Inland Revenue
Te Tari Taake

**TECHNICAL DECISION SUMMARY >** ADJUDICATION

**WHAKARĀPOPOTOTANGA WHAKATAU Ā-TURE >** WHAKAWĀ

# Whether GST Taxable Activity and whether in business

Decision date | Te Rā o te Whakatau: 22 October 2021

Issue date | Te Rā Tuku: 25 February 2022

**TDS 22/02**

# Subjects | Ngā kaupapa

GST: Taxable Activity; Income Tax: Whether in business; TAA: Shortfall penalties

# Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

| | |
|---|---|
| **CCS** | Customer and Compliance Services, Inland Revenue |
| **Commissioner** | Commissioner of Inland Revenue or CIR |
| **GST** | Goods and Services Tax |
| **GSTA** | Goods and Services Tax Act 1985 |
| **ITA 2007** | Income Tax Act 2007 |
| **NOPA** | Notice of proposed adjustment |
| **NOR** | Notice of response |
| **TAA** | Tax Administration Act 1994 |
| **TCO** | Tax Counsel Office, Inland Revenue |

# Taxation laws | Ngā ture take

Goods and Services Tax Act 1985; Income Tax Act 2007; Tax Administration Act 1994

# Facts | Ngā meka

1. The Taxpayer is an individual and was registered for GST. The Taxpayer claimed input tax deductions for GST and returned self-employment losses for income tax.
2. An audit was conducted by Customer and Compliance Services of Inland Revenue (**CCS**). CCS concluded that:
   - the Taxpayer's GST and income tax returns were fraudulent
   - no taxable activity existed for GST purposes
   - the Taxpayer was not in business for income tax purposes
   - the expenditure was private in nature.

3. As a result, CCS reassessed the Taxpayer's GST returns to disallow the deductions claimed and cancelled the Taxpayer's GST registration from the start date as there was no taxable activity. CCS also reversed the self-employment losses in the income tax returns. Evasion shortfall penalties were applied.
4. The Taxpayer argued that:
   - All the GST assessments for the disputed periods should be returned to the original amounts.
   - The income tax assessment for the latest income tax year should be returned to its original amount.
   - The decision to cancel the GST registration should be reversed.
5. The Taxpayer did not dispute CCS's income tax assessments for the earlier two income tax years.

# Issues | Ngā take

6. The main issues in this case were:
   - Did the Taxpayer carry on a taxable activity for GST purposes? If so, did the Taxpayer claim input tax they were not entitled to?
   - Was the Taxpayer in business for income tax purposes? If so, did the Taxpayer claim deductions they were not entitled to?
   - Was the Taxpayer liable for a shortfall penalty for evasion or a similar act?
7. This case also involves the following preliminary issues:
   - The onus and standard of proof.
   - Whether the Taxpayer has accepted the Commissioner's income tax assessments for the earlier two income tax years.
   - Taxpayer credibility.

# Decisions | Ngā whakatau

8. TCO decided that:
   - The Taxpayer did not have a taxable activity in the disputed periods. As a result the GST assessments made by CCS for the disputed periods were confirmed. Similarly, CCS's decision to cancel the Taxpayer's GST registration from the start date was also confirmed.

- Even if the Taxpayer did have a taxable activity, it was not shown that the Taxpayer was entitled to all of the input tax deductions that CCS proposes, in the alternative, to disallow.
- The Taxpayer was not in business in the latest income tax year. As a result the assessment made by CCS for the latest income tax year was confirmed.
- Even if the Taxpayer was in business, it was not shown that the Taxpayer was entitled to all of the income tax deductions that CCS proposes, in the alternative, to disallow.
- The Taxpayer was not liable for evasion shortfall penalties for the disputed GST periods or the disputed income tax year.

# Reasons for decisions | Ngā take mō ngā whakatau

## Preliminary Issue 1 | Take tōmua tuatahi: Onus and standard of proof

9. 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]

10. 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.

