Vol 38 No 4 May 2026

TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

ISSN 1177-620X (Online)

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Ref	Draft type	Title	Comment deadline
ED0261	Standard practice statement	Options for relief from tax	8 May 2026
PUB00544	Question we've been asked	Income tax – Bare trusts and mortgages	11 May 2026
PUB00511	Interpretation statement	Goods and services tax – Reduced value rule in s 10(6) for supplies of domestic goods and services in commercial dwellings	29 May 2026

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IN SUMMARY

BINDING RULING

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

BR Prd 26/02: Industrial and Commercial Bank of China (New Zealand) Limited

Issued: 14 April 2026

The Arrangement is a mortgage offset banking product that the Industrial and Commercial Bank of China (New Zealand) Limited offers to customers (individuals) who take out a home loan.

The Product involves "offsetting" (for interest calculation purposes) a home loan account balance ("offset portion") against a credit balance in a Specified Account. This reduces the interest payable by a customer on their home loan balance.

START DATE – END DATE
{01/04/2025 – 31/03/2030}

Product Ruling – BR Prd 26/02

This is a Product Ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling

This Ruling has been applied for by Industrial and Commercial Bank of China (New Zealand) Limited (the Bank).

Taxation Laws

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of:

- ss BG 1, CC 7, EW 15, EW 31, GA 1, RE 1 to RE 6, RF 1, RF 2, RF 2B, RF 2C, RF 3, RF 4; and
- ss 86F and 86I of the Stamp and Cheque Duties Act 1971 (SCDA).

The Arrangement to which this Ruling applies

The Arrangement is a mortgage offset banking product (the Product) that the Bank offers to customers (individuals) who take out a home loan.

The Product involves "offsetting" (for interest calculation purposes) a home loan account balance ("offset portion") against a credit balance in a Specified Account. This reduces the interest payable by a customer on their home loan balance.

Further details of the Arrangement are set out in the paragraphs below.

Documents relevant to the Arrangement

The Arrangement is set out in the documents listed below, copies of which the Tax Counsel Office, Inland Revenue, received on 21 January 2026:

- General Terms and Conditions;
- Home Loan Application Form;
- Home Loan Approval Letter;

- Home Loan General Terms and Conditions;
- Home Loan Agreement; and
- Retail Banking Fees and Charges Brochure.

Primary feature of the Product

1) Customers may have a variety of accounts with the Bank, including transaction accounts, savings accounts and loan accounts. Loan accounts may be table only, principal and interest, interest only, fixed, or variable home loan accounts.
2) The primary feature of the Product is the offsetting feature. This feature operates as described below.
3) To participate in the Product, a customer must have a home loan with an offset portion. Customers may convert an existing non-offset home loan to an offset home loan account.
4) Where a customer has a loan account with an offset portion, the customer must also have a Specified Account so interest can be calculated on the offset portion of the customer's loan.
5) The Product applies an offset to an offset portion of a home loan against a Specified Account, with offset being one category of loan applicable to home loans.

How the offsetting works

6) The offsetting is to calculate the interest payable on only the offset portion of the home loan.
7) Interest on the offset portion of the home loan is calculated, then paid by the customer, on the difference between the offset portion of the home loan balance and the credit balance of the customer's Specified Account. Under the terms and conditions agreed between the Bank and its customers for the Product, the Bank pays no interest on the credit balance that is offset against the offset portion of the home loan.
8) Where the credit balance of the customer's Specified Account exceeds the balance of the offset portion of the home loan it is offset against, the balance of the excess credit balance on which interest is receivable will be subject to the resident withholding tax (RWT), non-resident withholding tax (NRWT) or approved issuer levy (AIL) rules.
9) The interest payable on the home loan account is calculated by reference to the balance of the offset portion of the home loan less the credit balance of the Specified Account. This is the case as a matter of law (in terms of the Product's documentation) and as a matter of practice (in terms of the Bank's computer system). There is no actual set-off netting or transfer of funds, or transfer of any interest in or entitlement to funds. Offsetting occurs before debit or credit interest is calculated.
10) No provision exists for any interest saved under offsetting to reduce the "minimum payment". The effect of offsetting is the same as a decrease in the floating interest rate and a decision not to reduce the amount of the minimum payment. The term of the loan is reduced because the principal portion of the payment is effectively increased.
11) If the credit balance of the Specified Account is greater than the debit balance of the offset portion of the home loan, credit interest is applied to the difference and paid to the credit balance account.
12) The Bank calculates interest on a daily basis. If, during a month, the Bank is entitled to receive interest (that is, the balance of the offset portion of the home loan exceeds the balance of the Specified Account) and, at another point in the month, is obliged to pay interest (that is, the balance of the Specified Account exceeds the balance of the offset portion of the home loan), the two interest payments are made and not set off.
13) The offsetting feature of the Product essentially offers the same benefits to customers as a revolving credit loan in terms of lower interest costs and a shorter time to repay the loan. However, this feature overcomes a perceived disadvantage of a revolving credit loan because it allows customers to retain separate account balances (which customers may prefer when managing their finances).

Terms and conditions for the Bank's home loan products

14) Each of the Bank's home loans is explained in a collection of documents, including a:
    a) home loan general terms and conditions, which is a standard form "master" document that contains primarily generic provisions that apply to all the Bank's personal and home loan facilities;
    b) home loan approval letter, which approves the Bank's lending arrangements, outlining the type of loan and loan amount, as well as any loan-to-value applicable to the loan; and
    c) loan agreement, which contains details of the parties to the loan, amounts borrowed, and terms and conditions applicable to the loan drawn down by the customer.

15) Table loans provide for regular payments and a set date when they will be paid off. Most payments early in the loan term comprise interest, while most of the later payments comprise principal repayments. Customers repay the same amount of the principal each time and interest is charged separately. The Product can be used for table loans to reduce the amount of interest charged on the offset portion if the Specified Account has a credit balance.

16) Where an amount of a home loan is subject to offsetting, two separate repayments occur: one of interest and one of principal. Customers repay an amount of principal each time and interest is charged separately. If the variable offset interest rate increases during the loan's term, the payment amounts increase so the loan is paid off over the same term as originally agreed between the Bank and the customer. If the variable offset interest rate decreases during the loan's term, the payment amounts remain the same and the term of the offset portion of the home loan is reduced (but, a customer has the option to reduce the payment amounts instead if the variable offset interest rates reduce over the term of the loan).

Bank's objectives

The Bank's objectives in providing the Product are to:

- increase its market share, particularly for home loans and transaction-type accounts;
- increase customer satisfaction and customer retention;
- ensure customers are using the most appropriate product for their needs; and
- improve its brand awareness and be seen as a market leader.

Condition stipulated by the Commissioner

This Ruling is made subject to the following condition:

a) All interest rates related to the Product are arm's length market interest rates.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any condition stated above, the Taxation Laws apply to the Arrangement as follows.

Financial arrangements rules

When a credit balance of a Specified Account and a debit balance of the offset portion of the home loan are offset, no amount of consideration is paid or payable because of that offset for the calculation of income and expenditure under ss EW 15 and EW 31 of the "financial arrangements rules" (as defined in s EW 1(2)).

Resident withholding tax, non-resident withholding tax and approved issuer levy

Under the offsetting feature of the Product, the following apply:

a) There is no payment of or entitlement to "interest" (as defined in s YA 1) for the credit balance of a Specified Account and no obligation to deduct RWT or NRWT or pay AIL, except to the extent that the credit balance exceeds the debit balance of the offset portion of the home loan.

b) To the extent that interest is credited to a Specified Account:

   i) RWT and NRWT (as defined in s YA 1) must be deducted by the Bank from the interest credited to the Specified Account in accordance with the RWT rules (as defined in ss RE 1(1) and YA 1) and the NRWT rules (as defined in ss RF 1(1) and YA 1); and

   ii) for an account that is "registered security" (as defined in s 86F of the SCDA), AIL (as defined in s 86F of the SCDA) may be paid by an "approved issuer" (as defined in s 86F of the SCDA) for the interest credited to that account under ss 86F and 86I of the SCDA.

Section CC 7

No income arises under s CC 7 for the Bank or its customers in relation to the Arrangement.

Section BG 1

Section BG 1 does not apply to the Arrangement.

Period or income year for which this Ruling applies

This Ruling applies for the period beginning on 1 April 2025 and ending on 31 March 2030.

This Ruling is signed by me on the 14th day of April 2026.

Sarah Kiely

Group Lead
Significant Enterprises

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

Some interpretation statements may be accompanied by a fact sheet summarising and explaining the main points. Any fact sheet should be read alongside its corresponding interpretation statement to completely understand the guidance. Fact sheets are not binding on the Commissioner. Check **taxtechnical.ird.govt.nz/publications** for any fact sheets accompanying an interpretation statement.

IS 26/02: GST treatment of supplies of payment processing or facilitation services to merchants

Issued | Tukuna: 23 March 2026

This interpretation statement applies to entities that provide payment processing or facilitation services, including payment technology, to merchants. These entities include payment service providers (PSPs), buy now, pay later (BNPL) providers and other suppliers of payment technology or infrastructure.

The statement provides a framework to determine whether services provided to merchants are financial services. When the supply to merchants includes settlement services, there will be a supply of financial services, and these supplies will be GST exempt (or zero-rated if applicable). The statement also explains whether there is a single supply or multiple supplies of services that may have different GST treatments.

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

Key terms | Kīanga tau tāpua

Acquirer means the financial institution that provides banking services to the merchant.

BNPL means a buy now, pay later arrangement where the BNPL provider pays the merchant for the purchase, and the customer repays the BNPL provider.

Customer means the person buying goods or services from the merchant using a credit card, debit card, contactless payment method or BNPL service.

Issuer means the financial institution that issues the payment card to the customer.

Merchant means the retailer providing goods or services to the customer.

PSP means, for the purposes of this statement, a service provider that supplies payment processing services, technology or infrastructure and/or facilitates payments between the merchant and its customers. It also includes a BNPL provider.

Settlement services means making the relevant decisions to authorise and make payment, and/or ensuring payments are made (bearing the risk if anything goes wrong). Settlement services are not provided when the PSP is simply relaying information between parties (such as when the issuer authorises payment and the PSP passes on that information to the acquirer).

Summary | Whakarāpopoto

1. This interpretation statement provides a framework for working out whether supplies of payment processing or facilitation services, including payment technology, to merchants are supplies of financial services for GST purposes.

2. When supplies are financial services, they are exempt from GST or may in some cases be treated as zero-rated.[1] In either situation, the supplier does not charge an amount of GST on the supply made to the merchant. When the supplies are not financial services, then generally they are subject to GST (unless other exemptions or zero-rating provisions apply).

Who this statement applies to

3. This statement applies to payment service providers, BNPL providers and other entities that provide payment processing or facilitation services, including payment technology, to merchants. For ease of reference, these service providers are referred to together as PSPs throughout this statement.

4. This statement applies to payment processing or facilitation services, including payment technology. These types of services may include:

   - settlement services;[2]
   - providing technology such as a payment gateway and other processing services; and
   - facilitating the exchange of information between parties through requesting authorisation from the issuer and relaying that information to the acquirer or merchant.

5. Other services that may be provided along with the above services include:

   - administrative, compliance or reporting services; and
   - marketing, advertising or promotional services.

How GST applies to payment processing or facilitation services

6. GST is a transaction-based tax and generally follows from the contractual arrangements entered into. It is important to first identify what services are being supplied to the merchant in exchange for a merchant service fee, and who is supplying those services to the merchant. For example, the PSP may undertake the performance of these services itself, or it may subcontract another entity to perform those services on its behalf or to the PSP.

7. PSPs will need to carefully consider their own arrangements and may wish to seek advice if it is not clear from their contracts what services they have agreed to provide to a merchant and who is providing those services to the merchant.

8. While it will be fact dependent, generally the provision of settlement services to the merchant is a supply of financial services. Settlement services include making the relevant decisions to authorise and make payment, and/or ensuring payments are made (bearing the risk if anything goes wrong).[3] They do not include services that only relay information between parties. When a PSP is not providing settlement services along with its payment processing or facilitation services, then generally it will not be making supplies of financial services. In that situation, the supplies will be taxable supplies and will be subject to GST.

9. When a PSP is involved in providing settlement services, some other supplies they make may also be included as financial services. This includes other services they provide that are reasonably incidental and necessary to that supply of settlement services, or that are treated as being part of a single composite supply of financial services (discussed from [72]).

10. Whether or not supplies of other services are reasonably incidental and necessary to supplies of settlement services will be fact dependent. Reasonably incidental and necessary services may include: [4]

    - facilitating the exchange of information between parties; and
    - providing technology such as a payment gateway and other processing services.

11. Generally, reasonably incidental and necessary services to the supply of settlement services are unlikely to include:

    - administrative, compliance or reporting services; and
    - marketing, advertising or promotional services.

1 Supplies of financial services are exempt under s 14(1)(a) or may be zero-rated under s 11A when made between registered persons, an election is made, and certain other requirements are met.

2 These types of services are explained under "Key Terms" above.

3 These services are financial services under (respectively) s 3(1)(b) and/or s 3(1)(c) or (ka).

4 Reasonably incidental and necessary services are included in s 14(1)(a).

12. However, these types of services could still be included as financial services if they form part of a single composite supply of financial services.

13. Whether there is a single supply or multiple supplies will be fact dependent, based on the contractual arrangements. When a PSP is providing some services that are financial services and other services that are not financial services, it needs to work out, based on its contractual arrangements, whether it is supplying:

    a single composite supply of services that has a single GST treatment (taking the treatment of the dominant element of the supply); or

    multiple supplies that are treated differently for GST purposes.

14. When a PSP's supply includes settlement services, it is likely that the settlement of the payments, along with reasonably incidental and necessary processing services, is the dominant element of the service. Therefore, the dominant element is likely the supply of financial services. Any administrative, compliance or reporting services related to the payment processing may be considered part of a single supply of the settlement service. Therefore, all those components of that supply are treated as a single supply of financial services.

15. In some cases, other services may be provided that are not directly related to the settlement service, like advertising, marketing or promotional services. It will be fact dependent whether these types of additional services are considered part of the supply of settlement services, or a separate supply that is treated differently for GST purposes. For more information on how to determine the nature of a supply, see **IS 18/04 Goods and Services Tax – Single supply or multiple supplies**.

16. For a summary of whether a PSP's supplies of services are treated as financial services, see Figure | Hoahoa 1.

Figure | Hoahoa 1 – When certain types of services are financial services

Type of service	Is the service a financial service?	Is the service agreeing or arranging a financial service?	Is the service reasonably incidental and necessary to financial services?	Is there a single composite supply of financial services?
A Settlement services Making the decision to debit/credit accounts Bearing the risk of settlement, ensuring payment is made	✓ s 3(1)(b) s 3(1)(c) or (ka)			
B Payment processing services - providing technology or infrastructure (eg, a payment gateway)	✗	✗	If **A** is also provided by the PSP, **B** is reasonably incidental and necessary to **A** (s 14(1)(a))	
C Facilitating information - requesting authorisation from the issuer and relaying information between the issuer, acquirer and merchant	✗	✗	If **A** is also provided by the PSP, **C** is reasonably incidental and necessary to **A** (s 14(1)(a))	
D Administrative, compliance or reporting services	✗	✗	✗	If **D** is provided along with **A**, there may be a single supply of financial services
E Advertising, marketing or promotional services	✗	✗	✗	This is fact dependent – see from [72] for more information

Introduction | Whakataki

17. This statement provides a framework for providers of payment processing or facilitation services, including payment technology (referred to in this statement as "PSPs") to work out whether they are making supplies of financial services. This is relevant because financial services are generally exempt supplies, and in some cases may be treated as zero-rated supplies.[5] Because contractual arrangements differ, this statement is intended as a general guide.

18. To determine whether it is supplying financial services, a PSP needs to:

    - examine the nature of what it is contractually supplying to the merchants;
    - determine whether it is making a supply of financial services; and
    - consider, when it is providing more than one service, whether it is supplying a single supply or multiple supplies of services to the merchants.

19. GST is a transaction-based tax and generally follows from the contractual arrangements entered into. It is important to first identify what services are being supplied to the merchant in exchange for a merchant service fee, and who is supplying those services to the merchant. For example, the PSP may undertake the performance of these services itself, or it may subcontract another entity to perform those services on its behalf or to the PSP. PSPs will need to carefully consider their own arrangements. Relevant considerations are the specific terms of the agreements entered into, the arrangements in place with any other parties involved and the specific services that are agreed by the PSP to be provided to the merchant.

Payment processing or facilitation services, including technology

20. This statement considers the following types of services that may be provided to merchants:

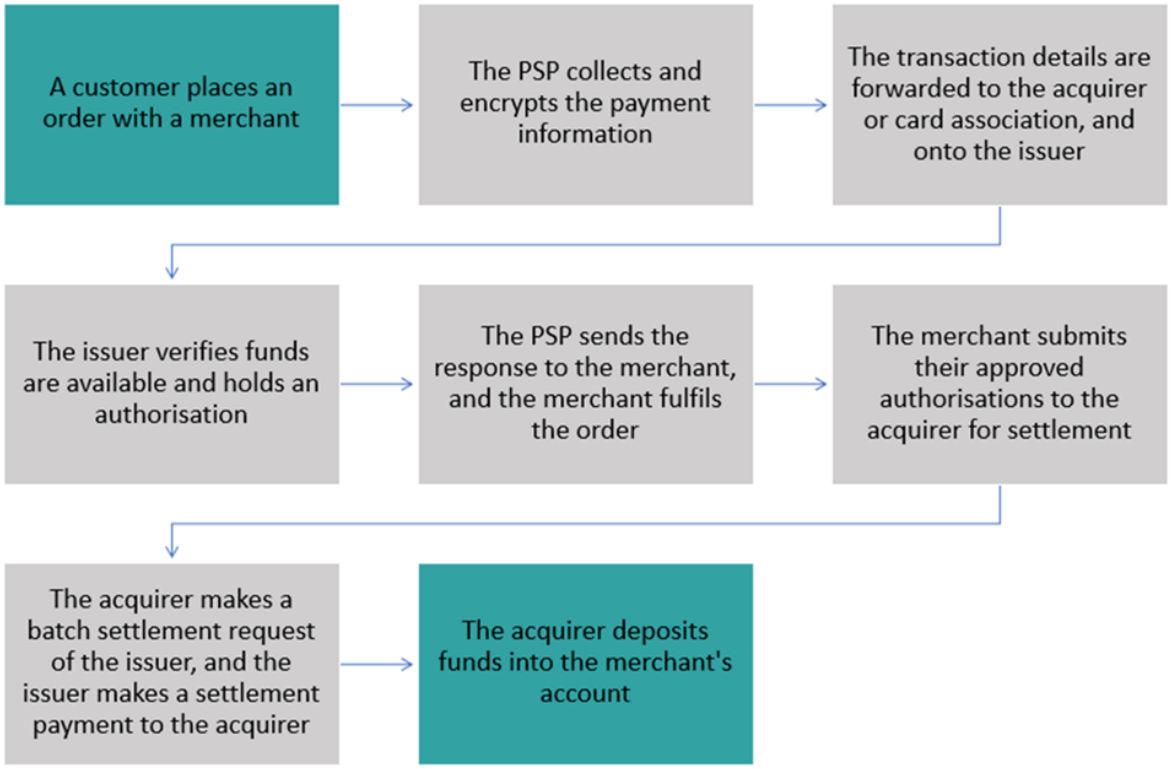
    - settlement services;
    - providing technology such as a payment gateway and other processing services;
    - facilitating the exchange of information between parties through requesting authorisation from the issuer and relaying that information to the acquirer or merchant;
    - administrative, compliance or reporting services; and
    - marketing, advertising or promotional services.

21. Figure | Hoahoa 2 illustrates the types of steps that may be involved in a general payment transaction.[6]

5 Financial services are exempt under s 14(1)(a) although they may be zero-rated under s 11A when made between registered persons, an election is made, and certain other requirements are met.

6 These steps illustrate a payment transaction where the acquirer is undertaking settlement. In some situations, the PSP may be the acquirer or may otherwise contract an acquirer to undertake settlement.

Figure | Hoahoa 2 – Steps in a general payment transaction



BNPL arrangements

22. BNPL arrangements are entered into between the BNPL provider and the merchants (and also between the BNPL provider and customers). These arrangements allow the customer to acquire goods or services upfront and pay for them over time.

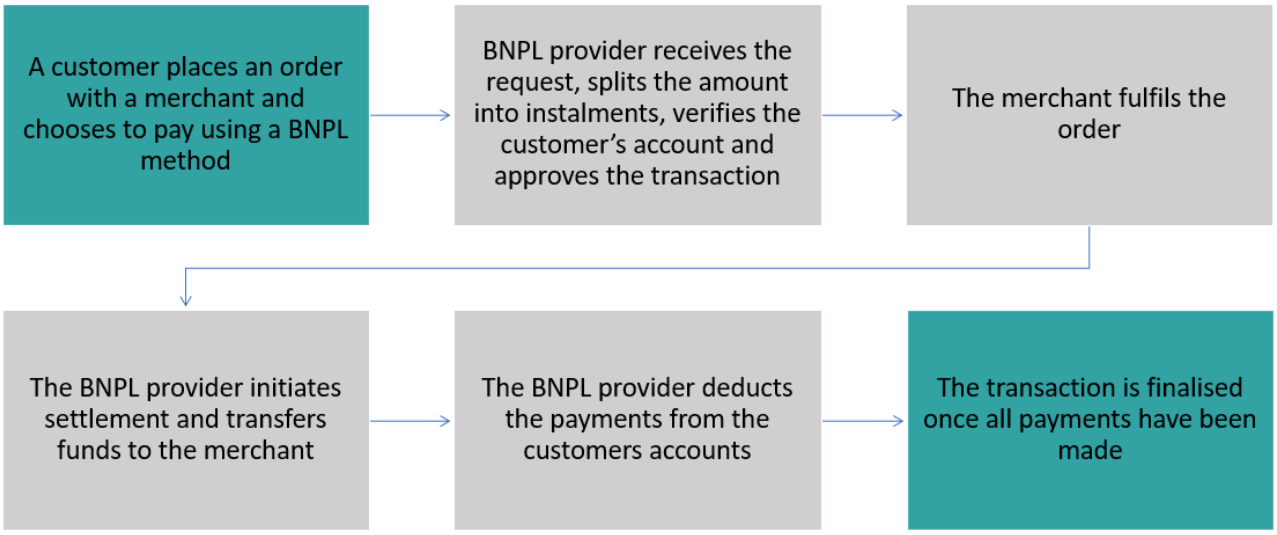
23. Under these arrangements, generally the BNPL provider makes a loan to the customer to enable them to purchase goods or services from the merchant. The merchant receives payment for the goods or services from the BNPL provider (typically via a mobile payment app). The merchant provides the customer with the goods or services upfront. The loan that the BNPL provider makes to the customer is repaid by the customer, typically in a series of instalment payments. The BNPL provider assumes all the risks should the purchaser fail to make any payments. The terms are generally interest-free, but other charges are likely to apply to the customer.[7]

24. A BNPL provider may also provide other services to the merchant, such as marketing services, foreign exchange and the technical infrastructure to facilitate the payments.

25. Figure | Hoahoa 3 illustrates the types of steps that may be involved in a general transaction involving a BNPL provider.

7 BNPL arrangements are also addressed in QB 23/06 GST – Goods purchased on deferred payment terms, from [16].

Figure | Hoahoa 3 – Steps in a general BNPL transaction



Analysis | Tātari

26. GST is imposed on the supply, not including an exempt supply, of goods and services by a registered person in the course or furtherance of their taxable activity.[8] When a registered person makes exempt supplies, they do not charge GST on those supplies and cannot claim input tax deductions for goods or services acquired for use in making those supplies. When a registered person makes zero-rated supplies, those supplies are technically taxable supplies but charged at the rate of 0%.

27. The courts' approach in determining the nature of a supply is to:[9]

    - consider the true nature of the legal arrangements entered into and carried out by the supplier and the recipient;
    - examine the contractual arrangements between the parties to determine who is supplying what to whom; and
    - examine the supply from the recipient's point of view by considering the true and substantial nature of what is provided to the recipient for the payment.

28. Therefore, it is important to first identify what services are being supplied to the merchant in exchange for a merchant service fee, and who is supplying those services to the merchant. For example, the PSP may undertake the performance of these services itself, or it may subcontract another entity to perform those services on its behalf to the merchants, or to the PSP. PSPs will need to carefully consider their own arrangements when applying this statement.

Supplies of financial services

29. Supplies of financial services are generally exempt from GST. Relevantly, s 14(1)(a) provides that the following services are exempt supplies:

> (a) the supply of any financial services (together with the supply of any other goods and services, supplied by the supplier of those financial services, which are reasonably incidental and necessary to that supply of financial services), not being a supply referred to in subsection (1B):

30. Exempt supplies of financial services exclude supplies of financial services that are zero-rated under s 11A. Financial services may be zero-rated under s 11A when they are provided by a registered person (who has made a relevant election) to another registered person, and certain other requirements are met. For example, 75% or more of the total value of supplies made by the recipient in a particular period must be taxable supplies (that are not zero-rated).

8 Section 8(1).

9 *Marac Life Assurance Ltd v CIR* (1986) 8 NZTC 5,086 (CA); *CIR v Databank Systems Ltd* (1990) 12 NZTC 7,227 (PC); *Auckland Institute of Studies v CIR* (2002) 20 NZTC 17,685 (HC) and *Wilson & Horton Ltd v CIR* (1995) 17 NZTC 12,325 (CA).

31. Financial services are defined in s 3(1). These services relevantly include:
    - the issue, payment, collection, or transfer of ownership of a cheque;[10]
    - the issue, allotment, drawing, acceptance, endorsement, transfer of ownership, renewal or variation of a debt security;[11]
    - the payment or collection of interest, principal, or another amount in respect of a debt security;[12]
    - agreeing to do, or arranging, any of the above activities.[13]

32. *Databank* is a key Privy Council decision that considered GST and financial services. Databank provided banks with computer data-processing services. The services involved processing cheques, crediting and debiting the banks' customers' accounts, and general account maintenance. The issue was whether Databank supplied financial services to the banks. As discussed further at [37], the Privy Council recognised that the banks used Databank's computing services to supply financial services to their customers. However, the computing services Databank supplied to the banks were not financial services. The terms of the agreements between Databank and the banks meant Databank was supplying its services to the banks, not to the banks' customers. This decision highlights the importance of understanding the contractual arrangements in place and, importantly, who is providing the relevant services to the recipient.

33. Other cases have also considered the issue of who is making a relevant supply when multiple parties are involved.[14] What is relevant is who is contractually making the supply of services and what services they are agreeing to supply. The supplier may then contract to receive services from another supplier to help it make its agreed supplies (as in the *Databank* case). For example, Supplier A agrees to make supplies of services to customers. Supplier A needs to acquire goods or services from Supplier B to help make its supplies to customers. As a result, there is a supply by Supplier B to Supplier A; and a supply by Supplier A to the customer.

34. PSPs need to carefully consider what supplies they are making to merchants under the contracts. It does not matter if a different supplier performs some of the services that the PSP has agreed to supply, as long as the PSP is contractually providing that supply to the merchants. If the other parties are contractually liable for those supplies to the merchants, then they will be the relevant supplier of those services.

35. Once a PSP has worked out what supplies it is making, it then needs to consider whether it is supplying financial services. The most relevant parts of the definition of financial services that may potentially apply to PSPs are likely to be the provisions relating to cheques and debt securities, discussed below.

Cheques

36. Financial services include the issue, payment, collection or transfer of ownership of a cheque or letter of credit.[15] A "cheque" includes any order or authorisation in writing, by electronic means, or otherwise to a financial institution to credit or debit any account. This definition covers payments made by credit cards and debit cards.[16]

37. In *Databank* Lord Templeman said that the collection of a cheque is not the possession of the instrument in writing but the collection of the money (for which the cheque is authority). Payment of a cheque is the payment of money. His Honour said:

> … Databank is a supplier of computer services to banks and not a supplier of financial services to banks or customers. Databank has no money to pay and collects no money. A customer of a bank pays money into a bank and draws money out of a bank. The customer does not pay money to Databank or collect money from Databank. A customer may not know or care whether Databank supplies to the banks machinery, which transmits instructions and requests by and between banks and by and between banks and customers, and gathers information and keeps records in accordance with the programmed instructions of the banks. Banks provide financial services and computer companies provide computer services.

10 Section 3(1)(b).

11 Section 3(1)(c).

12 Section 3(1)(ka).

13 Section 3(1)(l).

14 *Suzuki New Zealand Ltd v CIR* (2001) 20 NZTC 17,096; *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84; *Customs and Excise Commissioners v Redrow Group* [1999] 2 All ER 1; *C&E Comrs v Plantiflor Ltd* [2002] UKHL 33; *Airtours Holidays Transport Limited* v *Revenue and Customs Commissioners* [2016] UKSC 21; *Turakina Maori Girls College Board of Trustees & Ors v CIR* (1993) 15 NZTC 10,032 (CA).

15 Section 3(1)(b).

16 Section 3(2).

38. In *Databank*, the Privy Council distinguished the payment and collection of money (as a financial service) from the transmission of instructions to pay or collect money. Similarly, a European Union value-added tax case, *Bookit Ltd*, concerned a booking agent that received orders for tickets and imposed a card handling fee.[17] The court held the card handling service did not transfer funds between the parties. Instead, the service involved transferring information between Bookit, the card issuer and acquiring banks. While this service was essential for the transfer of funds to occur, it did not amount to a payment or transfer of money. The court said that the fact that a service is essential for completing a financial transaction does not mean that the service is itself a supply of financial services. The booking agent did not directly debit or credit the accounts, did not act by accounting entries, and did not instruct the provision of debit or credit.

39. Similar to the situation in *Databank*, where a PSP provides services to transmit and record information between the issuer, acquirer and merchant, but does not itself order or authorise the crediting or debiting of an account, it will not be providing services in relation to the issue, payment, collection or transfer of ownership of a cheque. In this situation, the issuer and acquirer order or authorise the credit or debiting of the customer's and merchant's accounts.

40. However, in some situations the PSP has authority to make the decision to debit or credit accounts such as when it is acting as the acquirer or otherwise contractually agrees to provide these services to merchants and contracts out the services to an acquirer. In these situations, it will be providing financial services relating to the issue, payment, collection or transfer of ownership of a cheque.

41. Therefore, there is a distinction between a PSP that provides information or relays instructions to authorise or record a payment, and a PSP that provides settlement services. For example, when a PSP is only providing payment gateway technology by itself, this does not involve the movement of funds by the PSP, but instead the PSP is facilitating an exchange of information. However, providing settlement services will often involve making decisions about the crediting and debiting of accounts, and/or bearing the risk that payment will be made.

42. Whether a BNPL provider is involved in the issue, payment or collection of a cheque is fact dependent and the same considerations as above apply. That is, it depends whether the BNPL provider is directly involved in the authorisation process and is making decisions about debiting or crediting accounts.

Debt securities

43. Financial services include the issue, allotment, drawing, acceptance, renewal, variation, payment or collection of amounts in respect of debt securities.[18]

44. A "debt security" has a wide meaning. It includes an interest in, or right to be paid money that is, or will be, owing by any person. It includes a right to be paid money in the future.

45. The courts have considered the definition to be broad. In particular, the courts considered it was appropriate to have regard to the definition of a "debt security" in the Securities Act 1978 (SA 1978) in interpreting the definition of "debt security" in the GSTA.[19] Under the SA 1978, a debt security included money deposited with, or lent to, a person, or is otherwise owing by that person, so the investor retained an interest in the money or a right to be repaid.[20] Also, under the SA 1978, a buy-back provision was a debt security because the purchaser had a right to be repaid. A debt security does not require an obligation on both sides to pay or repay money.[21]

46. The relevant provisions that deal with debt securities include:
    - its issue or allotment;
    - its renewal or variation; or
    - any payment or collection of amounts owing.

17 *Bookit Ltd v Commissioners for Her Majesty's Revenue and Customs* [2016] EUECJ C-607/14.

18 Section 3(1)(c), (g) and (ka).

19 *Case S54* (1996) 17 NZTC 7,354 (TRA). Although note that the SA 1978 has since been repealed.

20 *Francken v Ministry of Economic Development* (HC Dunedin CRI 2008- 412-000025, 1 December 2008).

21 *Culverden Retirement Village v Registrar of Companies* [1997] 1 NZLR 257 (PC).

47. An allotment of a debt security is made by a person (the issuer of the debt security) who confers a right under a security. Generally, an allotment is made when the contract is formed. This occurs when the issuer accepts the offer to acquire the security. For example, the Commissioner considers there is a supply of an allotment of a debt security when a retirement village resident is entitled to receive repayment of the lump sum payment they paid on entry.[22] This is because the retirement village undertakes a contractual obligation to pay money to the resident when they terminate their occupation. The resident receives a financial service – the acceptance of an obligation to pay money (ie, the allotment of a debt security under which the resident has the right to be paid money).

48. The issue of a security generally involves the delivery of a document or some act that perfects the title of the holder of the security.[23]

49. In a payment transaction, several debt securities may be in place between the customer, merchant, issuer and acquirer. Whether there are services provided in relation to a debt security involving the PSP will be fact dependent. In particular, it depends on whether the PSP:
    - is involved in settlement (eg, the issuer has an obligation to remit funds to the PSP (the acquirer), which has an obligation to remit funds to the merchant);[24] or
    - undertakes other issuer or acquirer services (either by doing so itself or by agreeing to do so and subcontracting those services to a third party).[25]

50. A PSP that makes decisions to credit or debit accounts as part of completing the payment is involved in the settlement process and will be making supplies in relation to debt securities. Also, PSPs that control the disbursement of funds are effectively collecting payments on behalf of, and making payment to, the merchants.

51. If the PSP is acting as acquirer or otherwise providing those services through agreements with other providers, there will be debt securities between the PSP and the issuer (as the PSP has the right to receive funds from the issuer). The transfer of funds from the issuer to the PSP is the collection of amounts in relation to a debt security. The PSP then has the obligation to settle the amount with the merchant, which is also a payment of an amount in relation to a debt security.

52. Any PSPs that do not have obligations to pay and receive amounts in relation to the payments process (or otherwise bear the risk of settlement) would not be making the relevant types of supplies involving debt securities.

53. In BNPL arrangements, the BNPL provider may be involved in making supplies relating to debt securities, although this is fact dependent. For example, where the customer owes money to the BNPL provider, the customer has issued the BNPL provider with a debt security and the BNPL provider is collecting funds in relation to that debt security. The BNPL provider may in some situations bear the risk of settlement with the merchant, if it takes on the risk that it may not collect the funds from the customer for the transaction.

54. Example | Tauira 1 illustrates a situation where a PSP is not providing financial services. Example | Tauira 2 and Example | Tauira 3 illustrate situations where a PSP is providing financial services.

Example | Tauira 1 – Services that are not financial services

PSP provides a bundle of payment processing services to merchants, including:

- payment gateway technology and other processing services;
- facilitating the exchange of information (such as whether the payment is authorised);
- administrative, compliance or reporting services; and
- marketing, advertising or promotional services.

PSP receives a service fee in consideration for these services.

PSP is not supplying financial services. The service fee is consideration for a taxable supply and is subject to GST.

22 IS 15/02 Goods and Services Tax - GST and retirement villages.

23 *Agricultural Mortgage Corporation Ltd v Inland Revenue Commrs* [1978] 1 All ER 248 (CA); *Trustees Executors and Agency Company of New Zealand Ltd v Deutsche Hypothekenbank Frankfurt-Hamburg Aktiengesellschaft* (2000) 8 NZCLC 262,208 (HC).

24 Section 3(1)(ka).

25 Section 3(1)(c) or (ka).

Example | Tauira 2 – Services that are financial services

PSP decides to include settlement services as part of its bundle of services that it provides to merchants. In addition to the services it provided in Example | Tauira 1, PSP agrees with the merchants that it will bear the risk of settlement and ensure that the final exchange of payment is made.

PSP enters into agreements with an acquirer for the provision of settlement services. The acquirer is making supplies of financial services to PSP.

PSP is now making supplies of financial services to the merchants. This is because it is involved in making the decision to credit or debit accounts, issues and receives debt securities and collects and pays amounts relating to those debt securities (ie, PSP ensures that the final payment is made to the merchant and collects that payment from the issuer).

For the treatment of the other services provided, see Example | Tauira 4.

Example | Tauira 3 – BNPL services

PSP decides to offer a BNPL scheme to merchants and receives a service fee. As part of its BNPL service, PSP also provides administrative services and includes the merchants in its advertising and promotional materials.

Under the BNPL scheme, PSP agrees to pay the merchant for a customer's purchase of goods or services and then receives instalment payments from the customer over a 3-month period.

PSP collects payments in relation to a debt security issued by the customer.

To the extent that any payment to the merchant is not made immediately, the PSP is issuing a debt security to the merchant (and making payments in respect of that debt security). PSP is also providing a financial service to the merchant because it is making decisions to debit and credit accounts (ie, collecting and making payments).

Therefore, PSP is making supplies of financial services to the merchant (and also the customer).

For the treatment of other services provided, see Example | Tauira 4.

Agreeing or arranging financial services

55. Financial services also include agreeing or arranging to do any of the activities specified in para (a) to (ka) as financial services.[26] The GSTA does not define the words "agreeing" and "arranging". The *Concise Oxford English Dictionary* defines "agreeing" as "say that one will do something" and "arranging" as "organise or plan".

