



PRACTICE NOTE

PN 7/86

Date: 29th August 1986

**Changes Contained In Income Tax (Amendment) Act 1986
Concerning: 1. Submission Of Return Forms 2. Additional
Assessments 3. Penalties 4. Interest On Tax Lost Due To Taxpayer's
Default**

A. Introduction

1. Submission of Return Forms

Section 12 Income Tax (Amendment) Act 1986 inserts subsection(2) into Section 108 Income Tax Act 1970 to ensure a taxpayer makes his return or complies with certain other requirements of Income Tax Act 1970.

2. Additional assessments

Following a decision given by the Income Tax Commissioners it was found that one of the provisions of the Income Tax Act 1970 (as amended) did not achieve what had been intended. Section 10 Income Tax (Amendment) Act 1986 closes this loophole by introducing the new Section 84A Income Tax Act 1970, specifically empowering the Assessor to raise additional assessments in specified circumstances.

3. Penalties

Section 13 Income Tax (Amendment) Act 1986 amends some parts of Section 111 Income Tax Act 1970 (as already amended by Section 17 Income Tax Act 1973) to ensure that a penalty is eligible in respect of any income negligently or fraudulently omitted from a Return Form and any income not returned at the proper time. It also gives the Assessor the power to mitigate penalties.

Interest on tax lost due to taxpayer's default

Section 14 Income Tax (Amendment) Act 1986 inserts S111B into Income Tax Act 1970 to impose an interest charge on omitted income or income returned late.

B. Specific Points

1. Submission of Return Forms

Before this new enactment the Courts had been able to fine those taxpayers who were prosecuted for failing to make a return, etc., but if the taxpayer still failed to make the return after having been fined there was no power to oblige him to comply. The new provision enables the Courts to order that the return etc. be made. Continued failure to comply would mean that the taxpayer would be in contempt of Court and subject to whatever punishment the Court saw fit to impose.

Additional assessments

It is now clear that the Assessor may make an additional assessment:

- to recover tax on income which ought to have been but was not assessed;
- to recover tax if the assessment is or has become insufficient;
- to withdraw any relief which is not due.

Unless any form of dishonesty or negligence has been committed by or on behalf of the taxpayer, the Assessor can raise an additional assessment only within six years after the end of the year of assessment to which the additional assessment relates (e.g. for 1981/82 by 5th April 1988). There is of course the same right of appeal against an additional assessment as against a first assessment.

Examples

- if the Income Tax Office omits to assess income which is declared, the assessment must be made within the six year time limit because the taxpayer has not been negligent or dishonest
- if a taxpayer omits income from his return, there is no time limit where he has been dishonest or negligent
- if a married man has not been informed by his wife as to her true income and has consequently not included the full amount on his return, there is no time limit because his wife has been dishonest or negligent on his behalf.
- if a self employed person has amounts in support of his return prepared by someone else who has been dishonest or negligent in not ensuring that the full profit is reflected in those accounts, there is no time limit because dishonesty or negligence has been committed on behalf of the self-employed taxpayer.

Additional assessments may be made in relation to the years 1986/87 and earlier as well as later.

3. Penalties

All the 1986 amendments concerning penalties are effective in relation to tax for 1986/87 and earlier as well as later years.

I. Income Omitted From A Return

Because of doubt about the opening words of Section 111(1) ITA 1970 no penalty has been charged up to now in respect of income omitted from a return, or in respect of allowances or relief's falsely claimed, for a year where an assessment had not already been made or where the existing assessment was a provisional or default assessment e.g. if it was discovered that income had been omitted for the years 1981/82 to 1984/85 inclusive

whilst the 1984/85 Return Form was being examined, a penalty was applied only for the years 1981/82 to 1983/84 inclusive, even though the tax relating to the 1984/85 omission was recovered as part of the investigation.

It is now clear that there is no requirement for an assessment based on the return to have been made before the penalty is applied. This removes anomalies e.g. if two directors of a company had omitted to declare dividends received from that company and this was not discovered until after the first but before the second director's assessment had been made, the first director would have been charged with a penalty but the second director would not. Now both directors would be penalised.

Ii Return Made Late

A penalty is now eligible where anyone fraudulently or negligently fails to make or deliver a return.

The time limits are:

- 562 Income Tax Act 1970, by 30 June;
- S3 ITA 1970, within three months of the end of the year of assessment during which self employment commenced;
- S5 ITA 1970, within three months of the end of the year of assessment during which residence in the Isle of Man commenced

It is thus very important for people newly liable to Manx Income Tax to notify the Assessor so that he can issue the necessary Return Forms.

The pre 1986 legislation did provide for penalties in certain of these cases: the new enactment strengthens the existing legislation.

In practice, the Assessor does not intend to charge a penalty under the new legislation in minor cases where the income which has escaped tax is small or where the return is only slightly late: practical difficulties in submitting returns on time are already recognised and due lee-way will continue to be given. A penalty is likely to be charged if two or more returns are submitted late and the tax escaped is substantial, but a penalty is unlikely if a default assessment already exists which charges only slightly less than the correct amount of tax.

Iii Mitigation Of Penalties

As most accountants will know, the Assessor has concessionally mitigated penalties on a structured basis since the inception of the Income Tax Investigation Section. He is now empowered to do so by statute.

The 1986 amendments are effective from the date the Act was announced to Tynwald, 17 June 1986, but where investigation cases were all but concluded under the operation of the pre 1986 legislation, penalties will be mitigated to have the same effect as if the investigation had been settled before then.

4. Interest and tax lost through taxpayer's default

Section 111B Income Tax Act 1970 extends the interest charge on overdue tax under Section 111A ITA 1970 where an assessment has been made for the purpose of making good a loss of tax wholly or partly attributable to the fraud, wilful default or neglect of any person.

The interest will start to accrue from 1 January in the year which the assessment relates until the tax is paid.

Because Section 111A ITA 1970 was not effective until 1 January 1986, neither is Section 111B ITA 1970. Its application will be effective in future years.

EXAMPLE

Income omitted relates to 1988/89 year of assessment

Omission discovered in September 1992

Assessment raised in November 1992 (when tax etc. involved has been agreed)

tax paid 1 December 1992

Interest due from 1 January 1989 to 1 December 1992

The Assessor has power to mitigate interest under Section 111A (5) ITA 1970, so no interest under Section 111B will be charged on any penalty included in the assessment for any period before the tax becomes payable following the issue of the assessment, i.e. it is not intended to penalise anyone twice for the same duty. The structure for mitigation of penalties will also be adjusted as Section 111B is brought into operation, so that the penalties and interest together charged in an investigation settlement will not be any more onerous than at present. In future where minor amounts of income have been omitted it may be that interest will be charged under Section 111B ITA 1970 and no penalty will be exacted.

Accountants And Banks

NOTE Your attention is particularly drawn to item B 3(ii) of the attached Statement of Practice.