

# Deductions, zero-rating and shortfall penalties

Decision date | Rā o te Whakatau: 17 February 2025

Issue date | Rā Tuku: 8 May 2025

TDS 25/11

## DISCLAIMER | Kupu Whakatūpato

This document is a summary of the original technical decision so it may not contain all the facts or assumptions relevant to that decision.

This document is made available for **information only** and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs.** It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

For more information refer to the [Technical decision summaries guidelines](#).

## Subjects | Kaupapa

Whether the Taxpayer was entitled to input tax and income tax deductions it claimed (including whether one of the transactions was zero-rated). Whether the Taxpayer was required to return GST output tax on refunds and dishonoured supply payments. Whether the Taxpayer was liable for shortfall penalties.

## Taxation laws | Ture tāke

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

## Summary of facts | Whakarāpopoto o Meka

1. The Taxpayer was a company registered for GST on a payments basis. The Taxpayer had one shareholder and two directors.
2. There was another company (S Co) with the same shareholder and the same two directors as the Taxpayer. S Co purchased land and began to set up a business.
3. After a while, the Taxpayer purchased the business from S Co. S Co issued a document purporting to be a tax invoice for the purchase price. The purchase price essentially reimbursed S Co for amounts it had incurred on business assets and other business related set up costs (set up costs).
4. The Taxpayer filed its GST return for the period in which the purchase took place and claimed (among other things) an input tax deduction for the GST content of the purchase price (which included the set up costs). CCS argued that no input tax deduction could be claimed for the set up costs because:
  - those costs were incurred by S Co, and
  - the transfer of the business was a going concern (ie, should have been zero-rated).
5. Similarly, the Taxpayer filed its income tax return for the year in which the purchase took place and claimed (among other things) a deduction for the set up costs. CCS argued that set up costs were capital in nature because they were for the acquisition of the business from S Co.
6. The Taxpayer began to run the business and filed monthly GST returns and annual income tax returns. The Taxpayer claimed input tax and income tax deductions for

expenditure on various goods and services. CCS argued that some of the expenditure was private in nature and/or the Taxpayer had not provided adequate business records to support the deductions.

7. In some of its GST returns, the Taxpayer included GST outputs on refunds and supply payments that had been dishonoured. CCS argued that the output tax in relation to these amounts were not true outputs and had been accounted for by adjusting the underlying input claims in the respective periods.
8. CCS proposed to assess the Taxpayer with shortfall penalties for gross carelessness under s 141C of the Tax Administration Act 1994 (TAA) in relation to the tax positions taken. In the alternative, CCS proposed shortfall penalties for not taking reasonable care under s 141A of the TAA.

## Issues | Take

9. The issues considered in this dispute were:
  - Whether the Taxpayer was entitled to the GST input tax deductions claimed in the periods in dispute.
  - Whether the Taxpayer was entitled to income tax deductions claimed in the income years in dispute.
  - Whether the Taxpayer was required to return GST output tax on refunds and dishonoured supply payments in the periods in dispute.
  - Whether the Taxpayer was liable for shortfall penalties for gross carelessness in taking its tax positions (s 141C of the TAA). Alternatively, whether the Taxpayer was liable for shortfall penalties for not taking reasonable care in taking its tax positions (s 141A of the TAA).
10. There was also a preliminary issue on the onus and standard of proof.

## Decisions | Whakatau

11. The Tax Counsel Office (TCO) decided:
  - The Taxpayer was entitled to an input tax deduction for the purchase price of the business (including the amount attributable to set up costs) in the relevant GST period.

- It could not be definitively concluded which input tax deductions claimed by the Taxpayer in remaining GST periods in dispute were valid. However, not all of the input tax deductions claimed by the Taxpayer were valid.
- The Taxpayer was not entitled to an income tax deduction for the purchase price of the business (or any part of it) because it was capital expenditure.
- It could not be definitively concluded which deductions claimed by the Taxpayer for income tax purposes were valid. Not all of the deductions claimed by the Taxpayer were valid.
- The adjustments proposed by CCS to output tax for refunds and dishonoured supply payments should be made.
- The Taxpayer was not liable for any shortfall penalty in relation to input tax deduction claimed for the set up costs. This was because the Taxpayer was allowed the deduction (ie, no tax shortfall).
- The Taxpayer was liable for the remaining gross carelessness shortfall penalties proposed by CCS.