56. In *Databank* (HC), Davison CJ held that "arranging" means "cause to occur". This suggests the need for certainty that the financial services will take place. In the Privy Council, Lord Templeman indicated that "arranging" does not extend to steps that merely result in financial services taking place.

57. More than one person may be involved in arranging a financial service.[27]

58. In *Mac's Convenience Stores*, the installation of an ATM in the taxpayer's stores did not amount to the taxpayer arranging a supply of financial services.[28] Similarly, UK decisions require a close link between the steps undertaken that are the "making of arrangements" and the supply of financial services. For example, many steps undertaken that may be essential to a supply of financial services, such as promotional, publicity and marketing activities, are not arranging the supply of the financial services.[29]

59. Therefore, agreeing or arranging financial services means organising or planning or causing financial services to occur. It is not sufficient that the activity is one that eventually results in a supply of a financial service. An activity that merely facilitates or makes it possible for another person to supply financial services or records the effect of financial services that another person supplies is not arranging a financial service.

26 Section 3(1)(l).

27 *Canadian Medical Protective Assn v R* [2009] FCA 115.

28 *Mac's Convenience Stores Inc v The Queen* [2012] TCC 393.

29 *Dogbreeders Association v C&E Commissioners* [1989] VATTR 317.

60. In the PSP context, the settlement process is an integral part of a payment transaction. Without someone authorising that the payment can be made and debiting and crediting accounts, the transaction (and payments relating to the debt securities issued) cannot proceed. In many cases, the decision to proceed with the payment transaction is made by the issuer. While it is fact dependent, in situations where the PSP is not involved in this part of the process but only transmits information between the parties, the supply of the information services is not arranging a financial service.

61. The types of services PSPs provide as discussed in this statement are not generally "arranging" the supply of financial services. Examples of services that would not be "arranging" include providing a payment gateway facility, facilitating the exchange of information, or any administrative, compliance, or reporting services or other services like providing foreign exchange, advertising and marketing.

Supplies that are reasonably incidental and necessary to the supply of financial services

62. Section 14(1)(a) also includes the supply of any other goods and services, by the supplier of the financial services, that are reasonably incidental and necessary to that supply of financial services. The *Concise Oxford English Dictionary* defines these terms as:

> **incidental** … occurring as a minor accompaniment; occurring by chance in connection with something else. … (incidental to) liable to happen as a consequence of.
>
> **necessary** required to be done, achieved, or present; needed … inevitable

63. "Incidental" means to occur in connection with, or as a consequence of something else. The courts have considered that the meaning of "necessary" lies somewhere between "indispensable" and "useful" or "expedient", such as "really needed".[30]

64. The use of both "incidental" and "necessary" indicates that the phrase is designed to determine two separate but related things:

- the level of connection between the supply of goods and services and the supply of financial services; and
- whether the supply of goods and services is essential to the supply of financial services.

65. "Reasonably incidental" means it is reasonable to expect the service to be provided in the course of undertaking a supply.[31] To be "reasonably necessary" to the supply of financial services, it would not be sufficient that the supply of other goods and services is desirable for the supply of financial services. There must be a degree of need for the other goods and services to be supplied with financial services.

66. In summary, for a service to be "reasonably incidental and necessary" to the provision of a financial service, the service must be:

- supplied by a person who also supplies financial services;
- of a type that it is reasonable to expect the supplier to provide in the course of undertaking the supply of the financial service;
- secondary to and dependent on the financial service as the primary service, and supplied together with or as a consequence of that financial service; and
- seen from the surrounding circumstances to be needed or required for the supply of the financial service.

67. PSP services that are generally not financial services may come within s 14(1)(a) if they are "reasonably incidental and necessary" to a supply of any financial services made by the PSP. As set out earlier, the types of financial services that a PSP may provide broadly involve settlement services.

68. Where a PSP is providing financial services such as settlement services, then any payment processing facilities it provides (including a payment gateway and facilitating exchanges of information regarding authorisation services) that facilitate the payments are likely to be reasonably incidental and necessary to the settlement service. Therefore, they would be included as financial services as well.

30 *Re an Inquiry under the Company Securities (Insider Dealing) Act 1985* [1988] 1 All ER 203.

31 *Databank, Williams and Glynn's Bank Ltd v Commissioners of Customs and Excise* (1974) I BVC 1,021; [1974] VATTR 262 and *Barclays Bank Plc v Commissioners of Customs and Excise* (1988) 3 BVC 692; [1988] VATTR 23.

69. A PSP that is not providing financial services (eg, one that provides only a payment gateway without being involved in settlement) will not provide other services that are reasonably incidental and necessary to financial services.

70. Other services provided by that PSP, such as administrative, compliance, reporting, advertising, promotional and marketing services, are not reasonably incidental and necessary to the supplies of financial services. However, as discussed from [72], many of these types of services may form part of a single, composite supply of financial services when supplied along with settlement services, and so will ultimately be supplies of financial services in any event.

71. Example | Tauira 4 illustrates a situation where a PSP provides reasonably incidental and necessary services.

Example | Tauira 4 – Reasonably incidental and necessary services

PSP's bundle of services provided to merchants in consideration for the service fee (obtained from Example | Tauira 2 in combination with Example | Tauira 1) include:

- settlement services;
- payment gateway technology and other processing services;
- facilitating the exchange of information;
- administrative, compliance or reporting services; and
- marketing, advertising and promotional services.

PSP is providing financial services because it supplies settlement services.

While payment processing and information exchange services are not financial services on their own, they are financial services here because:

- facilitating the exchange of information is reasonably incidental and necessary to the settlement services; and
- the payment gateway and processing services are also reasonably incidental and necessary to the supplies of the settlement services.

Any administrative, reporting, compliance, advertising and marketing services that the PSP supplies to the merchant are not reasonably incidental and necessary to the supplies of financial services, so are not treated as supplies of financial services.

However, see Example | Tauira 5 for an explanation on how these additional services are likely to form part of a single, composite supply of financial services in any event (when supplied along with other financial services).

Whether the supply of services is a single supply or multiple supplies

72. If a PSP is providing some financial services to merchants along with other services that are not financial services, it may need to consider whether it is providing a single supply of services or multiple supplies. If there is a single supply of services, then the dominant element of that supply determines the GST treatment. If there are multiple supplies, then the service fee will need to be apportioned for different GST treatment of the various supplies made.

73. Standard GST principles apply for determining how many supplies there are. For a detailed explanation, see **IS 18/04** . In summary, to determine whether there is a single supply or multiple supplies, the following questions are relevant:

- What is the true and substantial nature of what is supplied to the recipient for the payment?
- What is the relationship between the different goods or services supplied?
- Is it reasonable to sever the supply into separate supplies?

74. The true and substantial nature of what the PSP supplies to the recipient is examined from the recipient's perspective. The fact that different parts of a supply could have been supplied separately does not mean those parts should be severed from the rest of the supply. Also, the fact that a single price is charged does not determine how many supplies are made.

75. Determining the relationships between the different goods or services supplied requires considering whether one part of the supply is either ancillary or incidental to, another part of the supply, or a necessary part of it. This includes considering whether part of the supply is an aim in itself, or whether it facilitates, contributes to or enables the supply of the dominant part. This is a different test to the "reasonably incidental and necessary" test outlined earlier. Also relevant is whether part of the supply is an optional extra and is not in any real or substantial sense part of the consideration for which the payment is made.

76. It is reasonable to sever a supply into separate supplies if a sufficient distinction exists between the different parts of the transaction. Determining this requires taking an overall view and looking for the essential purpose of the transaction rather than artificially splitting what, from an economic point of view, is a single supply.

77. For example, a supply of services such as reporting and compliance services may not be considered necessary to the supply of payment processing and settlement services and may not in isolation qualify as a "reasonably incidental and necessary service". However, it is likely that supplying reporting and compliance services along with the payment processing services is required to ensure the practical usefulness of the service to the merchant. Such a service is ancillary to, facilitates, and contributes to the supply of the payment processing services.

78. Once the number of supplies is established through applying these principles it is necessary to determine whether the relevant supply or supplies satisfy the meaning of financial services, as set out above.

79. Example | Tauira 5 explains whether the supply of services is a single supply or multiple supplies.

Example | Tauira 5 – Supplies of services are multiple supplies

PSP provides the same bundle of services to merchants as in Example | Tauira 4 and receives a service fee from each merchant.

PSP is providing financial services because it supplies settlement services. Therefore, any reasonably incidental and necessary services are also financial services such as the supplies of a payment gateway, processing and facilitating the exchange of information. As explained in Example | Tauira 4 the administrative, reporting, compliance, advertising and marketing services that it provides are not supplies of financial services in and of themselves.

PSP now needs to determine whether it is making a single composite supply or multiple supplies of these services in return for the service fee paid by the merchants:

- The true and substantial nature of what is supplied to the merchants for the payment comprises the settlement services and other reasonably necessary and incidental services. These are the primary services for which the merchants are engaging the PSP.
- The relationship between the different services supplied is that there are effectively three types of services – payment related; administrative related; and advertising and marketing.

Administrative, reporting and compliance services could be said to sufficiently relate to the settlement services. The merchants require these services in relation to the other services they have also acquired. That is, receiving these services is not an aim in itself, but facilitates, contributes to or enables the supply of the settlement services. These services are not just an optional extra.

However, any advertising and marketing services that it supplies in addition to payment processing are not necessarily merely ancillary to the supply of settlement services. Instead, these are an optional extra or an aim in itself. These types of supplies are considered to be separate supplies.

Therefore, PSP's service fee is consideration for two separate supplies and will require apportionment:

- The supplies of settlement services are financial services that are exempt supplies (or zero-rated if conditions are met) and any administrative, compliance and reporting supplies that are merely ancillary to or a necessary part of those other supplies also are treated as a single supply of settlement services.
- The supplies of advertising and marketing services, while related, are not ancillary to or a necessary part of the settlement services and are separate supplies. These supplies are taxable supplies for GST purposes.

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IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall"

Issued | Tukuna: 27 March 2026

This interpretation statement explains the requirements for a "tax position" and "tax shortfall", common to all the shortfall penalties provided for under ss 141A–141E of the Tax Administration Act 1994.

All legislative references are to the Tax Administration Act 1994.

REPLACES | WHAKAKAPIA

- **IS0053:** Shortfall penalty for not taking reasonable care (October 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)
- **IS0055**: Shortfall penalty – Unacceptable interpretation and unacceptable tax position (April 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)
- **IS0060:** Shortfall penalty for gross carelessness ((August 2004) *Tax Information Bulletin* 168-104 Vol 16, No 8 (September 2004): 10
- **IS0061:** Shortfall penalty for abusive tax position (December 2005) *Tax Information Bulletin* Vol 18, No 1 (February 2006)
- **IS0062:** Shortfall penalty – evasion (November 2006) *Tax Information Bulletin* Vol 18, No 11 (December 2006)

Key terms | Kīanga tau tāpua

Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for that period.
Taxpayer's total tax figure	The amount shown in the taxpayer's tax return as tax paid or payable (before any group offset election or subvention payment), a net loss (treated as having a positive value multiplied by the basic rate of income tax for companies) or a refund.

Introduction | Whakataki

1. A shortfall penalty may apply where a taxpayer has taken a "tax position" and a "tax shortfall" arises, and the legal test for the relevant penalty is met.[1]
2. This item explains the "tax position" and "tax shortfall" requirements.
3. This item should be read alongside the following items, as relevant in the circumstances, which discuss the legal tests for the various types of shortfall penalties:[2]
   - **IS 26/04: Shortfall penalty for not taking reasonable care**
   - **IS 26/05: Shortfall penalty for unacceptable tax position**
   - **IS 26/06: Shortfall penalty for gross carelessness**
   - **IS 26/07: Shortfall penalty for taking an abusive tax position**
   - **IS 26/08: Shortfall penalty for evasion or a similar act**

1 Sections 3 and 141A-141E.

2 Sections 141A-141E.

4. This item should also be read alongside **IS 26/09: Shortfall penalties – reductions and other matters**, which explains other matters relevant to shortfall penalties. The other matters include when the amount of certain shortfall penalties may be capped at $50,000, when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.

5. The flowchart at Figure 1 | Hoahoa 1 shows how the "tax position" and "tax shortfall" requirements apply.

Summary | Whakarāpopoto

6. In summary, this interpretation statement explains the "tax position" and "tax shortfall" requirements for all the shortfall penalties as follows.

The taxpayer has taken a tax position

7. A "tax position" is a position or approach regarding tax under a tax law.[3]

8. Shortfall penalties can be imposed on tax positions taken in respect of the following tax types:

   - Income tax;
   - Except in the case of a shortfall penalty for taking an unacceptable tax position:
     - Withholding-type taxes such as PAYE, FBT, and RWT;
     - GST;[4]
     - Tax credits such as working for families tax credits; and
     - Employer obligations under the Child Support Act 1991 and the Student Loan Scheme Act 2001.

9. **An unacceptable tax position shortfall penalty does not apply to tax positions relating to GST. The unacceptable tax position shortfall penalty applies only to tax positions relating to income tax** (excluding withholding-type taxes such as PAYE, FBT, and RWT) and, beginning 1 January 2027, multinational top-up tax.[5]

10. A tax position can be taken in a tax return. A "tax return" includes the pre-populated account of an individual's income held by Inland Revenue when finalised.[6]

Tax shortfall

11. A tax shortfall arises when the taxpayer's tax position is not correct and results in too little tax to pay or overstates a tax benefit, credit or advantage.[7] Generally, the tax shortfall is the difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for the period.

12. **For an unacceptable tax position shortfall penalty to apply, the tax shortfall must be more than both of:**[8]

    - **$50,000; and**
    - **1% of the total tax figure for the relevant return period.**

3 Section 3.

4 Although a tax position may be taken in relation to GST, an unacceptable tax position shortfall penalty does not apply to tax positions relating to GST (see [9]).

5 Section 141B(2) and s 154 of the Taxation (Annual Rates For 2023–24, Multinational Tax, And Remedial Matters) Act 2024.

6 Section 3.

7 Section 3.

8 Section 141B(2).

Legislation

13. Section 3(1) defines "tax position" as follows:

> **tax position** means a position or approach with regard to tax under 1 or more tax laws, including without limitation a position or approach with regard to—
>
> (a) a liability for an amount of tax, or the payment of an amount of tax:
>
> (b) an obligation to deduct or withhold an amount of tax, or the deduction or withholding of an amount of tax:
>
> (c) a right to a tax refund, or to claim or not to claim a tax refund:
>
> (d) a right to a credit of tax, or to claim or not to claim a credit of tax:
>
> (e) the provision of a tax return, or the non-provision of a tax return:
>
> (f) the derivation of an amount of income or exempt income or a capital gain, or the inclusion or non-inclusion of an amount in income:
>
> (g) the incurring of an amount of expenditure or loss, or the allowing or denying as a deduction of an amount of expenditure or loss:
>
> (h) the availability of a tax loss component or loss balance, or the use of a tax loss component or loss balance:
>
> (i) the attaching of a credit of tax, or the receipt of or lack of entitlement to receive a credit of tax:
>
> (j) the balance of a tax account or memorandum account of any type or description, or a debit or credit to such an account:
>
> (k) the estimation of the provisional tax payable:
>
> (kb) the use of the AIM method for provisional tax and the software product of an approved AIM provider:
>
> (l) whether the taxpayer must provide information to the Commissioner on the income other than reportable income that they derive for a tax year:
>
> (m) the application of Part 3, subpart 3B:
>
> (n) a right to a tax credit (1B)

14. Section 3 defines "tax shortfall" as follows:[9]

> **tax shortfall**, for a return period, means—
>
> (a) the difference between the tax effect of a taxpayer's tax position for the return period and the correct tax position for that period, when the taxpayer's tax position—
>
> (i) results in too little tax paid or payable by the taxpayer or another person:
>
> (ii) overstates a tax benefit, credit, or advantage of any type or description whatever by or benefiting the taxpayer or another person; but
>
> (b) for a person that has taken a tax position for section 23K (the **tax position**) and has not made an election under section RD 7B of the Income Tax Act 2007, the amount of tax that they would have been liable to pay, if they had made an election under section RD 7B of that Act for the period, for the difference between the tax position and the correct tax position

9 Section 3(1). Paragraph (b) of the "tax shortfall" definition relating to employee share schemes is set out and explained at [37].

Analysis | Tātari

Taxpayer must have taken a tax position

15. A tax position is widely defined as a position or approach regarding tax under a tax law.[10] "Tax law" includes provisions of "Inland Revenue Acts" and Orders in Council or regulations made under tax laws.[11] "Tax" includes, among other things, GST and income tax and tax credits such as a Working for Families tax credit.[12] "Income tax" includes withholding-type taxes such as PAYE, FBT, and RWT.[13]

16. "Tax" also includes certain amounts payable to the Commissioner under the Child Support Act 1991, the KiwiSaver Act 2006, and the Student Loan Scheme Act 2011. Section 3(1) provides:

> **tax**—
>
> (a) means—
>
> (i) a tax, levy, or duty of any type imposed by a tax law, regardless of how the tax, levy, or duty is described:
>
> (ii) an amount deemed by a tax law to be a tax, levy, or duty:
>
> (iii) any other amount payable to the Commissioner under a tax law, including:
>
> …
>
> (C) an amount payable by a payer (as defined in section 153 of the Child Support Act 1991) under Part 10 of the Child Support Act 1991:
>
> (CB) an amount required to be deducted under subpart 1 of Part 3 of the KiwiSaver Act 2006:
>
> (CC) KiwiSaver Act 2006 employer contributions:
>
> (CD) an amount of compulsory employer contributions unpaid, specified in a notice under section 141(5) of the KiwiSaver Act 2006:
>
> (D) a salary or wage deduction (as defined in section 4(1) of the Student Loan Scheme Act 2011), or an amount recovered in accordance with section 193 of that Act:
>
> (iv) a credit of tax under a tax law:
>
> (v) a tax of the general character described in any of paragraphs (i) to (iv)—
>
> (A) that is imposed on or payable by a taxpayer in a country or territory other than New Zealand; or
>
> (B) that is relevant under a tax law for the purposes of determining a tax position:
>
> …

17. However, tax does **not** include financial support under the Child Support Act 1991 or repayment obligations under the Student Loan Scheme Act 2011.[14] That is, tax includes only amounts an employer is required to withhold and pay to Inland Revenue under the Child Support Act 1991 and the Student Loan Scheme Act 2011.

18. Accordingly, except for a shortfall penalty for taking an unacceptable tax position, shortfall penalties can be imposed on tax positions relating to the following tax types:

- Income tax, including withholding-type taxes such as PAYE, FBT, and RWT;[15]
- GST;[16]
- Tax credits such as a Working for Families tax credit;[17]

10 See [12].

11 Section 3(1). Inland Revenue Acts are listed in sch 1.

12 Section 3(1). Although a tax position may be taken in relation to GST, an unacceptable tax position shortfall penalty does not apply to tax positions relating to GST (see [9]).

13 Section RA 2 of the Income Tax Act 2007.

14 Section 3(1) definition of "tax" at para (a)(ix) and (x).

15 Section RA 2 of the Income Tax Act 2007.

16 Although a tax position may be taken in relation to GST, an unacceptable tax position shortfall penalty does not apply to tax positions relating to GST (see [18]).

17 Section 3(1).

- Child support payments but **not** financial support under the Child Support Act 1991 (that is, only amounts an employer is required to withhold and pay to Inland Revenue);[18]
- Student loan deductions but **not** repayment obligations under the Student Loan Scheme Act 2011 (that is, only amounts an employer is required to withhold and pay to Inland Revenue); and[19]
- KiwiSaver employee deductions.

19. An unacceptable tax position shortfall penalty does not apply to tax positions relating to GST. Shortfall penalties for taking an unacceptable tax position can only be imposed on tax positions relating to income tax (excluding withholding-type taxes such as PAYE, FBT, and RWT) and, beginning 1 January 2027, multinational top-up tax.[20]

20. A taxpayer can take a tax position knowingly, intentionally or involuntarily by:[21]

- claiming or not claiming, or returning or not returning, a tax position; or
- being placed in a tax position.

21. A taxpayer may be placed in a tax position when something is done on their behalf by another party. For example:

- a taxpayer may be placed in a tax position by someone acting as their agent;[22]
- a beneficiary may be placed in a tax position by a trustee of a trust;
- a partner in a partnership may be placed in a tax position by other partners;
- an employee may be placed in a tax position by their employer in relation to PAYE deductions; and
- a bank customer may be placed in a tax position by their bank in relation to the rate of withholding tax deducted.

22. A tax position may be taken in a tax return or an individual's final account that is treated as a tax return or in respect of a due date. The definition of "taxpayer's tax position" states:[23]

> **Taxpayer's tax position** means—
>
> (a) a tax position taken by a taxpayer in or in respect of—
>
> (i) a tax return; or
>
> (ii) an individual's final account that is treated under section 22I(1)(a) as a return of income; or
>
> (iii) a due date

23. A "tax return" is a form or document a taxpayer is required to complete and return to the Commissioner. It includes the "pre-populated account" of an individual's income held by Inland Revenue when finalised.[24] A "pre-populated account" includes an individual's "reportable income", which is income Inland Revenue receives regular information about such as PAYE income and resident and non-resident passive income, and any other income the Commissioner considers the individual has derived for the income year.[25]

24. A tax position in a tax return or individual's final account may be taken explicitly or implicitly.[26]

25. A "due date" is the last day on which a taxpayer can pay tax, provide a tax return or tax form, or do any other thing under a tax law before being liable for a penalty or interest.[27]

18 Penalties for non-compliance by liable parents are covered by the Child Support Act 1991.

19 Penalties for non-compliance by student loan borrowers are covered by the Student Loan Scheme Act 2011. As student loan repayment obligations are calculated based on the borrower's income for tax purposes, where an income tax shortfall exists, it is likely there will also be a repayment obligation shortfall under the Student Loan Scheme Act 2011. If a shortfall penalty is imposed on the income tax shortfall under any of ss 141A-141E, a student loan shortfall penalty may also be imposed on the student loan repayment obligation shortfall under the Student Loan Scheme Act 2011 (ss 158 and 159 of the Student Loan Scheme Act 2011).

20 Section 141B(2) and s 154 of the Taxation (Annual Rates For 2023–24, Multinational Tax, And Remedial Matters) Act 2024.

21 Section 4A(1)(b). See also *Chapman v CIR* (2002) 20 NZTC 17,950 (HC) at [35] and [43].

22 *Case Z14* (2009) 24 NZTC 14,165.

23 Section 3(1).

24 Section 22D(5) and (6).

25 Section 22D(3).

26 Section 4A(1)(c) and (ca).

27 Section 3(1).

26. A taxpayer who fails to provide a tax return by the due date is treated as having taken a tax position based on the amount of tax they have paid for the return period.[28] Where the return period is for an income tax year, the amount of tax paid includes any provisional tax paid for that year.[29] A taxpayer who has not paid any tax for the period is treated as having taken a tax position that they had no tax to pay. Section 4A(5) provides:

> (5) If a taxpayer does not provide a tax return for a return period, the taxpayer is deemed, in relation to each type of tax, to take, in respect of every due date that would be covered by a tax return for the return period if a return were provided, a tax position that is based on the tax of that type paid by the taxpayer for that return period.

27. Any resulting tax shortfall is calculated by reference to the tax position the taxpayer is treated as having taken.[30] The meaning of tax shortfall is discussed from [34].

28. Example | Tauira 1 illustrates a tax shortfall calculation where an individual has income but no return is filed and no tax is paid. The example illustrates the calculation where the individual's income is not "reportable income" and, as a variation, where the individual has "reportable income" and other income. Example | Tauira 2 illustrates a tax shortfall calculation in a situation where a company has income and pays provisional tax but no return is filed.

Example | Tauira 1 – Tax shortfall calculation where no return filed and no tax is paid

Facts

A self-employed individual received $55,000 income for lawnmowing and yard maintenance work during the 2024 income year, and no other income. The individual did not file a tax return for the year or pay any tax on the income. The individual is deemed to take a tax position that they had no income and no income tax to pay.[31] The individual's tax position is not correct. The Commissioner issued a default assessment showing the correct tax position, that is $55,000 taxable income.

Tax shortfall calculation

The tax shortfall is the difference between the tax effect of the individual's deemed tax position (that they have no taxable income) and the correct tax position (that the individual has $55,000 of taxable income). The tax shortfall is calculated using the individual's marginal rates of tax. The marginal rates for the 2024 income year are:

Taxable income	Tax rate
$0–14,000	10.50%
$14,001–48,000	17.50%
$48,001-$70,000	30.00%
$70,001-$180,000	33.00%
$180,000 upwards	39.00%

28 See [27] for the date on which a taxpayer is treated as having taken the tax position. "Return period" is the period covered by a tax return or would be covered by a tax return if one were provided (s 3). For a return that relates to a transaction, "return period" means the time within which the transaction must be returned (s 3).

29 Sections LA 6(1)(b) and LB 2 of the Income Tax Act 2007.

30 Section 4A(5) and [24].

31 See s 4A(5) and [24].

The tax shortfall is $9,520.00, calculated as follows:

Income		Tax rate		
$14,000	x	10.50%	=	$1,470.00
$34,000	x	17.50%	=	$5,950.00
$7,000	x	30.00%	=	$2,100.00
$55,000				**$9,520.00**

Variation

In addition to the $55,000 income from lawnmowing and yard maintenance work, the individual received $40,000 PAYE income. The individual took a tax position when their prepopulated account was finalised that $40,000 was their only income. The Commissioner corrects the individual's income tax assessment to include the extra $55,000 income from lawnmowing and yard maintenance work by way of an agreed adjustment. The tax shortfall is the difference between the tax effect of the individual's tax position (that they had $40,000 PAYE income) and the correct tax position (that they had $40,000 PAYE income and $55,000 from lawnmowing and yard maintenance work).

Tax shortfall calculation

The tax shortfall would be $16,250, calculated as follows:

Income		Tax rate		
$8,000	x	17.50%	=	$1,400.00
$22,000	x	30.00%	=	$6,600.00
$25,000	x	33.00%	=	$8,250.00
$55,000				**$16,250.00**

Example | Tauira 2 – Tax shortfall calculation where provisional tax paid but no return filed

Facts

A company received net income of $75,000 from its equipment hire business during the 2024 income year. The company paid provisional tax of $21,000 income tax ($75,000 x 28%) in three instalments for the 2024 income year but failed to file a tax return by the due date. The company is deemed to have taken a tax position based on the income tax paid by way of provisional tax payments, that is, $21,000.[32] This is the correct tax position. In the absence of a return, the Commissioner issues a default assessment showing $75,000 income and $21,000 tax to pay.

Tax shortfall calculation

As there is no difference between the tax effect of the company's deemed tax position ($21,000 tax on $75,000) and the correct tax position ($21,000 tax on $75,000), there is no tax shortfall.

32 Section 4A(5), see [24]. The company would also be liable to a late filing penalty under s 139A for not completing and filing a tax return.

29. A taxpayer who files a tax return takes a tax position on the date they file the return.[33] If the taxpayer's tax position is incorrect, any tax shortfall arises on that date. This is the outcome even if the tax position is later corrected and the correct amount of tax paid before the due date.[34] The tax shortfall is calculated based on the taxpayer's original tax position. In some cases, the amount of any shortfall penalty may be reduced if the tax shortfall is voluntarily disclosed.[35]

30. A taxpayer who fails to provide a tax return is treated as having taken a tax position on the due date for payment of the tax covered by the return.[36]

31. Individuals who have derived reportable income **and** other income are treated as having taken a tax position when their pre-populated account is finalised.[37] Generally, a pre-populated account is finalised when the individual confirms the information in the account is correct and complete or when Inland Revenue is satisfied the information is correct and complete.[38] Before an account is finalised, an individual can amend the information in it without taking a tax position.

32. The position is different for individuals who have derived **only** reportable income.[39] Such individuals may amend the information in their finalised account at any time before their terminal tax date for the year. In that case, the amended information becomes the individual's tax position. The earlier tax position taken when the individual's account was first finalised is regarded as not having been made.[40]

33. A default assessment may be issued if the Commissioner is not satisfied the information in an individual's pre-populated account is complete and correct.[41] In that case, the individual takes a tax position based on the information in their account after the date by which they must have adjusted or corrected their account. For individuals deriving only reportable income, this is their terminal tax date for the year.[42] For other individuals, this is 7 July of the year following the tax year or later if the individual has an extension of time to file a return.[43] The tax shortfall will be calculated based on the difference between the tax position the individual takes based on the information in their prepopulated account and the tax position in the Commissioner's default assessment.

Tax position results in a tax shortfall

34. A tax shortfall arises when the taxpayer's tax position is not correct and results in too little tax to pay or overstates a tax benefit, credit or advantage.[44]

35. A "tax shortfall" is the difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for the period, when the tax position results in too little tax paid or overstates a tax benefit, credit, or advantage.[45]

33 See ss 33 and 92 for income tax and ss 16 and 92B of the Goods and Services Tax Act 1985 for GST. See also *Ben Nevis Forestry Ventures Ltd v CIR; Accent Management Ltd v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188, at [176].

34 Example | Tauira 3 illustrates a tax shortfall calculation in a situation where a tax position is corrected before the due date for payment of the tax. Some taxpayers attempt to correct an incorrect tax position by filing what are often referred to as "amended returns". However, the Act does not make any provision for amended returns (*CIR v FB Duvall Ltd* (2005) 22 NZTC 19,142 (HC)). For example, a taxpayer assesses their income tax on the date they file their income tax return (ss 33 and 92). If a taxpayer subsequently considers their income tax return is incorrect, they may propose an adjustment to their assessment by issuing a Notice of Proposed Adjustment or request the Commissioner to amend their assessment (ss 89DA and 113 and see SPS 20/03: Requests to amend assessments *Tax Information Bulletin* Vol 32, No 6 (July 2020): 11). The Act also makes provision for the correcting of minor errors in income tax, GST, and FBT in the next return that is due (s 113A).

35 The voluntary disclosure of tax shortfalls is considered in IS 26/09: Shortfall penalties – other matters.

36 Section 4A(5) and see [24].

37 An individual makes a return of income and assesses their income tax liability on that date (ss 22H, 22I(1)(c) and (2), and 92(2B)). "Reportable income" is explained in [21].

38 Section 22H.

39 An individual who derives only reportable income is a "qualifying individual", see s 22D(2) and (3).

40 Sections 22D and 22G(3).

41 Sections 22G(4) and 106.

42 Section 22G(3).

43 Section 22H(4) and the s 3(1) definition of "tax position", para (l).

44 An incorrect tax position overstating the amount of a loss a taxpayer is entitled to may not result in too little tax to pay. However, the incorrect tax position overstates a tax benefit or advantage, *Case 4/2017* [2017] NZTRA 04, (2017) 28 NZTC 4-003, at [69] and example 5.

45 Section 3(1), "tax shortfall" (see [13]).

36. The tax effect of a tax position is calculated using:[46]
    - the taxpayer's marginal tax rate or tax rates during the return period; or
    - where the taxpayer has no tax to pay, the tax rate or lowest marginal tax rate that would apply to the taxpayer during the return period if they had tax to pay.
37. The "correct tax position" for a period is the "correct tax position established under 1 or more tax laws".[47]
38. The difference between the tax effect of the taxpayer's tax position and the tax effect of the correct tax position is the "tax difference, in monetary terms, for the taxpayer between the two positions".[48]
39. Specific provision is made for the calculation of a tax shortfall where an employer has understated the value of a benefit provided to an employee under an employee share scheme and has not elected to withhold and pay tax for the benefit. In that case, the tax shortfall is the tax the employer would have been liable to pay for the difference in value if they had made the election.[49] The following examples illustrate tax shortfall calculations in situations where a tax position is corrected before the due date for payment of the tax, where a taxpayer's taxable income is increased, where a claimed loss is reduced, and where a claimed loss is extinguished.

Example | Tauira 3 – Tax shortfall where tax position later corrected

Facts

A company filed a GST return for the period ended 31 January 2024 on 15 February 2024 showing $106,500 output tax, $87,700 input tax and $18,800 GST to pay. The company paid the $18,800 GST the same day.

The senior employee responsible for the preparation and filing of the company's GST returns had delegated the task of preparing and filing the GST return to a new inexperienced employee and did not check the correctness of the return before it was filed.

On 20 February 2024, the senior employee discovered an error in the GST return. Due to their inexperience, the new employee had overlooked including $12,000 of sales and income on which GST output tax of $1,565.21 was payable. Also on 20 February 2024, the company made a request in myIR for the Commissioner to amend its return and paid the extra GST.

Tax shortfall calculation

There was a tax shortfall despite the company making a request for the Commissioner to amend its return and paying the extra GST before the due date for returning and paying the tax (28 February 2024).

The tax shortfall is the difference between the tax effect of the tax position the company took on 15 February 2024 when it filed its GST return (GST payable of $18,800, which excluded the GST output tax of $1,565.12) and the correct tax position ($20,365.21). The tax shortfall is $1,565.21.

46 Section 141(12).

47 Section 3(1).

48 *Accent Management Ltd v CIR* (2007) 23 NZTC 21,323 (CA).

49 Paragraph (b) of the definition of "tax shortfall" in s 3 (see [13]).

Example | Tauira 4 – Tax shortfall calculation where taxable income is increased

Facts

A company filed its 2024 income tax return showing $150,000 taxable income. In its tax return, the company took a tax position that $100,000 it received on the sale of a property was a capital receipt and not income. When reviewing the company's income tax return, Inland Revenue discovered the $100,000 receipt was income and the taxpayer's tax position was not correct.

Tax shortfall calculation

The tax shortfall is the difference between the tax effect of the company's tax position (that the $100,000 is not income) and the correct tax position (that the $100,000 is income).

The tax shortfall is $28,000, calculated using the company tax rate of 28% ($100,000 x 28%).

Example | Tauira 5 – Tax shortfall calculation where claimed loss is reduced

Facts

An individual filed their 2024 income tax return showing a $65,000 loss for the year. In their tax return, the individual took a tax position that a $50,000 distribution from a trust they received during the year was not income. When reviewing the individual's income tax return, Inland Revenue discovered the $50,000 receipt was income and corrected the individual's tax position by way of agreed adjustment. After adjustment, the claimed loss is reduced to $15,000.

Tax shortfall calculation

The tax shortfall is the difference between the tax effect of the individual's tax position (that the $50,000 is not income) and the correct tax position (that the $50,000 is income). As the individual has no tax to pay (their loss is reduced but not extinguished), the tax effect of the individual's tax position is calculated using the lowest marginal tax rate that would apply if the individual had tax to pay, that is, 10.5% for the 2024 income year.[50]

The tax shortfall is $5,250 ($50,000 x 10.5%).

Example | Tauira 6 – Tax shortfall calculation where claimed loss is extinguished

Facts

An individual filed their 2025 income tax return showing a $10,000 loss for year. In their tax return, the individual took a tax position that they were entitled to a $30,000 deduction for a revenue expense. When reviewing the individual's income tax return, Inland Revenue discovered the $30,000 expense was not deductible. The correct tax position is that the expense is capital in nature and not deductible. Consequently, the individual had understated their income by $30,000. After adjustment, the claimed loss of $10,000 is extinguished, and the individual has $20,000 taxable income.

Tax shortfall calculation

The tax shortfall is calculated based on the $30,000 difference between the individual's tax position and the correct tax position using the individuals marginal rates of tax.

The relevant marginal rates for the 2025 income year are:

Taxable income	Tax rate
$0–14,000	10.50%
$14,001–15,600	12.82%
$15,601–48,000	17.50%

50 Section 141(12) and Part A of sch 1 of the Income Tax Act 2007.

The tax shortfall is $4,195.12, calculated as follows:

Income		Tax rate		
$14,000	x	10.50%	=	$1,470.00
$1,600	x	12.82%	=	$205.12
$14,400	x	17.50%	=	$2,520.00
$30,000				**$4,195.12**

40. A taxpayer's tax return for a return period may include multiple tax positions. If more than one of the tax positions is incorrect, a separate tax shortfall calculation is required for each incorrect tax position. If a taxpayer takes the same incorrect tax position in more than one return period, a separate tax shortfall calculation is required for each return period and for each tax position.[51]

41. If, in the same return period, a taxpayer is liable to pay one or more shortfall penalties in respect of the same tax type and the taxpayer's liability to the tax is overstated in one or more respects, the tax shortfall is calculated by setting off the tax effects of the overstatements:[52]

    - against the understatement, in the case of one tax shortfall; or
    - prorated against the understatements, in the case of more than one tax shortfall.

42. The Commissioner may offset credit adjustments against debit adjustments for the purpose of calculating shortfall penalties. This includes offsetting between different tax types, periods, and associated taxpayers.[53]

43. If, in the same return period, a taxpayer has a tax shortfall in respect of one tax type and refund in respect of different tax type, the Commissioner may reduce the tax shortfall by the amount of the refund.[54] The tax shortfall must have arisen as a result of an adjustment made by the Commissioner. The tax refund must have resulted from an adjustment made by the Commissioner as a consequence of the adjustment giving rise to the tax shortfall. If the 2 tax types have different return periods, the Commissioner may, for the purpose of determining a tax shortfall, treat the return periods as the same return period.[55]

44. The Commissioner may also reduce a taxpayer's tax shortfall by the amount of a tax refund an associated person is entitled to or reduction in the tax they must pay. The tax shortfall and refund or reduction must relate to the same tax type and return period, must have resulted from adjustments made by the Commissioner, and the adjustments resulting in the refund or reduction must be linked to the adjustment resulting in the tax shortfall.[56]

45. The Commissioner may make the offset if the taxpayer and associated person have different return period. This is if the taxpayer's return period overlaps the associated person's return period and the taxpayer's tax position is not an abusive tax position and does not involve evasion or similar act.[57]

46. Generally, in calculating tax shortfalls, the Commissioner will make these offsets unless there is good reason not to, such as where taxpayers have deliberately sought to avoid meeting their tax obligations.