11. 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.[5] 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.[6]

## Preliminary Issue 2 | Take tōmua tuarua: Income tax assessments for the earlier two income tax years

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

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

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

12. CCS raised the issue of whether the Taxpayer had accepted (or was deemed to have accepted) the Commissioner's income tax assessments for the earlier two income tax years.

13. Under s 89D of the TAA the Taxpayer can issue a NOPA in relation to assessments but must do so within the response period set out in s 89AB of the TAA.

14. CCS argued that the Taxpayer's NOPA did not dispute the income tax assessments for the earlier two income tax years and therefore these assessments were accepted (or were deemed to have been accepted) by the Taxpayer.

15. The Taxpayer's second NOPA referred to the latest income tax year only and not to the assessments for the earlier two income tax years. Therefore, TCO concluded that the response periods for the earlier two income tax years had passed and the Taxpayer had no further ability to dispute those assessments.

## Preliminary Issue 3 | Take tōmua tuatoru: Credibility

16. The Tax Counsel Office adjudicates disputes solely on the documentary evidence provided by the parties to the dispute. It does not see or hear taxpayers give evidence and so is not able to assess their credibility first hand.

17. Sometimes CCS assesses credibility based on its dealings with the taxpayer. When adjudicating a dispute, the Tax Counsel Office will consider any assessment made by CCS as to a taxpayer's credibility. All the parties' arguments and the available evidence will also be considered.

18. A taxpayer will have the opportunity in any later challenge proceedings to have their credibility assessed by the TRA or a Court.

## Issue 1 | Take tuatahi: Taxable activity

19. The Taxpayer argued that there was a taxable activity. The Taxpayer argued that this was demonstrated by the time and effort put into the activity up until the Taxpayer was injured (during the latest income tax year). The Taxpayer argued that for a number of reasons the activity was not very successful but that there was still a taxable activity in the disputed periods.

20. CCS argued that the Taxpayer did not have a taxable activity as there was no evidence of the Taxpayer making supplies on a continuous or regular basis for consideration. CCS argued that any activity was a hobby and the exclusion in s 6(3)(a) of the Goods and Services Tax Act 1985 (**GSTA**) applies.

21. If there was no taxable activity, the assessments and decision made by CCS would be confirmed. If there was a taxable activity, a second issue arises which is whether

the Taxpayer claimed input tax deductions that they were not entitled to. This issue will be dealt with separately.

22. 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.[7] Establishing that there is a taxable activity is crucial to whether a person should be registered for GST and subject to the GSTA.

23. There are four requirements that must be satisfied to show there is a taxable activity (s 6(1)(a) of the GSTA):[8]

- There must be an activity.[9]
- The activity must be carried on continuously or regularly by a person.[10]
- The activity must involve, or be intended to involve, the supply of goods and services to another person.[11]
- The supply or intended supply of goods and services must be made for a consideration.[12]

24. It is noted that:

- Activity is not defined in the GSTA.
- Activity is a broad concept involving a combination of tasks undertaken, or a series of acts or course of conduct pursued by a person.
- The focus is on the activity as a whole and not on the individual steps involved in carrying on that activity.
- Activity for GST purposes is not the same as a "business" for income tax purposes.

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[7] Section 8(1) of the GSTA.

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

[9] *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].

[10] *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.

[11] 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].

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

25. Section 6(2) of the GSTA 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.

26. An activity will not be a taxable activity if it is carried on essentially as a private recreational pursuit or hobby (s 6(3) of the GSTA). To be carried on "essentially as a private recreational pursuit or hobby", an activity must be in essence of such a nature.[13]

27. An activity, organised in a coherent fashion to achieve a pecuniary profit, would not be carried on essentially as a private recreational pursuit or hobby. The derivation of enjoyment or pleasure by a taxpayer will not detract from this conclusion. However, if the dominant reason for carrying on the activity has the characteristics of personal refreshment, pleasure or recreation, the activity will be classed as a private recreational pursuit or hobby. As part of an overall assessment, it may be useful to contrast the activity stated to be a private recreational pursuit or hobby with how a taxpayer spends the rest of their time.

