

CASE SUMMARY

Absence of evidence makes it impossible to prove nexus with the expenditure and the claimed deductions

Decision date: 16 January 2025

CSUM 25/08

CASE

***The Disputant v The Commissioner of Inland Revenue* [2025] NZTCRA 01 (TCRA)**

LEGISLATIVE REFERENCES

Income Tax Act 2007, ss BD2, DA 1, DA 2, HG 1

Tax Administration Act 1994, ss 42(4), s 138G, s 138E(1)(e)(iv), s 149A(2)

CASE LAW REFERENCES

Commissioner of Inland Revenue v Banks [1978] 2 NZLR 472 (CA)

Buckley & Young Ltd v Commissioner of Inland Revenue [1978] 2 NZLR 485 (CA)

Case V17 (2002) 20 NZTC 10,192 (TC)

Accent Management Ltd v Commissioner of Inland Revenue (2005) 22 NZTC 19,027 (HC)

Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue [2008] NZSC 115, [2009] 2 NZLR 289 (SC)

PL Brown Farms Ltd v Commissioner of Inland Revenue [2014] NZHC 1601 (HC)

Commissioner of Inland Revenue v Trustpower Limited [2015] NZCA 253 (CA)

Trustpower Limited v Commissioner of Inland Revenue [2016] NZSC 91 (SC)

FORUM

The Taxation and Charities Review Authority

REVENUE TYPE(S)

Income Tax

RESULT

The Disputant's challenge to the income tax assessments for the years 2013, 2014 and 2015 were dismissed, and the Commissioner's assessments were upheld without alteration.

Summary

The Taxation and Charities Review Authority (**TCRA**) upheld the income tax assessments by the Commissioner of Inland Revenue (the **Commissioner**) because the evidence failed to establish a material link between the disputed expenditure and the receipt or expectation of income.

The Disputant had business interests with a Mr A which concerned an intended business of exporting dairy products to Asia through various corporate entities (the **dairy business**). The Disputant paid money to Mr A related to the expenses of the dairy business and sought to deduct those payments against his other income. The Disputant alleged that the legal fees Mr A and/or the other corporate entities in the dairy business paid him, proved a connection with the expenses he had paid to Mr A. The Disputant's position was that he was engaged in legal practice and other business activities, and the expenses at issue were simply part of his other business activities and were deductible on ordinary principles.

The Commissioner's position was, the Disputant is not entitled to deduct the payments he paid to Mr A because the expenses were not related to earning his taxable income; and regardless the payments were capital expenses which are not deductible.

The Disputant also claimed there was a "loose agreement" for an unincorporated joint venture with himself and Mr A which used corporate entities as vehicles to develop the joint enterprise. The Commissioner said the Disputant had raised this too late in the process to be considered by the TCRA.

The TCRA found that there was no evidence as to what Mr A did with the money the Disputant paid him; there was no evidence to suppose Mr A paid the money to a third party to create a source of income for the Disputant from some other entity. The TCRA could only conclude that the Disputant had paid Mr A.

The Disputant failed to prove that the legal fees paid to him by Mr A and/or companies involved in the dairy business were connected with the expenses he had paid to Mr A. This

was because there was no contract or other arrangement that would establish a nexus of that kind.

The TCRA found the “loose agreement” failed to advance his case as the evidence failed to show what the terms of the “loose agreement” were, who was involved in it or how the Disputant was to receive income from it. The Disputant needed to show that as part of this unincorporated joint venture, he was personally involved in sharing expenses and/or income in some way and show a nexus with the expenditure he claims to deduct. The evidence did not support that. Instead, the paucity of evidence left the TCRA with no foundation to conclude there was a joint venture of any kind. Furthermore, the Disputant failed to prove that he met the general permission under either section DA 1(1)(a) or (b) of the Income Tax Act 2007 (**ITA**).

Facts

The Disputant was a lawyer who operated his legal practice personally; it was not an incorporated law firm. While practising, the Disputant developed business interests with Mr A which concerned the dairy business. The Disputant was a director and shareholder of two of the entities involved, **Entity 1** and **Entity 2**.

Trading as the Disputant’s Legal Practice, the Disputant agreed to provide legal services to Mr A under a letter of engagement dated 22 January 2008 which contemplated legal advice and services being provided in respect of Entity 1 and another entity called ABD. It did appear that the relevant services were provided to Mr A under the letter of engagement including during the 2013, 2014 and 2015 tax years. However, Entity 1 was not incorporated until 24 March 2011 (Entity 2 was incorporated on 17 July 2015). There was no evidence of a separate letter of engagement for either entity, but the Disputant did invoice Entity 1 and Entity 2 and one other entity for legal services and the use of an office space.

The Disputant’s Case

The Disputant paid Mr A money relating to expenses of the dairy business during the 2013 to 2015 tax years and deducted those payments against his other income. The Disputant said he was entitled to claim the deductions because he had an unincorporated joint venture with Mr A. The “loose agreement” they had was to use corporate entities as vehicles to develop a joint enterprise. The Disputant’s position was that the payments to Mr A were to:

- a) obtain business clients;
- b) research market demands and packaging;
- c) arrange finance and contracts;
- d) manage customs and GST issues;
- e) manage supply issues;
- f) manage logistics and importation; and

- g) manage market regulatory issues.

The Disputant claimed that his legal practice was only a trading name and that he personally was the entity engaged to provide legal services and engage in other business. As such, the expenses in issue were simply part of his non-legal business activity and were deductible on ordinary principles.

The Disputant also put forward the argument that as he had been held personally liable for approximately \$900,000 (settled for a payment of \$350,000) in a High Court liquidation matter where he was sued by one of the companies involved in the joint venture with Mr A. This was proof of the nexus between his non-legal business and his other income.