47. Tax shortfalls arising from tax positions taken in the same return period can be aggregated if the tax positions are similar or identical and relate to similar or identical arrangements, articles, items or matters.[58]

51 Section 141(3).
52 Section 141(5).
53 Section 141(6)-141(9).
54 Section 141(6).
55 Section 141(9).
56 Section 141(7).
57 Section 141(7B).
58 Section 141(10).

48. The following examples illustrate when overstatements of tax are offset against understatements when calculating tax shortfalls.

Example | Tauira 7 –Same taxpayer, same tax types and same return periods

Facts

A company is liable for a shortfall penalty for gross carelessness for an incorrect tax position it took in its income tax return for the 2025 income year. The incorrect tax position resulted in the company's sales income being understated by $100,000. The company's income for the 2025 income year was also overstated by $10,000 as the company mistakenly returned a non-taxable capital amount as income. The company returned $160,000 income for the 2025 income year. The correct tax position is that the company had $250,000 income for the 2025 income year.

Tax shortfall calculation

The tax shortfall is calculated by offsetting the tax effect the understated income against the tax effect of the overstated income:[59]

tax effect of understated income - tax effect of overstated income

= $28,000 ($100,000 x 28%) - $2,800 ($10,000 x 28%)

= $25,200

Example | Tauira 8 – Same taxpayer, different tax types and different return periods

Facts

During an audit, Inland Revenue discovers that a GST registered company has incorrectly claimed a $1,304.35 input tax deduction for $10,000 salary and wages paid to employees in its GST return for the period ended 31 March 2025. The error occurred due to a genuine misunderstanding about what should be included in a GST return. There is no evidence the company claimed the input tax deduction knowing it was not entitled to it.

Due to the same misunderstanding, the company included the salary and wages expense in its income tax return for the year ended 31 March 2025 using an amount adjusted for GST (that is, $8,695.65). Consequently, the company's income for the 2025 income year was overstated by the amount of GST not included in the salary and wage expense (that is, $1,304.35).

Inland Revenue proposes adjustments to the company's GST assessment for the period ended 31 March 2025 to reverse the incorrect input tax deduction and to the company's 31 March 2025 income tax assessment to increase the amount of the salary and wage expense. The company agrees. After the adjustments, there is a GST tax shortfall of $1,304.35 and the company is entitled to an income tax refund of $365.22 (28% of $1,304.35).

Tax shortfall calculation

Inland Revenue decides to treat the $365.22 income tax refund as GST paid by the company for the period ended 31 March 2025. This is because the GST tax shortfall arose due to a genuine error made the taxpayer, not deliberate non-compliance. Also, although the income tax and GST return periods are different, Inland Revenue decides to treat the return periods as being the same.[60] Consequently, the company's GST tax shortfall is reduced to $939.13.[61]

59 Section 141(5).

60 Section 141(9).

61 Sections 141(6) and (9).

Example | Tauira 9 – Associated persons, same tax type and return periods, and Commissioner adjustments

Facts

Company A and company B are associated.[62] They have identical shareholders, directors, and GST registrations and share offices. In June 2025, company A purchased a fishing vessel from a non-resident, non-GST registered, vendor for $1.8 million and imported it into New Zealand. Due to confusion in their shared offices, company B claimed a $234,782.60 input tax deduction in its GST return for the 2-month period ended 31 July 2025 for the GST collected by New Zealand Customs at the border when the vessel was imported. Inland Revenue reviewed company B's GST assessment for the period and discovered the error. The Commissioner corrected each company's GST assessment for the 2-month period ended 31 July 2025 by way of agreed adjustments. After the adjustments, company B has a $234,782.60 GST tax shortfall for the 2-month period ended 31 July 2025 and company A is entitled to a $234,782.60 GST refund.

Tax shortfall calculation

The Commissioner exercises discretion to treat the GST refund owing to company A in the 2-month period ended 31 July 2025 as GST paid by company B in that period. This is because the companies share the same GST return period and there was a genuine error and no evidence of any deliberate non-compliance on the part of either company. Consequently, company B has no GST tax shortfall in the 2-month period ended 31 July 2025.[63]

Example | Tauira 10 –Associated persons, same tax type and return period, but no Commissioner adjustment

Facts

A married couple are the trustees of a family trust and the partners of a partnership through which they operate an orchard business. The partnership and the trust are associated for GST purposes.[64]

The trust is not GST registered, but the partnership is, with a 2-month GST period. In February 2025, the trust purchases an item of plant for the packing shed for $1 million (including GST). Through a misunderstanding about the transaction, the partnership claims a $130,434.78 input tax deduction for the purchase in its GST return ending 31 March 2025.

When reviewing the partnership's GST return, Inland Revenue discovers the partnership is not entitled to the input tax deduction for the plant purchased by the trust. Inland Revenue proposes an adjustment reversing the deduction. The partners agree to the adjustment. After the adjustment, the partnership has a $130,434.78 GST tax shortfall.

The trust then applies for GST registration. The Commissioner accepts the trust's application and registers the trust for GST from 1 February 2025 with a 2-month GST period. The trust claims an input tax deduction relating to the purchase of the plant in the GST period ended 31 March 2025 and is entitled to a $130,434.78 GST refund.

Tax shortfall calculation

In calculating the partnership's tax shortfall, the trust's GST refund cannot be offset against the partnership's GST tax shortfall. To be offset, the trust's GST refund must have resulted from an adjustment made by the Commissioner and no such adjustment was made when the trust filed its GST return.[65] For shortfall penalty purposes, the partnership's GST tax shortfall is $130,434.78.

62 Section 3(2) and s YB 2 of the Income Tax Act 2007.

63 Section 141(7).

64 Section 3(2) and ss YB 4, YB 12, and YB 14 of the Income Tax Act 2007.

65 Section 141(7).

Example | Tauira 11 –Associated persons, same tax type and return period, and non-compliance

Facts

Company C and company D are associated.[66] They have identical shareholders, directors, and GST registrations. Company C purchased a supply chain software platform in the GST period ended 31 July 2025 for $2.3 million (including GST). Company C is entitled to claim a $300,000 input tax deduction relating to the purchase in its GST return for the period ended 31 July 2025. If company C claimed the input tax deduction, its return for the period would show a $200,000 refund. Company C needs the refund to be able to pay its suppliers and other creditors to ease a temporary cashflow problem. However, company C has a significant amount of unpaid GST relating to previous GST periods. Company C is concerned that if it claims the input tax deduction the Commissioner will offset the refund against company C's GST arrears. Consequently, company C and company D decide that the input tax deduction should be claimed by company D in its GST return for the period ended 31 July 2025 because it does not have any outstanding GST. The Commissioner reviews company D's GST assessment for the period and discovers the error. The Commissioner corrects each company's GST assessment for the period by way of an agreed adjustment. After the adjustments, company D has a $300,000 GST tax shortfall and company C has a $200,000 GST refund.

Tax shortfall calculation

In calculating company D's tax shortfall, the Commissioner exercises discretion not to treat the company C's $200,000 GST refund as GST paid by company D in the GST period ended 31 July 2025. This is because the companies deliberately claimed an input tax deduction in the wrong entity to prevent the Commissioner from using the GST refund company C would otherwise be entitled to pay its tax debt.[67] For the purpose of imposing a shortfall penalty, company D's GST tax shortfall is $300,000.

Tax shortfall threshold for unacceptable tax position shortfall penalty

49. For a taxpayer to be liable for an unacceptable tax position shortfall penalty, the tax shortfall must exceed:[68]
    - $50,000; and
    - 1% of the "taxpayer's total tax figure" for the relevant return period.
50. The taxpayer's total tax figure is the amount shown in the taxpayer's tax return (as filed by the taxpayer) as tax paid or payable, a net loss or a refund.[69] Where a taxpayer has paid tax or has tax to pay, the amount is the tax paid or payable before any group offset election or subvention payment.[70] Where a taxpayer has no tax to pay, the amount is equal to the net loss of the taxpayer, treated as having a positive value multiplied by the basic rate of income tax for companies.[71]
51. For the purpose of determining whether a tax shortfall exceeds the threshold amounts:[72]
    - a tax return provided by a partnership, look-through company or group of persons is treated as if it were a tax return of every partner in the partnership, effective look-through interest holder for the look-through company, or person in such group; and
    - the tax rate applying to a partnership or look-through company is the same as the basic rate for income tax for companies.[73]

66 Section 3(2) and s YB 2 of the Income Tax Act 2007.

67 Section 141(7).

68 Sections 141B(2) and (3).

69 Section 141B(3).

70 Section 141B(3)(a).

71 Section 141B(3)(b). On and after 1 January 2027, s 141B(3)(b) will not apply to multinational top-up tax (Taxation (Annual Rates for 2023-2024, Multinational Tax, and Remedial Matters) Act 2024). This is because, when multinational top-up tax applies, there will always be tax to pay. See IS 26/05 Shortfall penalty for taking an unacceptable tax position, example 4, on how to calculate 1% of the "taxpayer's total tax figure" for the relevant return period.

72 Section 141B(8).

73 Section 141B(8). This is except in the case of a multinational top-up tax (Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024).

52. Where there is more than one tax shortfall in a return period, the threshold amounts in s 141B(2) are applied to each tax shortfall. This is except for tax shortfalls arising from similar or identical tax positions that are aggregated and deemed to be 1 tax shortfall.[74]

53. Example | Tauira 12 shows how to determine whether a tax shortfall exceeds the threshold amounts where there is more than one tax shortfall in a return period.

Example | Tauira 12 –More than one tax shortfall in a return period

Facts

The following unacceptable tax positions and tax shortfalls are identified during an audit of a company's income tax returns for the 2021, 2022, and 2023 income years:

Unacceptable tax position	2021 tax shortfall	2022 tax shortfall	2023 tax shortfall	Total tax shortfall
Deduction claimed for a non-deductible capital expense	$30,000	$25,000		$55,000
Income under-reported due to incorrect accounting procedures	$10,000	$30,000	$51,000	$91,000
Total	**$40,000**	**$55,000**	**$51,000**	

None of the tax shortfalls are more than 1% of the company's "total tax figure".[75]

Result

The only return period in which the s 141B(2) threshold is met is the 2023 income year. In this year, the tax shortfall relating to the under-reported income exceeds the $50,000 threshold amount or 1% of the company's "total tax figure".

The tax shortfalls in the 2021 and 2022 income years do not exceed the s 141B(2) threshold amounts because:

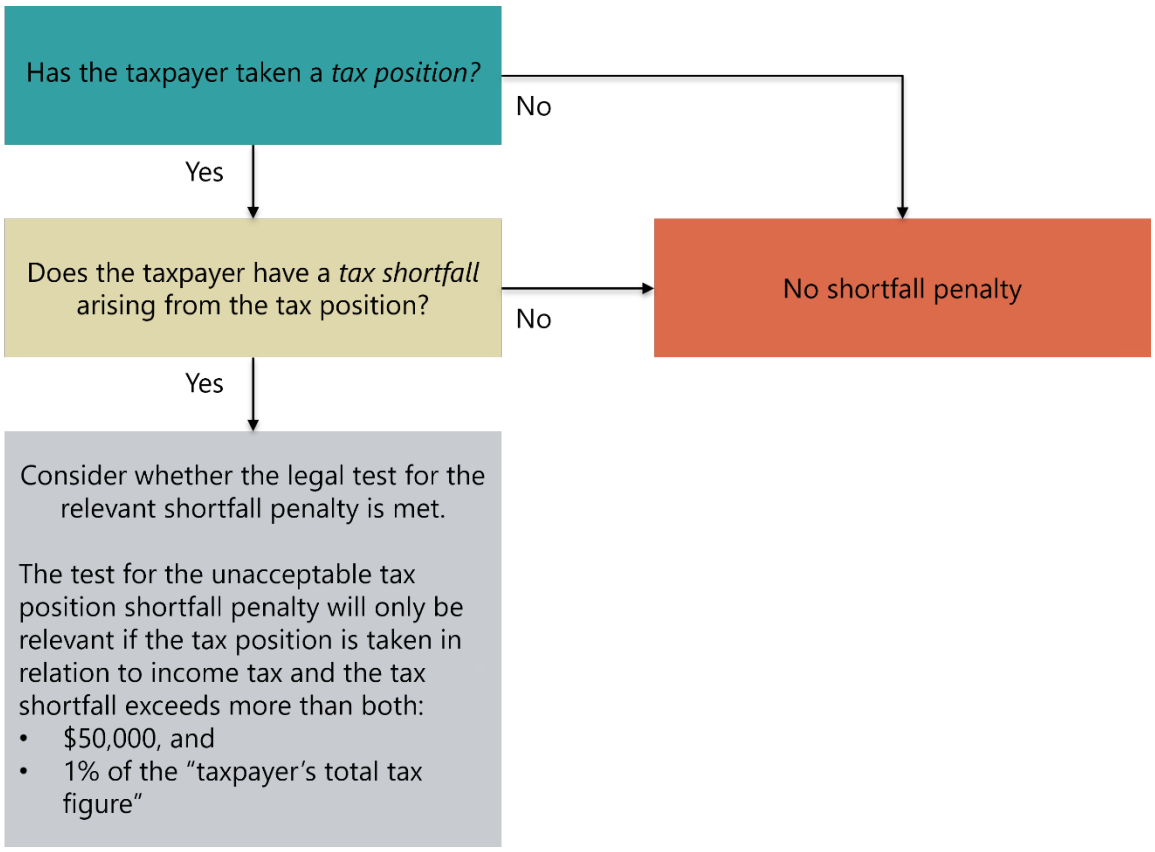
- each tax shortfall is less than $50,000 and 1% of the company's "total tax figure", and
- the tax shortfalls do not arise from similar or identical tax positions and cannot be aggregated and deemed to be 1 tax shortfall.

54. The following flowchart shows how the "tax position" and "tax shortfall" requirements apply.

74 Section 141(10).

75 See [49].

Figure 1 | Hoahoa 1 showing how the "tax position" and "tax shortfall" requirements apply



References | Tohutoro

Legislative references | Tohutoro whakatureture

Child Support Act 1991

Goods and Services Tax Act 1985, ss 16, 92B

Income Tax Act 2007, s RA 2, sch 1 part A

Student Loan Scheme Act 2011, ss 158, 159

Tax Administration Act 1994, ss 3(1) ("tax", "tax law", "tax position", "tax shortfall", "taxpayer's tax position"), 4A(1) and (5), 22D, 22G, 22H, 22I, 33, 89DA, 92, 113, 113A, 141, 141A to 141E, sch 1

Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024

Case references | Tohutoro kēhi

Accent Management Ltd v CIR (2007) 23 NZTC 21,323 (CA)

Ben Nevis Forestry Ventures Ltd v CIR; Accent Management Ltd v CIR [2008] NZSC 115, (2009) 24 NZTC 23,188

Chapman v CIR (2002) 20 NZTC 17,950 (HC)

CIR v FB Duvall Ltd (2005) 22 NZTC 19,142 (HC)

Case 4/2017 [2017] NZTRA 04, (2017) 28 NZTC 4-003

Case Z14 (2009) 24 NZTC 14,165

Other references | Tohutoro anō

IS 26/04: Shortfall penalty for not taking reasonable care
taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-04

IS 26/05: Shortfall penalty for taking an unacceptable tax position
taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-05

IS 26/06: Shortfall penalty for gross carelessness
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IS 26/04: Shortfall penalty for not taking reasonable care

Issued | Tukuna: 27 March 2026

This interpretation statement explains the meaning of "reasonable care" in relation to the shortfall penalty for not taking reasonable care in s 141A of the Tax Administration Act 1994.

All legislative references are to the Tax Administration Act 1994.

REPLACES | WHAKAKAPIA

- **IS0053**: Shortfall penalty for not taking reasonable care (October 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)

Key terms | Kīanga tau tāpua

Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for that period.

Introduction | Whakataki

1. Section 141A imposes a shortfall penalty for not taking reasonable care where:
   - the taxpayer takes a tax position;
   - a tax shortfall arises from the tax position; and
   - the taxpayer did not take reasonable care in taking the tax position.
2. The penalty applies to tax positions taken in relation to most tax types, including GST and income tax. Income tax includes withholding-type taxes treated as income tax, eg PAYE, FBT, and resident withholding tax.
3. The penalty is 20% of the tax shortfall. The amount of the penalty may be capped at $50,000 if certain requirements are met.[1]
4. **IS 26/03: Shortfall penalties – requirement for a "tax position" and a "tax shortfall"** explains the requirements for a "tax position" and a "tax shortfall".
5. This interpretation statement explains the meaning of "reasonable care" in s 141A.
6. **IS 26/09: Shortfall penalties – reductions and other matters** explains other matters relevant to the penalty, including the cap of $50,000 on the amount of the penalty if certain requirements are met, when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.
7. The flowchart at Figure 1 | Hoahoa 1: Flowchart of how s 141A applies.

Summary | Whakarāpopoto

8. In summary, this interpretation statement explains the meaning of reasonable care as follows:
   - "Reasonable care" means doing what a reasonable person in the particular circumstances would do.
   - Whether a taxpayer takes reasonable care is decided objectively. Whether the taxpayer believed they were being sufficiently careful is irrelevant to this decision.

1 Section 141JAA. See IS 26/09: Shortfall penalties – reductions and other matters.

- Taking reasonable care involves considering whether a reasonable person in the particular circumstances would have seen the risk of a tax shortfall and the actions they would have taken to prevent it. It includes taking sufficient steps to determine the correctness of a tax position, keeping adequate tax records, and generally making a reasonable attempt to comply with the tax laws. The level of care required may vary depending on factors such as the knowledge and experience of the taxpayer.
- When deciding whether a reasonable person in the particular circumstances would have seen the risk of a tax shortfall, the Commissioner will consider the size and materiality of the tax shortfall compared with the taxpayer's overall tax position.
- Even though a taxpayer who makes a mistake in calculating or recording numbers in a return does not take an "unacceptable tax position" for the purposes of the shortfall penalty for taking an unacceptable tax position, they may still be liable for a shortfall penalty for not taking reasonable care.
- A taxpayer who relies on the advice of a "tax advisor", or a "tax agent", to whom they have provided all relevant information, is treated as having taken reasonable care except where the taxpayer:
  - is the employer of the tax advisor;
  - does not adequately inform or instruct the tax advisor about their tax position;
  - has reason to believe that the action or advice is incorrect; or
  - has, in the previous 4 years, had a tax shortfall for the same error or action and has failed to take reasonable care to stop it happening again.
- A taxpayer who takes an "acceptable tax position" is also treated as having taken reasonable care.

Legislation

141A Not taking reasonable care

(1) A taxpayer is liable to pay a shortfall penalty if the taxpayer does not take reasonable care in taking a taxpayer's tax position (referred to as not taking reasonable care) and the taking of that tax position by that taxpayer results in a tax shortfall.

(2) The penalty payable for not taking reasonable care is 20% of the resulting tax shortfall.

(2B) A taxpayer who, in taking a tax position, relies on an action or advice of a tax advisor engaged by the taxpayer, or by a company in the same group of companies as the taxpayer, takes reasonable care in relying on the action or advice except if the taxpayer—

(a) is the employer of the tax advisor:

(b) does not provide to the tax advisor adequate information relating to the tax position:

(c) does not provide to the tax advisor adequate instructions relating to the tax position:

(d) has reason to believe that the action or advice is incorrect:

(e) has previously, for a period ending less than 4 years before the beginning of the period to which the tax position relates, had a tax shortfall for the same type of tax arising from a corresponding tax position and does not take reasonable care to avoid the further tax shortfall.

(3) A taxpayer who takes an acceptable tax position is also a taxpayer who has taken reasonable care in taking the taxpayer's tax position.

(4) Subsection (3) and section 141B(1B) do not exclude a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care.

Analysis | Tātari

9. The Tax Administration Act 1994 does not define "reasonable care", other than in specifying that a taxpayer who relies on the action or advice of their tax advisor or takes an "acceptable tax position" is treated as having taken reasonable care.[2]

10. The general meaning of taking reasonable care is explained in the first section. The following sections then set out the circumstances in which a taxpayer is treated as taking reasonable care.

What it generally means to take reasonable care

11. To take reasonable care is to give appropriately serious attention to imposed obligations.

The test is objective

12. The test is an objective one. In the context of the shortfall penalty for not taking reasonable care, the test involves considering whether a reasonable person in the particular circumstances would have seen the risk of a tax shortfall and the actions they would have taken to prevent it.[3] It is irrelevant whether the taxpayer believed they were being sufficiently careful. Whether the taxpayer acted intentionally is not a consideration.[4]

The test involves taking sufficient steps to determine the correctness of a tax position

13. Taking reasonable care includes taking sufficient steps to determine the correctness of a tax position, keeping adequate tax records and generally making a reasonable attempt to comply with the tax laws.[5]

14. The care expected of taxpayers generally is set out in s 15B:[6]

> **15B Taxpayer's tax obligations**
>
> A taxpayer must do the following:
>
> (aa) if required under a tax law, make an assessment:
>
> (a) unless the taxpayer is a non-filing taxpayer, correctly determine the amount of tax payable by the taxpayer under the tax laws:
>
> (b) deduct or withhold the correct amounts of tax from payments or receipts of the taxpayer when required to do so by the tax laws:
>
> (c) pay tax on time:
>
> (d) keep all necessary information (including books and records) and maintain all necessary accounts or balances required under the tax laws:
>
> (e) disclose to the Commissioner in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose:
>
> (f) to the extent required by the Inland Revenue Acts, co-operate with the Commissioner in a way that assists the exercise of the Commissioner's powers under the tax laws:
>
> (g) comply with all the other obligations imposed on the taxpayer by the tax laws.

2 Section 141A(2B) and (3).

3 *Hong v CIR* [2018] NZHC 2,539, (2018) 28 NZTC 23-073, upheld on appeal in *Hong v CIR* [2019] NZCA 336, (2019) 29 NZTC 24-015; *Case W4* (2003) 21 NZTC 11,034; *Case Y21* (2008) 23 NZTC 13,227.

4 *Case W3* (2003) 21 NZTC 11,014 at [113]; *Case W4* at [60]; *Case Y21* at [74]; *TRA 010/18* [2019] NZTRA 6, (2019) 29 NZTC 5,005 at [66].

5 *Hong v CIR* (HC); s 15B. See also *Case W3* at [113]; *Case W4* at [60]; *Case Y21* at [74], *TRA 03/11* [2013] NZTRA 03, (2013) 26 NZTC 2,002 at [38] (upheld on appeal in *Brown v CIR* [2014] NZHC 1,599, (2014) 26 NZTC 21-089); *TRA 007/15* [2016] NZTRA 09, (2016) 27 NZTC 3-031 at [45]–[46].

6 *Hong v CIR* (HC) at [24]. See also *Chapman v CIR* (2002) 20 NZTC 17,950 at [40].

The size and materiality of the tax shortfall will be considered

15. When deciding whether a reasonable person in the particular circumstances would have seen the risk of a tax shortfall, the Commissioner will consider:

    - the size of the tax shortfall compared with the taxpayer's total tax liability;
    - the size of the error compared with the amount of the taxpayer's assessable income, if the tax shortfall relates to incorrect assessable income; and
    - the size of the error compared with the amount of the taxpayer's deductions if the tax shortfall relates to incorrect deductions.

16. In *Case W4*, Judge Barber said:

> [61] … Materiality must be implicit in the standard of reasonable care so that consideration will be given not only to the nature of the shortfall, but also to its size in relation to the taxpayer. …

17. The more substantial the tax shortfall is relative to the taxpayer's tax liability, or the more substantial the error is compared with the taxpayer's assessable income or deductions, the more likely it may be that a reasonable person would have seen the risk and taken appropriate action.

18. For example, omitting to return $10,000 income is substantial when compared with a total assessable income of $60,000. The relatively large size of the error suggests a reasonable person would have realised $50,000 assessable income was too low and would result in a tax shortfall, and that they should double-check the amount.

19. On the other hand, omitting to return $10,000 income is not substantial when compared with a total taxable income of $50 million. The relatively small size of the error would not necessarily suggest a reasonable person would have realised $50 million assessable income was too low and would result in a tax shortfall, and that they should double-check the amount.

20. The number of transactions giving rise to the income or deductions may also be relevant. For example, it may be easier to review and check a smaller number of transactions than a large volume. This is, however, subject to the expectation that to take reasonable care with a large volume of transactions, or with a smaller volume of transactions that involve large amounts, the taxpayer would be expected to have suitable systems in place to deal with these transactions.

The level of care may vary depending on the circumstances

21. A taxpayer must make the effort that a reasonable person would make in the circumstances.[7] The actions a reasonable person would have taken to prevent a tax shortfall may vary depending on the circumstances and factors such as:[8]

    - the complexity of the particular transaction and the tax law;
    - how difficult it would have been to prevent the tax shortfall;
    - for a business, the size and nature of the business and its internal controls and record-keeping practices;
    - the taxpayer's health; and
    - the taxpayer's knowledge and experience of business and tax matters.

22. In *Case W3*, Judge Barber listed the factors to consider:

> [113] In terms of the concept of not taking reasonable care, **I accept that the level of care may vary depending upon the type of tax involved and the size and nature of the business under scrutiny. One needs to consider the complexity of the law, the particular transaction, the gravity of the consequence of size of the risk regarding the shortfall, and the difficulty and expense of taking appropriate precautions and, for a business, the size and nature of it and its internal controls and record keeping practices. There may be varying degrees of care required depending on the particular circumstances**. An expert in a particular field is not required to exercise a greater degree of care than an ordinary person unless holding himself (or herself) out to be such. *Stokes v Guest, Keen & Nettlefold (Bolts & Nuts) Ltd* [1968] 1 WLR 1776. An inexperienced person must exercise the care of an ordinary person *Nettleship v Weston* [1971] 2 QB 691 at p 699 per Lord Denning. **It is not whether a person tried to exercise reasonable care but rather whether he or she has in fact done so** *Bailey v Taylor* [1936] NZLR 806 (SC). The burden of proof is always on the taxpayer. [Emphasis added]

7 *Case W4* at [61].

8 *Case W3*; *Case W4*; *Case Y21*; *Brown v CIR*; *TRA 010/18*.

23. In *Case Y21*, Judge Barber stated there must be some tolerance of a person suffering ill health at material times:

> [80] I agree with the contention for the Commissioner that the disputant has not acted as a reasonable person would have in the same circumstances. **I consider there needs to be quite some tolerance of a person suffering continued ill health at material times** as the disputant did, but the disputant's lack of records is reprehensible. The shortfall penalty for lack of reasonable care must be applied pursuant to s 141A of the Act (as distinct for gross carelessness pursuant to s 141C). [Emphasis added]

24. The level of care required is that appropriate for a reasonable person in the same category of taxpayer, rather than that of the individual taxpayer concerned. In *Case W4*, Judge Barber said:

> [61] **The effort required of the taxpayer is commensurate with the reasonable person in the taxpayer's circumstances. What must be expected is the achievement of a standard appropriate to the category of taxpayer, rather than that of the individual taxpayer concerned. …** This means there may be varying degrees of care required depending on the particular circumstances. [Emphasis added]

25. An expert in a particular field is not required to exercise a greater degree of care than an ordinary person unless holding themselves out as an expert in that field. In *Case W3* Judge Barber said:[9]

> [113] … There may be varying degrees of care required depending on the particular circumstances. An expert in a particular field is not required to exercise a greater degree of care than an ordinary person unless holding himself (or herself) out to be such. *Stokes v Guest, Keen & Nettlefold (Bolts & Nuts) Ltd* [1968] 1 WLR 1776. An inexperienced person must exercise the care of an ordinary person *Nettleship v Weston* [1971] 2 QB 691 at p 699 per Lord Denning. … [Emphasis added]

26. One of the issues in *Case W3* was whether a chartered accountant in private practice preparing tax returns for clients and accounting for GST had taken reasonable care in taking a tax position in their own GST returns. Judge Barber held the taxpayer had not taken reasonable care taking into account that they were an experienced chartered accountant and more could be expected of their accounting and record keeping practices than of some other individual.[10]

27. Similarly, in *Brown v CIR*, a chartered accountant who prepared and reviewed tax returns for clients was held to a higher standard of care when attending to their own tax matters than a person with ordinary skill. McKenzie J said he agreed with the Taxation Review Authority that the taxpayer could be expected to have a high level of knowledge and experience regarding business transactions and the tax legislation.[11] As an accountant, the taxpayer was in a position to research relevant tax law and take advice. McKenzie J said:[12]

> [11] The Authority held that a shortfall penalty was payable because the taxpayer did not take reasonable care in taking the tax position which he did when claiming a deduction for the amounts paid to the bank. On this, the Judge said:
>
> > **The disputant is a partner in a firm of chartered accountants and is a member of the New Zealand Institute of Chartered Accountants. As an accountant, he was involved at relevant times in preparing and/or reviewing financial accounts and income tax returns for clients. In doing this work the disputant is obliged to maintain competency standards and otherwise comply with appropriate technical and professional standards. In his evidence before the Authority the disputant stated that he gave tax advice to clients.** The firm's website also refers to his areas of expertise as including: "tax minimisation, succession planning and restructuring businesses". As well, the disputant was a businessman with extensive farming interests. **I agree with the Commissioner's submission that the disputant could be expected to have had a high level of knowledge and experience regarding business transactions and the tax legislation relating to interest deductibility.** The disputant says that if he was wrong to make the deductions then that error arose from an error of law where he had a reasonable argument supporting his stance.
> >
> > The disputant did not produce any evidence as to the steps which he took to ascertain the correct tax position. **As an accountant, he was in a position to research the law on interest deductibility and to take advice (including legal advice as to the operation of the various guarantees in place).** Taking the above matters into account I accept the Commissioner's contention that the disputant has not acted as a reasonable person would have in the same circumstances.
>
> [12] I agree entirely with the Judge. Her conclusions on the imposition of a shortfall penalty were correct, for the reasons she gave. There is nothing that I need to add. [Emphasis added]

28. In summary, a taxpayer is required to exercise the level of care expected of a reasonable person in the same category of taxpayer and circumstances as the taxpayer.

9 See also *Case W4* at [62] and *Case Y21* at [74].

10 *Case W3* at [112].

11 *X (Chartered Accountant) v CIR* [2013] NZTRA 03, *Case 3/2013* (2013) 26 NZTC ¶2-002. The Taxation Review Authority became the Taxation and Charities Review Authority on 5 July 2024 (see s 4 of the Charities Amendment Act 2023).

12 Footnotes omitted.

Other factors indicating a lack of reasonable care

29. Other factors indicating a lack of reasonable care include:

    - repeated errors where the taxpayer has been advised or is otherwise aware that they have previously made mistakes but takes no action; and
    - systems failures where the risks were foreseeable, but the taxpayer had not established adequate safeguards and monitoring to address them.[13]

30. For a business taxpayer, Inland Revenue will take into account the taxpayer's tax governance practices (that is, their tax policies, procedures and controls) when considering whether the taxpayer has taken reasonable care.[14]

Following Inland Revenue advice

31. A taxpayer who asks for, and follows, Inland Revenue advice after disclosing full and correct facts takes reasonable care. As a taxpayer has the onus of proving they have taken reasonable care, they should document any oral advice from Inland Revenue, showing details of when and from whom they sought the advice, and retain any written advice from Inland Revenue.

Delegation

32. Where a taxpayer delegates matters relating to taking a tax position to an officer or employee, the taxpayer is liable if the officer or employee does not take reasonable care.[15] Whether the taxpayer has exercised reasonable care in making the delegation may also be considered. For example, where an employer delegates responsibility to an employee who a reasonable person in the circumstances would have known or suspected was inexperienced or inadequately supervised or trained, the employer may not have taken reasonable care.

A taxpayer relying on the actions or advice of a tax advisor

33. Generally, a taxpayer who relies on an action or advice of their tax advisor in taking a tax position takes reasonable care. Exceptions to this are where the taxpayer:

    - is the employer of the tax advisor;
    - does not adequately inform or instruct the tax advisor about their tax position;
    - has reason to believe that the action or advice is incorrect; or
    - has, in the previous 4 years, had a tax shortfall for the same error or action and has failed to take reasonable care to stop it happening again.

34. If any of the exceptions apply, the taxpayer may be liable to a shortfall penalty for not taking reasonable care despite relying on the action or advice of their tax advisor.

13 *Case W4* at [64].

14 Click on this link to the Inland Revenue website for more information on tax governance and what Inland Revenue looks for in a tax control framework: How to get tax governance right in New Zealand

15 *Canadian Pacific Railway Co v Lockhart* [1942] 2 All ER 464 (PC) at 467; *Union Steam Ship Company of New Zealand v Colville* [1960] NZLR 100 (CA); *Various Claimants v WM Morrison Supermarkets plc* [2020] UKSC 12. See also S Todd, *Todd on Torts* (9th ed, Thomson Reuters, Wellington, 2023), ch 21.

35. Section 141A(2B) provides:

> (2B) A taxpayer who, in taking a tax position, relies on an action or advice of a tax advisor engaged by the taxpayer, or by a company in the same group of companies as the taxpayer, takes reasonable care in relying on the action or advice except if the taxpayer—
>
> (a) is the employer of the tax advisor:
>
> (b) does not provide to the tax advisor adequate information relating to the tax position:
>
> (c) does not provide to the tax advisor adequate instructions relating to the tax position:
>
> (d) has reason to believe that the action or advice is incorrect:
>
> (e) has previously, for a period ending less than 4 years before the beginning of the period to which the tax position relates, had a tax shortfall for the same type of tax arising from a corresponding tax position and does not take reasonable care to avoid the further tax shortfall.

36. A "tax advisor" is a natural person who is subject to the code of conduct and disciplinary procedures of a group of advisors that has a significant function of giving tax advice and is approved by the Commissioner, such as Chartered Accountants Australia and New Zealand.[16] Section 20B provides:

> ...
>
> (4) A tax advisor is a natural person who is subject to the code of conduct and disciplinary process, referred to in subsection (5)(a)(ii) and (iii), of an approved advisor group.
>
> (5) An approved advisor group is a group that—
>
> (a) includes natural persons who—
>
> (i) have a significant function of giving advice on the operation and effect of tax laws; and
>
> (ii) are subject to a professional code of conduct in giving the advice; and
>
> (iii) are subject to a disciplinary process that enforces compliance with the code of conduct; and
>
> (b) is approved by the Commissioner for the purposes of this definition.

37. To have taken reasonable care, a taxpayer does not necessarily have to have relied on the action or advice of a "tax advisor".[17] Taxpayers who rely on a "tax agent" or bookkeeper who is not a "tax advisor" may have taken reasonable care.[18] This may be the case where the tax agent or bookkeeper is someone a reasonable person would regard as reputable, the taxpayer engages and pays the tax agent or bookkeeper for their services, adequately informs them, and has no reason to believe their actions or advice are incorrect.

38. Also, other steps a taxpayer takes to understand their tax obligations will be enough if those steps are what a reasonable person would do given the complexity and exceptionality of the tax position. For example, generally a taxpayer with relatively simple tax affairs, such as a salary and wage earner, would reasonably be expected to consider relevant tax guides and other information freely available on Inland Revenue's website (**www.ird.govt.nz**) and to seek clarification if necessary.

39. What constitutes reasonable care for a taxpayer using artificial intelligence in taking a tax position depends on how the technology is used and applied. For example, when faced with a complex tax question, it would not be taking reasonable care to use a single prompt to a general-purpose artificial intelligence system and rely solely on its response. Taking reasonable care when using artificial intelligence involves the use of accurate facts, checking sources are verified and trusted (such as legislation, case law, and Inland Revenue rulings and other guidance), and reviewing outputs for accuracy and applicability in the circumstances.

16 The list of advisor groups approved by the Commissioner is published on the Inland Revenue website: approved advisor groups.

17 *Hong v CIR* (CA).

18 A "tax agent" is a person who prepares income tax returns for 10 or more persons and carries on a professional public practice or business, is carrying on a business, occupation, or employment in which returns of income are prepared and filed, and/or is the Māori Trustee (s 124C). The person may apply to be listed with the Commissioner as a "tax agent".

A taxpayer who takes an acceptable tax position takes reasonable care

40. A taxpayer who takes an "acceptable tax position" takes reasonable care. Section 141A(3) provides:

> (3) A taxpayer who takes an acceptable tax position is also a taxpayer who has taken reasonable care in taking the taxpayer's tax position.

41. An "acceptable tax position" is defined in s 3(1) as a tax position that is not an "unacceptable tax position". The meaning of "unacceptable tax position" is explained in **IS 26/05: Shortfall penalty for taking an unacceptable tax position**. In summary, an "unacceptable tax position" is one that, viewed objectively, fails to meet the standard of being "about as likely as not to be correct".[19] Whether the taxpayer believes their tax position was correct or acceptable is irrelevant. A taxpayer's tax position will meet the "about as likely as not to be correct" standard if:[20]

- even though wrong, it can be argued on rational grounds to be right;
- it is one on which "reasonable minds could differ". There must be room for a real and rational difference of opinion;
- it has about an equal chance of being correct.