28. For the Taxpayer to have a taxable activity, that activity must be carried on continuously or regularly. An activity is carried on regularly if the elements of it recur at fairly fixed times, or at generally uniform intervals, to be of a habitual nature and character. The focus is on the activity as a whole and not the individual steps of the activity. There need not be continuous and regular sales.

29. In this dispute the activity was not just the maintaining of the activity's assets, but also using those assets to produce a product for sale. Looking at the Taxpayer's activity as a whole and realistically, TCO considered that the Taxpayer had not provided enough evidence to show that the activity had been carried on continuously or regularly. This was because:

    - the Taxpayer stated that there was no production in the first year
    - there was little evidence of any production in the second year
    - there was no evidence of any production in the latest year
    - in any event, there was no plan or evidence of any attempt to systematically sell any product that may have been produced.

30. In addition, the Taxpayer wished to cease the GST registration from the end of the latest tax year.

31. TCO concluded that the Taxpayer had not shown on the balance of probabilities that a taxable activity was being carried on. As it was concluded that the Taxpayer

[13] *Case N27* (1991) 13 NZTC 3,229 at 3,240.

was not carrying on a taxable activity there was no need to consider whether the activity was a private recreational pursuit or hobby.

## Issue 2 | Take tuarua: Input tax deductions

32. The conclusion in the earlier section that the Taxpayer was not carrying on a taxable activity made it unnecessary to consider whether the Taxpayer was entitled to all the input tax deductions claimed.

33. However, TCO considered the issue in case the dispute proceeded to the challenge stage and the TRA or a court subsequently decided that the Taxpayer was carrying on a taxable activity.

34. CCS argued that, if the Taxpayer was carrying on a taxable activity, the Taxpayer was not entitled to all the input tax deductions that were claimed because they were either private in nature or unsupported by evidence.

35. The calculation of GST payable by a registered person is set out in s 20 of the GSTA. 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.

36. For a taxpayer to be eligible for GST input tax deductions under s 20(2) of the GSTA:

- 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 of the GSTA.
- It is not enough that the taxpayer merely shows there was a supply made to them. The taxpayer must go further and provide sufficient particulars of the supply, generally in a tax invoice.[14]
- 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.[15]

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

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

37. The evidence provided for this dispute in relation to input tax deductions falls into three categories:
    - Expenses related to the taxable activity with tax invoices provided.
    - Expenses likely related to the taxable activity but without the required tax invoice or other documentation to support an input tax deduction.
    - Expenses where the Taxpayer has not shown the goods or services were used, or available for use, in the taxable activity (with or without a tax invoice).
38. TCO concluded that even if the Taxpayer was carrying on a taxable activity, it was not shown that the Taxpayer was entitled to all the input tax deductions claimed. The Taxpayer had not shown that:
    - All of the goods and services to which the input tax relates were used or available to use in making taxable supplies.
    - The required tax invoices were held.

## Issue 3 | Take tuatoru: Business

39. If the Taxpayer was not in business, the assessment made by the Commissioner to remove self-employed income losses in the disputed period would be confirmed.
40. If the Taxpayer was in business, a second issue arises which is whether the Taxpayer claimed deductions for expenditure to which they were not entitled. This issue will be dealt with separately.
41. The Taxpayer argued that there was a business for the latest income tax year (although as noted above under preliminary issues the Taxpayer did not dispute the Commissioner's income tax audit assessments for the previous two income tax years). The Taxpayer argued that the time and effort that was put into the activity up until they were injured shows that there was a business. The Taxpayer argued that for a number of reasons the business was not very successful but that they were still in business.
42. CCS argued that the Taxpayer did not intend to make a profit from the activity in the latest income tax year (or any previous tax years) and that the character and circumstances of the Taxpayer's activity meant that the Taxpayer was not in business. CCS also stated that the Taxpayer admitted that the activity was probably a hobby.

