**TECHNICAL DECISION SUMMARY >** ADJUDICATION

**WHAKARĀPOPOTOTANGA WHAKATAU Ā-TURE>** WHAKAWĀ

# GST: Private recreational pursuit or hobby, taxable activity

Decision date | Te Rā o te Whakatau: 11 November 2021

Issue date | Te Rā Tuku: 15 June 2022

**TDS 22/09**

# Subjects | Ngā kaupapa

GST: Private recreational pursuit or hobby, taxable activity

# Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

| | |
|---|---|
| **Commissioner** | Commissioner of Inland Revenue |
| **GST** | Goods and services tax |
| **GST Act** | Goods and Services Tax Act 1985 |
| **CCS** | Customer & Compliance Services of Inland Revenue |
| **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 a horse racing syndicate formed by a company that breeds, agists, and sells racehorses (Company). The Taxpayer was formed by the director of the Company (not by the individual members).
2. The agreement constituting the Taxpayer (Agreement) sets out the names of the Taxpayer's members and their shareholdings. The Taxpayer's shares were held in various proportions by a number of natural persons and the Company.
3. The Agreement does not state the purpose for which the Taxpayer was formed. However, the Taxpayer argued that it was formed with an intent to be successful so that the members would become long term participants in the racing industry. The Taxpayer also argued:
    - The intent of the Company was that a profit would be made from the Taxpayer's activity.

- In line with their marketing and breeding policies, as well as to share costs of improving the value of its horses, the Company leased horses to syndicates (managed by itself) for up to 3 years.
- The syndicates looked after the racing of the horses until they were ready to breed.

4. The Agreement sets out the Taxpayer's rules. In particular, the rules name the director of the Company as the Taxpayer's manager (Manager).

5. The Taxpayer leased the horses. Among other things, the leases provide that:

- The Taxpayer had no right to purchase any of the horses.
- The lessor would not charge any percentage of the stakes earned by a horse.
- The lessee could terminate the lease at any time after giving one month's notice.
- At the end of each lease, the horses were to be delivered back to the lessor.

6. Several of the horses had varying racing success resulting in stakes income. The other horses did not generate any stakes income. All the horses were withdrawn from the Taxpayer's racing activity before the end of the lease terms. The horses were not replaced as they were withdrawn and the Taxpayer's racing activities ceased shortly after the last horse was withdrawn.

7. The Taxpayer was registered for GST purposes. The Taxpayer returned outputs (sales) and inputs (expenses) in its GST returns. The inputs consistently exceeded the outputs. Accordingly, all the Taxpayer's returns showed GST refunds.

## Issues | Ngā take

8. The main issue in dispute is whether the Taxpayer was carrying on a taxable activity.

9. There was also a preliminary issue on the onus and standard of proof.

## Decisions | Ngā whakatau

10. The Tax Counsel Office decided that:

- The Taxpayer was not carrying on a taxable activity.
- The Taxpayer carried on its activity as a private recreational pursuit or hobby.

# Reasons for decisions | Ngā take mō ngā whakatau

## Preliminary issue | Take tōmua: Onus and standard of proof

11. 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]

12. 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 | Take: Taxable activity

13. GST is imposed on taxable supplies. These are supplies of goods and services in New Zealand made by a registered person in the course or furtherance of a taxable activity carried on by the registered person.[5] To be GST registered and subject to the Goods and Services Act 1985 (GST Act) a person must be carrying on a taxable activity. A taxable activity does not include an activity carried on essentially as a private recreational pursuit or hobby.

14. A taxable activity is an activity:

- carried on continuously or regularly by a person
- whether or not for a pecuniary profit
- that involves, or is intended to involve, the supply of goods and services to another person for consideration.[6]

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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] Section 8(1) and the definition of "taxable supply" in s 2(1) of the GST Act.

[6] Section 6(1)(a) of the GST Act.

15. It is noted that s 5(11CB) of the GST Act:

- provides that a prize received from a racing club by a registered person in the course of a taxable activity for the performance in a race of a horse is treated as consideration for a service supplied to the racing club, but
- does not cause or deem a horse racing activity carried on by a person to become a taxable activity.[7]

16. An activity will not be a taxable activity if it is carried on essentially as a private recreational pursuit or hobby.[8]

17. To be carried on "essentially as a private recreational pursuit or hobby", an activity must be in essence of such a nature. In *Case N27*, Judge Bathgate said:[9]

> The word "essentially" in the phrase mentioned, I think emphasises the necessity for the activity being clearly a private recreational pursuit or hobby. …
>
> For an activity to be carried on essentially, as a private recreational pursuit or hobby, that activity must be in essence of such a nature, in the context of sec 6, so that although an activity may have some of the appearances or some of the attributes of such an activity, it will not be exempt from the definition of "taxable activity" unless it is in essence a private recreational pursuit or hobby. An activity that might also seem to be a business would not, to my mind, be one that was "carried on essentially as a private recreational pursuit or hobby".

