penalty to be remitted, e.g., a penalty of \$100 on a debt paid off over 6 months will be remitted to \$40.

48. It should be noted that the above sliding scale refers only to late payment penalties. In negotiating the settlement of a debt or a payment arrangement, if DMS decide to remit the late lodgement penalty they will use the sliding scale above, and consider remission of any other penalties in accordance with this practice statement. For example, if remission of late lodgement penalties under section 94 of the *Income Tax Act* are being considered by DMS at the same time as late payment penalties, the late lodgement penalties will be remitted according to paragraphs 21 to 33 of this practice statement. The incentive given to taxpayers by the sliding scale is not applicable to any penalty other than late payment penalty.
49. If at some future time the penalties under paragraph (b) and (c) of section 60 of the *VAT Decree* are re-instated, the total penalty calculated for the taxpayer under paragraphs 60(a), (b) and (c) will be subject to remission in accordance with paragraphs 47 to 48.

## **FAILURE TO DEDUCT & REMIT PENALTY**

50. Section 93 of the *Income Tax Act* imposes a penalty where a person fails to deduct, or fails to remit on time, amounts withheld under the Pas-As-You-Earn (PAYE) provisions or other withholding taxes. It is **not** a late payment penalty, and will be imposed whether or not the amount deducted is ever remitted to FIRCA.

51. Subsection 93(1) states:

“If any person shall fail—

(a) to deduct any amount required to be deducted by him under section **8, 9, 9A, 10** or **10A** or under the regulations made pursuant to the provisions of section **81** or **107**; or

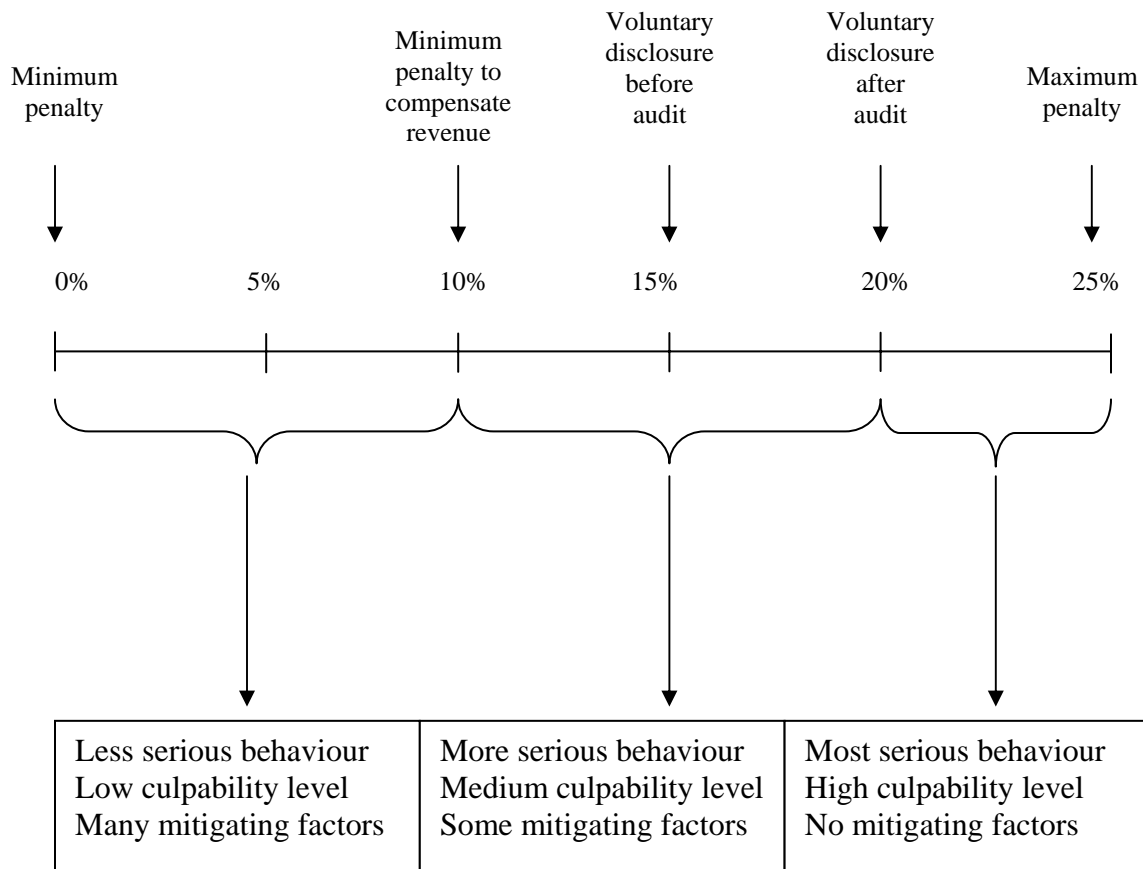
(b) to remit or pay to the Commissioner, or as the Commissioner should so direct, any amount which has been deducted by him under sections **8, 9, 9A, 10** or **10A** or under the regulations made pursuant to the provisions of sections **81** and **107** by such date or dates as may be prescribed by those sections or regulations,