Mistakes in the calculating or recording of numbers

42. A taxpayer does not take an "unacceptable tax position" by making a mistake in calculating or recording numbers used in, or for use in preparing, a return.[21] However, s 141A(3) is subject to the qualification that a taxpayer who makes such a mistake is not excluded from being liable for a penalty for not taking reasonable care. Section 141A(4) provides:

> (4) Subsection (3) and section 141B(1B) do not exclude a taxpayer who makes a mistake in the calculation or recording of numbers in a return from being liable for a penalty for not taking reasonable care.

43. Accordingly, even though a taxpayer who makes a mistake in calculating or recording numbers in a return does not take an "unacceptable tax position", they may still be liable for a shortfall penalty for not taking reasonable care.

Examples

44. Example | Tauira 1 and Example | Tauira 2 illustrate the kind of mistakes for which a taxpayer may be liable for a penalty for not taking reasonable care. Example | Tauira 3 illustrates the kind of circumstance where a taxpayer who relied on the advice of its tax advisor may be treated as having taken reasonable care. Example | Tauira 4 and Example | Tauira 5 illustrate the kind of circumstance where a taxpayer who relied on the advice of their tax advisor may not be treated as having taken reasonable care.

Example | Tauira 1 – Repeated transposition error made by staff member

A staff member of a business makes a transposition error when entering an amount into the business' accounting software. The error is carried through into the business' GST return and there is a $10,000 tax shortfall. The owner of the business is aware that the same staff member has made similar transposition errors before. However, the owner has not taken any steps to reduce the risk of transposition errors. They have not arranged any supervision of, or training for, the employee. They did not check the GST return before it was filed.

In the circumstances, a reasonable business owner would have foreseen a risk and put simple checks in place to reduce the risk of transposition errors. The business owner did not do so. The business owner has not taken reasonable care.

19 Section 141B; *TRA 010/18* at [61].

20 *Ben Nevis Forestry Ventures Ltd & Ors v CIR; Accent Management Ltd & Ors v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188 at [184] and [185]; *TRA 010/18* at [62].

21 Section 141B(1B).

Example | Tauira 2 – Taxpayer did not take reasonable care

The taxpayer is an experienced tax accountant in private practice preparing financial statements and tax returns for clients.

When the taxpayer's own tax affairs were audited, Inland Revenue found the taxpayer's records in disarray. After further investigation, it was established the taxpayer had overlooked returning some income for the tax year under audit. The taxpayer was also unable to provide supporting information to show they were entitled to some of the expenses claimed as deductions. There was a tax shortfall.

A reasonable person with the same skill and experience as the taxpayer (a practising tax accountant) would have appropriate accounting and record-keeping systems in place. They would have seen the risk of a tax shortfall if their records were in disarray and kept them in good order. Good accounting and record-keeping practices are not onerous, especially for a reasonable person of the taxpayer's skill and experience. The taxpayer has not taken reasonable care.

Example | Tauira 3 – Company relying on the advice of a tax advisor took reasonable care

A GST-registered company claimed an input tax deduction for a significant, one-off expense. The input tax deduction was not justified, the tax position taken when the company filed its GST return was incorrect and there was a tax shortfall.

Prior to filing the GST return, the company had sought and received advice from its accountant that an input tax deduction was available for the expense. The company's accountant was an experienced tax accountant and a member of an approved advisor group. The company had fully informed and instructed the accountant about the nature of the expense, had no reason to believe the accountant's advice was incorrect, and had not previously had a tax shortfall for GST.

The company has taken reasonable care. It relied on the advice of its tax advisor and none of the exceptions in s 141A(2B) applies.

Example | Tauira 4 – Taxpayer provided insufficient information to tax advisor

A taxpayer decides to change banks. It opens a business account with a new bank and receives sales income into the account from the first day of a new income year. For the first two months of the income year the taxpayer also receives some sales income into the business account at their old bank before the account is closed.

The taxpayer uses a tax advisor to prepare their income tax return. At the end of the income year, the tax advisor asks the taxpayer for their bank statements. The taxpayer delegates the task of collating and providing their bank statements to a new employee. The new employee sends the tax advisor the bank statements for the taxpayer's account with the new bank but does not include statements for the taxpayer's account with their old bank. The tax advisor prepares the taxpayer's income tax return omitting the two months of sales income received into the taxpayer's account with their old bank. Before filing the income tax return, the tax advisor sends a copy to the taxpayer to check. The taxpayer approves the return without checking it, assuming it is correct. The return is filed and there is a tax shortfall.

The taxpayer has not taken reasonable care. A reasonable person in the taxpayer's position would have checked the information the inexperienced employee collated and provided to the tax advisor, and checked the income tax return prepared by the tax advisor before it was filed. Although the taxpayer has used a tax advisor to prepare their income tax return, the taxpayer did not provide the tax advisor with adequate information. Accordingly, s 141A(2B) will not apply to treat the taxpayer as having taken reasonable care.

Example | Tauira 5 – Company did not take reasonable care

A company carries on a business buying and selling land. It engages in numerous sizeable land transactions and has an average annual turnover of $10 million. The company's directors are experienced in carrying on the company's business. The company used a tax advisor to prepare its financial statements and income tax returns.

One of the directors purchased some land as nominee for the company. The company reimbursed the director for the $1,450,000 purchase price of the land.

The following income year, the director sold the land on behalf of the company. The $1,575,000 sale proceeds were initially received into the director's bank account and the company overlooked returning them as income.

The company had no systems in place to ensure all property sales and purchases were recorded. In addition, it had no process for reconciling property purchases with property sold or held to ensure income was returned for tax purposes as required.

The company did not advise its tax advisor that the property had been sold, nor did it check that the sale was shown in the financial statements and income tax return the tax advisor prepared for the year of sale.

The property was one of five the company sold in the relevant income year. The company's total tax liability for the year was $140,000.

The company took a tax position when its income tax return was filed and there was a $35,000 tax shortfall.

A reasonable person in the circumstances (of being involved in numerous sizeable land transactions) would:

- understand how tax laws applied to their property transactions, including the nominee arrangement, and that the $1,575,000 sale proceeds were assessable income of the company;
- have systems in place to ensure all property sales and purchases were recorded with a process for reconciling property purchases with property sold or held, with the result that income would be returned as required;
- have seen a tax shortfall as likely if the sale proceeds were not returned as income – given the mismatch with the deduction for the cost of the property taken in the prior income year, the size of the tax shortfall when compared with the company's total tax liability, and the number of property transactions for the relevant year; and
- have advised their tax advisor the property had been sold and checked the financial statements and income tax return prepared by their tax advisor to ensure they included the sale.

The company has not done what a reasonable person would have done in the circumstances.

Although it used a tax advisor to prepare its income tax returns, the company did not inform its tax advisor of the sale transaction.[22]

The tax position the company took when its tax return excluded the sale proceeds was not an "acceptable tax position".[23] It was not "about as likely as not to be correct". That the sale proceeds were income that should have been returned for tax purposes was not something on which reasonable minds could differ.

The company has not taken reasonable care. The taxpayer may also have been grossly careless, in which case a shortfall penalty for gross carelessness may apply.[24] In that case, the higher penalty, a shortfall penalty for gross carelessness, would be imposed.[25]

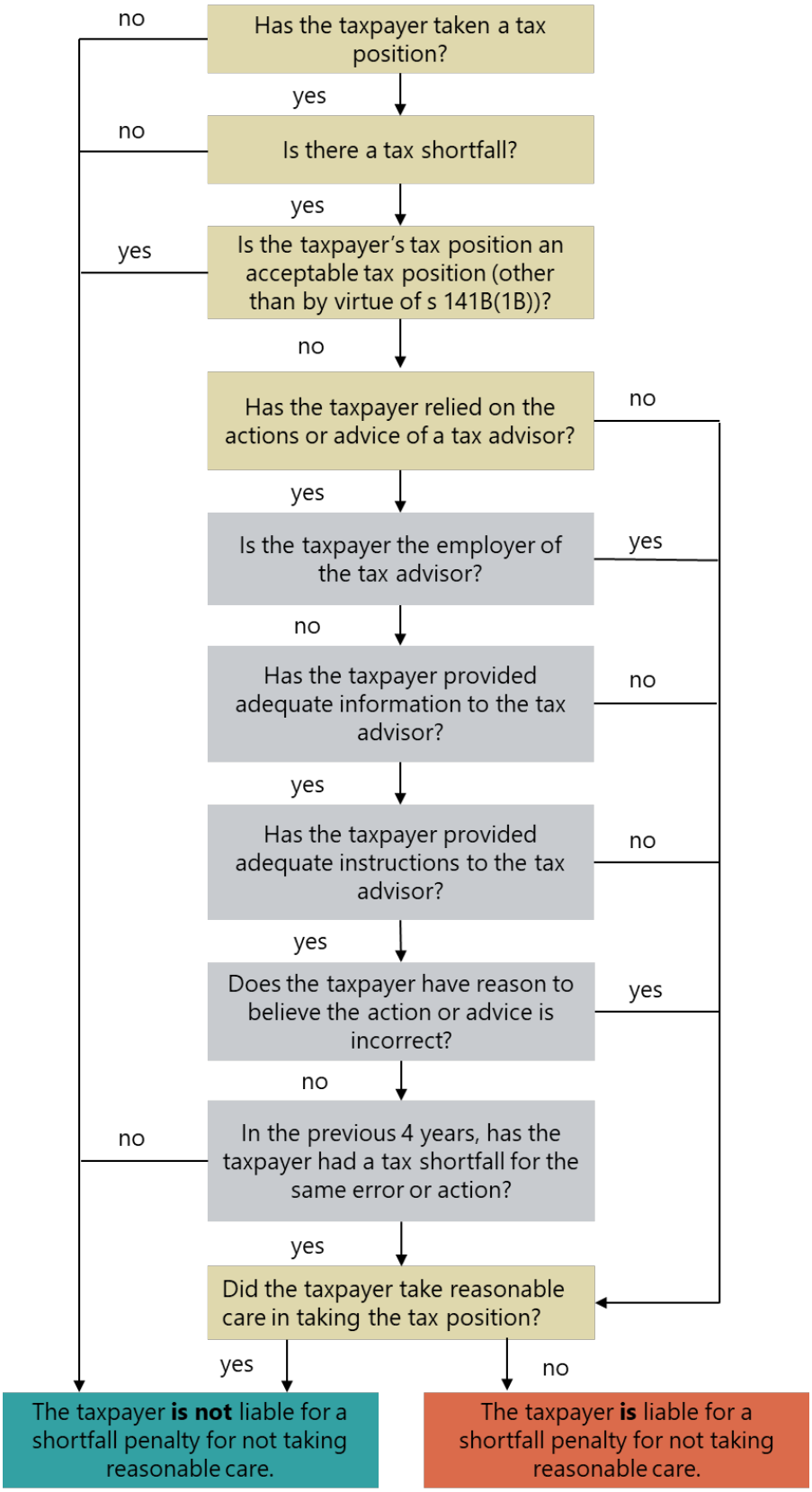
22 Section 141A(2B); see [33]–[37].

23 As noted in [40] and [41], a taxpayer who takes an "acceptable tax position" takes reasonable care.

24 See IS 26/06: Shortfall penalty for gross carelessness.

25 See IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

Figure 1 | Hoahoa 1: Flowchart of how s 141A applies



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IS 26/05: Shortfall penalty for taking an unacceptable tax position

Issued | Tukuna: 27 March 2026

This interpretation statement explains the meaning of "unacceptable tax position" in relation to the shortfall penalty for taking an unacceptable tax position in s 141B of the Tax Administration Act 1994.

All legislative references are to the Tax Administration Act 1994.

REPLACES | WHAKAKAPIA

- **IS0055**: Shortfall penalty – Unacceptable interpretation and unacceptable tax position (April 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)

Key terms | Kīanga tau tāpua

Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for that period.
Taxpayer's total tax figure	The amount shown in the taxpayer's tax return as tax paid or payable (before any group offset election or subvention payment), a net loss (treated as having a positive value multiplied by the basic rate of income tax for companies) or a refund.
Commissioner's official opinion	An opinion about the taxpayer's own tax affairs, given by the Commissioner after the taxpayer has provided all relevant and correct information, or a finalised official statement issued by the Commissioner that specifically applies to that taxpayer's situation. It does not include a private binding ruling.

Introduction | Whakataki

1. Section 141B imposes a shortfall penalty for taking an unacceptable tax position where:
   - the taxpayer has taken a tax position;[1]
   - **the tax position relates to income tax** (excluding withholding-type taxes such as PAYE, FBT, and RWT) and, beginning 1 January 2027, multinational top-up tax;[2]
   - a tax shortfall arises from the tax position and **the tax shortfall is more than both**:[3]
     - **$50,000, and**
     - **1% of the taxpayer's total tax figure for the relevant return period**; and
   - the tax position is an "unacceptable tax position".
2. The penalty is 20% of the tax shortfall. The amount of the penalty may be capped at $50,000 if certain requirements are met.[4]

1 See IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

2 Section 141B(2) and s 154 of the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024. See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

3 Section 141B(2). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall" for how to calculate 1% of the taxpayer's total tax figure for relevant return period.

4 Section 141JAA. See IS 26/09: Shortfall penalties – reductions and other matters.

3. Notably, **an unacceptable tax position penalty will only apply where the taxpayer's tax position relates to income tax** (excluding withholding-type taxes such as PAYE, FBT, and RWT) and, beginning 1 January 2027, multinational top-up tax**.** The penalty does not apply to tax positions relating to GST.

4. **In addition, for the penalty to apply, the resulting tax shortfall must exceed both $50,000 and 1% of the taxpayer's total tax figure for the relevant return period**.[5] The taxpayer's total tax figure is the amount shown in the taxpayer's tax return (as filed by the taxpayer) as tax paid or payable, a net loss or a refund.[6] Where a taxpayer has paid tax or has tax to pay, the amount is the tax paid or payable before any group offset election or subvention payment. [7] Where a taxpayer has no tax to pay, the amount is equal to the net loss of the taxpayer, treated as having a positive value multiplied by the basic rate of income tax for companies.[8] For the purpose of determining whether a tax shortfall exceeds the threshold amounts:[9]

    - a tax return provided by a partnership, look-through company or group of persons is treated as if it were a tax return of every partner in the partnership, effective look-through interest holder for the look-through company, or person in such group; and
    - the tax rate applying to a partnership or look-through company is the same as the basic rate for income tax for companies.[10]

5. Where there is more than one tax shortfall in a return period, the threshold amounts in s 141B(2) are applied to each tax shortfall. This is except for tax shortfalls arising from similar or identical tax positions that are aggregated and deemed to be 1 tax shortfall.[11]

6. Example 4 shows how to calculate 1% of the taxpayer's total tax figure for the relevant period.

7. **IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall"** explains the requirements for a "tax position" and a "tax shortfall".

8. This interpretation statement explains the meaning of "unacceptable tax position" in s 141B.

9. **IS 26/09: Shortfall penalties – reductions and other matters** explains other matters relevant to the penalty, including the cap of $50,000 on the amount of the penalty if certain requirements are met, when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.

10. The flowchart at Figure 1 | Hoahoa 1 shows how s 141B applies.

Summary | Whakarāpopoto

11. In summary, this interpretation statement explains the following matters:

    - An "unacceptable tax position" is a tax position that is **not** "about as likely as not to be correct".
    - A tax position will be "about as likely as not to be correct" if:
        - even though wrong, it can be argued on rational grounds to be right;
        - it is one on which "reasonable minds could differ". There must be room for a real and rational difference of opinion;
        - it has about an equal chance of being correct.
    - Whether a tax position is "about as likely as not to be correct" is decided objectively. Whether the taxpayer believes that their tax position was correct is irrelevant to this decision.

5 Section 141B(2).

6 Section 141B(3).

7 Section 141B(3)(a).

8 Section 141B(3)(b). On and after 1 January 2027, s 141B(3)(b) will not apply to multinational top-up tax (Taxation (Annual Rates for 2023-2024, Multinational Tax, and Remedial Matters) Act 2024). This is because, when multinational top-up tax applies, there will always be tax to pay.

9 Section 141B(8).

10 Section 141B(8). This is except in the case of a multinational top-up tax (Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Act 2024).

11 Section 141(10).

- A taxpayer's tax position must be "about as likely as not to be correct" when the taxpayer takes that position, based on the law at that time.
- The focus is on the legal soundness of the tax position. However, where factual issues turn on questions of evaluation, whether a taxpayer's view of the facts is "about as likely as not to be correct" may be considered in making the decision.
- It is possible for a taxpayer to take an unacceptable tax position even though they have followed the advice of a tax advisor.
- A taxpayer does not take an unacceptable tax position merely by making a mistake in calculating or recording numbers used in, or for use in preparing, a return.
- A taxpayer does not take an unacceptable tax position to the extent they have relied on an official opinion that the Commissioner gives.
- Generally, a taxpayer does not take an unacceptable tax position merely by using the accounting income method (**AIM**) to calculate their provisional tax and an approved AIM provider's AIM-capable accounting system.

Legislation

12. Section 141B provides:

> **141B Unacceptable tax position**
>
> (1) A taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct.
>
> (1B) A taxpayer does not take an unacceptable tax position merely by making a mistake in the calculation or recording of numbers used in, or for use in preparing, a return.
>
> (1C) A taxpayer does not take an unacceptable tax position if—
>
> (a) the taxpayer adopts IFRSs for the purposes of financial reporting before the 2007–08 income year; and
>
> (b) the taxpayer's tax position relates to a period—
>
> (i) starting on and including the first day of the first income year for which a person adopts IFRSs for the purposes of financial reporting; and
>
> (ii) finishing on and including the last day of the 2006–07 income year; and
>
> (c) a tax shortfall for a return period in the period described in paragraph (b) arises from actual or potential accounting under IFRSs; and
>
> (d) the tax shortfall is due to an application of IFRSs which, if viewed objectively, passes the standard of being about as likely as not to represent acceptable accounting practice under IFRSs; and
>
> (e) the taxpayer has fully disclosed the IFRS-related tax position.
>
> (1D) A taxpayer does not take an unacceptable tax position to the extent to which they have taken their position because they have relied on a Commissioner's official opinion.
>
> (1E) A taxpayer does not take an unacceptable tax position merely by using the AIM method and an approved AIM provider's AIM-capable accounting system.
>
> (1F) Subsection (1E) does not apply for a taxpayer that—
>
> (a) is approved under section 124ZE:
>
> (b) uses a large business AIM-capable system.
>
> (2) A taxpayer is liable to pay a shortfall penalty if the taxpayer takes an unacceptable tax position in relation to income tax as defined in section YA 1 of the Income Tax Act 2007, but ignoring the effect of section RA 2 of that Act, and the tax shortfall arising from the taxpayer's tax position is more than both—
>
> (a) $50,000:
>
> (b) 1% of the taxpayer's total tax figure for the relevant return period.

(3) For the purposes of this section, a taxpayer's total tax figure is—

(a) the amount of tax paid or payable by the taxpayer in respect of the return period for which the taxpayer takes the taxpayer's tax position before, in the case of income tax, any group offset election or subvention payment; or

(b) where the taxpayer has no tax to pay in respect of the return period, an amount equal to the product of—

(i) the net loss of the taxpayer in respect of the return period, ascertained in accordance with the provisions of the Income Tax Act 2007 and treated as having a positive value; and

(ii) the basic rate of income tax for companies in the relevant return period,—

that is shown as tax paid or payable, or as net losses of the taxpayer, or as a refund to which the taxpayer is entitled, in a tax return provided by the taxpayer for the return period.

(4) Where subsection (2) applies, the shortfall penalty payable is 20% of the resulting tax shortfall.

(5) For the purposes of this section, the question whether any tax position is acceptable or unacceptable shall be determined as at the time at which the taxpayer takes the taxpayer's tax position.

(6) The time at which a taxpayer takes a tax position for a return period is—

(a) the time at which the taxpayer provides the return containing the taxpayer's tax position, if the taxpayer provides a tax return for the return period:

(b) the due date for providing the tax return for the return period, if the taxpayer does not provide a tax return for the return period.

(7) The matters that must be considered in determining whether the taxpayer has taken an unacceptable tax position include—

(a) the actual or potential application to the tax position of all the tax laws that are relevant (including specific or general anti-avoidance provisions); and

(b) decisions of a court or a Taxation Review Authority on the interpretation of tax laws that are relevant (unless the decision was issued up to 1 month before the taxpayer takes the taxpayer's tax position).

(8) For the purpose of determining whether the resulting tax shortfall is in excess of the amounts specified in subsection (2),—

(a) a tax return provided by—

(i) a partnership; or

(ib) a look-through company; or

(ii) any other group of persons that derive or incur amounts jointly or that are assessed together,—

(b) is to be treated as if it were a tax return of every taxpayer who is a partner in the partnership, effective look-through interest holder for the look-through company, or person in such group; and

the tax rate in a return period applying to a partnership or a look-through company is deemed to be the same as the basic rate of income tax for companies for the relevant period.

(9) The amounts or the percentage specified in subsection (2) may be varied from time to time by the Governor-General by Order in Council.

(10) An order under subsection (9) is secondary legislation (see Part 3 of the Legislation Act 2019 for publication requirements).

Analysis | Tātari

What an unacceptable tax position is

13. An "unacceptable tax position" is a tax position which is **not** "about as likely as not to be correct".[12] Meaning of "about as likely as not to be correct"

14. To satisfy the standard of "about as likely as not to be correct", the likelihood of an interpretation being correct needs to be about equal to the likelihood of it being incorrect. In *Case U47*, Judge Barber stated the use of the word "about" allowed for the standard to be met if the interpretation was close to or around 50% likely to be correct. Judge Barber stated:[13]

> [37] … No statutory guidance is given as to how the phrase "about as likely as not to be correct" is to be interpreted but, the words "as likely as not" indicate an even balance of 50/50. **There would need to be an about equal chance of an interpretation being likely to be correct as it is to be incorrect.** It follows that where one of two interpretations does not have about a 50% chance of being correct in the view of a Court, the taxpayer will have failed to meet the required standard under limb (b). … I agree with counsel that the word "about", which precedes the above phrase must be taken into account as it makes the test less stringent and provides some latitude in applying the test. I accept that **the use of the word "about"** in the phrase "about as likely as not to be correct" **allows for the standard to be met if the interpretation is close to or around 50% likely to be correct.** It follows that where a Court subsequently holds an interpretation to be incorrect, the test in s 141B may potentially be satisfied if it is close to being 50% correct. Perhaps that may be the case where a Court finds two possible interpretations attractive, but prefers one to the other. [Emphasis added]

15. In *Ben Nevis Forestry Ventures Ltd & Ors v CIR*, the majority of the Supreme Court referred with apparent approval to what Hill J stated in the Australian case *Walstern Pty Ltd v C of T* about a similar standard of "about as likely as not correct".[14] Hill J stated there must be room to argue for which position is correct so, on balance, the taxpayer's argument, while wrong, can be argued on rational grounds to be right. For the standard to apply, there must be room for a real and rational difference of opinion. The case must be one where reasonable minds could differ. Hill J stated:

> [108] …
>
> > 5. … The word "about" indicates the need for balancing the two arguments, with the consequence that there must be room for it to be argued which of the two positions is correct so that **on balance the taxpayer's argument can be said to be one that while wrong could be argued on rational grounds to be right**.
> >
> > …
> >
> > 7. … That is to say the two arguments, namely, that which is advanced by the taxpayer and that which reflects the correct view will be finely balanced. **The case must thus be one where reasonable minds could differ** as to which view, that of the taxpayer or that ultimately adopted by the Commissioner was correct. **There must, in other words, be room for a real and rational difference of opinion** between the two views such that while the taxpayer's view is ultimately seen to be wrong it is nevertheless "about" as likely to be correct as the correct view. A question of judgment is involved. [Emphasis added]

16. The majority of the Supreme Court in *Ben Nevis* considered that the standard did not require the taxpayer's tax position to have a 50% chance of success but that the merits of the taxpayer's arguments must be substantial. In *Frucor*, the majority of the Supreme Court agreed that a mathematical assessment was not required.[15] However, they did not regard a test of substantiality as particularly helpful. The majority of the Court stated:

> [100] In *Ben Nevis*, a majority in the Supreme Court commented on the s 141B test:
>
> > [184] On its terms this standard does not require that the appellants' tax position had a 50 per cent prospect of success but, subject to that qualification, the merits of the arguments supporting the taxpayer's interpretation must be substantial. The stipulation of an objective test means that the taxpayer's belief that the position taken was correct, or not unacceptable, is irrelevant.
>
> This passage has sometimes been construed as substituting for the statutory language a test of substantiality.

12 Section 141B(1). As noted, for an unacceptable tax position shortfall penalty to apply, the tax position must relate to income tax (excluding withholding-type taxes such as PAYE, FBT, and RWT) and, beginning 1 January 2027, multinational top-up tax (see [1] and [2]).

13 *Case U47* (2000) 19 NZTC 9,410.

14 *Ben Nevis Forestry Ventures Ltd & Ors v CIR; Accent Management Ltd & Ors v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188 at [185]; *Walstern Pty Ltd v C of T* (2003) 138 FCR 1 (FCA). See also *Case X25* (2006) 22 NZTC 12,203, where Judge Willy approved of what Hill J stated in *Walstern*.

15 *Frucor Suntory New Zealand Ltd v CIR* [2022] NZSC 113, (2022) 30 NZTC 25-024.

> [101] We agree that a mathematical assessment is not appropriate but do not regard substituting "substantiality" for the statutory language as particularly helpful. "[A]bout as likely as not" is an ordinary, perhaps slightly colloquial, English expression with its own nuances of meaning—nuances not necessarily fully captured by the language of substantiality. Indeed, we doubt whether such a substitution was intended in the passage just cited. As we will indicate, when applying s 141B in *Ben Nevis*, this Court reverted to the statutory language. [Footnotes omitted]

17. Even if sophisticated and credibly advanced, to meet the standard, arguments relied on in support of a tax position must be "about as likely as not" to be accepted by a New Zealand court. In *Frucor*, the majority said:[16]

> [142] The second point by way of response is more general. We accept that the approaches to facts and law proposed by Glazebrook J are based on arguments that are sophisticated and are (and were) capable of being credibly advanced. This, however, is not controlling. This is because the result we arrive at in relation to penalties reflects our assessment that as at 2006 and 2007 when the returns were filed, such arguments nonetheless were not "about as likely as not" to be accepted by New Zealand courts.

18. The meaning of "about as likely as not to be correct" may be summarised as follows:

- Even though wrong, the taxpayer's tax position must be able to be argued on rational grounds to be right.[17]
- The taxpayer's tax position must be one on which "reasonable minds could differ". There must be room for a real and rational difference of opinion.[18]
- The taxpayer's tax position must have about an equal chance of being correct.

How to determine whether a tax position is "about as likely as not to be correct"

19. Whether a tax position is "about as likely as not to be correct" is decided objectively. Whether the taxpayer believes that their tax position was correct is irrelevant to this decision.[19]

20. A taxpayer's tax position must be "about as likely as not to be correct" at the time the taxpayer takes it, based on the law at that time.[20] In establishing whether a tax position meets this standard, it is necessary to consider tax laws, including anti-avoidance provisions, and court and Taxation and Charities Review Authority decisions issued up to 1 month before the taxpayer took the tax position.[21] A taxpayer's ignorance of the law is no excuse.[22]

21. In the absence of relevant case law, considered and published views such as commentary on the law, Inland Revenue rulings, expert opinions and legal articles may assist. Inland Revenue documents not intended for publication are irrelevant.[23]

22. Establishing whether a taxpayer's tax position meets the "about as likely as not to be correct" standard involves a judgment of the weight of the arguments supporting the taxpayer's tax position in applying the law to the relevant facts. In *Ben Nevis*, the majority of the Supreme Court stated:

> [185] … Whether a taxpayer's interpretation meets the standard in any case accordingly comes down to a judgment of the weight of the arguments that support the taxpayer's position in the application of the law to the relevant facts. The Act requires that the application of all tax laws, including the general anti-avoidance provision, be taken into account in making this judgment. As well, discussions of the courts and Taxation Review Authority on the interpretation of relevant tax laws must be considered. [Footnotes omitted]

16 See also [31] and [32].

17 *Walstern*; *Case X25*; *Ben Nevis*; *Frucor*.

18 *Walstern*; *Case X25*.

19 *Erris Promotions Ltd & Ors v CIR* (2003) 21 NZTC 18,330 (HC); *Ben Nevis*; *Alesco New Zealand Ltd v CIR* [2013] NZCA 40, (2013) 26 NZTC 21-003.

20 *Alesco* at [148]; see [31].

21 Section 141B(5) and (7). The Taxation Review Authority became the Taxation and Charities Review Authority on 5 July 2024 (see s 4 of the Charities Amendment Act 2023).

22 *Case U47*.

23 *Case U47*; *Walstern*; *Accent Management & Ors v CIR* (2005) 22 NZTC 19,027 (HC); *ASB Bank Ltd v CIR* [2014] NZHC 2184, (2014) 26 NZTC 21-098.

23. The focus is on the legal soundness of the tax position. However, where factual issues turn on questions of evaluation, whether a taxpayer's view of the facts is "about as likely as not to be correct" may be considered. In *Frucor*, the majority of the Supreme Court stated:

> [111] As we will explain later, we see the application of the "about as likely as not to be correct" standard in this case at least as requiring a focus on the legal soundness (or otherwise) of the tax positions adopted. **The starting point for our assessment must therefore be the facts as we have found them to be. If, on those facts, the tax positions adopted by DHNZ satisfy the standard of being "about as likely as not to be correct", there can be no liability to shortfall penalties. If they did not, then shortfall penalties will be applied**. [Emphasis added]

24. Examples of factual issues that may turn on questions of evaluation include the categorisation of a receipt as capital or revenue or assessments of economic substance and effect.[24] In *Frucor*, the majority of the Supreme Court said:

> [128] As we have foreshadowed, we propose in this case to apply the "about as likely as not to be correct" standard on the basis of the facts as we have found them to be. **We accept that in some cases, for instance, where the factual issues turn on questions of evaluation or assessment, there may be scope for taking into account a taxpayer argument along the lines that the view of the facts on which the tax position was premised was "about as likely as not to be correct". Conceivably this may sometimes be so in relation to assessments of economic substance and effect. A possible example of this is *Commissioner of Inland Revenue v John Curtis Developments Ltd* which turned on the categorisation of certain receipts as capital or revenue**. … [Emphasis added and footnotes omitted]

25. In *CIR v John Curtis*, the evaluation question was whether a receipt was revenue or capital in nature. Kós J disagreed with the taxpayer that a receipt was capital in nature and held it was taxable.[25] However, Kós J stated the taxpayer's argument was "plainly a stance which a reasonable mind might adopt" and decided not to impose a shortfall penalty for an unacceptable tax position.[26]

26. *Easy Park Ltd v CIR* is another case where a factual issue turned on a question of evaluation.[27] As in *John Curtis*, in *Easy Park* the evaluation question concerned whether a receipt was revenue or capital in nature. The High Court disagreed with the taxpayer's argument that the receipt was capital in nature, instead deciding it was revenue. Even so, Ellis J decided the taxpayer was not liable for a shortfall penalty for taking an unacceptable tax position.[28]

27. In deciding to impose no penalty, Ellis J said the fact she had ruled against the taxpayer on the evaluation question was not determinative. The factors Ellis J considered in reaching this decision included:
    - there was no authority "squarely against" the taxpayer's argument;
    - the evaluation question was "notoriously oblique" and, were it not for a recent clarifying amendment, it was conceivable circumstances could arise where such a receipt may have been regarded as capital; and
    - the taxpayer's argument was not irrational and was persuasively advanced.

28. Ellis J said:

> [94] … As the wording of s 141B makes clear, the lens through which an unacceptable tax position is assessed is objective rather than subjective. **The taxpayer's actual belief in its correctness is irrelevant. But so too is the fact that I have ruled against the Easy Park. That is not determinative of the question. If the taxpayer's argument "can objectively be said to be one that, while wrong, could be argued on rational grounds to be right", shortfall penalties will not be appropriate. But it must be a matter on which reasonable minds could differ.** As the Court of Appeal has noted, there is "some element of fuzziness in the underlying concept".
>
> [95] I find the present case a difficult one. As I have said, **there was no authority which tells squarely against the position taken by Easy Park**. Public Rulings are not binding on taxpayers and the very existence of a ruling arguably suggests that its subject matter may be difficult or controversial. Moreover BR PUB 09/06 expressly acknowledged that arguments similar to those advanced before me (based on dicta in *McKenzies*) had previously been raised. **The capital revenue divide is notoriously oblique and, as my discussion above indicates, were it not for the clarity wrought by the recent amendment to the ITA [Income Tax Act 2007], it is conceivable that circumstances could yet arise where a lease surrender payment might properly be regarded as an affair of capital in the hands of the lessor. Mr Harley's submissions were not irrational; they were persuasively advanced**. [Emphasis added and footnotes omitted]

24 *Frucor*.

25 *CIR v John Curtis Developments Ltd* (2014) 26 NZTC 21,113 (HC) at [107].

26 *John Curtis* at [107].

27 *Easy Park Ltd v CIR* (2017) 28 NZTC 23,024.

28 The Commissioner did not question Ellis J's decision on the penalty on appeal: *Easy Park Ltd v CIR* (2018) 28 NZTC 23,066 (CA).

29. In *Frucor*, the question was whether the taxpayer had suffered the economic burden of "interest incurred", a question critical to the application of the general anti-avoidance provision relevant in that case.[29] The majority stated an argument the taxpayer had suffered the economic burden would not be "about as likely as not to be correct". The majority stated it was plain the taxpayer did not suffer the economic burden of the "interest incurred" and was aware of that. The majority stated:

> [128] … In the present case, we consider that an argument that the economic burden contemplated by deductibility for "interest incurred" was met would not meet the "about as likely as not to be correct" standard. We say this because all those relevantly involved were well aware of the economic substance of the funding arrangement. Indeed, they went as far as to record that substance in the management accounts of DHNZ and DAP and in other contemporaneous documentation.

30. The majority concluded the taxpayer's tax position was unacceptable. This conclusion did not automatically follow from the majority's finding of tax avoidance. Rather, the taxpayer's tax position was unacceptable because, on the law as it applied when the tax position was taken, the tax position was not "about as likely as not to be correct". In summary, the majority of the Court stated:

- the principles relating to the construction of the general anti-avoidance provision had been settled;[30]
- there was a need to consider the economic substance of the transaction;[31]
- the taxpayer did not suffer the economic consequences Parliament contemplated;[32] and
- arguments supporting the taxpayer's tax position, while sophisticated and capable of being credibly advanced, were not "about as likely as not to be correct".[33]

31. Although that view was not shared by the High Court, the Court of Appeal, or the dissenting judge in the Supreme Court in *Frucor*, the majority explained the "about as likely as not to be correct" standard was, nevertheless, not met because:

- When assessing the standard, the focus was on the legal soundness of the taxpayer's tax position based on the facts as the majority found them to be.
- The High Court applied the standard to factual findings that were wrong.
- The Court of Appeal did not apply the standard to the facts as it found them to be. Instead, it allowed its conclusion to be controlled by the result arrived at by the High Court based on factual findings the Court of Appeal did not accept.
- The Supreme Court judge's dissent was based on views of the facts and the law different from those of the majority. Although the approaches to the facts and law proposed by the dissenting Supreme Court judge were founded on sophisticated and credibly advanced arguments, the arguments were not "as likely as not to be correct".

32. The majority said:

> [111] As we will explain later, we see the application of the "about as likely as not to be correct" standard in this case at least as requiring a focus on the legal soundness (or otherwise) of the tax positions adopted. The starting point for our assessment must therefore be the facts as we have found them to be. If, on those facts, the tax positions adopted by DHNZ satisfy the standard of being "about as likely as not to be correct", there can be no liability to shortfall penalties. If they did not, then shortfall penalties will be applied.
>
> [112] We consider that the approaches of the High Court Judge and the Court of Appeal to shortfall penalties were erroneous. Muir J approached this aspect of the case on the basis of the factual findings that underpinned his conclusions as to the non-applicability of s BG 1(1)—factual findings that we consider to be wrong. And, the Court of Appeal did not seek to apply the "as likely as not to be correct standard" to the facts as it found them to be. Instead, it allowed its conclusion to be controlled by the result arrived at by Muir J as to s BG 1(1) despite it being based on factual findings which the Court of Appeal did not accept.
>
> …
>
> [139] The dissent of Glazebrook J is based on views of the facts and law sufficiently different from those expressed in these reasons as to make detailed response not particularly practicable. There are, however, two points that we wish to make.

29 *Frucor* at [132]. Section BG 1 of the Income Tax Act 2004 was relevant in that case.

30 *Frucor* at [130].

31 *Frucor* at [141].

32 *Frucor* at [130]. See also *Frucor* at [128], set out at [29].

33 *Frucor* at [142].

...

[142] The second point by way of response is more general. We accept that the approaches to facts and law proposed by Glazebrook J are based on arguments that are sophisticated and are (and were) capable of being credibly advanced. This, however, is not controlling. This is because the result we arrive at in relation to penalties reflects our assessment that as at 2006 and 2007 when the returns were filed, such arguments nonetheless were not "about as likely as not" to be accepted by New Zealand courts.

33. Accordingly, a lower court decision or dissenting judgment supporting a taxpayer's tax position does not necessarily mean the tax position is about as likely as not to be correct. Based on *Frucor*, a lower court decision or dissenting judgment that relies on facts rejected by the appeal court or majority of the court, will not be conclusive.

