Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTOTANGA WHAKATAU Ā-TURE> WHAKAWĀ

GST - Input tax deductions, penalties

Decision date | Te Rā o te Whakatau: 30 June 2021

Issue date | Te Rā Tuku: 18 November 2021

TDS 21/05

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Subjects | Ngā kaupapa

GST: input tax deductions, taxable activity; TAA: shortfall penalties

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services of Inland Revenue
Commissioner	Commissioner of Inland Revenue
Customs	New Zealand Customs Service
GST	Goods and services tax
GST Act	Goods and Services Tax Act 1985
TAA	Tax Administration Act 1994

Taxation laws | Ngā ture tāke

All legislative references are to the Goods and Services Tax Act 1985 (GST Act) unless otherwise stated.

Facts | Ngā meka

1. The Taxpayer is an incorporated company registered for GST. Its stated taxable activity is the importation and distribution of goods.
2. The Taxpayer filed GST returns over four taxable periods during 2017 (the relevant periods). All the returns gave rise to refunds, which were paid out to the Taxpayer, except for one that was withheld pending investigation.
3. Despite repeated requests for information by the Customer and Compliance Services group of Inland Revenue (CCS), the Taxpayer failed to provide any documentation to support the refunds. CCS was able to obtain some bank statements from a bank during their audit activities. The bank statements covered part of the relevant periods,

but no further information or explanation was provided regarding the nature of the transactions in the bank statements.

4. During the disputes process, the Taxpayer provided two invoices addressed to the Taxpayer that showed GST and duty paid to Customs. Both invoices were dated in 2021.

Issues | Ngā take

5. The main issues considered in this dispute were:
   - whether the Taxpayer was carrying on a taxable activity;
   - if not, whether the Taxpayer's GST registration should be cancelled from the date of its registration;
   - whether the Taxpayer was entitled to claim the input tax deductions;
   - whether the Taxpayer is liable for a shortfall penalty for evasion or similar act;
   - alternatively, whether the Taxpayer is liable for a shortfall penalty for gross carelessness.
6. A preliminary issue on the onus and standard of proof was also considered.

Decisions | Ngā whakatau

7. The Tax Counsel Office decided that:
   - the Taxpayer was not carrying on a taxable activity during the relevant periods;
   - the Taxpayer's GST registration should be cancelled from the date of registration;
   - the Taxpayer was not entitled to the input tax deductions claimed;
   - the Taxpayer was not liable for a shortfall penalty for evasion or a similar act; and
   - the Taxpayer was liable for a shortfall penalty for gross carelessness.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary issue | Take tōmua: Onus and standard of proof

8. The onus of proof in civil proceedings[1] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[2] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[3]

9. The standard of proof in civil proceedings is the balance of probabilities.[4] This standard is met if it is proved that a matter is more probable than not. Whether the Taxpayer has discharged the onus of proof is considered in the relevant issues.

Issue 1 | Take tuatahi: Taxable activity

10. GST is imposed on taxable supplies of goods and services made by a registered person in the course or furtherance of a taxable activity carried on by the registered person (s 8(1)). There are four requirements that must be satisfied to show there is a taxable activity (s 6(1)(a)):[5]

    - There must be an activity.[6]
    - The activity must be carried on continuously or regularly by a person.[7]
    - The activity must involve, or be intended to involve, the supply of goods and services to another person.[8]

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[1] Challenge proceedings (ie, the proceedings that would follow if this dispute proceeds to the Taxation Review Authority or a court) are civil proceedings.

[2] Section 149A(2) of the Tax Administration Act 1994 (TAA).

[3] *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA); *Beckham v CIR* (2008) 23 NZTC 22,066 (CA).

[4] Section 149A(1) of the TAA; *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC); *Case X16* (2005) 22 NZTC 12,216; *Case Y3* (2007) 23 NZTC 13,028.

[5] *Case 14/2016* [2016] NZTRA 14, (2016) 27 NZTC 3-036 at [63]-[70].

[6] *Newman v CIR* (1994) 16 NZTC 11,229 (HC) at 11,233; *CIR v Bayly* (1998) 18 NZTC 14,073 (CA) at 14,078; *CIR v Newman* (1995) 17 NZTC 12,097 (CA) at [32]; *Case 14/2016* at [63].