such person shall be liable to pay every such amount to the Commissioner and, in addition, shall be liable to a penalty of 25 per cent of each such amount or \$2 whichever is the greater sum, unless the Commissioner otherwise directs, and every such amount and every such penalty shall be payable as if the same were tax payable by such person on the date when such amount was required to be deducted, remitted or paid, as the case may be, and the provisions of sections **75, 76** and **77** shall apply thereto; and any person so failing as aforesaid shall be guilty of an offence and shall be liable, on conviction, to a fine of \$2,000 or to imprisonment for 1 year or to both such fine and imprisonment in respect of each such offence.”

52. In this context “remit” means “send to the Commissioner”, as opposed to use of the word “remit” to refer to the Commissioner’s power to reduce a penalty. The administrative penalty in subsection 93(1) is 25% of the amount not deducted or not remitted.

53. The subsection 93(1) penalty is very light when compared to some other penalties (such as income tax and VAT incorrect return penalties), for what is arguably worse behaviour, i.e., misuse of monies held in trust. State revenue is impacted in that not only does it suffer from lacking the unremitted amounts, but it must also credit the person from whom tax was deducted as if the amounts had been remitted. In view of this, the penalty should therefore be fixed at the maximum of 25% in all cases, to act as a deterrent against this type of behaviour.

54. Penalty imposed for failure to deduct/remittance at the above rates may be further remitted upon request or objection by the taxpayer providing valid reasons for such further reduction. A further remission may be justified based on the degree of culpability of the taxpayer, the seriousness of the breach of obligation, and whether any mitigating factors exist.
55. If the non-deduction or non-remittance was caused by a clerical error or some other non-deliberate behaviour quickly rectified by the taxpayer, the penalty should be reduced to 10%, representing a discount rate to compensate the revenue for not having use of the money during the period of non-deduction or non-remittance.
56. Voluntary disclosures by the taxpayer that they have failed to deduct or remit tax would also warrant a lesser rate of tax, provided that this did not occur after the taxpayer had been notified they would be subject to an audit. In such cases a penalty of 15% is warranted. If a voluntary disclosure is made by a taxpayer after the notification of an audit, this would warrant a discounting of the penalty to 20% in recognition of any time saved for the auditor in detecting the non-deduction or non-remittance. This is summarised by the following diagram:



## **INCORRECT RETURN PENALTY**

57. The term “incorrect return penalty” refers to the penalties imposed under section 95 of the *Income Tax Act* and section 76A of the *VAT Decree*. A single practice covers both penalties as the behaviour which gives rise to each is essentially the same, i.e., making an incorrect income tax return or VAT return.

58. Section 95 of the *Income Tax Act* states:

“(1) Any person liable to pay any tax under this Act who makes or causes or permits to be made on his behalf a return on which the income is stated to be less than the true amount shall pay to the State the additional amount of tax due and, in addition, interest at the rate of 10 per cent per annum upon such amount from the last day prescribed for making such return until the same is paid. If the amount of the income omitted from his return exceeds 10 per cent of the correct income, but is under 20 per cent of the same, such person shall pay to the State an additional amount equal to one-half of the amount of such deficiency, and, if the deficiency amounts to 20 per cent or more of the correct income, such person shall pay to the State an additional amount equal to the amount of such deficiency. The penalties specified in this section are additional penalties and not in lieu of any penalty that may be imposed under the provisions of section 96. All penalties and interest under this subsection shall be assessed and collected from the person liable therefor in the same manner in which tax is assessed and collected.

