

GST and income tax: Liable as agent for tax obligations of a company?

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TDS 22/14

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Subjects | Ngā kaupapa

GST and income tax: Is the Taxpayer liable as agent for a company's tax obligations under s 61 of the Goods and Services Tax Act 1985 and s HD 15 of the Income Tax Act 2007?

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
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
SOP	Statement of Position

Taxation laws | Ngā ture tāke

All legislative references are to the Income Tax Act 2007 (**ITA 2007**) unless otherwise stated.

Facts | Ngā meka

Background

1. The Taxpayer is a citizen and resident of Australia and was the sole director and shareholder of a company, ABC Ltd (in liquidation) (**ABC**). The Taxpayer performed the services which are the subject of this dispute in New Zealand.
2. ABC was registered for GST on the payments basis. ABC's business was "Computer Programming Service". ABC did not have its own bank account, but an Australian

company with a similar name (ABC Pty Ltd (**ABC Aus**)) did have a New Zealand bank account. The Taxpayer was the sole signatory on ABC Aus' bank account.

First agreement to provide services

3. The Taxpayer (trading as ABC) entered into a written agreement with XYZ Ltd (**XYZ**, a large New Zealand registered company). The Taxpayer (trading as ABC) agreed to provide services to XYZ. XYZ agreed to pay all reasonable disbursements incurred by ABC in the course of carrying out the services. All payments made by XYZ to ABC for the period in dispute were made to ABC Aus' bank account.
4. There was a factual dispute between Customer & Compliance Services (**CCS**) and the Taxpayer about whether ABC was an independent contractor to XYZ or whether the Taxpayer was an employee of XYZ.

Second agreement to provide services

5. A second New Zealand registered company was involved in the dispute, DEF Ltd (**DEF**). An Australian resident individual (who is apparently unrelated to the Taxpayer) was the sole director and shareholder of DEF. DEF was the corporate trustee for the DEF Trust (**Trust**).
6. CCS obtained a copy of an agreement between XYZ and DEF (and two subsequent variation agreements). The agreements were signed by the Australian resident individual. The services provided under the agreements included providing personnel who were based in New Zealand or Australia to XYZ.
7. DEF made payments to ABC Aus' bank account on a regular basis. DEF also made a number of payments to the Taxpayer's personal bank account.
8. CCS considered the payments DEF made into ABC Aus' bank account were for services that ABC provided to the Trust and/or DEF. The Taxpayer did not agree.

The New Zealand bank account

9. CCS reviewed ABC Aus' bank statements and found:
 - There was a regular pattern of funds being transferred to Australia.
 - Once a payment was received into ABC Aus' bank account from XYZ or DEF, funds were transferred to an Australian bank account or transferred to the Taxpayer's joint account with his spouse.

- This left just enough to cover the Taxpayer's private costs until the next payment was received.
- No surplus was retained or built up.
- When the contract with XYZ was completed there were no funds left in ABC Aus' bank account.
- All funds had been transferred to Australia.

Assessments issued by the Commissioner

10. Following an investigation, CCS issued assessments of GST and income tax to ABC. The assessments increased the amount of tax payable by treating certain payments made into ABC Aus' bank account as outputs for GST and income for income tax purposes. The assessments were not disputed by ABC and were deemed to be accepted. Consequently, these assessments are not in dispute.

Notice of disputable decision

11. Shortly after the assessments of GST and income tax were issued to ABC, CCS issued a notice of disputable decision and assessment determining that the Taxpayer was personally liable, as agent, for the GST and income tax debts of ABC under s 61 of the Goods and Services Tax Act 1985 (**GSTA**) and s HD 15.
12. The Taxpayer disputes that they were liable for ABC's tax debts.

Issues | Ngā take

13. The issue for decision by the Tax Counsel Office was whether the Taxpayer was liable as agent for ABC's tax obligations for the relevant periods under s 61 of the GSTA and s HD 15.
14. As noted above at [4], the Taxpayer also raised an issue regarding whether they were an employee of XYZ. While this was a matter relating to the Taxpayer's assessments, the Tax Counsel Office considered it to be outside the scope of their report because ABC did not dispute the assessments and was deemed to have accepted the liability. The parties' arguments regarding this issue are briefly summarised below at [16]-[19] as a preliminary issue.