34. *Ben Nevis* confirmed that, from a finding of tax avoidance, it remains a separate decision whether the taxpayer's tax position was not "about as likely as not to be correct" when the taxpayer took it. The inquiry into whether there is tax avoidance differs from the inquiry into whether the taxpayer's tax position is unacceptable. The tax avoidance inquiry concerns whether there is a tax avoidance arrangement applying s BG 1 of the Income Tax Act 2007. The unacceptable tax position inquiry involves considering whether, applying the law at the time the taxpayer took the tax position, arguments supporting the taxpayer's tax position were "about as likely as not to be correct". As the majority of the Supreme Court stated in *Ben Nevis*:[34]

[185] ... Whether a taxpayer's interpretation meets the ["about as likely as not to be correct"] standard in any case accordingly comes down to a judgment of the weight of the arguments that support the taxpayer's position in the application of the law to the relevant facts. ...

35. In *Alesco*, referring to the above paragraph from *Ben Nevis*, the Court of Appeal stated:

[148] ... ***Ben Nevis* also confirms that a finding of tax avoidance does not necessarily lead to a conclusion that the tax position was not more likely than not to be correct when it was taken**. The inquiry is not to be influenced by a later finding that the tax position taken was incorrect. [Emphasis added and footnote omitted]

36. It is possible for a taxpayer to take an unacceptable tax position even though they have followed the advice of a tax advisor. In *Case U47*, Judge Barber stated that it is the taxpayer that takes the tax position and that will include any associated interpretation by an agent:

42. ... **It must be the taxpayer who takes the tax position and, by inference, that will include any associated interpretation by an agent.** ... **It follows that because I find that the disputant has followed the advice of a tax agent** (which advice has led to the making of an unacceptable interpretation), **that does not prevent the disputant from being liable for any shortfall penalty payable under s 141B**. That unacceptable interpretation becomes the disputant's interpretation, for the purposes of s 141B, by virtue of the disputant's agency arrangement with its Accountant. [Emphasis added]

37. In *Erris*, Ronald Young J found the taxpayers who had taken a tax position through the advice and guidance of their tax agent were bound to the knowledge and actions of the agent:

[372] ... In this case either directly or indirectly upon receiving the depreciation loss advice from Actonz the Plaintiffs, subject to penal tax, had filed a tax return claiming the loss. Clearly therefore a tax position has been taken by them through the advice and guidance of their tax agent Actonz/AML. In those circumstances the Plaintiffs are bound to the knowledge and actions of their appointed agents AML/Actonz and Mr Anderson.

38. *Case U47* and *Erris* were concerned with an earlier version of s 141B that referred to the prior "unacceptable interpretation" test. However, *Alesco* confirms the same approach applies in relation to the current s 141B. When considering whether the taxpayer had taken an "unacceptable tax position", Harrison J said the taxpayer's reliance on professional advice did not prevent if being liable for shortfall penalties:

[142] Second, Mr McKay submits that Alesco NZ entered into the OCNs arrangement after receipt of reputable and expert taxation advice. Other taxpayers had done the same, adopting a similar template. It must be assumed, he says, that the advice received by Alesco NZ was positive in concluding that s BG 1 did not apply.

[143] Again, this argument postulates a subjective inquiry and is irrelevant. Alesco NZ's **acceptance of professional advice does not immunise it from a statutory liability for shortfall penalties**. The fact that it was positive does not mean it was correct. ... [Emphasis added and footnote omitted]

34 See [22].

39. A taxpayer is primarily responsible for correctly determining their tax liabilities.[35]

40. A taxpayer relying on the advice of a tax advisor may be treated as having taken reasonable care for the purposes of the shortfall penalty for not taking reasonable care.[36] For an explanation, see **IS 26/04**: **Shortfall penalty for not taking reasonable care**.

41. Example | Tauira 1, Example | Tauira 2, Example | Tauira 3, Example | Tauira 4, and Example | Tauira 5 show the kind of tax positions that may be unacceptable.

Example | Tauira 1 – Overlooking to include bonus shares in a tax return

Facts

An individual invests in shares. During the income year, the individual receives cash dividends and shares from a taxable bonus issue.

The individual includes the cash dividends in their income tax return for the year but overlooks the bonus shares and does not include them. The individual's income tax return shows they have $60,000 in tax to pay. If the individual had included the bonus shares, they would have had $500 more in tax to pay.

Outcome

When they filed their return, the individual took a tax position that the bonus shares were not taxable. The individual's tax position was incorrect, leading to a $500 tax shortfall.

Viewed objectively, the individual's tax position is **not** "about as likely as not to be correct". The value of the bonus shares was income. This is not something on which reasonable minds could differ. Although the individual overlooked including the bonus shares in their return, this was not a mistake they made in calculating or recording numbers used in a return. The individual has taken an unacceptable tax position.

However, the $500 tax shortfall is below the thresholds for the penalty applying. The shortfall is less than $50,000 and $600 (ie, 1% of the taxpayer's total tax figure of $60,000).[37] Accordingly, the individual is not liable for the shortfall penalty for an unacceptable tax position.

The individual may, nevertheless, be liable for a shortfall penalty for not taking reasonable care under s 141A.[38]

Example | Tauira 2 – Overlooking to include land sale proceeds in a tax return

Facts

A self-employed surveyor acquired a block of land to subdivide and sell. The subdivision never went ahead and, after a couple of years, the surveyor sold the land undivided.

When the time came to complete their income tax return at the end of the year, the surveyor was preoccupied with finalising a large project. They included the income from their surveying business in their income tax return, but overlooked including the proceeds from the sale of the land. The surveyor filed their return showing they had $80,000 in tax to pay. If they had included the land sale proceeds, they would have had $140,000 in tax to pay.

35 Section 15B.

36 Section 141A.

37 Sections 141B(2) and (3). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

38 See IS 26/04: Shortfall penalty for not taking reasonable care.

Outcome

When they filed their return, the surveyor took a tax position that the proceeds from the sale of the land were not income. The surveyor's tax position was incorrect, resulting in a $60,000 tax shortfall.

Viewed objectively, the surveyor's tax position is **not** "about as likely as not to be correct". The surveyor should have returned the land sale proceeds as income. There is no room for a real and rational difference of opinion about this. The surveyor's tax position does not have about an equal chance of being correct. Although the surveyor was preoccupied, this was not a mistake they made in calculating or recording numbers used in a return. They have taken an unacceptable tax position.

The $60,000 tax shortfall is above the thresholds for the penalty applying. It is more than $50,000 and $800 (ie, 1% threshold of the surveyor's total tax figure of $80,000).[39]

Accordingly, the surveyor is liable for a shortfall penalty for an unacceptable tax position.

Depending upon the circumstances, the surveyor may also be liable for a higher shortfall penalty.[40] In that case, the higher penalty would be imposed.[41]

Example | Tauira 3 – Claiming a deduction for a capital expense

Facts

A company owns several commercial properties from which it derives rental income. When the tenant of one of the properties vacated, the company undertook work on the property before re-leasing it. The work involved repairs to the existing building and the addition of a new office and a toilet block. The company spent $100,000 on the repairs and $200,000 on the additions.

The company's tax advisor instructed the company's accounting staff to code the $200,000 spent on the additions to expenses.

In its income tax return for the year, the company claimed the entire $300,000 expense as a deduction. The company's income tax return shows $30,000 tax to pay after a $40,000 subvention payment to a group company.

Outcome

When it filed its income tax return, the company took a tax position that the $200,000 it spent on the addition of the new office and toilet block was deductible. The company's tax position was incorrect, resulting in a $56,000 tax shortfall.

Viewed objectively, the company's tax position is **not** "about as likely as not to be correct". Based on case law that applied at the time the company took its tax position, the $200,000 the company spent on the additions was a non-deductible capital expense. This is not something on which reasonable minds could differ. It cannot be argued on rational grounds that the $200,000 the company spent on the additions was deductible. The company's tax position does not have about an equal chance of being correct. The company has taken an unacceptable tax position.

The $56,000 tax shortfall is above the thresholds for the penalty applying. It is more than $50,000 and $700 (ie, 1% of the company's total tax figure of $70,000, being the amount of tax payable by the taxpayer for the income year before the subvention payment).[42]

Accordingly, the company is liable for a shortfall penalty for taking an unacceptable tax position.

39 Sections 141B(2) and (3). Also see IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

40 See IS 26/06: Shortfall penalty for gross carelessness, IS 26/07: Shortfall penalty for taking an abusive tax position, and IS 26/08: Shortfall penalty for evasion or similar act.

41 See IS 26/09: Shortfall penalties – reductions and other matters.

42 Sections 141B(2) and (3). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

Example | Tauira 4 – Claiming a deduction in the wrong income year

Facts

A company carries on a business buying and selling land. It acquires land for $1.2 million and claims a deduction for the cost of the land in same income year. However, the land is "revenue account property", the cost of which is not deductible until the income year in which the company disposes of the land.[43]

The company's income tax return for the year shows a $100,000 loss and no tax to pay.

Outcome

The company took a tax position when it filed its tax return claiming a deduction for the cost of the land. The company's tax position is incorrect and there is a tax shortfall of $336,000. The tax shortfall is more than $50,000. It is also more than 1% of the "taxpayer's total tax figure" for the income year of $280, calculated as follows:[44]

> 1% x (the taxpayer's net loss, treated as having a positive value x the company tax rate)
>
> 1% x ($100,000 x 28%)
>
> 1% x $28,000 = $280

Viewed objectively, the tax position is **not** "about as likely as not to be correct". The cost of the land was not deductible in the income year the land was acquired. This is not something on which reasonable minds could differ. The company's tax position does not have about an equal chance of being correct. Consequently, the company is liable for a shortfall penalty for taking an unacceptable tax position.

Example | Tauira 5 – Failing to recognise the cost of goods in transit

Facts

A company is a wholesaler of imported goods. In the 2025 income year, the company purchased a shipment of stock from an overseas supplier. The company paid and received ownership of the stock while it was still in transit. However, the company overlooked including the cost of the stock in transit in the closing stock figures it provided to its tax agent. Consequently, the 2025 income tax return the tax agent filed for the company understated the company's income.

Outcome

The company took a tax position when its tax agent filed its 2025 income tax return without having recognised the cost of the stock in transit. The taxpayer's tax position was incorrect and resulted in a tax shortfall exceeding the threshold amounts.[45]

Viewed objectively, the taxpayer's tax position was **not** "about as likely as not to be correct". The cost of the goods was required to be included in the taxpayer's closing stock for the 2025 income year. This is not something on which reasonable minds could differ. Consequently, the company's tax position was an unacceptable tax position and it is liable for a shortfall penalty for taking an unacceptable tax position.

43 Section EA 2(2) of the Income Tax Act 2007.

44 Section 141B(2) and (3). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

45 See [4].

Mistakes in calculating or recording numbers

42. A taxpayer does not take an unacceptable tax position merely by making a mistake in calculating or recording numbers used in, or for use in preparing, an income tax return.[46]

43. This exception is limited in its application to inadvertent mistakes involving the transposition of numbers or a mistake in applying mathematical formula to numbers. In *Case Z14*, Judge Barber stated:

> [25] The disputant's challenge appears to be that the mistake of not including the two rural property sales in the 30 November 2004 GST return is a mistake which falls under the ambit of s 141B(1B). However, I agree with the defendant that s 141B(1B) is limited to where numbers have been recorded in a GST return, but incorrectly recorded eg such as a transposition of number or a mistake in applying mathematical formula to those numbers so recorded. The failure to record taxable supplies in a GST return, even by way of an honest mistake, is not a mistake within the ambit of s 141B(1B).

44. Other mistakes and oversights, such as overlooking income to include in a return, may attract a shortfall penalty for taking an unacceptable tax position.[47] Overlooking income to include in a return, even by way of an honest mistake, is different and more serious than "merely making a mistake in the calculation or recording numbers in, or for use in preparing, a return".[48] In *Case Z14*, Judge Barber stated:

> [33] The defendant also submits that the omitting of numbers from a GST tax return is a different and more serious mistake than "making a mistake in the calculation or recording of numbers in a return", and is not subject to the exclusion in s 141B(1B) . Again, I agree. There is no suggestion in this matter that there were any incorrect calculations in a return. Sales were overlooked and, therefore, omitted entirely from the relevant GST return.

45. The exception only excludes liability for a shortfall penalty for taking an unacceptable tax position. A taxpayer who makes a mistake in calculating or recording numbers used in, or in preparing, a return may be liable for a shortfall penalty for not taking reasonable care.[49]

46. Example | Tauira 6, Example | Tauira 7, and Example | Tauira 8 show the kind of mistakes that a taxpayer may make without taking an unacceptable tax position. Example | Tauira 9 shows a kind of error that is not mistake in calculating or recording numbers used in, or for use in preparing, a return.

Example | Tauira 6 – Coding mistake

Facts

A company uses codes to record items of income and expenditure for financial reporting purposes. It determines the correct code for a revenue receipt but inadvertently assigns an incorrect code for a capital receipt. The coding error is carried through into the company's tax return and its income is understated. The company's tax return shows $135,000 in tax to pay, instead of $200,000. That makes a $65,000 tax shortfall.

Outcome

The company took a tax position when it filed its tax return that the revenue receipt was not income. The company's tax position was incorrect. The resulting $65,000 tax shortfall is more than the thresholds for the shortfall penalty for the unacceptable tax position of more than $50,000 in total and $1,350 (ie, 1% of the taxpayer's total tax figure of $135,000).[50]

However, the company has not taken an unacceptable tax position. This is because the miscoding of the receipt was a genuine mistake that the company made in recording a number it used in, or for use in preparing, its tax return.

The company may, however, be liable for a shortfall penalty for not taking reasonable care.[51]

46 Section 141B(1B) and the definition of "return" in s YA 1 of the Income Tax Act 2007.

47 *Case Z14* (2009) 24 NZTC 14,165. *Case Z14* was decided when the unacceptable tax position penalty applied to GST (see [2]).

48 Mistakes other than in calculating or recording numbers used in, or for use in preparing, an income tax return, will only attract an unacceptable tax position penalty if the resulting tax shortfall exceeds the threshold amounts in s 141B(2) (see [4]).

49 Section 141A.

50 Sections 141B(2) and (3). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

51 See IS 26/04: Shortfall penalty for not taking reasonable care.

Example | Tauira 7 – Use of incorrect depreciation rate

Facts

Due to an undetected systems error, a company's new accounting software picks up an incorrect depreciation rate for a category of large depreciable assets owned by the company. The incorrect rate goes unnoticed and is carried through into the company's income tax return. Consequently, the deduction for depreciation loss claimed by the company for the income year is overstated and its income for the year is understated. The company's tax return shows $155,000 in tax to pay, instead of $211,000. That makes a $56,000 tax shortfall. When reviewing the company's income tax return, Inland Revenue discovers the depreciation rate error and corrects it by way of an agreed adjustment. This was the first time such an error had occurred. As soon as it became aware of the error, the company arranged for its software provider to fix the company's accounting software to prevent the error happening again.

Outcome

The company took a tax position when it filed its tax return that it was entitled to a deduction for the amount of depreciation loss claimed. The company's tax position was incorrect. The resulting $56,000 tax shortfall is more than the thresholds for the shortfall penalty for an unacceptable tax position. It is more than $50,000 and $1,550 (that is, 1% of the taxpayer's total tax figure of $155,000).[52]

However, the company has not taken an unacceptable tax position. This is because the company's use of the incorrect depreciation rate was a genuine mistake in the calculation or recording of numbers used in, or for use in preparing, the company's income tax return. The company did not make a conscious decision to use an incorrect depreciation rate. Nor did the company make a conscious decision to use the incorrect depreciation rate because it considered the rate was correct.

The company may, however, be liable for a shortfall penalty for not taking reasonable care.[53]

Variation

After becoming aware of the systems error in its accounting software, the company takes no action to have the error fixed. The following income year, the software picks up the same incorrect depreciation rate for the same category of large depreciable assets. The incorrect rate is carried through into the company's income tax return. The company fails to check the income tax return before it is filed. Consequently, the company's deduction for depreciation loss for the income year is overstated and its income is understated. The company's tax position for the year is not correct and there is a tax shortfall exceeding the thresholds for the unacceptable tax position penalty. This time, the company has not merely made a mistake in the calculation or recording of numbers used in, or for use in preparing, its return. The company did not make the error inadvertently. The company was aware of the systems error in its accounting software and chose to ignore it. The company's tax position is an unacceptable tax position. It is not about as likely as not to be correct.

52 Sections 141B(2) and (3). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

53 See IS 26/04: Shortfall penalty for not taking reasonable care.

Example | Tauira 8 – Mistake in calculation of rental income

Facts

A company owns and leases storage units at eight different locations. When totalling the rental income from each location, the company's bookkeeper inadvertently records the income from location 3 as $147,000 instead of $417,000.

Location	Actual storage rental income ($)	Recorded storage rental income ($)	Difference ($)
1	132,000	132,000	–
2	52,000	52,000	–
3	417,000	147,000	270,000
4	15,000	15,000	–
5	239,000	239,000	–
6	158,000	158,000	–
7	12,300	12,300	–
8	17,600	17,600	–
TOTAL	**1,042,900**	**772,900**	**270,000**

The mistake goes unnoticed and is carried through into the company's tax return. The company's tax return shows $356,000 in tax to pay instead of $431,600, resulting in a $75,600 tax shortfall.

Outcome

When it filed its tax return, the company took a tax position that its rental income from location 3 was $147,000. The company's tax position was incorrect, leading to a $75,600 tax shortfall. The tax shortfall is more than the thresholds for the unacceptable tax position shortfall penalty of more than $50,000 and $3,560 (ie, 1% of the taxpayer's total tax figure of $356,000).[54]

Even so, the company has not taken an unacceptable tax position and is not liable for an unacceptable tax position shortfall penalty. This is because the company merely made an inadvertent mistake when recording numbers used in preparing its tax return. The company may, however, be liable for a shortfall penalty for not taking reasonable care.[55]

Example | Tauira 9 – Overlooking end of year transactions

Facts

A taxpayer calculates their income and prepares a draft of their income tax return on 29 March. This is on the basis they will revise their calculations and return later to include their transactions for 30 and 31 March. However, when the taxpayer finalises their return, they inadvertently overlook including transactions for 30 and 31 March. Consequently, their income tax return does not include the income they derived on 30 and 31 March.

Outcome

The taxpayer took a tax position when it filed its tax return omitting the income it derived on 30 and 31 March. The taxpayer's tax position is incorrect and there is a tax shortfall.

Viewed objectively, the tax position is **not** "about as likely as not to be correct". The income the taxpayer derived on 30 and 31 March should have been included in its income tax return. This is not something on which reasonable minds could differ. The error the taxpayer made is not an inadvertent mistake in calculating or recording numbers used in, or for use in preparing, a return.[56]

However, the taxpayer would only be liable for a shortfall penalty for taking an unacceptable tax position if the tax shortfall exceeded $50,000 and 1% of the taxpayer's total tax figure for the income year.

54 Sections 141B(2) and (3). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

55 See IS 26/04: Shortfall penalty for not taking reasonable care.

56 Section 141B(2). See also IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall".

Relying on Inland Revenue advice

47. A taxpayer does not take an unacceptable tax position to the extent they have relied on an official opinion that the Commissioner gives. There are two types of "Commissioner's official opinion":
    - **Taxpayer-specific opinions**: The Commissioner publishes these after receiving all relevant and correct information. Only the taxpayer concerned may rely on the opinion.
    - **Official statements**: Inland Revenue publishes these statements, which include standard practice statements, interpretation statements, interpretation guidelines, questions we've been asked and Inland Revenue guides. An official statement must apply to a taxpayer's specific situation before the taxpayer can rely on it.
48. A "Commissioner's official opinion" does not include a private binding ruling. As private binding rulings bind the Commissioner, a taxpayer following the ruling will not be subject to a shortfall penalty for an unacceptable tax position.[57]
49. For more on the Commissioner's official opinions, see **Status of the Commissioner's advice** *Tax Information Bulletin* Vol 24, No 10 (December 2012): 86.
50. Example | Tauira 10 shows when the s 141B(1D) exception will not apply.

Example | Tauira 10 – Commissioner's official opinion

Facts

Following a review of the taxpayer's tax affairs for the 2025 income year, Inland Revenue discovers the taxpayer has claimed an income tax deduction for the cost of revenue account property acquired during the year and still held at year end. The legislation is clear that the cost of the property is not deductible until the year the property is sold.[58]

The taxpayer took a tax position when it filed its tax return claiming the deduction. The tax position is incorrect and there is a tax shortfall exceeding the threshold amounts for the unacceptable tax position shortfall penalty.[59] Viewed objectively, the tax position is **not** "about as likely as not to be correct". It does not have about an equal chance of being correct.

Inland Revenue considers the taxpayer is liable for an unacceptable tax position shortfall penalty. However, the taxpayer argues it is not liable for the penalty because the exception in s 141B(1D) applies. It refers to an Inland Revenue letter it received in May 2024 advising that, as part of Inland Revenue's compliance programme, a review of the taxpayer's tax obligations and compliance had been completed, and no formal audit would be conducted for the 2022 and 2023 income years. The taxpayer had applied the same incorrect approach to claiming income tax deductions for the cost of revenue account property in those years. However, the incorrect approach was not discovered or considered by Inland Revenue during its review of the taxpayer's tax obligations and compliance in those years.

The taxpayer argues the advice in the May 2024 letter is a "Commissioner's official opinion" that they relied on in support of their continued use of their approach to claiming deductions for the cost of revenue account property in the year the property was acquired. The taxpayer argues that, accordingly, the exception in s 141B(1D) applies and the incorrect tax position they took in the 2025 income year is not an unacceptable tax position.

Outcome

The statement in Inland Revenue's May 2024 letter is not a "Commissioner's official opinion" on which the taxpayer could have relied when taking the incorrect tax position in the 2025 income year.

The statement in the May 2024 letter is that a review of the taxpayer's tax obligations and compliance has been completed, and no formal audit is needed. The statement is not an opinion that the taxpayer's approach to claiming deductions for the cost of revenue account property is correct, made after all information relevant to forming such an opinion was provided. When it made the statement, Inland Revenue was not aware of and had not considered the taxpayer's approach to claiming deductions for the cost of revenue account property. It did not have all information relevant to form an opinion on the correctness of the approach.

Accordingly, the exception in s 141B(1D) would not apply. The taxpayer's tax position is an unacceptable tax position and they are liable for an unacceptable tax position shortfall penalty.

57 Sections 3 and 141B(1D).

58 Section EA 2 of the Income Tax Act 2007.

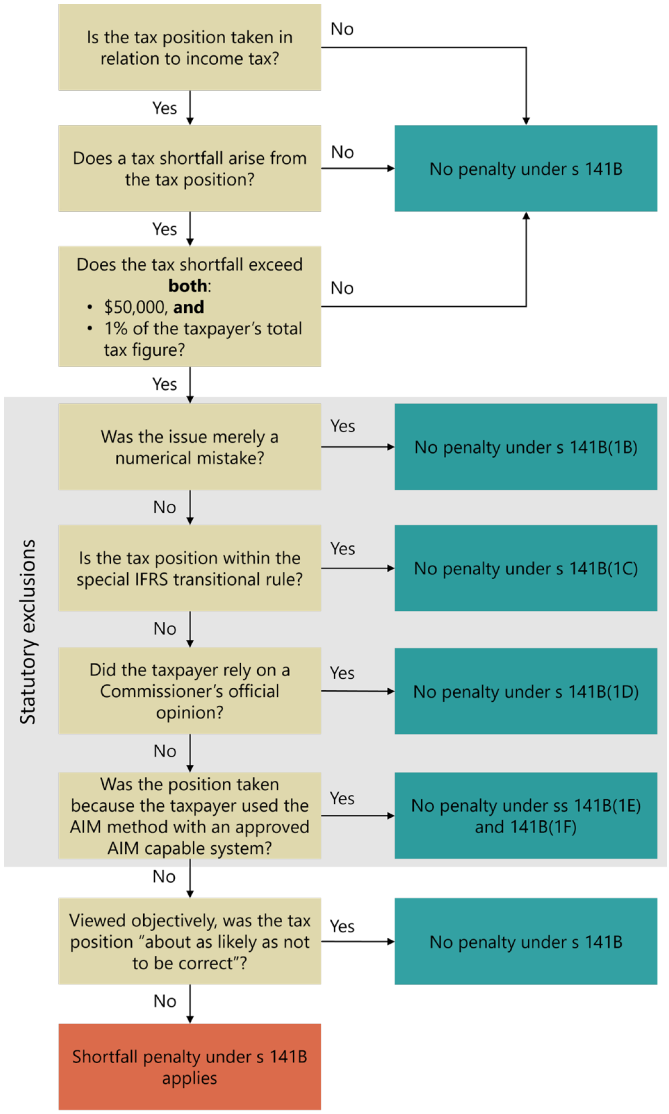
59 See [4].

Using the AIM method

51. The AIM regime allows taxpayers considerable judgment in the preparation of their provisional tax payments. If there is a large variation between the provisional tax paid by a taxpayer using AIM and the taxpayer's year end terminal tax liability, Inland Revenue will consider whether the taxpayer has taken reasonable care in using AIM. If they have not, a shortfall penalty for not taking reasonable care may be imposed.[60]

52. However, a taxpayer will **not** be liable for an unacceptable tax position shortfall penalty merely by using the AIM method and an approved AIM provider's AIMcapable accounting system.[61] This exception does not apply for larger taxpayers, with an annual gross income of more than $5 million, using "large business AIM-capable systems".[62]

Figure 1 | Hoahoa 1 Flowchart showing how s 141B applies



60 See IS 26/04: Shortfall penalty for not taking reasonable care and IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall". The definition of "tax position" in s 3(1) includes the use of the AIM method for provisional tax and the software product of an approved AIM provider.

61 Section 141B(1E).

62 Section 141B(1F) and ss 124Y, 124Z, 124ZD and 124ZE of the Tax Administration Act 1994; and s RC 7B of the Income Tax Act 2007. "Large business AIM-capable systems" are approved by the Commissioner for use under s 124ZD. See also the Commentary on the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill 2016 and s 141B(1E).

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IS 26/06: Shortfall penalty for gross carelessness

Issued | Tukuna: 27 March 2026

This interpretation statement explains the meaning of gross carelessness in s 141C of the Tax Administration Act 1994. It discusses the circumstances that could be relevant in determining whether someone has been grossly careless and how to distinguish gross carelessness from lower levels of negligence. It also discusses relevant case law and provides several practical examples for clarity.

All legislative references are to the Tax Administration Act 1994 unless otherwise stated.

REPLACES | WHAKAKAPIA

- **IS0060:** Shortfall penalty for gross carelessness (August 2004) *Tax Information Bulletin* Vol 16, No 8 (September 2004): 10

Key terms | Kīanga tau tāpua

Acceptable tax position	A tax position that although wrong can rationally be argued to be right, is one on which reasonable minds could differ and has about an equal chance of being correct.
Reasonable care	Doing what a reasonable person in the particular circumstances would do.
Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for that period.

Introduction | Whakataki

1. Section 141C imposes a shortfall penalty for gross carelessness where:
   - the taxpayer takes a tax position;
   - a tax shortfall arises from the tax position;
   - the taxpayer is grossly careless in taking the tax position.
2. The penalty applies to tax positions taken in relation to most tax types including GST and income tax. Income tax includes withholding-type taxes treated as income tax, eg, PAYE, FBT, and resident withholding tax.
3. The penalty is 40% of the tax shortfall.
4. **IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall"** explains the requirements for a "tax position" and a "tax shortfall".
5. This interpretation statement explains the meaning of "gross carelessness".
6. **IS 26/09: Shortfall penalties – reductions and other matters** explains when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.

Summary | Whakarāpopoto

7. In summary, this interpretation statement explains the meaning of "gross carelessness" as follows:

- Gross carelessness means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences.[1]
- Gross carelessness involves more than mere inadvertence or lack of reasonable care.
- For conduct to be grossly careless it must create a high risk of a tax shortfall occurring, where the risk and its consequences would have been foreseen by a reasonable person in the taxpayer's circumstances.
- Failing to give any thought to an obvious and serious risk constitutes gross carelessness.
- Whether the taxpayer acted intentionally is not a consideration.
- A person who takes reasonable care in taking the tax position has not been grossly careless.
- A taxpayer who takes an acceptable tax position is also a person who has not been grossly careless in taking that tax position.[2]

Legislation

141C Gross carelessness

(1) A taxpayer is liable to pay a shortfall penalty if the taxpayer is grossly careless in taking a taxpayer's tax position (referred to as **gross carelessness**).

(2) The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

(3) For the purposes of this Part, **gross carelessness means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences.**

(4) A taxpayer who takes an acceptable tax position is also a taxpayer who has not been grossly careless in taking the taxpayer's tax position.

Analysis | Tātari

The meaning of "gross carelessness"

8. "Gross carelessness" is defined in s 141C(3) and means doing or not doing something in a way that, in all the circumstances, suggests or implies complete or a high level of disregard for the consequences.

9. In *Case W4*, Judge Barber said that gross carelessness is characterised by conduct that creates a high risk of a tax shortfall occurring where the risk and its consequences would be foreseen by a reasonable person in the circumstances:

> [44] ... the definition of "gross carelessness" refers to a high level of disregard for the consequences and is characterised by conduct which creates a high risk of a tax shortfall occurring where this risk and its consequences would have been foreseen by a reasonable person in the circumstances.[3]

10. In any situation it is necessary to determine what constitutes a "high" risk or "high" level of disregard for the consequences, as opposed to a risk arising from a lack of reasonable care.

11. In *Case 11/2016*, Judge Sinclair said that to meet the gross carelessness test something more than mere inadvertence is required. The carelessness must be "flagrant".[4]

12. In *Case W4*, Judge Barber said gross carelessness under s 141C must be something similar to recklessness.[5] In *R v Caldwell*, Lord Diplock said that recklessness covered a range of states of mind from failing to give any thought to whether there is a risk to recognising the existence of a risk and deciding to ignore it.[6] In *R v Howe*, the Court of Appeal recognised that recklessness was not limited to deliberate risk taking but includes failing to give any thought to an obvious and serious risk.[7]

1 Section 141C(3).
2 Section 141C(4).
3 *Case W4* (2003) 21 NZTC 11,034 (TRA).
4 *Case 11/2016* (2016) 27 NZTC 3-033 (TRA) at [123].
5 *Case W4* at [48].
6 *R v Caldwell* (1981) 1 All ER 961 (HL) at 964.
7 *R v Howe* (1982) 1 NZLR 618 (CA).

13. The test for gross carelessness does not require that the taxpayer foresaw that their act or failure to act created a high risk of a tax shortfall occurring. Rather, the test is an objective one, based on what a reasonable person in the taxpayer's circumstances would foresee as conduct creating a high risk of a tax shortfall occurring.[8]

14. Further, whether the taxpayer acted intentionally is not a consideration.[9] In *Case W4*, Judge Barber said that if intention or knowledge was involved then there would be tax evasion rather than gross carelessness:

> [45] It seems to me that if *mens rea* [the mental element of intention and knowledge] is involved then there must be tax evasion rather than gross carelessness. …

> The gross carelessness test is objective, which means a taxpayer does not need to have acted intentionally. Deliberate actions (or omissions) are considered under the shortfall penalty for evasion or similar act.

15. It is the taxpayer's conduct and circumstances existing at the time it took the relevant tax position or positions that are relevant in determining whether a taxpayer has been grossly careless.[10] Section 141C(3) requires that "all the circumstances" are considered in determining whether a taxpayer has been grossly careless. This requirement means that whether certain behaviour is grossly careless depends on the circumstances in each case.[11]

16. Table | Tūtohi 1 sets out circumstances that could be relevant in determining whether a taxpayer is grossly careless. Depending on the particular facts, other circumstances may be relevant. The table also includes references to case law illustrating how the circumstance was considered in determining whether the taxpayer was grossly careless.

Table | Tūtohi 1 – Relevant circumstances in determining gross carelessness

Circumstances	Cases
The person's experience, education and skills	*Case W4*, *Case 9/2015* (2015) 27 NZTC 3-008 (TRA) and *Case 10/2016* (2016) 27 NZTC 3-032 (TRA)
The significance of the transaction, or transactions of a similar nature when viewed together, in the context of the taxpayer's business or activities	*Case W4* and *Case 9/2015*
The size of the tax shortfall	*Case W4*
The scale and duration of activities	*Case 5/2013* (2013) 26 NZTC 2-004 (TRA)
Warnings given by Inland Revenue or advisors in relation to the risk of the tax shortfall	
Pressures experienced by the taxpayer	*Case W3* (2003) 21 NZTC 11,014 (TRA)
The short time-frame between the purchase and the sale of the property	*Case W4*

8 Case 9/2014 (2014) 26 NZTC 2-019 (TRA) at [88].

9 Case W4 at [60].

10 *Case 9/2018* (2018) 28 NZTC 4-016 (TRA) at [98].

11 *Case W4* at [60].

17. The person's experience, education and skills could include experience in relevant tax laws, particular knowledge relevant to the tax position taken, or general commercial or business experience. The relevance of the person's experience, education and skills is illustrated in three cases:

    - In *Case W4*, Judge Barber referred to the disputant's lengthy experience in business and preparing GST returns for both himself and his company.
    - In *Case 10/2016*, Judge Sinclair referred to the sole director and shareholder's familiarity with mortgage documentation and the mortgagee sale process in the context of concluding whether a reasonable person in his position could have been expected to know that the bank does not act as agent for a mortgagor in realising its securities.
    - In *Case 9/2015*, Judge Sinclair accepted that the taxpayer was not knowledgeable in tax and accounting matters but nevertheless referred to him being a successful business man and qualified civil engineer.

18. Example | Tauira 1 illustrates a situation where the taxpayer's experience, education and skills were a significant factor in concluding the taxpayer was grossly careless.

Example | Tauira 1 – Consideration of taxpayer's experience, education and skills when determining gross carelessness

Reema, an experienced accountant, provides consultancy services. Over the years, Reema has returned consultancy income and claimed deductions for various expenses related to her consultancy business.

Reema did not file income tax returns for the income years ended 31 March 2022 and 31 March 2023, and default assessments were issued. It was established that Reema had earned consultancy income in both years. The amount of consultancy income earned in each of the income years was around 75% less than that earned in the past. It was also discovered that Reema had been mixing her personal and business expenses and was unable to provide supporting information to show that some of the expenses were genuinely related to the consultancy business. There was a tax shortfall.

Outcome

It is considered that Reema was grossly careless for the following reasons:

- A reasonable person with the same skills and experience as Reema (an accountant with years of experience in advising business clients and filing her own income tax and GST returns) would have been aware of the requirements to:
    - maintain proper business records, including properly recording expenses and retaining copies of invoices for expenditure claimed;
    - file income tax returns on time; and
    - return the amounts earned from the provision of consultancy services as income.
- A reasonable person in Reema's circumstances would have foreseen that treating the consultancy income as non-taxable by not declaring it as income in her income tax return, despite receiving regular amounts into her bank account for consultancy services, created a high risk of a tax shortfall occurring in each of the income years.

A question arises as to the relevance of the consultancy income earned in the relevant income years being considerably lower than that earned in previous income years (75% lower). It is considered that in this situation a reasonable person with the same skills and experience as Reema, where the consultancy income was her main source of income, would have foreseen that treating the (reduced) amount of consultancy income as non-taxable, created a high risk of a tax shortfall occurring.

Person who takes reasonable care is not grossly careless

19. A person who takes reasonable care is not grossly careless. In *Case W4*, Judge Barber said the degree of negligence for gross carelessness was greater than for a shortfall penalty for not taking reasonable care:

> [48] Clearly, any degree of negligence under the s 141C shortfall penalty provision will be of a greater magnitude than under s 141A.

20. The meaning of "reasonable care" is discussed in **IS 26/04: Shortfall penalty for not taking reasonable care**.

21. Taking reasonable care includes exercising reasonable diligence to determine the correctness of a return, keeping adequate records and generally making a reasonable attempt to comply with the tax law. In *Case W4*, Judge Barber said:

> [60] As with gross carelessness, whether the taxpayer acted intentionally is not a consideration. It is not a question of whether the taxpayer actually foresaw the probability that the act or failure to act would cause a tax shortfall, but whether a reasonable person in the circumstances of the taxpayer would have seen the tax shortfall as a reasonable probability. **Reasonable care must include exercising reasonable diligence to determine the correctness of a return. It must also include the keeping of adequate books and records or to properly substantiate items, and generally making a reasonable attempt to comply with the tax law**. [Emphasis added]

22. Further, generally a taxpayer who relies on an action or advice of their tax advisor in taking a tax position takes reasonable care.[12] This position is subject to exceptions, which are discussed in **IS 26/04: Shortfall penalty for not taking reasonable care** at [33] and [34].

23. It follows that a person who takes reasonable care by doing the following would also not be grossly careless:
    - exercising reasonable diligence to determine the correctness of a return, keeping adequate records and generally making a reasonable attempt to comply with the tax laws; and/or
    - relying on an action or advice of their tax advisor.

Distinguishing between gross carelessness and not taking reasonable care

24. As discussed at [10] and [19], the carelessness involved in gross carelessness is of a greater magnitude than that involved in not taking reasonable care.

25. In determining whether a taxpayer's conduct in the circumstances constitutes not taking reasonable care or gross carelessness, it is necessary to make a judgement about where the dividing line between the two standards is.

26. Where that dividing line is depends on the particular facts of the case. Example | Tauira 2 and Example | Tauira 3 illustrate situations where the carelessness involved is of a greater magnitude than that involved in not taking reasonable care and is gross carelessness.