[7] *Newman* (CA) at 12,100; *Smith v Anderson* (1880) 15 Ch D 247 at 277, 278; *Premier Automatic Ticket Issues Ltd v FCT* (1933) 50 CLR 268 (HCA) at 298; *Case 14/2016* at [67]-[68]; *Wakelin v CIR* (1997) 18 NZTC 13,182 (HC) at 13,185-13,186; *Case N27* (1991) 13 NZTC 3,229 at 3,238-3,239; *Allen Yacht Charters Ltd v CIR* (1994) 16 NZTC 11,270 (HC) at 11,274.

[8] Definition of "supply" in s 5(1); *Databank Systems Ltd v CIR* (1987) 9 NZTC 6,213 (HC) at 6,223; *Pacific Trawling Ltd v Chief Executive of the Ministry of Fisheries* (2005) 22 NZTC 19,204 (HC); *Case S77* (1996) 17 NZTC 7,483; *Case L67* (1989) 11 NZTC 1,391; *Case N27* at 3,238-3,239; *Case 14/2016* at [69].

- The supply or intended supply of goods and services must be made for a consideration.[9]

11. Section 6(2) provides that anything done in the beginning or ending of a taxable activity is treated as carried out in the course or furtherance of that taxable activity.

12. The Taxpayer did not show on the balance of probabilities that it was carrying on a taxable activity for these reasons:

    - The bank statements obtained by CCS contained a number of deposits and withdrawals that are mostly made in a period after the relevant periods. These transactions provide some evidence that an activity of importing and distributing goods may have commenced at some point during or before the relevant periods.
    - The later transactions could point to a broader pattern indicating the existence of a continuous or regular activity, or that there may have been an intention to involve the making of supplies for consideration. Further, preliminary actions undertaken during the relevant periods could form part of a later taxable activity.
    - However, the nature of these bank transactions is merely speculative, and the taxpayer had not provided any evidence to substantiate these transactions as business transactions.
    - The invoices that showed GST and Customs duties and levies paid in relation to goods do provide support for the Taxpayer's view that it was carrying on an activity of importing goods. However, these invoices are dated in 2021 and, while they may support the existence of an activity three years later, they do not support the existence of an activity during the relevant periods.

Issue 2 | Take tuarua: Cancellation of GST registration

13. The Commissioner may cancel a person's GST registration if the Commissioner is satisfied that the person is not carrying on a taxable activity (s 52(5)). The cancellation may be retrospective to a date not earlier than the date of registration if the Commissioner is satisfied that the person did not carry on any taxable activity from that date (s 52(5A)).

14. The Taxpayer has not satisfied the onus of proving on the balance of probabilities that it was carrying on a taxable activity during the relevant periods, or at any point after

[9] Definition of "consideration" in s 2(1); *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA) at 12,314.

that. Therefore, the Commissioner can cancel the Taxpayer's GST registration from a date not earlier than the date it was registered for GST.

Issue 3 | Take tuatoru: Input tax deductions

15. The Taxpayer cannot claim input tax deductions for the amounts claimed if it is not a registered person. The Taxpayer will not be registered during the relevant periods if the Commissioner deregisters it from the date of registration.

16. However, in the event the Taxpayer remains registered during some or all of the relevant periods, the issue of whether the Taxpayer was entitled to the input tax deductions claimed was considered.

17. The calculation of GST payable by a registered person is set out in s 20. Broadly, the input tax that a registered person has paid for acquiring goods and services for making taxable supplies can be offset against the GST output tax payable on taxable supplies made by the person in the same period.

