



TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

# GST - input tax, taxable activity, taxable supplies, registration

Decision date | Rā o te Whakatau: 24 September 2024

Issue date | Rā Tuku: 10 March 2025

TDS 25/05

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## Subjects | Kaupapa

GST input tax deductions, taxable activity, taxable supplies, GST registration

## Taxation laws | Ture tāke

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

## Summary of facts | Whakarāpopoto o Meka

1. The Taxpayer was a GST-registered company with multiple shareholders. It owned land that it leased to one of its shareholders.
2. The Taxpayer sold the land and ceased making taxable supplies. The Taxpayer did not de-register for GST.
3. Some of the Taxpayer's shareholders raised concerns about the previous administration of the Taxpayer and apparent irregularities in its accounts. The Taxpayer incurred legal fees defending the shareholder claims.
4. Around five years later, the Taxpayer claimed input tax deductions relating to legal fees it had incurred in the previous two years while the Taxpayer was not making any taxable supplies.
5. Customer and Compliance Services, Inland Revenue (CCS) argued that, as the Taxpayer had not made any taxable supplies during the previous five years, it had no taxable activity and was not entitled to the input tax deductions it had claimed for legal fees. CCS argued the Taxpayer's GST registration should be cancelled.
6. The Taxpayer argued it had always had a taxable activity and the legal fees it claimed related to that taxable activity. The Taxpayer said the legal fees related to the dispute with its shareholders and that it could not complete its taxable activity or start a new one until the dispute was resolved.

## Issues | Take

7. The main issue in dispute was whether the Taxpayer was entitled to the input tax deductions it claimed (s 20(3C)). The Tax Counsel Office (TCO) considered:
  - whether the Taxpayer was carrying on a taxable activity, and

- whether the legal services to which the input tax related was used for making taxable supplies.
8. A further issue was whether the Taxpayer's GST registration should be cancelled.
  9. There was also a preliminary issue concerning the onus and standard of proof.

## Decisions | Whakatau

10. TCO concluded that the Taxpayer was not entitled to the input tax deductions it claimed. The Taxpayer was carrying on a taxable activity as there were actions still being done in connection with the termination of the activity. However, the Taxpayer had not shown the legal services were used for making taxable supplies.
11. TCO also concluded the Taxpayer's GST registration should not be cancelled.

## Reasons for decisions | Pūnga o ngā whakatau

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

12. Except for proceedings relating to evasion or similar act or obstruction, the onus of proof is on the taxpayer to show that an assessment is wrong, why it is wrong, and by how much it is wrong.<sup>1</sup> However, if the taxpayer proves, on the balance of probabilities, that the amount of an assessment is excessive by a specific amount, the taxpayer's assessment must be reduced by the specific amount.<sup>2</sup>
13. The standard of proof required is the balance of probabilities.<sup>3</sup>
14. It is appropriate that the same onus and standard of proof be applied in the disputes process as in challenge proceedings. TCO considered whether the Taxpayer has discharged the onus of proof in the context of the issues raised by the parties in the dispute, based on the documentary evidence put before it.

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<sup>1</sup> Section 149A(2) of the TAA. See also *Case V17* (2002) 20 NZTC 10,192, *Accent Management Ltd v CIR* (2005) 22 NZTC 19,027 (HC), and *Vinelight Nominees Ltd v CIR (No 2)* (2005) 22 NZTC 19,519 (HC).

<sup>2</sup> Section 138P(1B) of the TAA.

<sup>3</sup> *Yew v CIR* (1984) 6 NZTC 61,710 (CA), *Case Y3* (2007) 23 NZTC 13,028, and *Case X16* (2005) 22 NZTC 12,216.

## Issue | Take: Whether the Taxpayer is entitled to the input tax deductions it claimed

15. To be entitled to an input tax deduction, a person must be carrying on a “taxable activity”.<sup>4</sup> In addition, the goods or services to which the input tax relates must be used for, or intended to be used in, making taxable supplies.<sup>5</sup>

### Taxable activity

16. A taxable activity is any activity carried on continuously or regularly by any person that involves or is intended to involve the supply of goods and services (s 6).
17. Anything done in connection with the ending of a taxable activity is treated as being carried out in the course of the taxable activity (s 6(2)).
18. The phrase “in connection with” requires a close and immediate connection.<sup>6</sup> It is a question of fact whether a close and immediate connection exists.<sup>7</sup>
19. Things done “in connection with” the ending of a taxable activity may include:
- The disposal of assets used in the taxable activity.<sup>8</sup>
  - Things done over a reasonable period after the making of taxable supplies had ceased to tidy up the affairs of the taxable activity and wind it up,<sup>9</sup> including things done during the process of the receivership of a company.<sup>10</sup>
  - Defending and attempting to settle legal proceedings for misrepresentation and breach of fiduciary duties following the sale of a business.<sup>11</sup>
  - The pursuing of trade debts after the cessation of trading.<sup>12</sup>

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<sup>4</sup> See the definition of “input tax” in ss 3A, 6, 20(3) and 51(1) and (3).

<sup>5</sup> Section 20(3C).

<sup>6</sup> *Case E84* (1982) 5 NZTC 59,446 and *Case Z9* (2009) 24 NZTC 14,100, which concerned similarly worded income tax provisions, and *Malololailai Interval Holidays New Zealand Ltd v CIR* (1997) 18 NZTC 13,137 (HC), which concerned s 11A(1)(1)(e).

<sup>7</sup> *Malololailai Interval Holidays New Zealand Ltd v CIR*.