Example | Tauira 2 – Determining the magnitude of carelessness

Over a 10-year period, the Jones Family Trust bought eight properties, built houses on them and sold them.

Despite the scale and frequency of these transactions, the trust did not file income tax or GST returns. The trustees considered the properties were used as family residences, so were not subject to income tax or GST.

After the sale of the third property, the trust's solicitor suggested the trustees get tax advice on the transactions. The trustees did not get any tax advice.

During an audit, it was determined the trust had engaged in the activities regularly and systematically, indicating a business operation rather than mere personal use and that income tax and GST was payable on seven of the eight property sales (one property met the main home exemption). Tax shortfalls arose.

Outcome

It is considered that the trust was grossly careless for the following reasons:

- A reasonable person in the trustees' circumstances would have foreseen, in light of the large number of properties purchased, improved and sold, the high risk of the tax shortfalls occurring.
- The trust's solicitor identified the risk of a tax liability and raised it with the trustees. Despite this, the trustees obtained no tax advice.

The trust's conduct in the circumstance suggests it had a high level of disregard for the accuracy of its tax returns, so was grossly careless.

Given the duration and scale of the activities, this outcome would be unchanged even if the trust's solicitor did not suggest the trustees get tax advice. However, if the duration and scale of activities was significantly less, the likelihood the trust was grossly careless would reduce. However, in that case other circumstances (such as the tax risk being identified by the trust's solicitor but ignored by the trustees) would still be relevant in determining whether the trust was grossly careless.

12 Section 141A(2B).

Example | Tauira 3 – Determining the magnitude of carelessness

Cher runs a building recycling operation, buying and selling material and fittings from buildings that are to be demolished or refurbished. Her suppliers are both registered and unregistered persons for GST purposes.

On audit, it was found Cher had claimed input tax credits on material purchased from unregistered persons under the secondhand goods provisions in s 20(3)(a)(ia) of the Goods and Services Tax Act 1985, which allows an input tax deduction only to the extent that payment has been made. Cher claimed several input tax credits on secondhand goods purchased from unregistered persons in the taxable period ended 31 March 2025 based on the full purchase price totalling $36,000, when during that period she had paid only $5,000 of the total amount due.

Similar mistakes had been identified during past investigations, and the investigator had advised Cher how to improve her bookkeeping system to prevent similar errors in the future. Despite 12 months having elapsed since this advice was given, Cher had failed to implement the suggested improvements.

Buying secondhand goods is a regular part of Cher's business.

Outcome

It is considered that Cher was grossly careless.

A reasonable person in Cher's circumstances would have foreseen that failing to implement the suggested improvements, including checks, to prevent input tax credits being claimed for secondhand goods not yet paid for, created a high risk of a tax shortfall occurring.

As such, the errors are not mistakes occurring because of mere inadvertence. Cher's conduct indicates indifference to the serious risk of recurring errors and complete or a high level of disregard for the consequences.

If, however, Cher had made a real attempt to implement system improvements, in the absence of any other factors, it is likely her conduct would not be regarded as having created a high risk of a tax shortfall occurring (that is, Cher would likely not have been grossly careless).

Taxpayer who takes an acceptable tax position is not grossly careless

27. A taxpayer who takes an "acceptable tax position" is also a person who has not been grossly careless in taking the tax position.[13]

28. An acceptable tax position is a tax position that is not an "unacceptable tax position".[14] The meaning of unacceptable tax position is explained in **IS 26/05: Shortfall penalty for taking an unacceptable tax position**. In summary, an unacceptable tax position is one that, viewed objectively, fails to meet the standard of being "about as likely as not to be correct".[15] Whether the taxpayer believes their tax position was correct or acceptable is irrelevant. A tax position will be "about as likely as not to be correct" if:[16]

    - even though wrong, it can be argued on rational grounds to be right;
    - it is one on which "reasonable minds could differ". There must be room for a real and rational difference of opinion;
    - it has about an equal chance of being correct.

29. A taxpayer does not take an unacceptable tax position merely by making a mistake in the calculation or recording of numbers used in, or used in preparing, a return.[17]

30. Example | Tauira 4 illustrates a situation where consideration was given to whether the taxpayer's tax position was acceptable.

13 Section 141C(4).
14 Section 3(1) definition of "acceptable tax position".
15 Section 141B.
16 See IS 26/05: Shortfall penalty for taking an unacceptable tax position at [13] to [18].
17 Section 141B(1B).

Example | Tauira 4 – Determining whether the taxpayer's tax position is an acceptable tax position

KiwiSmart Ventures Ltd (KiwiSmart Ventures) was recently incorporated to invest in residential property for long-term rental. It buys properties, renovates them if needed and leases them out.

For the year ending 31 March 2024, KiwiSmart Ventures claimed $65,000 as repairs and maintenance expenses.

On investigation, Inland Revenue found that business had begun and that $48,000 of the $65,000 was spent on one untenanted property bought during that year and related to the following work:

- repairing and cleaning the leaking roof;
- replacing unsafe broken porch steps and railings;
- replacing broken bathroom fittings;
- replacing worn carpet and vinyl; and
- repairing and repainting exterior and interior walls

All these repairs were done within months of purchasing the property and were essential so that it could be rented out.

None of the costs of the repairs were treated as capital (non-deductible) in nature. KiwiSmart Ventures argues its bookkeeper did not distinguish between capital and revenue expenses because they thought all the spending was for repairs and maintenance. The Commissioner considered that no deduction was allowed for the repairs of $48,000 because of the capital limitation in s DA 2(1). This was because the expenditure incurred was essential to restore and maintain the functionality of the property to the level required for its intended use for long-term rental. At the time of acquisition, KiwiSmart Ventures recognised it needed to incur further expenditure to bring the property up to the condition desired for its long-term use. The Commissioner also considered that:

- KiwiSmart Ventures should have done more to determine the deductibility or otherwise of the costs. Possible things that would demonstrate what a reasonable person in the circumstances would have done could include researching the issue, seeking advice from the Commissioner or from a tax advisor to determine the deductibility or otherwise of the repair costs because the capital revenue distinction is complex;
- Not doing any of the above suggests a high level of disregard for the consequences, so propose a penalty for gross carelessness.

On the assumption that the costs of $48,000 were in fact of a capital nature, should the proposed shortfall penalty for gross carelessness be imposed?

The first issue is whether it is appropriate to impose a shortfall penalty for gross carelessness in relation to the capital or revenue distinction given it is a contentious area of law and s 141C is a care provision rather than one relating to the accuracy of the tax position taken.

It is possible for a person to be grossly careless in taking a tax position no matter how contentious the applicable provision might be. In such a case, a reasonable person would be aware there was a greater need to research the issue or obtain advice, neither of which KiwiSmart Ventures did.

KiwiSmart Ventures will not have been grossly careless if it took an acceptable tax position.[18]

In this case, it is considered KiwiSmart Ventures' tax position (taken on their behalf by their employee bookkeeper) was not an acceptable one. Objectively, its tax position – that the expenditure was deductible where it recognised a need for further expenditure to bring the property up to the condition essential for long-term use as a rental property – was not "about as likely as not to be correct".[19] It was not close to being correct and there is not room for a real and rational difference of view.

18 Section 141C(4)

19 Section 141B.

Outcome

While KiwiSmart Ventures' tax position was not an acceptable one, it is considered that KiwiSmart Ventures is not grossly careless in this case.

Whether expenditure is of a capital or revenue nature requires a level of judgement based on several factors and KiwiSmart Ventures' relative inexperience counts against it having the required level of judgement. However, that KiwiSmart Ventures did not research the issue or obtain advice is not considered to suggest a total or high level of disregard for the consequences or an indifference to a serious risk that the expenditure would not be deductible. It is not evident that a reasonable person in KiwiSmart Ventures' circumstances would have been aware of the serious risk that the expenditure may not be deductible.

While the tax shortfall constitutes a large proportion of the expenditure deducted by KiwiSmart Ventures in the relevant income year, this factor in isolation is not sufficient to conclude it was grossly careless. Therefore, while KiwiSmart Ventures may not have taken reasonable care in taking its tax position, so may be liable for a shortfall penalty under s 141A, it is not considered in these circumstances that it had a high level of disregard for the consequences when filing its return.

Had there been, for example, earlier warnings from Inland Revenue or advice from a tax agent on the interpretative issue that KiwiSmart Ventures ignored, this would increase the likelihood that it had been grossly careless.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Goods and Services Tax Act 1985, s 20(3)(a)(ia)

Tax Administration Act 1994, ss 3(1) ("acceptable tax position", "unacceptable tax position"), 141B, 141C

Case references | Tohutoro kēhi

Ben Nevis Forestry Ventures Ltd & v CIR; Accent Management Ltd v CIR [2008] NZSC 115, (2009) 24 NZTC 23,188

Case 5/2013 (2013) 26 NZTC 2-004 (TRA)

Case 9/2014 (2014) 26 NZTC 2-019 (TRA)

Case 9/2015 (2015) 27 NZTC 3-008 (TRA)

Case 9/2018 (2018) 28 NZTC 4-016 (TRA)

Case 10/2016 (2016) 27 NZTC 3-032 (TRA)

Case 11/2016 (2016) 27 NZTC 3-033 (TRA)

Case W3 (2003) 21 NZTC 11,014 (TRA)

Case W4 (2003) 21 NZTC 11,034 (TRA)

Case X25 (2006) 22 NZTC 12,203 (TRA)

R v Caldwell (1981) 1 All ER 961 (HL)

R v Howe (1982) 1 NZLR 618 (CA)

Walstern Pty Ltd v C of T (2003) 138 FCR 1 (FCA)

Other references | Tohutoro anō

IS 26/09: Shortfall penalties – reductions and other matters
taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-09

IS 26/03: Shortfall penalties – requirements for a "tax position" and a "tax shortfall"
taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-03

IS 26/04: Shortfall penalty for not taking reasonable care
taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-04

IS 26/05: Shortfall penalty for taking an unacceptable tax position
taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-05

IS0060: Shortfall penalty for gross carelessness *Tax Information Bulletin* Vol 16, No 8 (September 2004): 10
taxtechnical.ird.govt.nz/tib/volume-16---2004/tib-vol16-no8
taxtechnical.ird.govt.nz/interpretation-statements/is0060-shortfall-penalty-for-gross-carelessness

Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill (Inland Revenue, September 1995)

IS 26/07: Shortfall penalty for taking an abusive tax position

Issued | Tukuna: 27 March 2026

This interpretation statement explains the meaning of "abusive tax position" in relation to the abusive tax position shortfall penalty in s 141D of the Tax Administration Act 1994.

All legislative references are to the Tax Administration Act 1994 (the Act), unless otherwise stated.

REPLACES | WHAKAKAPIA

- **IS0061**: Shortfall penalty for taking an abusive tax position

Key terms | Kīanga tau tāpua

Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for that period.
Unacceptable tax position	A tax position that, viewed objectively, fails to meet the standard of being about as likely as not to be correct.
Abusive tax position	An unacceptable tax position that, viewed objectively, a taxpayer takes in respect, or as a consequence, of an arrangement that has a dominant purpose of avoiding tax; or an unacceptable tax position that, viewed objectively, a taxpayer takes with a dominant purpose of avoiding tax.

Introduction | Whakataki

1. Section 141D imposes an abusive tax position shortfall penalty on a taxpayer where:
   - the taxpayer takes a tax position;
   - a tax shortfall arises from the tax position;
   - the taxpayer's tax position is an unacceptable tax position;
   - the taxpayer's tax position is an abusive tax position.
2. This interpretation statement explains the requirement that a taxpayer has taken an abusive tax position.
3. The amount of the abusive tax position penalty is 100% of the resulting tax shortfall.
4. The penalty is reduced to 20% of the resulting tax shortfall if the requirements of s 141D(3B)(a) to (c) are met. Broadly, those provisions require that:
   - the taxpayer is a party to an arrangement in respect of which a promoter is liable for a promoter penalty under s 141EB;
   - the sum of the tax shortfalls from the arrangement for the taxpayer and associated parties is less than $50,000; and
   - the taxpayer has received independent advice stating that the taxpayer's tax position is not an abusive tax position.
5. Standard practice statement **INV-290** describes how the Commissioner will apply the s 141EB promoter penalties provision.[1] In discussing the requirements of s 141EB, the statement also comments on what the Commissioner considers to be "independent advice" (at [42] to [45]). Those comments are also considered relevant as guidance in the application of s 141D(3B).

1 IR-SPS INV 290: Promoter penalties *Tax Information Bulletin* Vol 16, No 2, (March 2004): 18.

6. The requirements for a taxpayer to have taken a "tax position" and for a "tax shortfall" to have arisen from that tax position are considered in **IS 26/03**: **Shortfall penalties – requirement for a "tax position" and a "tax shortfall"**.

7. An unacceptable tax position is a prerequisite to an abusive tax position shortfall penalty applying. Section 141B(1) provides that an unacceptable tax position is a tax position that, viewed objectively, fails to meet the standard of being about as likely as not to be correct. Section 141B(2) limits the application of unacceptable tax position penalties to tax shortfalls that relate to income tax and that exceed a specified monetary threshold. Those limitations do not apply to the abusive tax position shortfall penalty. Section 141B is only relevant to the extent that it defines what an unacceptable tax position is. The requirements for a tax position to be an unacceptable tax position are not discussed further in this interpretation statement. A full discussion of those requirements is set out in **IS 26/05**: **Shortfall penalty for taking an unacceptable tax position**.

8. **IS 26/09**: **Shortfall penalties – reductions and other matters** discusses when a shortfall penalty may be reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, the assessment of a penalty, the payment of a penalty and disputing a penalty.

9. The flowchart at Figure | Hoahoa 1 shows how s 141D applies.

Summary | Whakarāpopoto

10. This statement can be summarised as follows:

- An unacceptable tax position is an abusive tax position under s 141D(7)(b)(i) or s 141D(7)(b)(ii) if the taxpayer took the tax position:
  - in respect or as a consequence of an arrangement entered into with a dominant purpose of avoiding tax (s 141D(7)(b)(i)); or
  - otherwise than in respect of such an arrangement, with a dominant purpose of avoiding tax (s 141D(7)(b)(ii)).
- Section 141D(7) requires an objective assessment of dominant purpose. Under s 141D(7)(b)(i), it is the dominant purpose of the arrangement that must be ascertained. The subjective purpose or motives of the parties who entered into the arrangement are not relevant.
- Under s 141D(7)(b) (ii), it is the dominant purpose of the taxpayer that must be ascertained. As the assessment is objective, the taxpayer's purpose must be ascertained by reference to objective facts. The subjective purpose or motives the taxpayer had when taking their tax position are not relevant.
- Purpose is the result or effect intended or sought by an arrangement (under s 141D(7)(b)(i)) or by a taxpayer (under s 141D(7)(b)(ii)).
- When there is more than one purpose, the "dominant purpose" will be the ruling, prevailing, governing, commanding or most influential or important purpose.
- The term "avoiding tax" is to be interpreted widely and is not limited to the statutory concept of "tax avoidance".
- The term "arrangement" is defined in s 3(1). The definition embraces all kinds of concerted action by which people may arrange their affairs for a particular purpose or to produce a particular effect.
- The factors that may indicate a dominant purpose of avoiding tax include artificiality, contrivance, circularity of funding, concealment of information, non-availability of evidence and spurious interpretations of tax laws.
- In determining whether an arrangement with more than one purpose has a dominant purpose of avoiding tax, it is necessary to ask whether the particular way the arrangement has been put together can be explained by a non-tax purpose or purposes.
- An abusive tax position penalty does not apply automatically where there is a "tax avoidance arrangement" under s BG 1 of the Income Tax Act 2007 (ITA 2007) or s 76 of the Goods and Services Tax Act 1985 (GSTA). Section BG 1 of the ITA 2007 and s 76 of the GSTA apply when an arrangement has a more than merely incidental purpose of tax avoidance. Under s 141D, an arrangement must have a dominant purpose of avoiding tax before an abusive tax position penalty can be applied. The dominant purpose requirement under s 141D is a higher threshold than the merely incidental requirement under s BG 1 of the ITA 2007 and s 76 of the GSTA.
- An abusive tax position penalty may be imposed in respect of an arrangement that is caught by an anti-avoidance provision or in respect of arrangement that is not caught by an anti-avoidance provision. In both cases, the penalty will only apply if the arrangement has a dominant purpose of avoiding tax.

Analysis: Taxpayer's tax position | Tātari

11. Section 141D(6) and (7) defines an "abusive tax position" as follows:

> **141D Abusive tax position**
>
> ...
>
> (6) A taxpayer's tax position may be an abusive tax position if the tax position is an incorrect tax position under, or as a result of, either or both of
>
> (a) a general tax law; or
>
> (b) a specific or general anti-avoidance tax law.
>
> (7) For the purposes of this Part and section 177C, an abusive tax position means a tax position that,—
>
> (a) is an unacceptable tax position at the time at which the tax position is taken; and
>
> (b) viewed objectively, the taxpayer takes—
>
> (i) in respect, or as a consequence, of an arrangement that is entered into with a dominant purpose of avoiding tax, whether directly or indirectly; or
>
> (ii) where the tax position does not relate to an arrangement described in subparagraph (i), with a dominant purpose of avoiding tax, whether directly or indirectly.

Two limbs to s 141D(7)

12. An unacceptable tax position may be an abusive tax position under either s 141D(7)(b)(i) or s 141D(7)(b)(ii). To come within those provisions, the tax position must be taken:

- in respect or as a consequence of an arrangement that is entered into with a dominant purpose of avoiding tax (s 141D(7)(b)(i)); or
- otherwise than in respect of such an arrangement, with a dominant purpose of avoiding tax (s 141D(7)(b)(ii)).

Whose purpose is tested

13. Both limbs of s 141D(7)(b) require a dominant purpose of avoiding tax. In *Ben Nevis Forestry Ventures Ltd v CIR*,[2] the Supreme Court had to determine whether it was the dominant purpose of the taxpayer in taking their tax position or the dominant purpose of the arrangement that is relevant under s 141D(7)(b)(i). The Court held that the qualification in s 141D(7) that a tax position must be "viewed objectively" means it is the dominant purpose of the arrangement and this must be ascertained from the terms of the arrangement and not the subjective purpose or motives of the parties to the arrangement. The Court said:[3]

> ...it is the purpose of the arrangement itself, not the purpose in the mind of the taxpayer, that is referred to in s 141D(7)(b)(i). This aspect of the definition of an "abusive tax position" is concerned with the means employed rather than intentions of taxpayers in taking a tax position. The section requires that the arrangement itself be examined to ascertain its dominant purpose from its terms, irrespective of what may be known or inferred concerning the motives of individual investors.

14. In contrast to s 141D(7)(b)(i), the dominant purpose of avoiding tax under s 141D(7)(b)(ii) is a test of the taxpayer's purpose and is tested at the time the taxpayer's tax position is taken. As was the case with s 141D(7)(b)(i), the qualifying words "viewed objectively" require an objective assessment. This means the taxpayer's purpose is ascertained by reference to objective facts such as the nature of the tax position taken, the taxpayer's conduct in taking the tax position, and any other surrounding circumstances that may assist. The taxpayer's subjective purpose or motives in taking the tax position are not relevant.

Dominant purpose of avoiding tax

15. The term "dominant purpose" is not defined in the Act. The *Oxford English Dictionary* defines "purpose" as follows:[4]

> 1. a. That which a person sets out to do or attain; an object in view; a determined intention or aim.
> 2. The reason for which something is done or made, or for which it exists; the result or effect intended or sought; the end to which an object or action is directed; aim.

2 *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188.

3 *Ben Nevis* at [207].

4 *Oxford English Dictionary* (online ed, Oxford University Press, accessed 23 March 2026).

16. The courts have held that the test of whether an arrangement has a tax avoidance purpose or effect under s BG 1 of the ITA 2007 and s 76 of the GSTA is objective. The courts have also held that purpose in this context means the intended effect an arrangement seeks to achieve and not the parties' motives, and that "effect" means the end accomplished or achieved by the arrangement. The Commissioner considers this approach also applies under s 141D.

17. The *Oxford English Dictionary* defines the word "dominant" as follows:[5]

    1. … ruling, governing, commanding; most influential.

18. In *Case Y18*,[6] Judge Barber referred to the decision of the High Court of Australia in *FCT v Spotless Services Ltd*[7] when discussing the meaning of "dominant purpose" in s 141D:[8]

    > The additional requirement for s 141D to apply, if s 141B already applies, is that, viewed objectively, the dominant purpose of entering into the arrangement was avoiding tax. In *FCT v Spotless Services Ltd & Anor* (1996) 186 CLR 404 (HCA), the High Court of Australia considered the meaning of the "dominant purpose" of enabling a taxpayer to obtain a "tax benefit". It held that: "In its ordinary meaning, dominant indicates that purpose which was the ruling, prevailing, or most influential purpose."

19. Judge Barber referred to *Spotless Services* in interpreting dominant purpose in s 141D. The High Court of Australia in *Spotless Services* considered the dominant purpose to be the ruling, prevailing or most influential purpose.

20. In summary, it is considered that purpose in the context of s 141D(7) is the result or effect intended or sought by a taxpayer (s 141D(7)(b)(ii)) or by an arrangement (s 141D(7)(b)(i)). In both cases, the test is objective and, where there is more than one purpose, the dominant purpose will be the ruling, prevailing, governing, commanding, or most influential or important purpose.

Meaning of "avoiding tax"

21. The term "avoiding tax" is not defined in the Act or the ITA 2007. However, the term "tax avoidance" is defined in s YA 1 of the ITA 2007 as follows:

> YA 1 Definitions
>
> In this Act, unless the context requires otherwise,—
>
> …
>
> **tax avoidance** includes—
>
> (a) directly or indirectly altering the incidence of any income tax:
>
> (b) directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:
>
> (c) directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax

22. The term "tax avoidance" is also defined in s 76(8) of the GSTA, for the purposes of the GSTA, as follows:

> 76 Avoidance
>
> …
>
> (8) For the purpose of this section—
>
> …
>
> **tax avoidance** includes—
>
> (a) a reduction in the liability of a registered person to pay tax:
>
> (b) a postponement in the liability of a registered person to pay tax:
>
> (c) an increase in the entitlement of a registered person to a refund of tax:
>
> (d) an earlier entitlement of a registered person to a refund of tax:
>
> (e) a reduction in the total consideration payable by a person for a supply of goods and services.

5 *Oxford English Dictionary* (online ed, Oxford University Press, accessed 23 March 2026).

6 *Case Y18* (2008) 23 NZTC 13,180 (TRA).

7 *FCT v Spotless Services Ltd* (1996) 186 CLR 404 (HCA).

8 *Case Y18* at [73]. Judge Barber described the test for a "dominant purpose" as an objective test but, arguably, relied on subjective factors when applying the test. Despite this, Judge Barber's discussion on the meaning of dominant purpose remains relevant.

23. The Commissioner considers that the term "avoiding tax" should be interpreted widely and is not limited to the statutory concept of tax avoidance. This is consistent with s 141D(6)(a) which provides that a taxpayer's tax position may be an abusive tax position if it is an incorrect tax position under either or both of an anti-avoidance provision or a general provision. Consequently, even when an adjustment is made under a provision other than an anti-avoidance provision, an abusive tax position shortfall penalty may apply provided there is a dominant purpose of avoiding tax.

24. Applying a wide interpretation to the term tax avoidance is also consistent with the commentary on the Bill that introduced s 141D into the Act, which states:[9]

> The penalty for abusive tax positions will apply not only in situations where a general or specific anti-avoidance provision is invoked, but also where other provisions have been applied. The need for the Commissioner to rely explicitly on an anti-avoidance provision does not necessarily indicate that the tax position is more deserving of a high penalty than an aggressive interpretation intended to avoid tax but which fails under another provision.
>
> The concept of "avoiding tax" encompasses the deferral of tax and the claiming of tax credits.

"Directly" or "indirectly"

25. Section 141D(7)(b)(i) and (ii) refer to a tax position taken with a dominant purpose of avoiding tax "whether directly or indirectly".

26. There is no discussion about the inclusion of the words "directly or indirectly" in the discussion documents relating to the abusive tax position penalty or in the commentary.[10] It appears the use of the words directly or indirectly in subparas (i) and (ii) was to ensure the abusive tax position penalty applies as widely as possible and to maintain consistency with the definition of tax avoidance in s YA 1 of the ITA 2007 and s 76(8) of the GSTA.

Meaning of "arrangement"

27. Section 141D(7)(b)(i) requires an arrangement that is entered into with a dominant purpose of avoiding tax.

28. "Arrangement" is relevantly defined in s 3(1) as follows:

> "**arrangement**" –
>
> (a) Means a contract, agreement, plan or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect:

29. The definition of arrangement provides for varying degrees of formality and enforceability. For example, an arrangement may be:

- a legally binding contract;
- an agreement or plan that may or may not be legally binding;
- an understanding that may or may not be legally binding; or
- a contract that is not enforceable at law due to public policy, contractual incapacity or illegality.

30. There is case law on the meaning of arrangement in the income tax context, particularly in the context of the general anti-avoidance provision.[11] An arrangement has been described as embracing all kinds of concerted action by which people may arrange their affairs for a particular purpose or to produce a particular effect.[12]

31. An arrangement may involve more than one transaction or document. Whether it does or not is a matter of fact.[13]

32. In determining whether transactions or documents (or both) are part of an arrangement, the courts ask whether:

- the transactions or documents are sufficiently interrelated or interdependent;
- an overall plan exists; and
- there is prior planned linking or sequencing (or both).

9 *Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill* (Inland Revenue, September 1995) at 15 and 16.

10 *Taxpayer Compliance, Standards and Penalties: A government discussion document* (government discussion document, Policy Advice Division of Inland Revenue, August 1994) and *Taxpayer Compliance, Standards and Penalties 2: Detailed proposals and draft legislation* (government discussion document, Policy Advice Division of Inland Revenue, April 1995).

11 The term arrangement is defined is s YA 1 of the ITA 2007.

12 *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450 (CA) at [45].

13 *Peterson v CIR* [2005] UKPC 5 at [33].

33. This requires consideration of the nature and extent of the relationship between the transactions or documents.

34. An arrangement, as defined, includes "all steps and transactions by which it is carried into effect". These words reflect that a "contract, agreement, plan, or understanding" may not describe all the practical steps and transactions needed to carry out an arrangement.

35. Therefore, the definition makes clear that an arrangement includes the various actions undertaken to carry the arrangement into effect even if those actions are not by themselves a contract, agreement, plan or understanding.

36. Other aspects of an arrangement include the following:

    - An arrangement is defined to include a "plan", which could involve a single person.[14]
    - An arrangement does not require a consensus or a meeting of minds of two or more people, so a taxpayer could be party to an arrangement even if they are not consciously involved in or aware of its details.[15]
    - An arrangement may consist of more than one agreement, contract, plan or understanding, so an agreement, contract, plan or understanding may be part of a wider arrangement as well as being part of a separate narrower arrangement.
    - An arrangement includes steps and transactions that are entered into or carried out outside New Zealand.[16]

Factors that may indicate a "dominant purpose of avoiding tax"

37. The commentary discussed indicators that may suggest a dominant purpose of avoiding tax:[17]

> Indicators of a dominant purpose of avoiding tax may include artificiality, contrivance, circularity of funding, concealment of information and non-availability of evidence, and spurious interpretations of tax laws.

38. The indicators referred to in the commentary can help to determine whether an arrangement or a taxpayer has a dominant purpose of avoiding tax. Factors that may be taken into account when considering whether there is a dominant purpose of avoiding tax include artificiality and contrivance, circularity of funding, concealment of information and non-availability of evidence, and spurious interpretations.

Artificiality and contrivance

39. Have the transactions been designed to appear to comply with the legislation? The legal form may not reflect the substance.

40. Consideration will be given to the commercial reality of the arrangement. Are the arrangements or schemes "self-cancelling" (ie, otherwise neutral commercial consequences, leaving only tax effects)?

41. The importance of the transaction's commercial purpose compared to the tax benefit the relevant taxpayer obtained must be examined.

Circularity of funding

42. Circularity may arise in two types of arrangement:

    - An arrangement that involves circular movements of money that have the economic effect of being self-cancelling and, in reality, no cost is suffered.
    - An arrangement, or a part of it, that involves steps that have the commercial effect of being self-cancelling. For example, where a commercial risk at one step is cancelled by another step with the effect that, in reality, there is no risk at all.

14 *Russell v CIR (No 2)* (2010) 24 NZTC 24,463 (HC) (footnote 33 at [101]) and *Russell v CIR* [2012] NZCA 128 at [54].

15 *Peterson v CIR* at [34].

16 *BNZ Investments Ltd v CIR* (2000) 19 NZTC 15,732 (HC) at [123].

17 *Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill* (Inland Revenue, September 1995) at 15.

Concealment of information and non-availability of evidence

43. Concealment of information may occur through the use of a tax haven or by other means. By going through a tax haven, disclosure protection may result due to the particular tax haven's secrecy laws. These laws usually do not allow information to be released to tax authorities. Concealment of information may provide an obstacle to the gathering of information to establish whether the transaction or arrangement is artificial or contrived. In these circumstances, the burden of proof remains on the taxpayer to establish their position.

Spurious interpretations

44. Spurious interpretation covers situations where a tax position taken has no or little basis at law or the interpretation made or position taken is frivolous.

No exhaustive list of factors

45. The factors discussed above are not an exhaustive list of the factors that may indicate a dominant purpose of avoiding tax. A discussion document published before the introduction of s 141D(7) stated:[18]

> 7.10 The draft legislation does not include a list of indicators of dominant purpose. Although such a list could highlight some of the factors to be considered in determining whether a penalty should be applied for abusive avoidance, rather than lack of a reasonably arguable position, the list could not be exhaustive, and the absence or inclusion of one factor might take on a significance which is unintended.

46. The factors were not listed in the legislation to prevent the absence of any factor having the unintended consequence of the penalty not applying. As discussed above, the test is whether the dominant purpose is avoiding tax. It is considered, therefore, that the absence of any of the factors will not indicate the penalty does not apply. Further, the penalty may still apply if none of the listed factors are present. For example, other factors (such as inflated values or a lack of economic substance) may indicate that the dominant purpose of an arrangement is avoiding tax.

Ascertaining the dominant purpose of an arrangement

47. When applying s 141D(7)(b)(i), the purposes of an arrangement must be identified and weighed to determine whether the arrangement has a dominant purpose of avoiding tax. If the only purpose of the arrangement is avoiding tax, that will be the dominant purpose. If there are other purposes, these must be weighed against the purpose of avoiding tax to see which, if any, is dominant.

48. Purposes are identified and weighed in the context of the arrangement's specific structure. As the test is to establish the dominant purpose of the arrangement, purposes are relevant if they explain the arrangement's specific structure. The fact that non-tax purposes may be able to be achieved by other structures does not in itself make the non-tax purposes irrelevant. The point is whether the particular way the arrangement has been put together can be explained by a non-tax purpose or purposes. If the arrangement's specific features are mainly explicable by the tax purposes, this suggests the dominant purpose is avoiding tax. If the arrangement's specific features are mainly explicable by the non-tax purposes, this supports the conclusion that the dominant purpose of the arrangement is not avoiding tax. If none of the purposes (tax or non-tax) is dominant, the penalty will also not apply.

49. The factors discussed in the commentary may be the same factors that indicate there is a tax avoidance arrangement.[19] However, the factors must be considered again in the context of the different standard in the dominant purpose test in s 141D. In other words, it is necessary to consider whether the factors support the conclusion that the dominant purpose of the arrangement is avoiding tax.

18 *Taxpayer Compliance, Standards and Penalties 2: Detailed proposals and draft legislation* (government discussion document, Policy Advice Division of Inland Revenue, April 1995).

19 *Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill* (Inland Revenue, September 1995).

Case law

50. The cases on s 141D(7) have generally considered whether an abusive penalty applied because there was an arrangement within s 141D(7)(b)(i) that had a dominant purpose of avoiding tax. Those cases have weighed the tax purposes of the relevant arrangements against the non-tax purposes: *Accent Management Ltd v CIR* (HC),[20] *Case Z23*[21] and *Krukziener v CIR*.[22] The cases also looked at various indicators to help to determine whether an arrangement's dominant purpose was to avoid tax. For example, the courts have looked at the substance of the arrangement, the presence of artificiality, and the extent to which the economic position of the person was altered by entry into the arrangement: *Erris Promotions Ltd v CIR*,[23] *CIR v Campbell Investments Ltd*,[24] *Alesco NZ Ltd v CIR*[25] and *Case 10/2015*.[26]

51. Consistent with the discussion at [48], the courts have also considered whether the form of an arrangement can be explained by a non-tax purpose. In *Vinelight Nominees Ltd v CIR*,[27] the Court of Appeal found that an arrangement had a dominant purpose of tax avoidance and, in doing so, observed that family objectives did not explain the form of the arrangement.[28] Similarly, in *Frucor Suntory NZ Ltd,* the Supreme Court found there was no plausible commercial reason other than tax avoidance for the way a funding arrangement had been structured.[29] Although this observation was made in the context of the Court's discussion of the merely incidental test in s BG 1 of the ITA 2007, the Court went on to hold that the arrangement had a dominant purpose of avoiding tax. The structuring of the arrangement together with the Court's finding that the arrangement had substantial elements of artificiality, contrivance, circularity and cancellation appear to have been important factors that supported this decision.[30]

Relationship with general anti-avoidance provisions

52. An abusive tax position penalty does not apply automatically under s 141D where there is a tax avoidance arrangement under s BG 1 of the ITA 2007 or s 76 of the GSTA. Section BG 1 of the ITA 2007 and s 76 of the GSTA require the arrangement's tax avoidance purpose or effect to be more than merely incidental. Section 141D requires the dominant purpose to be avoiding tax. Therefore, the tests are fundamentally different and the "dominant purpose" requirement imposes a higher threshold than the "merely incidental" requirement. The Commissioner's view on the relationship between s BG 1 of the ITA 2007 and s 141D is set out in **QB 12/12: Abusive tax position penalty and the anti-avoidance provision**.[31]

53. The Commissioner has not imposed an abusive tax position penalty in respect of all tax avoidance arrangements. In all the Taxation Review Authority and court cases where an arrangement was caught by s BG 1 of the ITA 2007 and the abusive tax position penalty was at issue, it was ultimately found that each arrangement had a dominant purpose of avoiding tax. No cases, therefore, have found that the arrangement's tax avoidance purpose or effect was more than merely incidental under s BG 1 of the ITA 2007 but the arrangement's purpose of avoiding tax was not dominant under s 141D. As a result, the courts have not yet provided guidance as to when a tax avoidance arrangement could be said to not have a dominant purpose of avoiding tax.

54. An abusive tax position penalty may be imposed in respect of an arrangement that is caught by an anti-avoidance provision or in respect of an arrangement that is not caught by an anti-avoidance provision. In both cases, the penalty will only apply if the arrangement has a dominant purpose of avoiding tax.

20 *Accent Management Ltd v CIR* (2005) 22 NZTC 19,027 (HC) at [370] (upheld in *Ben Nevis*).

21 *Case Z23* (2010) 24 NZTC 14,334 (TRA) at [125].

22 *Krukziener v CIR (No 3)* (2010) 24 NZTC 24,563 (HC) at [71].

23 *Erris Promotions Ltd v CIR* (2003) 21 NZTC 18,330 (HC) at [375]–[376] per Ronald Young J.

24 *CIR v Campbell Investments* (2004) 21 NZTC 18,559 at [51] per Wild J.

25 *Alesco NZ Ltd v CIR (No 2)* (2011) 25 NZTC ¶20-099 at [178]–[179] (HC) per Heath J (upheld in *Alesco NZ Ltd v CIR* (2013) 26 NZTC ¶21-003 (CA)).

26 *Case 10/2015* (2015) 27 NZTC 17,261 (TRA) at [117]–[118] (upheld by the High Court in Honk Land Trustees v CIR (2016) 27 NZTC ¶22-055 and by the Court of Appeal in *Honk Land Trustees Ltd v CIR* (2017) 28 NZTC ¶23-006).

27 *Vinelight Nominees Ltd v CIR* (2013) 26 NZTC ¶21-055 (CA).

28 *Vinelight* at [68].

29 *Frucor Suntory NZ Ltd v CIR* (2022) 30 NZTC ¶25-024 at [76] (SC).

30 *Frucor Suntory NZ Ltd* at [81]–[85].

31 QB 12/12: Abusive tax position penalty and the anti-avoidance provision *Tax Information Bulletin* Vol 24, No 9 (October/November 2012): 20.

Examples | Tauira

The following examples demonstrate the abusive tax position penalty applying in three situations. In Example | Tauira 1, there is an arrangement that is not caught by an anti-avoidance provision, in Example | Tauira 2 there is an arrangement that is caught by an anti-avoidance provision, and in Example | Tauira 3 there is no arrangement.

Example | Tauira 1 – Application of s 141D(7) where there is an arrangement

Facts

Andrew is a trustee of the Andrew Family Trust. Andrew and his family members are beneficiaries of the trust.

In the 2020 tax year, the trust acquires bare land with an intention of building a dwelling on the land, then selling it for a profit. The dwelling is completed in 2020. However, due to a downturn in the market, Andrew decides to lease the property to tenants. The property is managed by a property management company and the trust pays the company a fee. To help save costs, Andrew occasionally visits the property to carry out minor repair and maintenance tasks, free of charge.

After 3 years, Andrew decides to sell the property as the market has improved and he wishes to change the trust's investment focus. The sale yields a $100,000 taxable profit in the 2023 tax year.