(2) Any person liable to pay any tax under this Act who makes, or permits to be made on his behalf, a false statement in a claim for allowances, deductions and reliefs under any section of this Act, shall pay to the State the additional amount of tax due and, in addition, interest at a rate of 10 per cent per annum upon such amount from the last date prescribed for making such return until the same is paid. If the amount of the claim for allowances, deductions and reliefs from his return exceeds 10 per cent of the correct allowances, deductions and reliefs, but is under 20 per cent of the same, such person shall pay to the State an additional amount equal to one half of the amount of such excessive allowances, deductions and reliefs and, if the excessive allowances, deductions and reliefs amount to 20 per cent or more of the correct allowances, deductions and reliefs, such person shall pay to the State an additional amount equal to the amount of such allowances, deductions and reliefs. The penalties specified in this subsection are additional penalties and not in lieu of any penalty that may be, imposed under the provisions of section 96. All penalties and interest under this subsection shall be assessed and collected from the person liable therefor in the same manner in which tax is assessed and collected.

(3) For the purpose of subsection (1), “income” means total income before any deductions in terms of section 21(1)(h), section 22 and section 105.”

59. In summary, section 95 of the *Income Tax Act* imposes a penalty where a person:

- makes a return on which the income is stated to be less than the true amount; or
- makes a false statement in a claim for allowances, deductions or reliefs.

60. The amount of the penalty has two components. There is a 10% per annum interest component plus a magnitude component calculated as follows:

- if the omitted income or overclaimed deductions are less than or equal to 10% of correct income or deductions, zero; or
- if the omitted income or overclaimed deductions are over 10% and less than 20% of correct income or deductions, a penalty of 50% of the deficiency; or
- if the omitted income or overclaimed deductions are 20% or more of correct income or deductions, a penalty of 100% of the deficiency.

61. In computing the above, the omitted income or overclaimed deductions should be calculated as a percentage of “correct” income or deductions to three decimal places, then rounded down to the next whole number. The term “deficiency” in the law is interpreted as meaning the deficient tax, not the deficient amount of income. If an audit leads to a reduction in a loss carried forward, with no tax payable, then the section 95 penalty is not applicable.

62. The 10% interest component runs “from the last day prescribed for making such return until the same is paid”, where “the same” refers to the additional amount of tax due on the omitted income or overclaimed deductions.

63. For the purposes of remitting a penalty, amounts described as “interest” in the legislation are considered as penalties, which are capable of being remitted under the Commissioner’s power. The title of the provision in which they fall refers to a “penalty”, of which “interest” and other amounts are components. When remitting a multi-component penalty, the decision-maker should consider to what extent (if any) each component should be remitted.

64. Subsection 76A(1) of the *VAT Decree* states:

“In any case where -

- (a) a return under Part VII of this decree is furnished which understates output tax or overstates input tax; or

(b) an assessment under Section 44 of this Decree is made which understates a person's liability to pay tax and within 30 days from the date of the said assessment that person has not taken all such steps as are reasonable to draw the understatement to the attention of the Commissioner,

that person shall subject to subsection (2) of this section and Section 70(1) of this Decree be liable to a penalty not exceeding the full amount of the deficient tax.”

65. In summary, subsection 76A(1) of the *VAT Decree* imposes a penalty where:

- a return is lodged which understates output tax or overstates input tax; or
- an assessment is made which understates a person's liability to pay tax and within 30 days the person has not taken all reasonable steps to inform the Commissioner.

The amount of the penalty is not to exceed the full amount of deficient tax (i.e. in the range 0-100%).

66. Both section 95 of the *Income Tax Act* and Section 76A of the *VAT Decree* cover situations where an incorrect return has been made by the taxpayer, whether deliberately or not. Section 76 of the *VAT Decree* (discussed in next section on evasion penalty) is different, in that it cannot apply to non-deliberate incorrect returns. In applying section 95 of the *Income Tax Act* or Section 76A of the *VAT Decree*, a judgement needs to be made on whether the non-compliance was intentional as this will determine which penalty band will apply.

67. It should be noted that subsection 76A(1) contains an exception, i.e., where the taxpayer takes “all reasonable steps” to inform the Commissioner of the discrepancy. If the taxpayer does so, no penalty will be applied in the first place. The meaning of “all reasonable steps” will be different in each situation, but some factors to be taken into account in deciding they exist are:

- whether the taxpayer contacted or attempted to contact FIRCA;
- whether the taxpayer is located in a remote area; and
- whether an event such as a natural disaster occurred which prevented or delayed the taxpayer in contacting FIRCA.