Decisions | Ngā whakatau

15. The Tax Counsel Office decided that the Taxpayer was liable as agent for ABC's tax obligations for the relevant periods under s 61 of the GSTA and s HD 15.

Reasons for decisions | Ngā take mō ngā whakatau

Preliminary issue | Take tōmua: Was the Taxpayer an employee?

16. The Taxpayer argued that the contract entered into with XYZ was an employment agreement. Therefore, the Taxpayer argued that (as an employee) they could not be subject to s 61 of the GSTA and s HD 15. CCS argued that the facts did not support the view that the Taxpayer was an employee. CCS considered that the Taxpayer was an independent contractor.
17. The Tax Counsel Office discussed the main common law tests for determining employment status – the intention, control, fundamental, integration and independence tests – and noted the importance of bearing in mind that the application of the common law tests is a weighing-up process:¹
 - Sometimes the facts of a particular case may suggest different characterisations of the relationship, and there may be either overlap or tensions between the tests.
 - Also, as the characterisation of the relationship is dependent on the particular facts at hand, it is crucial that the facts are well understood, including any changes to the relationship that have occurred over time.

Applying the tests to the facts of a case required an objective weighing of the various relevant factors to determine the true nature of the relationship.

18. The Tax Counsel Office noted that its analysis was consistent with the Commissioner's Interpretation Guideline IG 16/01: *Determining employment status for tax purposes (employee or independent contractor?)*.
19. The Tax Counsel Office concluded that:

¹ See in particular *TNT Worldwide Express Ltd v Cunningham* [1993] 3 NZLR 681 (CA) and *Bryson v Three Foot Six Ltd* (2005) 22 NZTC 19,242 (SC).

- The common law tests indicated the Taxpayer was not an employee of XYZ.
- There was no evidence giving any reason to depart from the clear wording of the agreement, which specified that ABC was not an employee and contained clear terms consistent with that statement.
- Even if the Taxpayer was an employee, this would not have a notable impact on the overall tax liability payable by the Taxpayer. This was because ABC would be liable to account for GST charged regardless, and the Taxpayer would be required to account for PAYE not withheld from payments made by XYZ (s RD 21).

Issue | Take: Was the Taxpayer liable as agent for ABC's tax obligations under s 61 of the GSTA and s HD 15 of the ITA 2007?

Section HD 15

20. Section HD 15 permits income tax owing by a company to be recovered from the company's directors and shareholders where an arrangement has been entered into which has an effect that the company cannot meet a tax liability.
21. Similarly, GST owing by a company may also be recovered from the company's directors and shareholders under s HD 15. Section HD 15 applies for the purpose of the GSTA as if the terms "income tax" and "tax" read "goods and services tax".
22. Section HD 15(1) sets out four requirements that must be met before s HD 15 will apply:
 - an arrangement has been entered into in relation to a company
 - an effect of the arrangement is that the company cannot meet a tax liability (either an existing liability or one that arises later)
 - it is reasonable to conclude that a purpose of the arrangement is that the company cannot meet a tax liability, and
 - it is reasonable to conclude that if a director of the company at the time of the arrangement made reasonable inquiries, they could have anticipated at the time that the tax liability would, or would likely, be required to be met.

Was there an arrangement?

23. An arrangement is an agreement, contract, plan or understanding. The term “arrangement” is defined in s YA 1 as follows:
- arrangement** means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect
24. The definition states that the contract, agreement, plan, or understanding need not be enforceable. The definition of “arrangement” also explicitly includes all steps and transactions by which the arrangement is carried into effect.
25. It is necessary to consider all of the relevant dealings or set of circumstances between the parties to determine if there is an arrangement. An “arrangement” is not limited to a single document or transaction.² The test is whether the relevant documents, transactions, dealings or set of circumstances are sufficiently interrelated or interdependent to be considered a single arrangement.³
26. The Tax Counsel Office considered that there was an arrangement in this case because:
- This was not a simple series of sequential events that just occurred as a result of developing circumstances (as argued by the Taxpayer).
 - Each step was interrelated concerning the use and treatment of amounts paid by XYZ and DEF over a number of years.
 - Some elements on their own may have been simple business decisions by ABC.
 - However, taken together, all the elements demonstrate that the steps were planned as part of a wider arrangement.