<sup>8</sup> *Thompson v CIR* (2009) 24 NZTC 23,725 (HC).

<sup>9</sup> *Case U29* (2000) 19 NZTC 9,273.

<sup>10</sup> *Case Q43* (1993) 15 NZTC 5,208.

<sup>11</sup> *Case T30* (1997) 18 NZTC 8,216.

<sup>12</sup> *Case 4/2011* [2010] NZTRA 13, (2011) 25 NZTC 1-004.

20. The Taxpayer argued that defending the shareholders' claims was done "in connection with" the ending of its taxable activity. CCS argued that the defending of the claims was done "in connection with" the ending of the Taxpayer's structure, not the ending of its taxable activity.
21. TCO considered the Taxpayer was carrying on a taxable activity because, although not making, or intending to make, any taxable supplies, the Taxpayer's defending of the shareholders' claims was something done "in connection with" the ending of its taxable activity.
22. TCO noted that until the shareholders' claims were resolved, the land sale proceeds could not be distributed or otherwise disbursed. Further, the balance of the land sale proceeds available to be distributed or disbursed could not be determined.
23. TCO further noted resolution of the shareholders' claims may have required adjustments to the Taxpayer's financial statements, meaning they could not be finalised until the claims were resolved. Accordingly, unless the Taxpayer defended the shareholders' claims it would have been unable to tidy up the affairs of its taxable activity.
24. TCO found that s 6(2) applied to treat the Taxpayer's defending of the shareholders' claims as being carried out in the course of its taxable activity. The effect of this was that the Taxpayer's taxable activity was treated as continuing while it defended the shareholders' claims.

### **The legal services to which the input tax relates must have been used for making taxable supplies**

25. To be entitled to an input tax deduction it is not sufficient that a person is carrying on a taxable activity. The goods or services to which the input tax relates must be used for, or intended to be used in, making taxable supplies (use test) (s 20(3C)).
26. TCO noted that there was no relevant case law on the use test. TCO considered the sufficient nexus approach taken by the courts in relation to the former principal purpose test to be relevant. Before 1 April 2011, the requirement was that the goods or services must have been acquired for the "principal purpose of making taxable supplies" (principal purpose test).<sup>13</sup> In cases that considered the former principal purpose test the courts made it clear that there must be a sufficient connection or nexus between the acquisition of goods or services and the making of taxable supplies

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<sup>13</sup> See the Taxation (GST and Remedial Matters) Act 2010 which substituted s 3A(1)(a) and introduced ss 20(3C).

(sufficient nexus approach). The goods and services need not be directly linked to taxable supplies.<sup>14</sup> Whether a sufficient connection or nexus existed was a question of fact.<sup>15</sup>

27. Although support for the use test requiring the possibility of future supplies could arguably be seen in *Case Q43*, TCO considered that the better view was no such requirement existed. In the context of s 6(2), the use test may be met where there is a sufficient nexus between goods or services and taxable supplies made in the past.
28. The Taxpayer was not making, or intending to make, any taxable supplies when it acquired the legal services. Accordingly, for the legal services to be used in making taxable supplies they must have been sufficiently connected to the taxable supplies of land the Taxpayer made in the past.
29. The legal services were acquired in defending the shareholders' claims. TCO considered the nature of the shareholders' claims and whether they concerned matters sufficiently connected to the making of the Taxpayer's past taxable supplies. To the extent they did, then the legal services should also be sufficiently connected to the making of the Taxpayer's past taxable supplies.
30. TCO concluded that the Taxpayer had not shown that all the shareholders' claims were, or the extent to which they were, sufficiently connected to the making of the Taxpayer's past taxable supplies. Some of the claims related to loans and other transactions that were not taxable supplies or sufficiently connected with the making of taxable supplies. Insufficient information had been provided to show other claims were sufficiently connected to the making of the Taxpayer's past taxable supplies.
31. Although some of the claims were sufficiently connected with the making of the Taxpayer's past supplies, there was evidence the claims had been resolved before the legal services were provided.
32. In summary, the Taxpayer had not shown the shareholders' claims were sufficiently connected to the making of the Taxpayer's past taxable supplies. It follows that the legal services relating to the claims were not sufficiently connected to the making of the Taxpayer's past taxable supplies.
33. Accordingly, the use test was not met. The Taxpayer had not shown the legal services to which the input tax related were used for, or intended to be used in, making taxable supplies.

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<sup>14</sup> *CIR v Trustees in the Mangaheia Trust and Trustees in the Te Mata Property*.

<sup>15</sup> *Case 4/2011* [2010] NZTRA 13, (2011) 25 NZTC 1-004 and *Case W3* (2003) 21 NZTC 11,014.

## Cancellation of GST registration

34. Where the Commissioner is satisfied a registered person's taxable activity has ended, the Commissioner may cancel that person's GST registration. The cancellation takes effect from the last day of the taxable period in which the Commissioner was so satisfied or from any other date determined by the Commissioner. The date may be a retrospective date (s 52).
35. As the evidence showed the Taxpayer was continuing to defend the shareholders' claims, TCO considered that CCS could not cancel the Taxpayer's GST registration from the date proposed.

## Conclusion

36. The Taxpayer was not entitled to the input tax deductions it claimed. While the Taxpayer was carrying on a taxable activity, it had not shown the legal services to which the input tax related were used for making taxable supplies.
37. As the Taxpayer was carrying on a taxable activity while it defended the shareholders' claims, its GST registration should not be cancelled from the date proposed.