68. Incorrect return penalties (and evasion penalties) are usually applied by Compliance Section at the conclusion of an audit. Where a penalty under section 95 of the *Income Tax Act* applies to a discrepancy of 20% or more of the correct income/deductions, or a penalty under section 76A of the *VAT Decree* applies, the penalty must be set in the range 0% to 100%. The level imposed on a particular penalty will depend on the seriousness of the behaviour by the taxpayer, which led to the incorrect return. The penalty should be set within one of the following penalty bands:

Penalty Band 1	0-25%
Penalty Band 2	25-50%
Penalty Band 3	50-75%
Penalty Band 4	75-100%

Each of these penalty bands is described below. The first task in the penalty remission process is to locate the behaviour of the taxpayer in one of the bands. If the taxpayer has engaged in several types of non-compliant behaviour relevant to more than one penalty band, the band which contains the highest penalty should be chosen. Note that there is some overlap between bands, with the highest percentage of one band also being the lowest percentage of the next highest band. This provides additional flexibility for the decision-maker.

69. Penalty Band 1 contains the least severe or serious forms of behaviour, which lead to an incorrect return being made. There is a low or non-existent degree of culpability on the part of the taxpayer. Examples of behaviour which fall in this band are:

- a clerical error on the part of the taxpayer caused the incorrect return, and the taxpayer was quick to acknowledge this;
- a taxpayer was unaware of the deficiency, which was caused by their tax agent, employee, or other person;
- a lack of taxpayer knowledge caused the deficiency, and the taxpayer has taken reasonable steps to inform themselves of how the law should apply;
- the deficiency involved an unresolved area of the tax law, and the taxpayer has a reasonably arguable position in treating the income or deductions in the way they did;
- the taxpayer was a salary and wage earner who omitted an amount of interest or dividends from their return, and which was not a large amount in relation to their total income;
- the taxpayer provided full co-operation which expedited an audit; or
- a voluntary disclosure of the discrepancy was made by the taxpayer prior to the taxpayer being notified of an audit.

70. Penalty Band 2 contains an intermediate level of seriousness of behaviour, which leads to an incorrect return being made. There is a medium degree of culpability on the part of the taxpayer. Examples of behaviour which fall in this band are:

- there was reckless behaviour by the taxpayer in that they should have informed themselves of a tax requirement but chose not to;
- there was a deliberate discrepancy in a return of a lesser kind (such as private use percentage of a motor vehicle being understated, sales not being declared, an audit leading to an asset betterment discrepancy not traceable any particular source);
- non-co-operation falling short of obstruction of a tax auditor, such as delaying tactics; or
- a voluntary disclosure of the discrepancy was made by the taxpayer early after the commencement of an audit, which saved effort for the auditor.

71. Penalty Band 3 contains a high level of seriousness of behaviour, which leads to an incorrect return being made. There is a high degree of culpability on the part of the taxpayer. Examples of behaviour which fall in this band are:

- there was a deliberate discrepancy in a return of the worst kind, and this was the first occurrence for this taxpayer (such as keeping two sets of business records, making false statements made to an auditor, or holding a bank account in a false name);
- where a taxpayer corrupts their own employees or colludes with other taxpayers to create the discrepancy in the return;
- there are contracts for the avoidance of tax of the kind described in section 108 of the *Income Tax Act* or section 80 of the *VAT Decree*;
- a taxpayer has been involved in the use of “phoenix companies” (that is, using a newly-incorporated entity to take over the business and assets of a company which has substantial tax debts) or behaviour of the kind that section 31 of the *VAT Decree* seeks to prevent;
- the taxpayer has been involved in tax evasion through “split-loan” schemes, which seek to describe interest of a private nature as a deductible expense;
- the taxpayer has been involved in tax evasion through the manipulation of transfer prices, or other schemes involving overseas entities or tax havens; or
- the taxpayer has been unco-operative during an audit to the extent of obstruction, such as by preventing access by the auditor by locking doors.

72. Penalty Band 4 contains the highest level of seriousness of behaviour, which leads to an incorrect return being made. There is the highest degree of culpability on the part of the taxpayer. Examples of behaviour which fall in this band are:

- The taxpayer has been subject to an audit, during the course of which the taxpayer attempted to bribe or threaten the auditor;
- the taxpayer has been unco-operative during an audit to the extent of severe obstruction, such as by physically restraining an auditor;
- the taxpayer has been involved in the marketing of tax evasion schemes or in providing advice on them;
- the taxpayer has been involvement in organised crime, money laundering or similar practices; or
- The taxpayer has repeated behaviour of the kind in the Penalty Band 3 and administrative penalties have been ineffective in preventing the re-occurrence.