Effect of the arrangement

27. The Courts have ruled that an effect of an arrangement is a result or consequence of the arrangement. Determining an effect of an arrangement is an objective test having

² *Tayles v CIR* (1982) 5 NZTC 61,311 (CA) at 61,318.

³ *CIR v Penny and Hooper* [2010] NZTC 15,433 (CA) at 15,451, *CIR v Europa Oil* [1971] NZLR 641 (PC) at 651, *AMP Life Limited v CIR* (2000) 19 NZTC 15,940 (HC).

regard to the outcome or outcomes of the arrangement itself. The motives of the parties are irrelevant.⁴

28. Section HD 15 should apply in situations where before an arrangement takes effect a company was able to satisfy a tax liability (either an existing liability or one that arises later) but an effect of the arrangement is that the company cannot meet the tax liability.⁵
29. Section HD 15 should not apply if the arrangement has no effect on the company's ability to meet the tax liability. If a company cannot meet an existing or expected tax liability regardless of the arrangement it is unlikely to be an effect of the arrangement that the company cannot meet the tax liability.
30. The TRA decided in *Case X11* that s HK 11 of the ITA 1994 (an earlier equivalent of s HD 15) applied where an effect of an arrangement involved the depletion of the assets of a company with the result that the company could not meet an existing or future tax liability. The TRA stated that *something* about the arrangement must produce the result that the company cannot meet a tax liability—that *something* must involve depleting the assets of the company.
31. Since ABC had limited other expenses, and these other expenses were met using only a small portion of the funds paid to ABC, it is reasonable to conclude that if the bulk of these funds had not been diverted overseas, ABC would have been able to meet its tax liability with no difficulty. Accordingly, the Tax Counsel Office considered that an effect of the arrangement (specifically the stripping of assets by transferring them to Australian bank accounts) was to leave ABC in a position where it was unable to meet its tax liability.

Purpose of the arrangement

32. The purpose of an arrangement has been considered in the context of the general anti-avoidance provision s BG 1 and earlier equivalent provisions. By definition a tax avoidance arrangement is an arrangement that has tax avoidance as its *purpose or effect* (s YA 1). In this context the purpose of an arrangement has been said to mean the effect which it sought to achieve or its intended effect.⁶

⁴ *Auckland Harbour Board v CIR* (1999) 19 NZTC 15,433 (CA) at 15,451, *CIR v BNZ Investments Ltd* (2001) 20 NZTC 17,103 (CA), *Peterson v CIR* (2005) 22 NZTC 19,098 (PC) at 34, *Newton v FCT* [1958] 2 All ER 759 (PC) at 764.

⁵ *Case X11* (2005) 22 NZTC 12,175.

⁶ *Tayles v CIR* (1982) 5 NZTC 61,311 (CA) at 734, *Ashton v CIR* (1975) 2 NZTC 61,030 (PC), *Glenharrow Holdings Ltd v CIR* (2009) 24 NZTC 23,236 (SC).