Andrew is the sole shareholder and director of A Ltd, a company through which he carries on a business. In the 2023 tax year, A Ltd has a loss balance of $200,000. At the end of the 2023 tax year, Andrew purports to implement a service agreement between A Ltd and the trust for the provision of the repairs and maintenance work he carried out, even though no such agreement was in place at the time the work was done, and none was anticipated. Andrew sets a price of $100,000 for the work and prepares a $100,000 invoice on A Ltd's behalf and issues it to the trust. The invoiced transaction is recorded in the 2023 accounts of the trust and A Ltd.

In its return for the 2023 tax year, the trust claims a deduction for the $100,000 payment. A Ltd includes the payment as income in its return, reducing its loss balance to $100,000.

When questioned about the deduction, Andrew says:

- he considers the $100,000 payment meets the requirements of the general permission in s DA 1 because it was a payment for services;
- he had a genuine belief it was permissible to implement a service agreement retrospectively because work was carried out that was of value to the trust; and
- although the fee was calculated to match the trust's taxable profit and greatly exceeded the value of the work performed, this did not seem objectionable in a related-party situation.

Analysis

Did the trust take an unacceptable tax position?

The trust did not incur the $100,000 payment in deriving its income. While the amount purports to have been paid under a service agreement between A Ltd and the trust, there was no such agreement in place during the 2020-2023 years, and it was not possible to implement one on a retrospective basis. The correct characterisation of the events that occurred during the 2020-2023 years is that Andrew carried out work for the trust in his personal capacity, and did so free of charge.

Consequently, the trust is not entitled to deduct the $100,000 payment under the general permission (and the Commissioner does not have to consider the potential application of s BG 1).

The arguments raised by Andrew do not support his contention that the requirements of the general permission are met. Consequently, the trust's tax position does not meet the standard of being about as likely as not to be correct.

Did the trust take its tax position in respect, or as a consequence, of an arrangement?

Andrew's decision to issue an invoice to the trust and the recording of the $100,000 payment in the accounts of the trust and A Ltd constitute an arrangement. The trust's tax position was taken in respect of this arrangement because the arrangement was the basis upon which the trust claimed an entitlement to deduct the $100,000 amount. Accordingly, it is necessary to consider whether the arrangement is within s 141D(7)(b)(i), being an arrangement that has a dominant purpose of avoiding tax.

Does the arrangement have a dominant purpose of avoiding tax?

The arrangement was entered into at the end of the 2023 tax year when the trust became aware a tax liability would arise. The $100,000 payment is inflated when considered against the minor and occasional work carried out by Andrew and was calculated to match the amount of the trust's taxable profit. These circumstances indicate that the arrangement was carried out in response to the trust's tax liability and its intended effect was to create a transaction that would reduce the liability to zero. The arrangement and the resulting tax position taken by the trust were spurious as there was no legal basis which would support a conclusion the arrangement had the effect of the trust incurring $100,000 of deductible expenditure in the 2023 tax year.

These circumstances show that the dominant purpose of the arrangement was avoiding tax payable on the property sale.

Accordingly, the abusive tax position shortfall penalty applies.

55. Example | Tauira 2 involves the application of s BG 1 of the ITA 2007. The leading authority on whether an arrangement has a tax avoidance purpose or effect under s BG 1 of the ITA 2007 is the decision of the Supreme Court in *Ben Nevis*. *Ben Nevis* sets out the parliamentary contemplation test. The parliamentary contemplation test is applied to determine whether an arrangement has a tax avoidance purpose. The test is whether the arrangement, viewed in a commercially and economically realistic way, makes use of or circumvents a specific provision in a manner that is consistent with Parliament's purpose.

56. Detailed guidance on the Commissioner's approach when applying s BG 1 of the ITA 2007 and the parliamentary contemplation test is set out in **IS 23/01**.[32] Broadly, that approach involves several steps, which are set out in Example | Tauira 2.

Example | Tauira 2 – Application of s 141D(7) where a tax avoidance arrangement exists

Facts

Jack is the sole shareholder and director of J Ltd, a company through which he carries on a profitable business. Jack is also an employee of the business.

Loss Co has a carried forward loss and is controlled by Lewis, Jack's business advisor. Jack sells his shares in J Ltd to Loss Co for $3 million. Loss Co funds the purchase using an interest free on demand loan from Jack. The loan is secured by a mortgage over the shares and Jack declares that he holds the shares on trust for Loss Co.

After the sale, Jack remains a director of J Ltd and enters into a management agreement under which he continues to manage J Ltd's business in the same manner he did before the sale.

J Ltd agrees to pay Loss Co its net surplus every 6 months as an administration charge. The effect of the administration charge is that all of J Ltd's annual net profit is paid to Loss Co. The administration charge does not reflect work or services performed for J Ltd. Loss Co agrees to pay an amount equal to 86% of the administration charge to Jack in repayment of the outstanding loan.

Jack has a right of first refusal should Loss Co decide to sell its business or undertaking. Jack also has an option to repurchase J Ltd's business assets for an amount equal to J Ltd's liabilities plus $1. Jack is entitled to exercise the option five years from the date of the sale or at a time when the total administration charges paid to Loss Co equal $3,488,372 (86% of this amount being equal to the purchase price for the shares).

32 IS 23/01: Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007 *Tax Information Bulletin* Vol 35, No 2 (March 2023): 8.

Loss Co offsets the administration charges it receives against its carried forward loss and Jack treats the loan repayments he receives as non-taxable capital receipts. The proportion of the administration charge retained by Loss Co is calculated to be 50% of the tax that would have been paid on J Ltd's profits had they been taxed at the company rate of 28% instead of being paid to Loss Co as an administration charge and offset against its loss.

The Commissioner considers that s BG 1 of the ITA 2007 applies and, on this basis, applies s GA 1 to assess J Ltd's net profits as income derived by Jack.

Section BG 1 of the ITA 2007

As the Commissioner's position is that BG 1 of the ITA 2007 applies, it is necessary to set out the steps involved in applying that section before going on to consider the application of s 141D.

Step 1: Identify and understand the arrangement

There is an arrangement comprising:

- the share sale and the loan from Jack.
- the trust of the shares in favour of Loss Co.
- the management agreement and Jack's continued control and management of J Ltd after the share sale.
- the payment of J Ltd's net profits to Loss Co as an administration charge and the payment of 86% of the administration charge to Jack as a loan repayment.
- Jack's first right of first refusal and option to purchase.

The relevant tax effects are:

- J Ltd deducts the administration charge.
- Loss Co offsets the administration charge it receives against its carried forward loss.
- The loan repayments are non-taxable capital receipts.

Step 2: Identify Parliament's purpose for the specific provisions that are relevant

The specific provisions that are relevant include:

- Sections CE 1 (income from employment) and CA 1 (ordinary income) of the ITA 2007. Parliament's purposes for these provisions include taxing income from personal services.
- Section CD 1 of the ITA 2007 (dividend). Parliament's purposes for s CD 1 include taxing transfers of value from a company to a shareholder of the company.
- The loss grouping provisions in subpart IC of the ITA 2007. Parliament's purposes for these provisions include the prevention of loss trading by requiring a specified level of commonality of ownership between a profit company and a loss company before the loss company can share its loss with the profit company.

Step 3: Understand the commercial and economic reality of the arrangement

In the Commissioner's view, the administration charge was not commercial as it was not referrable to any services or work performed for J Ltd. In reality, the administration charge was a payment of J Ltd's profits to Loss Co.

The loan agreement was not a commercial financing transaction for the purchase of shares and the sale agreement was not a commercial agreement for the sale of shares.

Although Jack sold his shares to Loss Co, he did not relinquish control of J Ltd. He continued to manage the company in the same way as before the sale. In practice, nothing changed. Jack also stood to reacquire his shares under the option agreement once the arrangement had run its course.

Jack retained the economic benefits of ownership as the loan repayments he received were, in reality, J Ltd's profits reduced by the amount retained by Loss Co. The profits Jack received were his return for his investment in J Ltd's business.

These circumstances indicate a high level of artificiality and contrivance.

Step 4: Consider whether the arrangement circumvents the specific provisions in a manner consistent with Parliament's purpose

Loss Co was not entitled to share its loss with J Ltd under the loss grouping rules. The arrangement circumvented these rules by artificially treating J Ltd's profits as an administration charge that Loss Co was able to offset against its loss. The amount of the administration charge retained by Loss Co represented 50% of the tax saved and was, in reality, a payment for the use of Loss Co's loss. In this respect, the arrangement involved loss trading. These circumstances show that the arrangement circumvents the loss grouping rules in a manner that is outside of Parliament's purposes for those rules.

Under the arrangement Jack effectively controlled J Ltd and received its profits as his return for the work he did. When a shareholder receives a return from their company in the form of dividends or remuneration, Parliament intends that the return is taxable income of the shareholder. However, the amounts received by Jack were not taxable as they were capital receipts. The arrangement achieved this outcome by artificially characterising the amounts as loan repayments. This shows that the arrangement circumvented ss CA 1, CE 1 and CD 1 of the ITA 2007 in a manner that is outside Parliament's contemplation for those provisions.

Step 5: Decide whether a tax avoidance purpose or effect exists

The purpose of the arrangement was to avoid tax on J Ltd's net profits by offsetting the profits against Loss Co's loss and converting them into a capital receipt. The arrangement achieved this in a highly contrived and artificial way and so was outside of Parliament's purpose for the specific provisions that are relevant. This shows that the arrangement had a tax avoidance purpose.

Step 6: Determine whether the tax avoidance purpose or effect is merely incidental

The arrangement's tax avoidance purpose is not merely incidental as it is not a natural incident of another non-tax purpose.

Reconstruction

To counteract the tax advantages under the arrangement, it is appropriate to apply s GA 1 of the ITA 2007 to treat J Ltd's net profits as income derived by Jack. Given Jack's retention of control and economic benefits of ownership, treating the profits as derived by Jack most directly counteracts the tax advantages.

Shortfall penalty

Did Jack take an unacceptable tax position?

The very high levels of artificiality and contrivance in the arrangement mean an argument s BG 1 does not apply to the arrangement would not meet the "about as likely as not to be correct" standard.

Was the tax position taken in respect, or as a consequence, of an arrangement?

Jack took his position as a consequence of the arrangement discussed in relation to s BG 1 of the ITA 2007. Accordingly, it is necessary to consider whether the arrangement is also within s 141D(7)(b)(i), being an arrangement that has a dominant purpose of avoiding tax.

Did the arrangement have a dominant purpose of avoiding tax?

The high levels of artificiality and contrivance and the significant tax advantages obtained under the arrangement support a conclusion it had a dominant purpose of avoiding tax. Further, the way the arrangement was structured and implemented appears wholly explicable by the tax advantages, and this too supports a conclusion it had a dominant purpose of avoiding tax. Accordingly, the abusive tax position shortfall penalty applies.

This example is based on the facts and decision in *Case R25* (1994) 16 NZTC 6,120 (TRA) and appeal decisions in *Miller and Ors v CIR; McDougall and Anor v CIR; Managed Fashions Ltd and Ors v CIR* (1997) 18 NZTC 13,219 (HC) and *Miller v CIR; Managed Fashions Ltd v CIR* (1998) 18 NZTC 13,961 (CA).

Example | Tauira 3 – Application of s 141D(7) when there is no arrangement

Facts

In the 2018 tax year, Dennis receives a large inheritance that he uses to acquire an investment. The investment documentation Dennis fills out records that he is the sole investor. Accordingly, Dennis holds the investment in his own name.

The investment returns $80,000 of income annually from the start of the 2020 tax year. Dennis receives the income into his bank account and uses it to pay private expenditure, make lump sum mortgage repayments and fund other investments.

In the 2020–2024 tax years, Dennis derives a salary of $100,000 and his partner derives a salary of $50,000. In each of those years, Dennis prepares his own tax return and prepares tax returns on behalf of his partner and their three young children.

Dennis includes $14,000 of the investment income in each child's return (the children's returns do not include any other income), $20,000 in his partner's return and the balance of $18,000 in his return.

When asked why he split the income in this manner, Dennis says he did this because the income was family income. When asked if the family members received the amounts in their returns or, if not, whether they would receive them in the future, Dennis said they received some as the income was used to pay family expenditure. He also said they could expect to receive more in the future as the income was also used to pay for the family home and other investments, and he has left these assets to his family in his will.

Analysis

Did Dennis take unacceptable tax positions?

Dennis legally derives all $80,000 of annual income that the investment produces because he owns the investment. Consequently, the tax positions that he took in his returns for the 2020–2024 tax years are incorrect as he included only $18,000 of the income in the returns.

Dennis's tax positions do not meet the standard of being about as likely as not to be correct as there is no evidence and no authority that supports his contention the income is family income. There is nothing that suggests anyone other than Dennis was the legal owner of the investment, there is no evidence Dennis held the investment on trust for this family, and there is no evidence that any income from the investment was assigned to anyone else.

Were the tax positions taken in respect, or as a consequence, of an arrangement?

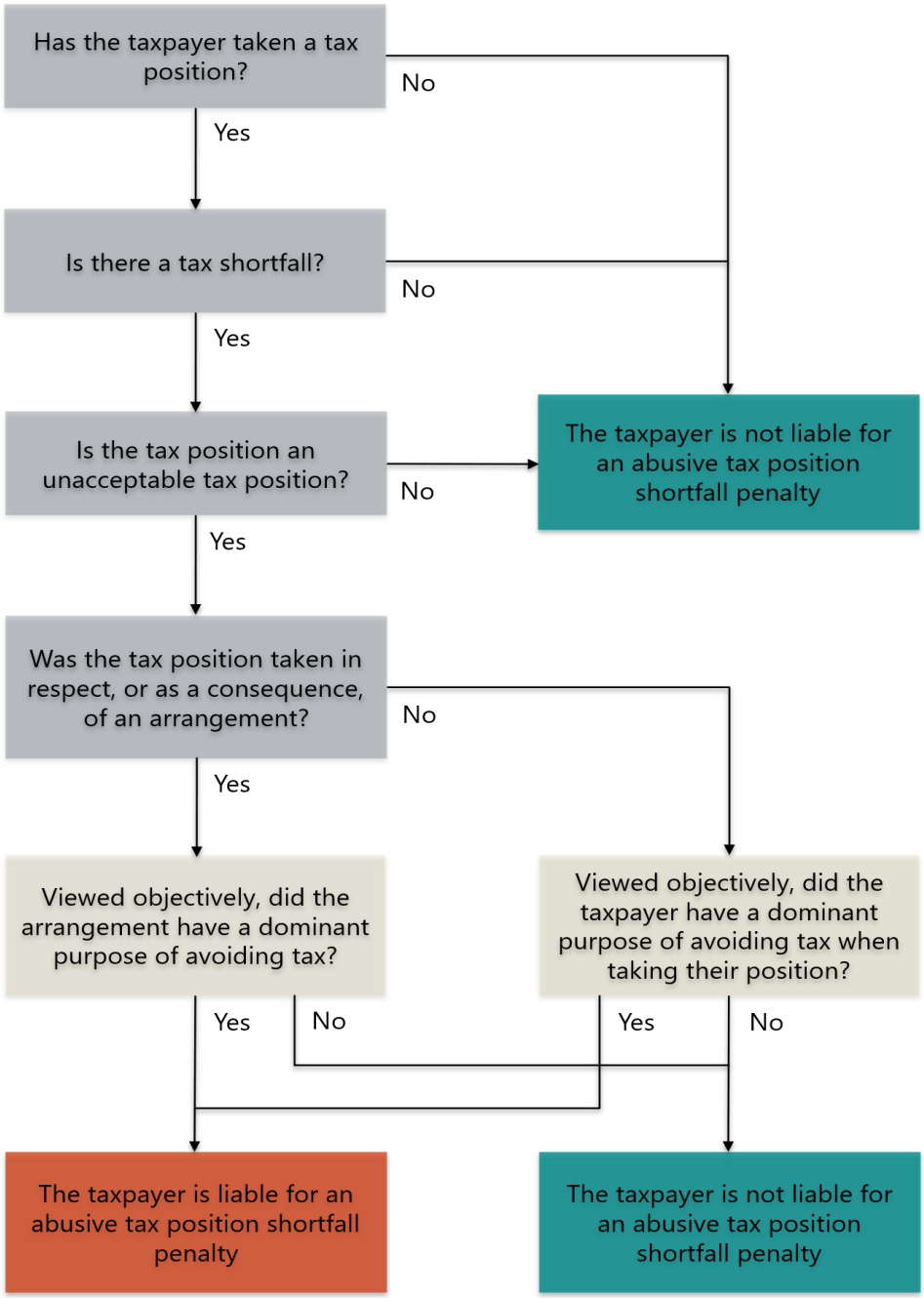
Dennis acted alone in apportioning his income between himself and his family members. It is arguable this constitutes an arrangement as the definition of arrangement includes a plan, and a plan can be carried out by a single person. However, there were no transactions, documents or steps underlying Dennis's tax position that effected, or attempted to effect, a reduction in his income. Instead, Dennis's tax position was based on his view that the income was family income and could be divided amongst his family for assessment purposes. These circumstances indicate there was no arrangement. This means it is necessary to consider whether Dennis's tax positions, viewed objectively, are within s 141D(7)(b)(ii), being tax positions taken with a dominant purpose of avoiding tax.

Did Dennis take his tax positions with a dominant purpose of avoiding tax?

Dennis allocated $14,000 of the investment income to each of his children and an amount to his partner that increased her income to $70,000. Both amounts are close to threshold amounts above which a person's marginal tax rate increases and Dennis's children and his partner are on lower marginal tax rates than he is. This indicates that in taking his tax positions, Dennis had a purpose of avoiding the tax that would otherwise have been payable had all the income been included in his returns. Further, there was no substantial evidential or legal basis that would support treating the income, in part, as belonging to Dennis and his family members for assessment purposes. This is indicative of a spurious interpretation and application of the applicable tax laws. These circumstances show that Dennis's tax positions were taken with a dominant purpose of avoiding tax.

Accordingly, the abusive tax position shortfall penalty applies.

Figure | Hoahoa 1: Flowchart showing how s 141D applies



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IS 26/08: Shortfall penalty for evasion or a similar act

Issued | Tukuna: 27 March 2026

This interpretation statement explains the shortfall penalty when a person evades the assessment or payment of tax, or does any of the similar acts specified in s 141E of the Tax Administration Act 1994. The interpretation statement explains what is required to satisfy the knowledge requirement, and other requirements, for evasion or a similar act.

All legislative references are to the Tax Administration Act 1994 (TAA) unless otherwise stated.

REPLACES | WHAKAKAPIA

- **IS0062**: Shortfall penalty – evasion
- **QB 10/04**: Shortfall penalty for evasion or a similar act - knowledge required and Interpretation Statement IS0062

Key terms | Kīanga tau tāpua

Subjective recklessness	This occurs when facts actually known to a taxpayer must have alerted them to a relevant risk, and the taxpayer makes a conscious decision to ignore the risk and proceed with the act or omission without making any further inquiry.
Tax position	A position or approach regarding tax under a tax law.
Tax shortfall	The difference between the tax effect of the taxpayer's tax position for the return period and the correct tax position for that period.
Wilful blindness	This is when a taxpayer deliberately "shuts their eyes" to their obligations and does not inquire further because they do not want their suspicions confirmed.

Summary | Whakarāpopoto

1. Section 141E imposes a shortfall penalty of 150% of the tax shortfall for evasion or a similar act if the following requirements are satisfied:
   - The taxpayer has taken a tax position.
   - Taking the tax position has resulted in a tax shortfall.
2. The taxpayer has done an act listed in ss 141E(1)(a)–(f), and an exception does not apply for para (b). Paragraph (a) is evasion of the assessment or payment of tax under a tax law. The other paragraphs outline various similar acts and omissions that require knowledge. The similar acts in paras (b)-(f) are:
   - Knowingly applying a deduction or withholding of tax other than in payment to the Commissioner (**s 141E(1)(b)**). The exceptions to para (b) are:
     - satisfying the Commissioner that the amount is accounted for and the failure to pay is due to illness, accident, or another reason outside the taxpayer's control (**s 141E(2)**), or
     - the unpaid deduction is PAYE to which a penalty under s 141ED applies (**s 141E(2B)**);
   - Knowingly failing to make a deduction or withholding of tax, or transfer or payroll donation (**s 141E(1)(c)**);
   - Obtaining (**s 141E(1)(d)**) or attempting to obtain (**s 141E(1)(da)**) a refund or payment of tax, if the taxpayer knows they are not lawfully entitled to the refund or payment;
   - Enabling another person to obtain (**s 141E(1)(e)**) or attempting to enable another person to obtain (**s 141E(1)(f)**) a refund or payment of tax, knowing the other person is not lawfully entitled to the refund or payment.

3. This interpretation statement does not provide a detailed explanation of when a taxpayer has taken a tax position or when taking a tax position results in a tax shortfall. The requirements for a taxpayer to have taken a "tax position" and for a "tax shortfall" to have arisen from that tax position are considered in the following item:

    - **IS 26/03: Shortfall penalties – requirement for a "tax position" and a "tax shortfall"**

4. This interpretation statement's focus is on the mental requirements for evasion or a similar act, and what is required for the acts outlined in ss 141E(1)(a)-(f). Broadly, evasion requires intention and actual knowledge, wilful blindness, or subjective recklessness. Negligence or carelessness is insufficient. Similar acts to evasion also require actual knowledge, wilful blindness, or subjective recklessness.

5. The following facts are relevant when considering whether the mental requirements for evasion or a similar act have been met:

    - The term "evade" connotes the exercise of will in avoiding. The person must intend to evade the assessment or payment of tax.
    - There must be more than mere failure to meet a tax obligation. There must be some blameworthy act or omission on the part of the taxpayer.
    - Evasion or a similar act requires knowledge of the relevant facts or tax obligation. There must be actual knowledge, or neglect of available means of knowledge.
    - Knowledge is tested subjectively but can be inferred from objective consideration of surrounding circumstances and conduct.
    - Subjective recklessness will also satisfy the mental elements of evasion or a similar act. Subjective recklessness requires a deliberate disregard of one's obligations, or an appreciation of a positive risk and proceeding regardless.
    - Knowledge can also be inferred from wilful blindness, which is when a taxpayer deliberately closes their eyes to their obligations.
    - An omission can constitute evasion or a similar act if the necessary knowledge requirement is present.
    - What the person needs to have knowledge of depends on the relevant paragraph. For evasion under s 141E(1)(a), the person must know their act or omission will breach a tax obligation.
    - For ss 141E(1)(d)-(f), which concern obtaining or attempting to obtain refunds or payments of tax, the taxpayer must know the relevant person is not lawfully entitled to the refund or payment. It is not sufficient merely to knowingly obtain or attempt to obtain the relevant refund.
    - For paras (b) and (c) in s 141E(1), knowledge of the relevant act is sufficient.

6. Unlike the other shortfall penalties, the onus of proof rests with the Commissioner to show that a taxpayer is liable for a shortfall penalty for evasion or a similar act under s 141E. The standard of proof is the balance of probabilities.

7. Where the Commissioner imposes a shortfall penalty, other matters may arise. **IS 26/09: Shortfall penalties – reductions and other matters** discusses when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.

Introduction | Whakataki

8. Section 141E imposes a shortfall penalty for evasion or a similar act if the following requirements are satisfied:

    - The taxpayer has taken a tax position.
    - Taking the tax position has resulted in a tax shortfall.
    - The taxpayer has done an act listed in ss 141E(1)(a)–(f), and an exception does not apply for para (b).

141E Evasion or similar act

(1) A taxpayer is liable to pay a shortfall penalty if, in taking a tax position, the taxpayer—

(a) evades the assessment or payment of tax by the taxpayer or another person under a tax law; or

(b) knowingly applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the Commissioner; or

(c) knowingly does not make a deduction, withholding of tax, or transfer of payroll donation required to be made by a tax law; or

(d) obtains a refund or payment of tax, knowing that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or

(da) attempts to obtain a refund or payment of tax, knowing that the taxpayer is not lawfully entitled to the refund or payment under a tax law; or

(e) enables another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law; or

(f) attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law—

(referred to as **evasion or a similar act**).

(2) No person shall be chargeable with a shortfall penalty under subsection (1)(b) if that person satisfies the Commissioner that the amount of the deduction or withholding has been accounted for, and that the person's failure to account for it within the prescribed time was due to illness, accident, or some other cause beyond the person's control.

(2B) No person shall be chargeable with a shortfall penalty under subsection (1)(b) for taking a tax position if the person is chargeable with a shortfall penalty under section 141ED for taking the tax position.

(3) If a taxpayer enables or attempts to enable another person to obtain a refund or payment of tax, knowing that the other person is not lawfully entitled to the refund or payment under a tax law, the taxpayer is liable to pay to the Commissioner an amount equal to the shortfall penalty that would have been imposed if the other person's tax position had been the taxpayer's tax position.

(4) The penalty payable for evasion or a similar act described in subsection (1) is 150% of the resulting tax shortfall.

9. This item's focus is on the mental requirements for evasion and what is required for the acts outlined in ss 141E(1)(a)-(f).

10. This interpretation statement refers to the shortfall penalty in s 141E for evasion or a similar act as an "evasion shortfall penalty".

11. The onus of proof rests with the Commissioner to show that a taxpayer is liable for an evasion shortfall penalty under s 141E (s 149A(2)(a)). This is different from the other shortfall penalties where the onus of proof is on the taxpayer. However, as with other shortfall penalties, it is a civil penalty, so the standard of proof is the balance of probabilities (s 149A(1)).

12. The flowchart at Figure | Hoahoa 1 shows how s 141E applies.

Analysis | Tātari

Intention and knowledge requirements for evasion or a similar act

13. The evasion shortfall penalty is unique among the shortfall penalties in that it requires the mental elements of intention and knowledge (often referred to as mens rea in legal contexts).[1] This is because the evasion shortfall penalty is the most serious of the shortfall penalties that the Commissioner may impose. The seriousness of the penalty is reflected in its rate of 150% of the resulting tax shortfall. By comparison, the other shortfall penalties of lesser severity vary from 20% to 100% of the resulting tax shortfall.

1 The distinction requiring mens rea or mental elements for evasion, as opposed to gross carelessness, was highlighted by Judge Barber in *Case W4* (2003) 21 NZTC 11,034 at [45]. In *Meulen's Hair Stylists Ltd v CIR* [1963] NZLR 797 (SC) at 799, Barrowclough CJ noted that mens rea was an essential element of "knowingly" misapplying a deduction.

14. Section 141E(1) concerns two types of behaviour. The first is evasion, which is set out in para (a). For the purposes of s 141E(1)(a), the person must intentionally evade the assessment or payment of tax, knowing their actions will breach a tax obligation.[2] This is sometimes referred to as acting with evasive intent.[3]

15. The second type of behaviour is set out in the remaining paragraphs of s 141E(1) and requires that the breaches set out in those paragraphs occurred "knowingly" or, in other words, with knowledge.[4] It is this knowledge requirement that makes a breach of one of these paragraphs a "similar act" to evasion.

16. For a non-individual, such as a company, the intent and knowledge of a responsible officer authorised to file the return can be attributed to the non-individual.[5]

Intention

17. Section 141E(1)(a) requires the taxpayer to endeavour or intend to avoid the assessment or payment of tax. In *Taylor v Attorney-General*, McGregor J stated that the word "evade" connotes the exercise of will in avoiding.[6] He also said:

> It involves, in my opinion, **the intentional avoidance of payment in circumstances indicating to the party that he is or may be under some obligation to pay duty**. The circumstances may consist of knowledge, or neglect of available means of knowledge, that the omission to pay is or may be in contravention of the Customs law … [Emphasis added]

18. In *Case N47*, Judge Bathgate said there must be some blameworthy act or omission on the part of the taxpayer.[7] In *CIR v Peterson*, Hammond J stated that evasion occurs when a taxpayer seeks to reduce tax through fraudulent misrepresentation:[8]

> [30] It has long been recognised that there are three broad categories by which taxpayers may seek to reduce the burden of tax. The first is outright taxation evasion. This is really a form of fraudulent misrepresentation, and is subject to heavy penalties, and even the criminal law.

19. While intention for evasion does not necessarily involve any underhand dealing, it involves more than a mere omission or neglect to include the amount in a return or pay.[9] Similarly, carelessness will not satisfy the intention requirement.[10]

20. In *Case H90*, Judge Barber said that intent (and knowledge) can be established by direct evidence or by inference.[11]

Knowledge

21. The standard for "knowledge" does not change regardless of the paragraph of s 141E(1) in issue. However, what the person must have knowledge of differs in some cases between paragraphs.

22. For evasion under s 141E(1)(a), the person must know their act or omission will breach a tax obligation.[12]

23. For ss 141E(1)(d)-(f), which relate to obtaining or attempting to obtain a refund or payment of tax, the person must know that they are acting unlawfully. This is because these paragraphs explicitly state that the person must act "knowing that the [taxpayer/other person] is not lawfully entitled to the refund or payment".

24. For ss 141E(1)(b) and (c), which refer only to "knowingly" doing an act, knowledge of the existence of the facts in question is sufficient.[13] The person does not need to know the act is explicitly unlawful or act with any specific intent.[14]

25. The following outlines what will satisfy the knowledge requirement generally for evasion or a similar act.

2 *Taylor v Attorney-General* [1963] NZLR 261 at 262.
3 *R v Rowley (No 2)* [2012] NZHC 1778.
4 *Meulen's Hair Stylists.*
5 *Case W3* (2003) 21 NZTC 11,014 at [53], citing *Meulen's Hair Stylists*. The principles around attribution of mens rea to a non-individual were summarised in more detail in *Meridian Global Funds Management Asia Ltd v Securities Commission* (1995) 7 NZCLC 260,836 (PC).
6 At 262.
7 *Case N47* (1991) 13 NZTC 3,388 at 3,393.
8 *CIR v Peterson* (2002) 20 NZTC 17,589 (HC).
9 *Taylor* at 262.
10 *Case W3* at [53].
11 *Case H90* (1986) 8 NZTC 619 at 624.
12 *Taylor* at 262.
13 *Case W3* at [53], citing *CIR v Gordon* (1989) 11 NZTC 6,082.
14 *CIR v Gordon* at 6,084.

26. Section 141E requires either actual knowledge or "neglect of available means of knowledge".[15] Neglect of available knowledge is also referred to as subjective recklessness, discussed from [33].

27. Knowledge is tested subjectively, which means it must be shown that the taxpayer actually knew the relevant facts.[16] It is not sufficient that a reasonable person in those circumstances ought to have known. However, subjective knowledge can be tested objectively from consideration of surrounding circumstances.[17]

28. Consistent with this, *Case P79* concerned whether a taxpayer was liable to a penalty for evading GST.[18] The taxpayer knew of his obligation to make the relevant GST payment but misunderstood when the GST should be paid. Judge Willy said that a mistake or a misunderstanding of the law could never amount to evasion.[19] Similarly, a mistake or misunderstanding would not satisfy the knowledge requirement for any of the similar acts. For example, if a person deducted PAYE but evidence indicated they simply forgot to file and pay the PAYE on time, this would not satisfy the knowledge requirement for s 141E(1)(b).

Knowledge can be inferred from wilful blindness

29. Knowledge can also be inferred through wilful blindness. In *R v Chahine–Badr*, in dismissing the taxpayer's appeal of his conviction for evading income tax, O'Connor J in the Ontario Superior Court of Justice said that wilful blindness may be equivalent to actual knowledge:[20]

> [29] In any event, whether raised by the Crown or the court during the trial, **the concept of wilful blindness is not an alternative theory of culpability. It is inherent in the concept of knowledge**. As with any criminal offence, the Crown must prove beyond a reasonable doubt the accused had the necessary knowledge of his wrongdoing and the intent to carry it out, i.e. the mens rea, to commit the offence. In *R. v. Harding* (2001), 160 C.C.C. (3d) 225 (Ont. C.A.), Weiler J.A. said at paragraph 66 that "Criminal law treats wilful blindness as equivalent to actual knowledge because the accused 'knew or strongly suspected' that inquiry on his part respecting the consequences of his acts would fix him with the actual knowledge he wished to avoid." **Thus the requisite knowledge of wrongdoing can be either actual or inferred through wilful blindness**. [Emphasis added]

30. In *Case N47*, the taxpayer partnership ceased their sharemilking business due to illness and personal circumstances, and failed to account for this properly in their GST returns, which were filed late. This occurred shortly after the introduction of GST, and the taxpayers asserted their returns were not intentionally false, but rather errors were due to struggling to understand the GST system. Judge Bathgate decided that the taxpayers had not evaded tax.[21] Judge Bathgate said that although the taxpayers may have been careless, they were not recklessly careless to the extent that they closed their eyes to their responsibilities with the intent to evade the payment of tax.[22]

31. In *Westminster City Council v Croyalgrange Ltd*, the House of Lords said that a finding of knowledge on the part of a person could be based on evidence that the person had deliberately shut their eyes to the obvious or refrained from inquiry to avoid having their suspicions confirmed.[23]

> … it is always open to the tribunal of fact, when knowledge on the part of the defendant is required to be proved, to base a finding of knowledge on evidence that the defendant has deliberately shut his eyes to the obvious or refrained from inquiry because he did not want to have his suspicion confirmed.

32. While these cases concerned the knowledge required for an intention to evade tax, wilful blindness is equally applicable to knowledge for the similar acts in other paragraphs of s 141E(1), as it is "inherent in the concept of knowledge".[24]

15 *Taylor* at 262.
16 *Case W3* at [53].
17 *Lloyds Bank Ltd v Marcan* [1973] 2 All ER 359 at 367, 368.
18 *Case P79* (1992) 14 NZTC 4,534.
19 *Case P79* at 4,537 and 4,538.
20 *R v Chahine-Badr* [2006] 2 CTC 243; 79 OR (3d) 671 and see also *Westminster City Council v Croyalgrange Ltd* [1986] 2 All ER 353, 359 (CA).
21 *Case N47* at 3,393-3,394.
22 *Case N47* at 3,394.
23 *Westminster City Council v Croyalgrange Ltd* at 359.
24 *R v Chahine-Badr* at [29].

Subjective recklessness is sufficient for the mental elements

33. In addition to actual knowledge, courts have also held that in some cases subjective recklessness will also satisfy the knowledge requirements for evasion or a similar act and the intention requirement for evasion. In *Babington v CIR (No 2)*, Turner J held that an evasive intent involves knowing that the act or omission intended is wrong or acting deliberately or recklessly as to whether or not the act or omission is wrong.[25] This approach to the mental elements for evasion or a similar act was followed by Judge Sinclair in *Case 9/2015*.[26] On appeal, the Commissioner argued the TRA did not properly articulate the correct test for "reckless evasion".[27] Williams J in the High Court found that the TRA correctly articulated the test:

> [97] In my view, the TRA was well aware of the correct test for subjective recklessness. Citing *Rowley (No 2)* and *Babington*, the Judge identified recklessness as an alternative mens rea standard. During the course of summarising the Commissioner's case, she set it out the relevant meaning of recklessness:[28]
>
> > The Commissioner contends in light of this evidence that the disputants either knew that the deductions that they were claiming were not properly deductible or, at the least, that the facts known to them at the time would have put the disputants on inquiry to seek further clarification as to the deductibility of the insurance expenses. The failure to make further enquiries amounted to wilful blindness or at the least, subjective recklessness.

34. In the context of the "other acts" in s 141E, Judge Barber in *Case W3* stated that "[r]ecklessness as to whether the PAYE has been paid is sufficient to amount to a known failure to pay".[29]

35. The term "recklessness" can refer to two inconsistent concepts: objective or inadvertent recklessness and subjective recklessness. Subjective recklessness requires some degree of knowledge on the part of the person of the risk of their behaviour, whereas objective recklessness does not require any knowledge of the risk, and turns on whether the behaviour was reckless from the perspective of a reasonable person.

36. In *Case P29*, Judge Willy considered case law in the tax context and New Zealand criminal law cases on recklessness. He held that recklessness was to be tested subjectively:[30]

> Although those expressions of what is the proper test to be applied in New Zealand relate to specific provisions of the Crimes Act I nevertheless think they are of general guidance … **there is still an ingredient of moral turpitude in a finding of recklessness. It must never in my view be confused with mere negligence or inattention. Before recklessness can be said to exist some degree of knowledge must be present**. As it is put by Mr Simon France in his article "A reckless approach to liability" 1988 18 VUWLR 144 at p 146 the person must:
>
> > **Have ignored a risk they knew to be present so as to avoid the unpleasantness of having their suspicions confirmed.**
>
> … **Where recklessness is alleged the Commissioner must prove beyond reasonable doubt that the facts which were actually known to the taxpayer were such that they must have put him on enquiry that the income returned for tax purpose was understated. Faced with those facts the Commissioner must then show that the taxpayer made the conscious decision to ignore them and to return the understated income without making any further enquiry**. [Emphasis added]

37. Judge Willy's adoption in *Case P29* of the subjective meaning of recklessness is consistent with Judge Barber's approach to recklessness taken in *Case S100*, that a "deliberate disregard" of one's obligations or an appreciation of a positive risk and proceeding regardless may amount to recklessness.[31] As quoted at [33], the High Court in *Edwards v CIR* also applied a subjective approach to recklessness in the context of an evasion shortfall penalty.

25 *Babington v CIR (No 2)* [1958] NZLR 152 (NZSC), cited with support in *R v Rowley* (HC) at [457].

26 *Case 9/2015* (2015) 27 NZTC 3,008 at [75].