73. Where a penalty under section 95 of the *Income Tax Act* applies to a discrepancy of 10% to 20% or more of the correct income/deductions, the penalty must be set in the range 0% to 50%. The penalty should be set within one of the following penalty bands in accordance with the above definitions:

Penalty Band 1	0-20%
Penalty Band 2	20-30%
Penalty Band 3	30-40%
Penalty Band 4	40-50%

74. The above examples in each penalty band are indicative of the type of behaviour that falls into each band. The circumstances under which taxpayers make incorrect returns varies greatly, and there are too many possible scenarios for a guideline such as this to cover. If a type of behaviour encountered by a decision-maker on penalty remission is not actually described above in the examples for each penalty band, the band, which contains behaviour of a similar nature, is appropriate. The examples given above are not meant to be exhaustive, but a merely indicators of classes of behaviour into which all behaviour which leads to breaches of the tax laws must fall.
75. Once the above guidelines have been used to determine which penalty band is suitable for a particular taxpayer, the next step is to fix the penalty to a particular percentage within the band. This depends on the seriousness of the non-compliant behaviour in comparison with other types of behaviour within that penalty band. While this is a subjective decision, it should be made as consistently as possible for all taxpayers that are dealt with by the decision-maker. An experienced FIRCA officer who is regularly involved in penalty decisions, such as an auditor, will over time be able to judge the comparative seriousness of a particular case by reference to all the incorrect returns ever encountered by that officer. Less experienced decision-makers will need to be mentored by their managers and peers. In addition, quality control on penalty decisions will be assisted by the sampling of decisions and feedback to the decision-makers.
76. If the penalty relates to an adjustment made after an audit, the tax compliance history of the taxpayer needs to be considered in determining the level of culpability. A history of general non-compliance would indicate a high level of culpability. If the taxpayer has been previously audited, and a similar adjustment made, this would indicate high culpability.

## **EVASION PENALTY**

77. The penal provisions for evasion are found in section 76 of the *VAT Decree*. There is no similar penalty in the income tax laws.

78. Subsection 76(1) of the *VAT Decree* states:

“Where –

(a) any registered person –

(i) evades; or

(ii) attempts to evade, or

(iii) does any act with intent to evade; or

makes default in the performance of any duty imposed upon that person by this Decree or regulations made under this Decree with intent to evade, the payment of any amount of tax payable (which amount is hereinafter referred to as the deficient tax); or

(b) any registered person –

(i) causes; or

(ii) attempts to cause, or

(iii) does any act with intent to cause; or

makes default in the performance of any duty imposed upon that person by this Decree or regulations made under this Decree with intent to cause,

the refund to that person by the Commissioner of any amount (which amount is hereinafter also referred to as the deficient tax), pursuant to subsection (8) of Section 39 of this Decree, in excess of the amount properly so refundable to that person;

that person shall be chargeable, by way of penalty for that offence, with additional tax hereafter called penal tax not exceeding an amount equal to treble the amount of the deficient tax.”

79. In summary, section 76 imposes a penalty where a registered person evades, attempts to evade, does any act with attempt to evade, or makes default in the performance of any duty imposed by the *VAT Decree* or its regulations, with intent to:

- evade the payment of any amount of tax payable; or
- obtain a refund in excess of the amount properly refundable.

The amount of the penalty is not to exceed treble the full amount of deficient tax (i.e. in the range 0-300%).

80. The difference in the penalties between s76 and s76A (discussed above) is that s76A can apply whether or not the incorrect return was deliberate. Section 76 only applies where the deficient tax arose from deliberate avoidance, not clerical error, lack of understanding on the taxpayer's part, etc. A section 76A penalty will usually only be raised after an audit has established that deliberate evasion or intent to evade exists.
81. Very high penalty rates are justified for evasion. For example, an attempt to consciously enter into a plan to obtain a refund the person knows they are not entitled to shows that the person intended to engage in criminal-like behaviour, equivalent to theft. Bearing this in mind there will rarely be grounds for imposing a penalty at the lower end of the range.
82. Refer to the penalty bands discussed above in relation to section 76A of the VAT Decree. Penalty Band 1 will not apply to section 76 penalties, as that band includes non-deliberate behaviour and section 76 only covers deliberate behaviour. Penalty Bands 2, 3 and 4 as discussed above should be used to determine the appropriate band in which the taxpayer's non-compliance falls, with the following percentage ranges applying to each band:

Penalty Band 2	0-100%
Penalty Band 3	100-200%
Penalty Band 4	200-300%

83. As with incorrect return penalties, evasion penalties have ranges in which a particular taxpayer's behaviour can be located. Within that range penalty should be fixed to a particular percentage based on the seriousness of the behaviour, culpability level and mitigating factors in accordance with paragraph 12.
84. If the taxpayer objects to the penalty any valid grounds for reducing it under these fixed percentages should be considered. However, as the penalty would not be applied in the first place without deliberate evasion or intent to evade being demonstrated by an auditor, there will rarely if ever be grounds for remission of the penalty.