18. For a taxpayer to be eligible for GST input tax deductions under s 20(2):

- The goods or services acquired by the taxpayer must be used for, or available for use in, making taxable supplies (s 20(3C)).
- The taxpayer must have held the relevant tax invoices when the input tax deductions were claimed (s 20(2)(a)).
- The tax invoice must generally satisfy the requirements for a "tax invoice" (ss 24(3) or 24(4)).
- The Commissioner may determine that no input tax deduction is available if sufficient records are not kept in accordance with s 75.
- It is not enough that the taxpayer merely shows there was a supply made to them. It must go further and provide sufficient particulars of the supply, generally in a tax invoice.[10]
- The requirement for a tax invoice is an evidential requirement of the GST Act to ensure real supplies are being made which are within the GST base.[11]

19. The Taxpayer was not entitled to the input tax deductions claimed for these reasons:

- The Taxpayer did not show that it paid input tax for goods or services used or available for use in making taxable supplies. The only evidence to support the

[10] *Case 1/2012* (2012) 25 NZTC 1-013 at [147].

[11] *Case Z12* (2009) 24 NZTC 14,142 at [27].

existence of any input tax paid are the bank transactions, which were largely outside the relevant periods and have not been substantiated with any further documentation.

- The Taxpayer also failed to show it was provided with tax invoices for the input tax deductions claimed. Even if the tax invoices exist, the Taxpayer has not complied with its record-keeping obligations in s 75.
- The invoices presented by the Taxpayer, being two invoices dated three years after the relevant periods, did not provide sufficient evidence of the existence of input tax paid during the relevant periods.

Issue 4 | Take tuawhā: Shortfall penalty for evasion

20. Section 141E(1) of TAA imposes a shortfall penalty for evasion or a similar act on a taxpayer if the following requirements are satisfied:[12]

- The taxpayer has taken a tax position. A tax position is a position or approach to tax under a tax law as taken in or in respect of a tax return, income statement, or due date.[13]
- Taking the tax position has resulted in a tax shortfall. A tax shortfall is the difference between the tax effects of the correct tax position and the tax effects of the taxpayer's tax position.[14]
- The taxpayer has done any of the acts set out in s 141E(1) of the TAA. In this dispute, the relevant provisions were ss 141E(1)(d) and 141E(1)(da) of the TAA.
- Under these provisions, a person must obtain or attempt to obtain a refund or payment of tax, and this includes a refund of excess input tax. The person must obtain or attempt to obtain the refund knowing that they are not lawfully entitled to the refund:
    - The "knowing" element requires actual knowledge on the part of the person or a responsible officer that they were not allowed the refund obtained or that they attempted to obtain. The required knowledge can be inferred from surrounding circumstances and conduct.[15]

[12] The shortfall penalty for evasion or a similar act is considered in the Interpretation Statement: *Shortfall Penalty—Evasion* as published in *Tax Information Bulletin* Vol 18, No 11 (December 2006).

[13] Definitions of "tax position" and "taxpayer's tax position" in s 3 of the TAA.

[14] Definition of "tax shortfall" in s 3 of the TAA.

[15] *Meulen's Hair Stylists Ltd v CIR* [1963] NZLR 797 at 798 (SC); *Lloyds Bank Ltd v Marcan* [1973] 2 All ER 359; *Case H90* (1986) 8 NZTC 619; *Case N47* (1991) 13 NZTC 3,388.

- Recklessness can amount to knowing in this context and involves the conscious taking of risk. Recklessness will be proven where: [16]
  - Facts actually known to the taxpayer were such that they must have put the taxpayer on inquiry that they were not allowed the refund they obtained or attempted to obtain.
  - The taxpayer made a conscious decision to ignore the facts without making further inquiry.

21. The penalty payable for evasion or a similar act is 150% of the resulting tax shortfall.

22. The onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion under s 141E of the TAA.[17] This is different from the other shortfall penalties where the onus of proof is on the taxpayer. The standard of proof is the balance of probabilities.[18]

23. The Taxpayer took a tax position that resulted in a tax shortfall. However, CCS did not prove on the balance of probabilities that the Taxpayer obtained or attempted to obtain refunds knowing that it was not lawfully entitled to the refunds for these reasons:

- The Taxpayer's director's failure to substantiate the input tax deductions claimed and engage with CCS is evidence that the Taxpayer has not met its record-keeping requirements. However, it is not necessarily evidence of intent or knowledge that the Taxpayer was not entitled to the amounts claimed.
- The evidence provided by CCS did not demonstrate that the Taxpayer's director knew facts which would have put them on inquiry that the Taxpayer was not entitled to the amounts claimed.
- The evident language barrier and the failure to meaningfully address CCS's arguments, showed a lack of understanding by the Taxpayer's director. This made it less likely that the Taxpayer had the necessary mental element for evasion.