43. "Business" is defined in s YA 1 of the Income Tax Act 2007 as including "any profession, trade, or undertaking carried on for profit". The courts have considered the meaning of "business" and the leading case is *Grieve v CIR*.[16]

44. In *Grieve* the court held that whether a business exists involves a twofold inquiry into:

- The nature of the activities carried on.
- The intention of the taxpayer in engaging in those activities.

45. Factors relevant to the inquiry include:

- the period over which the activity is engaged in
- the scale of operations and the volume of transactions
- the commitment of time, money, and effort
- the pattern of activity
- the financial results.

46. It may also be helpful to consider whether the activity is carried on in a manner similar to other activities of a similar nature. However, it is the character and circumstances of the activity in question which are crucial.

47. Statements by the taxpayer regarding their intent are relevant although these will be objectively assessed in light of the evidence. Actions will often speak louder than words.

48. Although there must be an intention to make a profit, there need not be a reasonable prospect of doing so. An activity that is carried on unprofitably can still be a business.

49. The broadest of the concepts covered by the definition of a business is an undertaking. There must at least be an organised and coherent plan, and sufficient in time, scale, volume and the commitment of money and effort, to warrant calling the whole an undertaking. An undertaking is organised and directed to an end result.[17]

50. A business commences when a profit-making structure has been established and ordinary current business operations have begun.[18]

[16] *Grieve v CIR* (1984) 6 NZTC 61,682 (CA).

[17] *Calkin v CIR* (1984) 6 NZTC 61,781.

[18] *Slater & Ors v CIR* (1996) 17 NZTC 12,453 (HC).

51. An activity engaged in not to make income, but to make casual gains, or for sport, amusement, or other recreation, may not be a business.[19]

52. TCO considered that the Taxpayer had not provided sufficient evidence to prove that they were carrying on the activity in a business-like way in the latest income tax year for the following reasons:

- The Taxpayer was not registered with the industry body as required by legislation.
- The Taxpayer had not provided any evidence such as a vehicle log book to prove how much time was spent on the activity once it had been set up.
- The Taxpayer had not provided sufficient proof of the level of production that was claimed; no invoice or other documentation from the product processor was supplied.
- Sales amounts were very small and were not done in a commercial way (being to workmates).
- The Taxpayer had not provided any evidence of sales or marketing activity to sell the indicated quantity of product.
- The Taxpayer had not provided any information regarding the activity in the second half of the latest income tax year. For example, invoices, bank statements, GST workings.

53. In summary the Taxpayer had not proved on the balance of probabilities that they were in business in the latest income tax year. While it was considered that the Taxpayer had an intention to make a profit, the nature of the Taxpayer's activities did not reflect the carrying on of a business. The Taxpayer had not provided sufficient evidence to prove that the activity was undertaken in a business-like way, sufficient in time, scale, volume and the commitment of money and effort, organised and directed to achieving an end result, such that it could be considered to be a business.

## Issue 4 | Take tuawhā: Deductions

54. The conclusion in the earlier section that the Taxpayer was not in business in the latest income tax year made it unnecessary to consider whether the Taxpayer was entitled to all the income tax deductions claimed.

[19] *Case F55* (1983) 6 NZTC 59,840 and *Case L24* (1989) 11 NZTC 1,154.

55. However, TCO considered the issue in case the dispute proceeded to the challenge stage and the TRA or a court subsequently decided that the Taxpayer was in business.

56. CCS argued that, if the Taxpayer was in business, the Taxpayer was not entitled to all of the income tax deductions that were claimed because they were either private in nature and had no nexus with income or they were unsupported by evidence.

57. To establish that a deduction for expenditure or loss is allowable under the general permission in s DA 1 of the ITA 2007 a taxpayer must show that:

- they have incurred the expenditure or loss[20]
- that there is a sufficient nexus or connection between the expenditure or loss and the derivation of income by the taxpayer, or the carrying on of a business for that purpose.[21]

58. Even if a deduction for an expense is allowed under the general permission in s DA 1, the deduction may be denied under s DA 2 of the ITA 2007 if the expense is capital or private in nature.