33. The wording of s HD 15(1)(c)(i) is different to the wording of the general anti-avoidance provision s BG 1. Section HD 15(1)(c)(i) refers only to the relevant arrangement's purpose. It requires that a purpose of the arrangement is to have the effect described in s HD 15(1)(b), ie that the company cannot meet a tax liability. Section HD 15(1)(c)(i) does not require the purpose to be that effect. The wording of s HD 15(1)(c)(i) suggests that the required purpose is the arrangement's intended purpose. Whether the arrangement has the required purpose involves considering the arrangement itself and the effect described in s HD 15(1)(b) (ie that the company cannot meet a tax liability), to determine whether a reason or an object of the arrangement was to have that effect.
34. Section HD 15(1)(c)(i) uses an indefinite article in the phrase "a purpose of the arrangement" (emphasis added). This means that it will be sufficient if any purpose of the arrangement was that the arrangement would have an effect involving the depletion of the assets of a company with the result that the company cannot meet an existing or future tax liability. It is not necessary for the purpose to have been the sole, dominant, or principal purpose.
35. The facts show:
- the Taxpayer's living and operating expenses were being met, and
 - the Taxpayer was living in Australia and was only in New Zealand to work for XYZ and DEF.
36. CCS argued that:
- the only reason additional funds would have been left in New Zealand would be to meet tax liabilities, and
 - since funds were not left in the account for the purpose of meeting tax liabilities, this demonstrates a purpose of the arrangement was that ABC could not meet its tax liabilities.
37. The Taxpayer did not give any explanation why funds were kept in New Zealand to meet every ongoing expense except tax. Therefore, in the light of this and agreeing with CCS's arguments, the Tax Counsel Office considered it reasonable to conclude that a purpose of the arrangement was for the Company to be unable to meet its tax liability.

Reasonable to conclude that a director could have anticipated the tax liability

38. The issue is whether it is reasonable to conclude that if a director of the company, at the time of the arrangement, made reasonable inquiries they could have anticipated that a tax liability would, or would likely, be required to be met (s HD 15(1)(c)(ii)).
39. It must be possible for the director to have anticipated that the tax liability would or would likely be required to be met. In *Commissioner of Police v Ombudsman Jeffries J* said that the words “would be likely” as used in s 6 of the Official Information Act 1982 meant that there was a distinct or significant possibility the result might occur.⁷
40. Adopting a similar approach to *Jeffries J*, the Tax Counsel Office considered that for the purposes of s HD 15(1)(c)(ii) the director must have been able to anticipate that:
 - the relevant tax liability would be required to be met, or
 - there was a distinct or significant possibility that the relevant tax liability would be required to be met.
41. The Tax Counsel Office considered it highly unlikely that a director of a company (making significant amounts of money from contract engagements) would not realise, on making reasonable inquiries, that GST outputs would need to be accounted for on GST charged, or that a company’s income was not being returned for income tax purposes.
42. In addition, even if the Taxpayer thought that he was an employee (which was not accepted by the Tax Counsel Office), the agreement was clear that ABC would be required to account for all its tax obligations. And, it would have been obvious that the amounts paid by XYZ did not have PAYE deducted.
43. For these reasons, the Tax Counsel Office considered it reasonable to conclude that the Taxpayer, the sole director of ABC, could have anticipated that the tax liability would be required to be met.

Conclusion

44. The Tax Counsel Office concluded that all of the requirements in s 61 of the GSTA and s HD 15 were met because:

⁷ *Comr of Police v Ombudsman* [1985] 1 NZLR 578 (HC) at 589.

- The Taxpayer, ABC, and ABC Aus (both companies operated by the Taxpayer) engaged in an arrangement that involved:
 - receiving payments into ABC Aus' New Zealand bank account
 - quickly transferring the bulk of the payments to Australian bank accounts under the Taxpayer's control
 - causing ABC's tax liability to be understated in tax returns that were filed with Inland Revenue, and
 - filing nil returns.
- Looked at objectively, this arrangement had an effect of depleting ABC's assets almost completely on a regular basis, which left ABC unable to meet its tax liability, or any expected tax liability that would naturally arise from the activities ABC engaged in.
- It was reasonable to conclude that:
 - a purpose of the arrangement was ABC could not meet its tax liability as funds were kept in New Zealand only if they were needed to meet the Taxpayer's and ABC's other expenses. All of these other expenses were met except ABC's tax liability, and funds were not retained in the account to meet any expected tax liability that might arise, and
 - the Taxpayer, as sole director of ABC, could have anticipated that ABC's tax liability would arise.