18. CCS did not dispute that the Taxpayer's activity met the taxable activity requirements in s 6(1)(a). However, CCS argued that the activity was not a taxable activity because, if carried on by a natural person, the activity would be carried on essentially as a private recreational pursuit or hobby (s 6(3)(aa)).

19. The Tax Counsel Office considered the case law referred to by the parties and provided the following summary of principles:

- An activity carried on essentially as a private recreational pursuit or hobby is a private pastime or pursuit carried on for the personal refreshment, pleasure or recreation of the person or persons concerned.[10]

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[7] See commentary on the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill at 94.

[8] Section 6(3)(aa).

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

[10] *Case N27*, *Case L24* (1989) 11 NZTC 1,154, *Shepherd v FCT* 75 ATC 4,244 (SC), *Martin v FCT* (1953) 10 ATD 226 (HCA), *Graham v Green* [1925] All ER 690 (KBD).

- An activity that is organised in a coherent fashion to achieve a profit will not be a private recreational pursuit or hobby.[11]
- An activity coherently organised for the purpose of making a profit will not necessarily be a private recreational pursuit or hobby if those involved derive private and personal enjoyment from the activity.[12]
- An activity that is a vocation or the source of the taxpayer's livelihood is unlikely to be carried on essentially as a private recreational pursuit or hobby.[13]
- Given the significant element of chance in relation to winning prize money from the racing of horses there must be a sufficient system in relation to the chances involved to show that a profit-making system has been devised.[14]
- The use of skill involved in training a horse is not decisive of whether a business is carried on and may not be relevant in many cases.[15]
- Whether an activity is a private recreational pursuit or hobby is a question of fact and depends on the totality of the evidence.[16]
- The focus is on the activity and how it is organised and carried on.[17]
- It is the collective purpose of an unincorporated body carrying on an activity that is relevant in determining the purpose for the activity carried on.[18]
- It is the dominant purpose of the taxpayer that is relevant in determining whether their activity is a private recreational pursuit or hobby.[19]

20. Applying those principles to the facts in this case, the Tax Counsel Office concluded that the Taxpayer carried on its activity as a private recreational pursuit or hobby. This was because:

- The Taxpayer had not shown that it was formed for the purpose of making a profit from its horse racing activity and operated in that manner. The evidence provided suggested that:

[11] *Case L24*, *Shepherd v FCT*, *Graham v Green*, *Martin v FCT*.

[12] *Case N27*, *Case M131* (1990) 12 NZTC 2,850.

[13] *Shepherd v FCT*, *Graham v Green*, *Case K40* (1988) 10 NZTC 343.

[14] *Shepherd v FCT*.

[15] *Shepherd v FCT*, *Graham v Green*.

[16] *Case N27*.

[17] *Case N27*, *Case L24*.

[18] *Case N27*, *CIR v Boanas & Ors* (2008) 23 NZTC 22,046 (HC).

[19] *Case L24*, *Case P73* (1992) 14 NZTC 4,489, *Shepherd v FCT*.

- the Taxpayer was formed for the personal interest or pleasure of its members
- the way the Taxpayer was organised and operated emphasised the recreational aspect of the Taxpayer's activity
- there was no clear indication of the purpose for which the Taxpayer was formed.

In addition, it would be inappropriate to attribute the Company's purposes to the Taxpayer's members.

- The Taxpayer had not shown that its activity was organised to achieve a pecuniary profit and operated in a systematic fashion that materially reduced the element that luck played in whether it won any prize money. The number of horses the Taxpayer leased and raced, the quality of the horses, and its use of top trainers may have been due to a system devised to reduce the element that luck played in winning prize money. However, the more likely reason was the Company's strategy to improve the quality of its horses by having more to breed from, have its horses looked after and raced until they were ready to breed from, and sharing the costs of improving the value of its horses. This was given other evidence suggesting that the Taxpayer was formed for the personal interest or pleasure of its members. The financial results of other horse racing syndicates established by the Company may show a possibility that the Taxpayer could have made a profit. However, the results also show that a significant amount of luck would have been involved. The results did not show there having been any material reduction in the element that luck played in the syndicates, including the Taxpayer, winning prize money.
- Given the number of horses the Taxpayer leased and raced and the number of members the Taxpayer had, the time involved in its management activities does not seem so significant or sufficient to show the Taxpayer's activity was carried on as a taxable activity rather than a private recreational pursuit or hobby. It might reasonably be expected that a similar amount of time would be involved whether the Taxpayer's activity was carried on as a taxable activity or private recreational pursuit or hobby. In addition, it seemed likely that some of the time was spent on behalf and for the benefit of the Company and not solely for the benefit of the Taxpayer.