Tax and the 'hidden economy'

Tradespeople, cafés and restaurants, and other people in the service sector often receive cash for goods and services and don't always declare it for GST and income tax purposes.

Saying no one uses cash any more is nonsense. In some sectors the use of cash is steadily declining but in others cash is still a very significant part of turnover – upwards of 50% in some more extreme cases, and not infrequently involves many hundreds of thousands of dollars.

Inland Revenue (IR) is getting very good at identifying undeclared cash, with multiple sources of information accessed with or without the taxpayers' knowledge.

Offering or accepting a substantial discount for cash, or making a sale and ringing up zero is a very clear signal the person is underpaying tax. Your client's 'customer' could be from IR!

Past shortfalls (ie underpaying tax) are almost inevitably subject to IR interest at well above market rates (the current rate is 8.27%), sometimes late payment penalties, and shortfall penalties that can range from 20% of the core tax for 'failing to take reasonable action', right up to 150% for tax evasion. Shortfall penalties are generally reduced by half if the taxpayer has not had a penalty in the past four years or so, but the reduced penalty is still on top of the core tax and interest.

If IR regards the behaviour as tax evasion, instead of applying a penalty, IR may decide to take the matter to court. If IR convinces a judge to prosecute, the starting penalty for over $100,000 of tax evaded is two years in jail.

Many taxpayers have not got the message, and do under declare their income. In these instances it is not a question of will IR identify it, it is when will they identify it.

There are significant benefits for making an early voluntary disclosure of a tax shortfall. If IR announces the intention to carry out an audit there is a short window of opportunity to make a 'post notification' disclosure, which provides a 40% reduction in the shortfall penalty component, and a reduced risk of prosecution.

To be valid, a disclosure must be full and complete and give IR enough information to calculate the shortfall. Professional assistance is extremely important. This window of opportunity is available until the IR audit commences. Unfortunately IR doesn't explain that in the audit letter, leaving uninformed taxpayers stumbling into a 'voluntary interview' and potentially losing the benefits of disclosure.

The best saving of all comes from a valid voluntary disclosure before IR announces an audit or investigation as it provides immunity from prosecution, and a minimum 75% reduction in shortfall penalties.

Deliberately underpaying tax is stealing from fellow citizens who do pay their share. Offering or accepting a discounted price for cash facilitates that.

Where a business is likely to receive cash, they should eliminate as far as possible the opportunity or temptation not to declare all cash received.

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