## 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

---

<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.

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.

## Issue 1 | Take tuatahi: GST input tax deductions

15. The amount paid by the Taxpayer to S Co was consideration for the purchase of the business in the relevant GST period. That the invoice issued by S Co referred to set up costs and/or the purchase price for the business was calculated with reference to (and sought to recover) costs incurred by S Co did not change this conclusion.
16. The zero-rating provision in s 11(1)(m) did not apply in this case because:
  - All of the requirements of s 11(1)(m) must be satisfied before a transaction can be zero-rated. Even if it could be established that the supply was of a going concern, there was no evidence that the Taxpayer and S Co agreed that the supply was of a going concern and recorded their agreement in a document.
  - The Taxpayer's tax agent's description of the transaction as the sale of the "business, lock, stock and barrel" was not sufficient to support the view that the Taxpayer and S Co agreed that the supply was of a going concern and recorded their agreement in a document.
17. The input tax deductions claimed in the remaining GST periods were not valid because the expenditure was private in nature and/or the Taxpayer did not provide sufficient business records to support the deductions. The Taxpayer acknowledged that it was not entitled to some of the input tax deductions claimed. CCS had provided details of other input tax deductions which the Taxpayer was not entitled to claim. The Taxpayer had not satisfied the onus of proof.
18. The effect of s 138P(1B) of the TAA was that the Taxpayer may be entitled to some of the input tax deductions claimed if it could provide sufficient evidence to support its entitlement to those deductions. However, no such evidence had been produced by the Taxpayer.

## Issue 2 | Take tuarua: Income tax deductions

19. The evidence supported the view that the amounts deducted in the first income year were for the purchase of the business from S Co. This expenditure was capital in nature because it concerned the structure of the business (being an amount paid to acquire the business) and was of a once and for all nature producing assets or advantages

which were of an enduring benefit to the Taxpayer (being a business that it could further develop and operate to derive income).<sup>4</sup>

20. The deductions claimed by the Taxpayer in later income years were not valid because the expenditure was private in nature and/or the Taxpayer did not provide sufficient business records to support the deductions. CCS had provided details of deductions claimed for private expenditure. The Taxpayer had not satisfied the onus of proof.
21. The effect of s 138P(1B) of the TAA was that the Taxpayer may be entitled to some of the input tax deductions claimed if it could provide sufficient evidence to support its entitlement to those deductions. However, no such evidence had been produced by the Taxpayer.

### **Issue 3 | Take tuatoru: GST output tax**

22. The adjustments to output tax for the refunds and dishonoured supply payments reduced the Taxpayer's output tax and were in the Taxpayer's favour.

### **Issue 4 | Take tuawhā: Shortfall penalties**

23. The Taxpayer took the tax positions by filing tax returns.
24. With the exception of the first GST period, the Taxpayer's tax positions were not correct and there were tax shortfalls.
25. The Taxpayer was grossly careless when it took the tax positions for the following reasons:
  - At the time the tax positions were taken, the Taxpayer's director was aware of the record keeping requirements.
  - Taking tax positions without records and continuing with this conduct even after it had been put on notice that its record keeping was inadequate created a high risk of tax shortfalls.
  - The risk was a serious and obvious one that would have been foreseen by a reasonable person in the circumstances.
  - The Taxpayer's director had a complete or high level of disregard for the consequences by taking the tax positions.

---

<sup>4</sup> *BP Australia Ltd v Commissioner of Taxation for the Commonwealth of Australia* [1966] AC 224 (PC) at 261, 264-264 and 271.

- The Taxpayer's director did not seek advice on the deductibility of costs related to the acquisition of the business. This was a significant transaction (the acquisition of its entire business structure) and for a significant amount.
26. The requirements for shortfall penalties for not taking reasonable care were also met. However, the shortfall penalty for gross carelessness applied because it was the higher penalty (s 149(2) and (3) of the TAA).
  27. The resulting shortfall penalties were reduced by 50% under s 141FB(2) of the TAA.