## **AUTOMATIC PENALTY REMISSIONS**

85. In many cases the circumstances of each individual taxpayer needs to be examined before the decision can be made over what level of penalty remission, if any, is justified. On the other hand, in some situations automatic remissions of penalty can take place. An automatic remission is a remission of penalty that applies to all taxpayers, or all taxpayers in a distinctive group such as an industry, without them asking for it.

86. The automatic remissions which have been discussed above are, in summary:

in the *Income Tax Act*:

- late lodgement penalty: section 94 (first limb) penalty of 50% of tax payable automatically remitted to 12% p.a.;
- late lodgement penalty: section 94 (second limb) penalty of \$10 per day automatically remitted to zero only where the late return discloses that no tax is payable or that a refund is due to the taxpayer; and

in the *VAT Decree*:

- late lodgement penalty and late payment penalty: paragraph 60(b) and (c) penalty components of 2.5% per month automatically remitted to nil.

87. Automatic remissions require the authorisation of the Commissioner of Inland Revenue, as the nominal amounts of penalty, which are foregone, may be significant. Parliament has enacted the penalty laws at specific percentages and amounts. A blanket remission of those percentages and amounts contrary to the intention of Parliament needs to be justified in terms of the benefits it will provide for the revenue.

88. Factors which need to be considered before an automatic remission is granted include:

- whether the granting of an automatic remission would provide significant savings to FIRCA in not having to devote resources to make numerous penalty remission decisions of a similar nature;
- the general economic conditions in the country or in a particular industry;
- whether political instability has caused hardship for the taxpaying community;
- whether, after the proposed automatic remission takes place, taxpayers who have failed in meeting a tax obligation have been sufficiently punished and the penalty acts as a deterrent to others; and
- whether the proposed remission would put the revenue base at significant risk.

## **SUMMARY OF PENALTY RATES**

<b>Penalty type</b>	<b>Legislation</b>	<b>Penalty range</b>	<b>Rates to apply</b>
Late lodgement	Income Tax s.94 1 <sup>st</sup> limb	0-50%	Penalty imposed at 12% p.a., up to a maximum of 50% of the net tax, and remitted in accordance with the diagram in paragraph 12.
Late lodgement	Income Tax s.94 2 <sup>nd</sup> limb	\$10 per day	Penalty imposed at 12% p.a., up to a maximum of 50% of the net tax, and remitted in accordance with the diagram in paragraph 12.
Late lodgement	VAT s.60	0-10%	Penalty imposed at maximum and remitted in accordance with the diagram in paragraph 12.
Insufficient advance payment penalty & Underestimated provisional tax penalty	Income Tax s.86 and s.92	0-10%	Penalty imposed at maximum rate and remitted in accordance with paragraphs 31-39.
Late payment	Income Tax s.97 and s.99 VAT s.60	0-25% 0-10%	Penalty imposed at maximum and remitted up to 100% on the sliding scale in paragraph 47 depending on length of arrangement to pay

Failure to deduct/remit	Income Tax s.93	0-25%	Penalty imposed at maximum and remitted in accordance with the diagram in paragraph 59.
Incorrect return	Income Tax s.95 (discrepancy over 20%)	0-100%	Penalty Band 1: 0-25% 2: 25-50% 3: 50-75% 4: 75-100% (Refer to descriptions of penalty bands in paragraphs 69 to 72, and to diagram in paragraph 12)
Incorrect return	Income Tax s.95 (discrepancy under 20%)	0-50%	Penalty Band 1: 0-20% 2: 20-30% 3: 30-40% 4: 40-50% (Refer to descriptions of penalty bands in paragraphs 69 to 72, and to diagram in paragraph 12)
Incorrect return	VAT s.76A	0-100%	Penalty Band 1: 0-25% 2: 25-50% 3: 50-75% 4: 75-100% (Refer to descriptions of penalty bands in paragraphs 69 to 72, and to diagram in paragraph 12)
Evasion	VAT s.76	0-300%	Penalty Band 2: 0-100% 3: 100-200% 4: 200-300% (Refer to descriptions of penalty bands in paragraphs 69 to 72, and to diagram in paragraph 12)