[16] *Case W3* (2003) 21 NZTC 11,014; *Case R31* (1994) 16 NZTC 6,171; *Godfrey Allan Ltd v CIR* (1980) 4 NZTC 61,548 (HC); *R v Harney* [1987] 2 NZLR 576 (CA); *Case P29* (1992) 14 NZTC 4,213; *Case S100* (1996) 17 NZTC 7,626.

[17] Section 149A(2) of the TAA.

[18] Section 149A(1) of the TAA.

Issue 5 | Take tuarima: Shortfall penalty for gross carelessness

24. Section 141C of the TAA imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:[19]

- The taxpayer has taken a tax position.
- Taking the tax position has resulted in a tax shortfall.
- The taxpayer has been grossly careless in taking the taxpayer's tax position. Gross carelessness means doing or not doing something in a way that, in all of the circumstances, suggests or implies a complete or high level of disregard for the consequences (s 141C(3)):
    - Gross carelessness is characterised by conduct which creates a high risk of a tax shortfall occurring where that risk and its consequences would have been foreseen by a reasonable person in the circumstances.[20]
    - The test for gross carelessness is not whether the taxpayer actually foresaw the probability that their act or omission would cause a tax shortfall but whether a reasonable person would have foreseen that probability.[21] Whether the taxpayer has acted intentionally is not a consideration.[22]
    - A person who takes reasonable care is not grossly careless. Taking reasonable care includes exercising reasonable diligence to determine the correctness of a return, keeping adequate records, and generally making a reasonable attempt to comply with tax law.[23]
    - A taxpayer who adequately informs and follows the advice of a qualified tax agent takes reasonable care and is not careless.[24]

25. The following factors may be relevant in determining whether a reasonable person would have foreseen that their conduct created a high risk of a tax shortfall occurring:[25]

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[19] The shortfall penalty for gross carelessness is considered in the Interpretation Statement: *Shortfall Penalty for Gross Carelessness* as published in *Tax Information Bulletin* Vol 16, No 8 (September 2004).

[20] *Case W4* (2003) 21 NZTC 11,034 at [44].

[21] *Case 9/2014* (2014) 26 NZTC 2-019 at [88].

[22] *Case W4* at [60].

[23] *Case W4* at [60].

[24] *Re Carlaw and FCT* 95 ATC 2166 (AAT); *Re Sparks and FCT* [2000] AATA 28 and see also *Pech v Tilgals* [1994] ATC 4206.

[25] *Case W4*.

- the significance of the transaction leading to the tax shortfall;
- the taxpayer's level of experience in the relevant tax laws;
- previous warnings given by Inland Revenue or advisors in relation to the risk of the tax shortfall.

26. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

27. As noted above, the Taxpayer took a tax position that resulted in a tax shortfall. Further, the Taxpayer did not prove that it was not grossly careless in taking a tax position for these reasons:

- The Taxpayer's apparent failure to retain tax invoices or any records substantiating the input tax deductions claimed indicates a level of negligence that supports the view that the Taxpayer was grossly careless in filing the returns.
- The director's English-language ability and lack of engagement with CCS indicates they may have limited knowledge or understanding of the GST system. However, having considered all the circumstances, even having regard to the Taxpayer's director's personal circumstances, it is considered the director had a high level of disregard for the consequences of their actions.
- A reasonable person in the circumstances would be aware of a general requirement to retain tax invoices or other evidence substantiating amounts claimed in a return, even with a language barrier.
- It is noted that the director of the Taxpayer has referred to the existence of an unnamed accountant, whose services were apparently required for gathering tax invoices in relation to the amounts claimed. This is relevant as a person who relies on the advice of a qualified tax advisor will not be careless. However, the Taxpayer has not provided any information about the accountant or any advice or involvement the accountant had in the Taxpayer's tax affairs. Therefore, this does not support the view that the Taxpayer was not grossly careless.