The Commissioner's Case

The Commissioner said there was no adequate nexus between the derivation of his own income and the disputed expenditure. Everything turned on s DA 1 of the ITA which required a nexus with income before expenditure is deductible (general permission) and whether either of the qualifying conditions were met. The Commissioner's position was that the capital limitation in s DA 2(1) of the ITA prevents deductibility because the expenditure was capital in nature.

The Commissioner did not dispute the payments claimed were paid and the amounts correctly quantified. The Commissioner's position was that on the facts:

- a) The Disputant did not derive any income from the dairy business;
- b) The structure of the dairy business was that a company would earn income, and that was a separate entity from the Disputant;
- c) It was the companies, not the Disputant that entered into contracts for the supply of products, so the Disputant could not have earned income from the dairy business under those arrangements;
- d) The Disputant had admitted his expectation of income was to earn dividends from the companies after they earned income from the contracts and proposed contracts; and
- e) The expenditure was to establish a business, not operational matters and accordingly capital in nature.

Furthermore, the onus is on the Disputant to prove that the assessments were wrong and by how much they were wrong. It is not sufficient to establish that some of the expenditure was not capital but rather a necessity to establish with reasonable clarity that at least a probable amount was not capital.

As to the unincorporated joint venture, the Commissioner said this argument was affected by s 138G of the Tax Administration Act 1994 (**TAA**), which provides that after a "disclosure notice" is issued only the "issues and propositions of law that are disclosed in the Commissioner's and disputant's statements of position" may be advanced. There was also no

evident legal effect of the unincorporated joint venture status and no documentation to substantiate the characterisation.

Issues

The issue before the TCRA was confined to whether payments made to Mr A were deductible. The TCRA had to determine:

- a) The nature of the disputed payments;
- b) The reasons for the payments; and
- c) Then apply the relevant legal tests to determine whether the Disputant was entitled to claim deductions. The key tests were first (1) whether the payments were made in deriving the Disputant's income, or in the course of carrying on a business to derive his income (general permission). If one or other of those bases for entitlement to deduct are established, then (2), whether deduction is none-the-less prohibited as the payments were capital in nature.

There was also the ancillary issue of whether there was a joint venture particularly as the Commissioner contends the Disputant had raised this too late in the process for it to be considered by the TCRA.

Decision

Nexus

The TCRA held that the evidence did not establish a material link between the disputed expenditure and the receipt or expectation of income. While the evidence was sufficient to conclude that the Disputant had paid Mr A the disputed expenditure, there was no contract or other arrangements whereby Mr A would pay him income because of those payments (the evidence to the extent it exists was to the contrary). Furthermore, there was no evidence as to what Mr A did with the money and accordingly there was no evidence to suppose Mr A paid the money to a third party to create a source of income for the Disputant from some other entity.

The TCRA held:

I must necessarily conclude that on the evidence produced I cannot reach conclusions as to where the expenditure went or in what proportions, aside from it being paid to Mr A. There is no evidence, nor can I reasonably infer that Mr A was a potential source of income for The Disputant because of the expenditure.

The disputed transactions

The Disputant had placed some reliance on a judgment in a liquidation proceeding. The TCRA held that the evidence in that proceeding did not assist the TCRA in deciding this matter.

The TCRA said the only thing that is clear is that the Disputant breached his duties as a director of a company and was found liable to pay damages; there is no link in the evidence between that company and the expenditure in issue here.

Capital Limitation

For the Disputant, to overcome the capital limitation, he needed to prove what the nature of the expenditure was and quantify the revenue expenditure.

The TCRA concluded that:

The evidence simply does not address those issues in a way that permits any meaningful evaluation. The principles in the *Buckley & Young* case must apply, there can be no deduction without quantification of how much expenditure was of a revenue nature.

An unincorporated joint venture

The TCRA was satisfied on the facts that there was no joint venture.

The TCRA held that if it had been satisfied that there was a joint venture, then allowing deductions to the appropriate extent established on the evidence would be necessary. However, the evidence was not sufficient to support the existence of a joint venture. The evidence did not establish with any particularity what the relationships between the entities were, and their connection with the Disputant and Mr A, other than some information regarding shareholding and in some cases details of directors. There was no evidence of any contracts or agreements between any of the other entities, this included between Mr A and the Disputant regarding the sharing of profits or costs. The Disputant also did not provide evidence that the necessary steps to create a group of companies for tax purposes was taken (or that it could have been taken).

The TCRA held that the absence of evidence is an important and determinative issue that makes it impossible for the Disputant to succeed. The TCRA said:

I am conscious that The Disputant represents himself. While he was a lawyer, tax disputes are not a matter where his key areas of expertise lay. Accordingly, I have been conscious of the potential for The Disputant not to appreciate the importance of providing some aspects of relevant evidence. However, The Disputant has been through the tax dispute process before these proceedings commenced. The Disputant has been repeatedly required to provide all relevant information, and the dispute process has clearly focused his attention on the material issues. Indeed, when The Disputant produced information shortly before the hearing the Commissioner's counsel explored those issues with him in cross-examination. Accordingly, I am satisfied that any absence of evidence is not the result of confusion or lack of understanding. I

have no reason to think that The Disputant has not had an informed opportunity to present any information that may support his case.

Conclusion

The Disputant's challenge to the assessments was dismissed, and the assessments upheld without alteration.

About this document

These are brief case summaries, prepared by Inland Revenue, of decisions made by the Taxation and Charities Review Authority, the District Court, the High Court, the Court of Appeal or the Supreme Court in matters involving the Revenue Acts. For Taxation and Charities Review Authority matters, names have been anonymized. The findings of the court described in a case summary will no longer represent current law where the matter has been successfully appealed or subsequent amended legislation has been enacted.