59. A taxpayer who carries on an activity or business for the purpose of deriving assessable income is required to keep sufficient records to enable the taxpayer's deductions to be readily ascertained.

60. TCO concluded that even if the Taxpayer was in business, the Taxpayer had not provided sufficient evidence to show that they were entitled to all the deductions claimed in the latest income tax year. From the information provided it was not possible to identify exactly what deductions have been claimed making it difficult to consider whether the requirements for claiming those deductions had been met.

61. If this dispute goes further and the Taxpayer is found to be in business, the quantity of any income tax deductions available to the Taxpayer is a matter that can be determined at that time.

## Issue 5 | Take tuarima: Evasion shortfall penalty

62. The issue is whether the Taxpayer is liable under s 141E of the TAA for a shortfall penalty for evasion or a similar act (reduced by 50% under s 141FB of the TAA for previous behaviour).

[20] *FC of T v James Flood* (1953) 88 CLR 492*; New Zealand Flax Investments Ltd v FC of T* (1938) 61 CLR 179 at 207 per Dixon J; *A M Bisley & Co Ltd & Ors v CIR* (1985) 7 NZTC 5,082.

[21] *CIR v Banks* [1978] 2 NZLR 472 (CA); *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485 (CA); (1978) 3 NZTC 61,271; *Cox v CIR* (1992) 14 NZTC 9,164 (HC) at 9168.

63. Section 141E(1)(a) of the TAA imposes a shortfall penalty for evasion on a taxpayer if the following requirements are satisfied:[22]

- 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.[23]
- 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.[24]
- The taxpayer has evaded the assessment or payment of tax. Evasion requires an intention to avoid the assessment or payment of tax known to be chargeable:
  - The element of intention will be satisfied if the taxpayer knows that their action or omission will breach a tax obligation. There must be some blameworthy act or omission on the part of the taxpayer. The required intent for evasion can be inferred from surrounding circumstances and conduct.[25]
  - Recklessness can amount to evasion and involves the conscious taking of risk. Recklessness will be proven where: [26]
    - Facts actually known to the taxpayer were such that they must have put the taxpayer on inquiry that a tax obligation may not be met.
    - The taxpayer made a conscious decision to ignore the facts without making further inquiry.

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

65. 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.[27] This is different from the

[22] 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).

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

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

[25] *Taylor v Attorney-General* [1963] NZLR 261 (SC); *Lloyds Bank Ltd v Marcan* [1973] 2 All ER 359; *Case H90* (1986) 8 NZTC 619; *Case N47* (1991) 13 NZTC 3,388; *R v G* [2013] NZCA 146.

[26] *Case H90* (1986) 8 NZTC 619; *R v Harney* [1987] 2 NZLR 576 (CA); *Case P29* (1992) 14 NZTC 4,213; *Case S100* (1996) 17 NZTC 7,626; *R v G* [2013] NZCA 146.

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

other shortfall penalties where the onus of proof is on the taxpayer. The standard of proof is the balance of probabilities.[28]

66. CCS was not able to prove, on the balance of probabilities, that the Taxpayer claimed certain income tax deductions or input tax deductions which had some connection with the activity knowing that the Taxpayer was not lawfully entitled to the refunds. CCS has proved on the balance of probabilities that the Taxpayer may have obtained or attempted to obtain certain other refunds, knowing that he was not lawfully entitled to those refunds where those refunds were not related to the activity. There were other amounts where it was not possible on the evidence provided for the Tax Counsel Office to determine their connection or otherwise with the activity.

67. Accordingly, CCS has not proved on the balance of probabilities that the tax shortfall used for the calculation of the evasion shortfall penalty was correct. Consequently, based on the evidence before it, TCO concluded that the Commissioner had not proven on the balance of probabilities that the Taxpayer was liable to a shortfall penalty for evasion or similar act for the disputed GST periods or the disputed income tax year.

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