27 *Edwards v CIR* (2016) 27 NZTC 22,064 (HC) at [90]. For further examples where subjective recklessness has been held to be sufficient to constitute evasion, see *Case N6* (1991) 13 NZTC 3,043 at 3,046; *Case N53* (1991) 13 NZTC 3,419 at 3,420; *Case Q19* (1993) 15 NZTC 5,104 at 5,107; and *Case Q20* (1993) 15 NZTC 5,108 at 5,111.

28 *Case 9/2015* at [70].

29 *Case W3* at [53], citing *Case R31* (1994) 16 NZTC 6,171.

30 *Case P29* (1992) 14 NZTC 4,213 at 4,222. While the quote refers to the Commissioner proving this "beyond reasonable doubt", this case was considered under the previous penal tax regime. As stated at [11], the standard of proof for current civil penalties is the balance of probabilities.

31 *Case S100* (1996) 17 NZTC 7,626 at 7,627.

38. It is noted that in contrast, an objective approach to recklessness was taken in *Case M117*.[32] This case concerned whether the taxpayer knowingly applied PAYE deductions for any purpose other than payment to the Commissioner (under the predecessor to what is now a shortfall penalty under s 141ED). In *Case M117*, Judge Barber relied on the objective approach to recklessness taken in the criminal law context in *R v Caldwell*,[33] later applied in New Zealand in *R v Howe*.[34] Judge Barber quoted the Court of Appeal in *Howe* in a passage which relevantly stated:[35]

> …[recklessness] is not limited to deliberate risk-taking but includes failing to give any thought to an obvious and serious risk…

39. However, the weight of authority, and more recent authority, supports a subjective approach to recklessness.

40. It follows that for an evasion shortfall penalty, the taxpayer must be subjectively reckless to meet the knowledge or intention requirement. If a taxpayer is objectively reckless, by failing to give thought to an obvious and serious risk, this will not meet the mental requirements for evasion, but may meet the requirements for a lesser shortfall penalty, such as for gross carelessness or for not taking reasonable care.[36]

Summary

41. In summary, for the mental requirements for evasion or a similar act:

- The term "evade" connotes the exercise of will in avoiding. The person must intend to evade the assessment or payment of tax.
- There must be more than mere failure to meet a tax obligation or to do a particular act. There must be some blameworthy act or omission on the part of the taxpayer.
- Evasion or a similar act requires knowledge of the relevant facts or tax obligation. There must be actual knowledge or neglect of available means of knowledge.
- Knowledge is tested subjectively but can be inferred from objective consideration of surrounding circumstances and conduct.
- Subjective recklessness will satisfy the intention and knowledge requirements. Subjective recklessness occurs when facts actually known to the taxpayer must have alerted them to the relevant risk, and the taxpayer makes a conscious decision to ignore the risk and proceed with the act or omission without making any further inquiry.

Other requirements for evasion or a similar act

42. The following provides specific guidance on other requirements in each of the relevant paragraphs in s 141E(1).

Section 141E(1)(a) – Evading the assessment of tax

43. Section 141E(1)(a) applies when a person evades the assessment or payment of tax by them or another person under a tax law.

44. As stated at [14], evasion under s 141E(1)(a) requires a person to intentionally evade the assessment or payment of tax, knowing their actions will breach a tax obligation. An omission (failure to act) may constitute evasion if the necessary intention is present.[37]

45. The "or" in "assessment or payment" indicates that the section will apply if the taxpayer evades the assessment of tax **or** the payment of tax. The section will be satisfied where both the assessment and payment of tax are evaded, but it is not necessary to establish that both are evaded.[38]

32 *Case M117* (1990) 12 NZTC 2,749.

33 *R v Caldwell* [1981] 1 All ER 961 (HL).

34 *R v Howe* [1982] 1 NZLR 618 (CA).

35 *Case M117* at 2,755.

36 Under ss 141C and 141A respectively; *Case W4* at [45]. See IS 26/06: **Shortfall penalty for gross carelessness** for more information about the requirements for this shortfall penalty.

37 *R v G* [2013] NZCA 146 at [27]–[29].

38 *Gilchrist v R* [2007] 1 NZLR 499 (SC) at [15].

46. Ordinarily, evasion of assessment and evasion of payment are both relevant, as excluding relevant amounts from returns is usually the method through which a person would evade payment of tax. However, there have been cases in the context of criminal penalties where a person was convicted of evading the assessment of tax but not the payment, and vice versa.[39]

47. A person can evade the assessment of tax even if the evasion is temporary and they intend to include the amount in a later return. In *Case N54*, Judge Barber considered the amount of penal tax imposed on a taxpayer who was two months late in paying the GST output tax on the sale of his truck.[40] Input tax was claimed on the new truck purchased but output tax on the old truck sold was not included in the same GST return, even though the taxpayer was registered for GST on a payments basis.

48. The taxpayer in *Case N54* accepted that the output tax was not returned in the correct GST period, but claimed it was always his intention to return this output tax in the next GST period. While Judge Barber was only required to consider quantum, he also addressed the argument that the taxpayer had not evaded tax, but merely tried to delay payment to assist with cash flow:[41]

> At one stage, Mr Lay appeared to be submitting that the respondent is not entitled to charge penal tax because the objector had not intended to evade the tax but merely tried to delay the payment of it to assist his cash flow. Nevertheless, the case was addressed before me only on the question of quantum and not on chargeability. **In any case there was evasion for two months.**
>
> ... If the objector never intended to return the output then I am confronted with a bad case of GST evasion ... In this case, I think that there are some quite unusual factors and, in particular, that I find **the evasion was only to continue for a two-month period** and took place at a time of extreme financial and matrimonial pressure on the objector. [Emphasis added]

49. It is the Commissioner's view that where a company and director are both potentially liable for an evasion shortfall penalty under s 141E(1)(a), only one shortfall penalty should be imposed, and where possible, that shortfall penalty should be imposed on the company. However, the Commissioner will impose a shortfall penalty on the director in circumstances where the penalty cannot be imposed on the company, such as where the company is struck off.

50. A person who uses an electronic sales suppression tool (such as software for manipulating sales information) to evade the assessment or payment of tax is also liable to pay a separate electronic sales suppression penalty of $5,000.[42]

51. Example | Tauira 1 and Example | Tauira 2 illustrate scenarios where a person evades the assessment and payment of tax, and how the intention and knowledge requirements for evasion might arise over time.

Example | Tauira 1 – Mental requirements for evasion

Amelia, a small-business person, did not include several items of income in her accounts or tax return as she felt she could not afford to pay tax on this income. While Amelia knew she should have included these amounts in her return, she assumed it "wouldn't be a big deal" as she would not be able to afford to pay tax on the rest of the income anyway.

Should an evasion shortfall penalty be imposed?

Yes. The mental elements of evasion relate to intentionally breaching a known tax obligation or a tax obligation which the taxpayer strongly suspects may exist. Amelia knew that she should have included the items of income in her return, but she deliberately omitted them from her return to avoid paying more tax than she could afford. By doing this, she evaded the assessment and payment of tax. Her actions went beyond a mere failure to pay or include the amounts in a tax return.

It is not relevant that Amelia felt she could not afford to pay tax on the amounts. There are options for tax relief available if a person is concerned that they may not be able to meet their tax obligations. In these circumstances, the person should include these amounts in their income tax return and contact Inland Revenue as soon as possible to discuss their situation. It is also not relevant that she did not think it would be a big deal.

39 In *CIR v Chand* [2021] NZDC 16,787, the taxpayer failed to file returns for many years, but nevertheless made payments of tax. In *Gilchrist v R* (SC), the taxpayer filed GST returns but failed to pay the relevant amounts, taking deliberate action to transfer debts to prevent recovery by the Commissioner.

40 *Case N54* (1991) 13 NZTC 3,427.

41 *Case N54* at 3,432–3,434.

42 Section 141EE. Acquisition or possession of an electronic sales suppression tool for such a purpose is sufficient to trigger liability for this penalty.

Example | Tauira 2 – Mental requirements arising over time

Tomoe starts streaming herself playing video games as a hobby in her free time. She is very good at a game called Flying Car Football (FCF) and gains popularity playing it.

In her first two years of streaming FCF, her popularity grows and she starts getting money from advertising revenue, subscriptions and donations. At first, the amounts are small and infrequent, but she starts getting regular payouts from her streaming platform, from Google for advertising revenue from edited videos uploaded to YouTube, and from a separate subscription platform. Tomoe assumes during this period that these amounts are not taxable income because she is not intending to profit – it is just a fun hobby for her. While she is receiving regular payouts, she thinks of them as a way to help fund her hobby by paying for things like new computer parts and in-game items.

In her third year of streaming, as her channel and popularity continues to grow, she starts to suspect the regular amounts she receives are taxable income. She talks to other streamer friends in Aotearoa New Zealand and finds out they all pay tax on the income they receive. She makes further enquiries and finds out that Inland Revenue has guidance on tax issues for digital content creators (see QB 17/05 and IS 21/08). A friend advises this guidance covers situations similar to hers. At this point, Tomoe strongly suspects she should be returning the income she receives from streaming FCF. She deliberately avoids reading any guidance or reaching out to a lawyer or accountant because she does not want her suspicions confirmed, and does not return any income from streaming for her third and fourth years.

Should an evasion shortfall penalty be imposed?

Yes, but only for tax shortfalls arising from the income years that correspond to her third and fourth years of streaming. The mental elements of evasion relate to intentionally breaching a known tax obligation or a tax obligation which the taxpayer strongly suspects may exist. For the first two years, there is no intent to evade a known or suspected obligation, so the behaviour does not amount to evasion, although the taxpayer may be liable to another lesser shortfall penalty, such as for gross carelessness under s 141C, or for not taking reasonable care under s 141A.

However, the behaviour later becomes evasion. From the third year, Tomoe strongly suspected an obligation may exist, but she chose not to investigate further (for example, by making enquiries of Inland Revenue or getting advice from an accountant or lawyer) as she did not want to have her suspicions confirmed. Tomoe chose to close her eyes to this issue by deliberately and intentionally refraining from taking any steps to discover the tax status of the income she received. This disregard of a suspected obligation from her third year of streaming amounts to subjective recklessness. This satisfies the mental elements of evasion.

Accordingly, an evasion shortfall penalty of 150% of Tomoe's resulting tax shortfall should be imposed starting from the income year that corresponds to her third year of streaming. She may be liable for lesser shortfall penalties for the previous years.

Section 141E(1)(b) – Failure to pay amount of deduction or withholding

52. Section 141E(1)(b) applies if a person knowingly applies an amount deducted or withheld under a tax law for any other purpose other than in payment to the Commissioner. This includes where the taxpayer permits an amount to be applied in this way, and also applies to amounts deemed to be deducted or withheld. As stated by Judge Barber in *Case W3*, the test under s 141E(1)(b) is whether the failure to account for the deduction was something known by the taxpayer to have occurred.[43] Generally, s 141E(1)(b) does not apply to unpaid PAYE if the amount was included in employment income information. Unpaid PAYE is subject to a separate penalty under s 141ED. See from [64] for more information about this exception.

53. If an officer of the taxpayer[44] applies a deduction or withholding of tax other than in payment to the Commissioner, s 141F provides that the Commissioner may apportion the shortfall penalty between the taxpayer and officers of the taxpayer. In determining whether and how to apportion, the Commissioner must have regard to the acts or omissions of the taxpayer and the officers, and whether those acts or omissions were reasonable.

43 *Case W3* at [53].

44 For example, where the taxpayer is a company.

54. Section 4A outlines how certain provisions are to be construed. Under ss 4A(2)(b) and 4A(2)(bb) respectively, an amount of tax is deemed to be withheld or a KiwiSaver contribution is deemed to be deducted when a PAYE income payment is made net of the amount of the withholding or deduction.[45]

55. Under s 4A(2)(c), the taxpayer will be treated as having applied a KiwiSaver contribution deduction or withholding of tax for a purpose other than payment of the amount to the Commissioner if the amount is not paid to the Commissioner by the relevant due date.

56. In addition, under s 4A(3), references to tax liabilities under the PAYE rules, to the extent necessary, also include references to liabilities under other statutory provisions that arise or are performed at the same time as the tax liabilities. These other liabilities are:

- Accident Compensation Corporation (ACC) premiums and levies;
- Child Support payments;
- KiwiSaver contributions; and
- Student loan repayments.

57. In *Meulen's Hair Stylists v CIR*, Barrowclough CJ considered the requirements for s 33(1)(b) of the Income Tax Assessment Act 1957, which imposed criminal liability in similar circumstances to those now covered by s 141E(1)(b). Barrowclough CJ relevantly asserted that if a company, by a responsible officer, "had knowledge that a payment was due on the preceding 20th and that it had not then been paid that would clearly be sufficient to establish that the appellant knowingly failed to make the payment".[46] As stated from [33], subjective recklessness as to whether an amount deducted or withheld has been paid is sufficient to amount to a known failure to pay the amount withheld or deducted.

58. In other words, for the requirements of s 141E(1)(b) to be satisfied, it is sufficient to establish that the person knew that a deducted or withheld amount was due and knew that it was not paid by that due date. However, there is an exception to this in s 141E(2).

Exception – s 141E(2) – Cause beyond the person's control

59. Under s 141E(2), a taxpayer is not liable for a shortfall penalty under s 141E(1)(b) if they satisfy the Commissioner that the:

- amount of the deduction or withholding has been accounted for, and
- failure to account for it within the prescribed time was due to illness, accident, or some other cause beyond the taxpayer's control.

60. For the exception to apply, there must be a direct causal connection between the illness, accident, or other cause put forward and the taxpayer's failure to pay. This was the view of Gallen J in *CIR v Joy Wright Ltd*.[47] In that case, the trial judge concluded that the principal officer of the company had a depressive illness and that this resulted in the failure to account to the Commissioner for the PAYE. In the High Court, Gallen J dismissed the Commissioner's appeal and held that the exception applied.

61. Generally, a lack of funds or liquidity problems do not constitute a cause beyond the taxpayer's control. An example of this is *Case W3*, where the taxpayer stated he had not paid PAYE deductions because the Commissioner had not released a GST refund.[48] In addition, it is not a defence to the application of s 141E(1)(b) that the amount owed would be offset against an expected tax credit.[49]

45 "PAYE income payment" is defined in s RD 3 of the Income Tax Act 2007 and means a payment of salary and wages, an extra pay, or a schedular payment.

46 *Meulen's Hair Stylists* at 800.

47 *CIR v Joy Wright Ltd* (1984) 6 NZTC 61,788 (HC).

48 *Case W3* at [61], citing *Driscoll v CIR* (1984) 6 NZTC 61,861 (HC); *Hammond v Walesby and Paramount Graphics Limited* (1986) 8 NZTC 5,185 (HC); and *CIR v JF McCormick Ltd* [1964] NZLR 56 (SC).

49 *Case W3* at [61], citing *CIR v Orme* (1984) 6 NZTC 61,831 (HC).

62. Even though the onus of proof for evasion is on the Commissioner, this exception explicitly requires the Commissioner to be satisfied that the requirements of the exception are met. The High Court in *Rogerson v CIR* observed that "[t]he discretion under s 141E(2) (if it arises) must be exercised by the Commissioner, and by him alone".[50] In considering the application of this discretion, the Commissioner will take into account all the evidence available to him, including the taxpayer's compliance history and past dealings with the Commissioner, in the context of his obligation to protect the integrity of the tax system.[51]

63. In summary, for the exception in s 141E(2) to apply, the following factors are relevant:

- The deduction or withholding amount must have been paid to the Commissioner.
- The failure to account must have been due to illness, accident, or some other cause beyond the taxpayer's control.
- There must be a direct causal connection between the reasons given and the failure to pay on time.
- Liquidity problems are generally insufficient for the exception to apply.
- The Commissioner must be satisfied that the requirements of the exception are met. The Commissioner will consider all evidence available to him, including past compliance history and dealings.

Exception – s 141E(2B) – Penalty under s 141ED applies

64. Under s 141E(2B), a taxpayer is not liable for a shortfall penalty under s 141E(1)(b) if they are liable for an employers' withholding payment penalty under s 141ED.

65. A penalty under s 141ED may apply if an employer provides employment income information under subpart 3C but does not pay the required amount by the due date, and the Commissioner has given notice of details of the penalty and actions the taxpayer can take to avoid the imposition of further penalties. There are exceptions for this penalty in some cases for liquidators and receivers, and where the employer is negotiating or agrees to an instalment arrangement to pay the unpaid PAYE.[52]

66. This essentially means that where PAYE is withheld and included in employment income information provided to the Commissioner, the relevant penalty is the shortfall penalty under s 141ED, not an evasion shortfall penalty under s 141E(1)(b).[53] Section 141E(1)(b) is still relevant for other types of deduction or withholding not included in employment income information, or where PAYE is deducted but not included in employment income information.

67. The shortfall penalty in s 141ED is a graduated penalty that can be applied repeatedly if payment is not made, up to a maximum of 150% of the tax shortfall. This is the only shortfall penalty that can be applied more than once in relation to a single tax shortfall.

68. Example | Tauira 3 illustrates a scenario where a person knowingly permits the application of a deduction or withholding of tax for purposes other than in payment to the Commissioner. The example also addresses the application of exceptions in ss 141E(2) and 141E(2B).

50 *Rogerson v CIR* (2005) 22 NZTC 19,260 (HC) at [61].

51 Consistent with *Rogerson v CIR* at [59]. Potter J observed at [63] that the High Court will be slow to interfere with decisions made by the Commissioner in the exercise of his judgment.

52 Section 141ED(3) outlines the circumstances in which these exceptions apply.

53 Commentary to the Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill is clear that s 141ED is intended to replace 141E(1)(b) in relation to unpaid PAYE. At 82 the commentary relevantly states, "Shortfall penalties for evasion will not be imposed if the employer files the employer monthly schedule but does not pay the PAYE".

Example | Tauira 3 – Failure to pay PAYE to Commissioner; apportionment between director and company

Sebastian was one of three shareholders and directors of a company which had operated a garden centre from 2003. Sebastian had always been the person who prepared and filed the company's employment income information (previously employer monthly schedule). From April this year until October (when it ceased trading) PAYE was deducted as usual from salary and wages paid to employees, but the company did not file employment income information for these periods and did not pay the PAYE to the Commissioner.

Sebastian states that he was not trying to evade assessment or payment. He has been suffering from a rare disease he contracted overseas which makes him confused at times and generally has put him under significant stress. Sebastian asserts that due to this, he forgot to handle the company's PAYE obligations for the relevant periods.

Should an evasion shortfall penalty be imposed?

Section 141E(1)(b) imposes a shortfall penalty on a taxpayer who knowingly applies or permits the application of the amount of a deduction or withholding of tax made or deemed to be made under a tax law for any purpose other than in payment to the Commissioner. A person is deemed under s 4A(2)(c) to have applied a deducted or withheld amount for a purpose other than in payment to the Commissioner if the amount is not paid to the Commissioner by the due date.

Sebastian did not pay the PAYE to the Commissioner by the due date. Therefore, the relevant element is whether this was done "knowingly". This requires knowledge of the doing of the act or omission. It does not require any specific intent, or knowledge that the act or omission is explicitly unlawful.

The question here then, is whether Sebastian (and, therefore, the company for which he is a responsible officer) knew he had failed to pay the PAYE due to the Commissioner. As Sebastian normally returns the employment income information for the company, it can be inferred that he (and therefore the company) knew that payments were due each month.

While Sebastian states that he forgot to handle the company's PAYE obligations due to his illness, he continued to manage other payroll responsibilities and conduct other business for the company. The evidence indicates the disease and stress did not affect his ability to function to the extent that it could be said he did not act "knowingly". While a lapse in concentration occasioned by the stress or the confusion brought on by the disease could be a plausible explanation for a single lapse, this was repetitive. In those circumstances, it can be inferred that he acted knowingly. It follows that Sebastian knowingly failed to make the payments.

Does an exception apply?

The next issue is whether any exception to s 141E(1)(b) applies.

141E(2B)

Under s 141E(2B), nobody is chargeable with an evasion shortfall penalty if they are chargeable with a shortfall penalty under s 141ED. Liability to pay a shortfall penalty under s 141ED arises if a taxpayer provides employment income information to the Commissioner but fails to pay the PAYE by the due date.

As the PAYE was deducted, but employment income information was not filed, s 141ED does not apply, so the exclusion in s 141E(2B) does not prevent the imposition of a shortfall penalty under s 141E(1)(b). Therefore, the exclusion in s 141E(2B) does not apply.

If Sebastian had filed employment income information for the relevant periods but failed to pay, a penalty could be imposed under s 141ED after the Commissioner provides the necessary notice to the taxpayer detailing the penalty and actions to be taken to prevent the imposition of further penalties. If Sebastian does not pay the outstanding amount, or enters into an instalment arrangement with the Commissioner but does not comply with it, further penalties may be imposed at monthly intervals.

In those alternative circumstances, the Commissioner could not impose an evasion shortfall penalty under s 141E(1)(b) for the unpaid PAYE.

141E(2)

Under s 141E(2), a person is not chargeable with a shortfall penalty under s 141E(1)(b) if they satisfy the Commissioner that the amount of the deduction or withholding has been accounted for, and that the failure to account was due to illness, accident, or some other cause beyond the person's control.

For s 141E(2) to apply, the deductions must since have been paid to the Commissioner, which they have not been. However, assuming they had been, it must be shown that the illness caused the failure to pay the PAYE deductions. The Commissioner must consider all the evidence available to him. Here, when Sebastian's evidence regarding his illness is weighed with all other evidence, the Commissioner would not be satisfied that it was the illness which was responsible for the failures.

Despite the illness, Sebastian managed his other responsibilities to the company, and the lapse was repetitive over an extended period, rather than a single moment of confusion or forgetfulness. The defence is not an ongoing one, and if Sebastian felt unable to prepare and file such returns there was ample time to arrange for someone else, such as an accountant or another officer of the company, to do it instead.

Accordingly, as the Commissioner is not satisfied the requirements are met, it is not open to the Commissioner to apply the exception under s 141E(2) to the company.

How should the penalty be apportioned between the company and Sebastian?

The starting point under s 141E(1)(b) is that the penalty is imposed on the company. However, s 141F(2) allows the Commissioner to apportion certain penalties imposed on a taxpayer between the taxpayer and an officer of the taxpayer. Section 141F(2) can apply where the taxpayer is required to make or account for a deduction or withholding of tax and an officer of the taxpayer fails to do so.

In this example, s 141F(2) would allow the Commissioner to apportion the shortfall penalty that the company is liable for under s 141E(1)(b) between the company and Sebastian. To determine apportionment, it is necessary to consider the relative actions or omissions of the company and Sebastian and whether they were reasonable.

The history and experience of both will be relevant. Here, this was ongoing and deliberate behaviour by Sebastian not to file or pay PAYE deductions to the Commissioner for a period of 7 months. It was not a one-off misunderstanding. The company too, however, may be considered blameworthy in not having any systems in place to check such behaviour. That is, the company lacked safeguards to ensure returns are filed and payment is made on time, and the other two shareholders and directors did not realise what was going on over a prolonged period.

Considering the deliberateness of Sebastian's actions and the company's lack of systems to check such behaviour, it could be considered that both were equally to blame for the shortfall. In this situation, the Commissioner could therefore consider it reasonable to apportion the penalty 50:50.

Section 141E(1)(c) – Failure to deduct or withhold

69. A person is liable for an evasion shortfall penalty under s 141E(1)(c) if they knowingly do not make a deduction, withholding of tax, or transfer of payroll donation required to be made by a tax law.

70. As stated in relation to s 141E(1)(b), an amount is deemed to be withheld or deducted when a PAYE income payment is made net of the amount of the withholding or deduction. It follows that a taxpayer knowingly does not make a deduction, withholding of tax, or transfer of payroll deduction if they knowingly make a PAYE income payment that is not net of the amount of the relevant withholding or deduction. Under s 4A(3), this includes amounts required to be withheld or deducted under other legislative provisions at the same time.

71. In the same manner discussed at [53] for s 141E(1)(b), if an officer of the taxpayer fails to make a deduction or withholding of tax, s 141F provides that the Commissioner may apportion the shortfall penalty between the taxpayer and officers of the taxpayer.

Section 141E(1)(d)-141E(1)(f) – Obtaining or attempting to obtain refund or payment of tax

72. Sections 141E(1)(d) to 141E(1)(f) all concern obtaining or attempting to obtain a refund or payment of tax, or enabling another person to do so.

Obtains

73. A taxpayer is liable for an evasion shortfall penalty under s 141E(1)(d) if they obtain a refund or payment of tax, knowing they are not lawfully entitled to the refund or payment. Section 141E(1)(da) applies if the taxpayer attempts to obtain such a refund or payment in the same circumstances.

74. "Obtain", "refund" and "payment" are not defined in the TAA for the purposes of s 141E. However, tax legislation does refer to amounts that the Commissioner is required to refund or pay to a taxpayer. For example, s LA 4(5) of the Income Tax Act 2007 states that the Commissioner "refunds a refundable tax credit by applying section LA 6, LA 7, or LA 8". Another example is s 20(5) of the Goods and Services Tax Act 1985, which requires the excess of input tax over output tax to be "refunded" by the Commissioner.

75. The term "refund" connotes paying back an amount paid, such as where an employee's PAYE for the year is higher than their end-of-year tax liability. "Payment" does not have this connotation and might include any amount paid to a taxpayer under a tax law.

76. It follows that a person obtains a refund or payment of tax if they receive an amount of money from the Commissioner that is within the broad definition of tax. If they do so knowing they, or the relevant person, is not lawfully entitled to the refund or payment, they will be liable for an evasion shortfall penalty.

Attempts to obtain

77. Under ss 141E(1)(da) and 141E(1)(f), a taxpayer can be liable for an evasion shortfall penalty if they attempt to obtain a refund or payment of tax, either for themselves under para (da) or for another person under para (f). These provisions were enacted in 2001 in response to a submission made by officials that ss 141E(1)(d), (e) and 141E(3) should be corrected to apply where a taxpayer attempts to obtain a refund or payment.[54] Officials relevantly commented with the following:[55]

> All taxpayers who knowingly seek to obtain a refund or payment to which they are not lawfully entitled should be subject to the evasion penalty. Taxpayers should not benefit from the department's actions which result in the refund or payment not being made.

78. This means a taxpayer can be liable for an evasion shortfall penalty even if the relevant person does not actually receive the refund or payment of tax.

Enables another person

79. A taxpayer can also be liable for an evasion shortfall penalty if they enable another person to obtain or attempt to obtain a refund or payment of tax, knowing the other person is not lawfully entitled to the refund or payment, under ss 141E(1)(e) and 141E(1)(f).

80. "Enables" is not defined in the TAA. The meaning was outlined by Rigby LJ in Guardians of *West Derby Union v Metropolitan Life Assurance Society*.[56]

81. Rigby LJ expressed the concept of "enables" as removing a disability when dealing with another person.[57] It follows that to "enable" someone could be by the positive act of assisting a person to do something, doing it on their behalf, or by removing an impediment to doing something.

82. In these circumstances, the person is liable to pay an amount equal to the shortfall penalty that would have been imposed if the other person's tax position had been the taxpayer's tax position.[58]

54 Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Bill (Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill, 19 February 2001).

55 At 86.

56 *Guardians of West Derby Union v Metropolitan Life Assurance Society* [1897] 1 Ch. 335.

57 *West Derby Union* at 357, 358.

58 Section 141E(3).

83. This means that two shortfall penalties may be imposed where, for example, a director of a company obtains a refund of tax for the company, knowing the company is not lawfully entitled to it. The company would be liable to pay an evasion shortfall penalty of 150% of the resulting tax shortfall and the director would be liable to pay the Commissioner an amount equal to the company's shortfall penalty.

84. Example | Tauira 4 illustrates a scenario where a person obtains or attempts to obtain a refund or payment of tax for another person.

Example | Tauira 4 – Obtaining and attempting to obtain a refund; imposition on company and director

Iosia is the sole shareholder and director of a GST registered company that operates a small landscaping business. Recently, the business has been running into cashflow issues due to some customers not paying invoices. Iosia has very recently purchased his dream truck for personal use. Stressed about upcoming bills, Iosia gets the idea to claim a GST input tax deduction for the truck. This would lead to a refund that would help him cover some of the running costs of the business until the outstanding invoices are paid.

In the company's next GST return, Iosia includes the GST portion of the truck, and then decides to claim a bit more to give him a buffer in case he does not get all the money he is owed. Iosia knows that the company cannot claim GST on the truck as he bought it for personal use, but he really needs the money.

The refund is paid out, but the company's financial situation has not improved in the next period, so Iosia includes further fraudulent input tax deductions in the company's following GST return. This second refund is flagged by Inland Revenue and the Commissioner notifies the company of his intention to investigate the circumstances of the return.

Should an evasion shortfall penalty be imposed on the company?

Yes, Iosia, as an officer of the company, obtained, and attempted to obtain for the second return, a refund. Iosia knew the company was not lawfully entitled to the amounts claimed. Therefore, the company is liable to pay a shortfall penalty under s 141E(1)(d) for the shortfall resulting from the first return and under s 141E(1)(da) for the shortfall resulting from the second return.

Should an evasion shortfall penalty be imposed on Iosia?

Yes. In most circumstances, the Commissioner will only impose one shortfall penalty in relation to each tax shortfall. However, if a taxpayer enables, or attempts to enable, a refund or payment of tax for another person, s 141E(3) provides that the taxpayer is liable to pay an amount equal to the shortfall penalty that would be imposed if the other person's tax position had been the taxpayer's tax position.

By acting on the company's behalf to claim the refunds, Iosia enabled the taxpayer to obtain, and to attempt to obtain, refunds to which he knew it was not lawfully entitled. It follows that Iosia could potentially be liable for an amount equal to the evasion shortfall penalty to which the company is liable. This means, in effect, two evasion shortfall penalties could be imposed for the same tax shortfall.

Relationship with criminal prosecution

85. Evasion may also be the subject of criminal liability, unlike other acts for which a taxpayer may be liable for a shortfall penalty. Section 143B(2) provides that it is a criminal offence for a person to evade or attempt to evade the assessment or payment of tax by themselves or another. Section 143B(1) covers acts (such as not making tax deductions or providing false returns) which are done either with the intent of evading the assessment or payment of tax, or in order to obtain a refund or payment of tax for themselves or any other person with the knowledge that there is no entitlement to such a refund or payment. The penalty for an offence under s 143B is imprisonment for a term not exceeding 5 years or a fine not exceeding $50,000, or both.

86. There are also offences for manufacturing or supplying,[59] and acquiring or possessing,[60] electronic sales suppression tools used to evade the assessment or payment of tax.[61]

87. Criminal liability for misapplying or not making tax deductions is imposed by s 143A. These offences cover the same acts set out in s 141E(1)(b) and (c).[62] The penalty for an offence against s 143A is $25,000 for a first offence and $50,000 for subsequent offences. The offence for misapplying deductions can lead, in most circumstances, to imprisonment for a term not exceeding 5 years or a fine not exceeding $50,000, or both.[63] For these criminal prosecutions, the onus of proof is also on the Commissioner,[64] but the standard of proof is beyond reasonable doubt.[65]

88. The Commissioner may not prosecute a taxpayer for taking an incorrect tax position if a shortfall penalty has already been imposed for taking that incorrect tax position.[66] However, the Commissioner can impose civil penalties (which includes the evasion shortfall penalty) after a taxpayer has been prosecuted for an offence under the Act, regardless of whether the prosecution was successful or not.[67]

89. It is considered that the reference to whether or not the prosecution was successful is an acknowledgement of the different standards of proof on the Commissioner in this area. As noted above, in criminal prosecutions the Commissioner has the onus of proof to the standard of "beyond reasonable doubt".[68]

90. For the shortfall penalty of evasion, the Commissioner has the onus of proof to the standard of the "balance of probabilities".[69] Because of this difference, the Commissioner may fail to satisfy the evidential standard in a criminal prosecution, yet have sufficient evidence to satisfy the lower threshold of the balance of probabilities for the evasion shortfall penalty.

91. The Commissioner may impose an evasion shortfall penalty as an alternative to prosecution in the following circumstances:

    - The likelihood is high that the taxpayer will voluntarily pay the shortfall penalty; or
    - The Commissioner is in a position to enforce payment; or
    - Although payment is unlikely to be recovered, bankrupting or liquidating the taxpayer would be an appropriate compliance outcome in the circumstances.

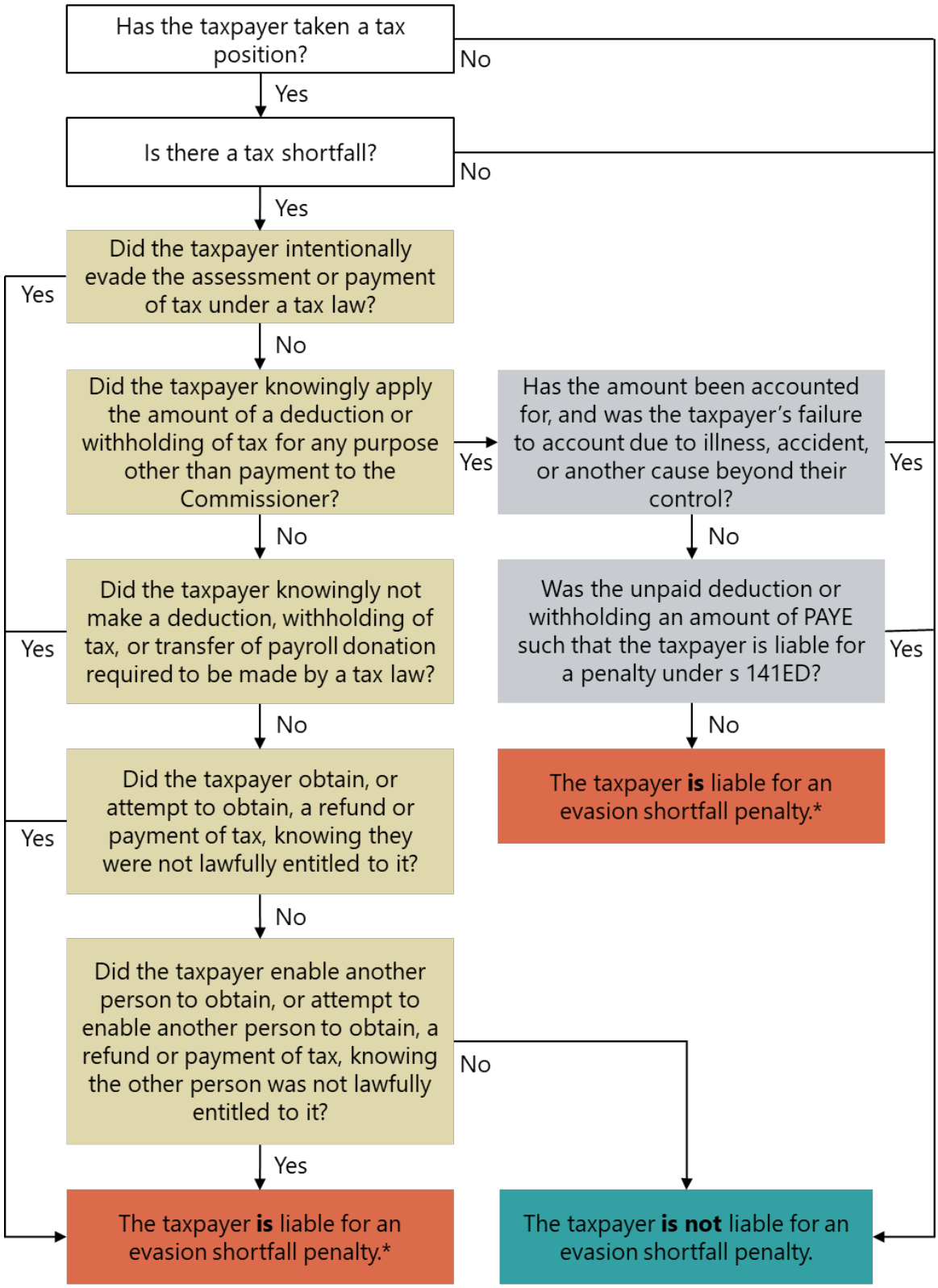
92. The Commissioner is unlikely to impose an evasion shortfall penalty, and will seek to prosecute, in the following circumstances:

    - An evasion shortfall penalty has been an ineffective compliance tool used against that taxpayer in the past; or
    - The likelihood is low that the taxpayer will pay the shortfall penalty and bankrupting or liquidating the taxpayer would not be an appropriate compliance outcome in the circumstances; or
    - Inland Revenue's compliance focus or the wider compliance context makes prosecution a more appropriate compliance outcome.

93. For more information about prosecution, see **CS 26/01**: Inland Revenue Prosecution Guidelines, issued on 19 December 2025.

59 Section 143BB.
60 Section 143BC.
61 As with the penalty under s 141EE, the requirements for an offence under s 143BC are satisfied if the person has a purpose in relation to the tool of evading the assessment or payment of tax.
62 Section 143A(1)(d) and 143A(1)(e).
63 Section 143A(8).
64 Section 149A(4).
65 Section 149A(3).
66 Section 149(5).
67 Section 149(4).
68 Sections 149(3) and 149A(4).
69 Sections 149A(1) and 149A(2).

Figure | Hoahoa 1: Flowchart of how s 141E applies



*However, the Commissioner may seek to prosecute instead of imposing a shortfall penalty, in accordance with the guidance above and CS 26/01.

References | Tohutoro

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Income Tax Act 2007, ss LA 4(5), RD 3

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Case N53 (1991) 13 NZTC 3,419 (TRA)

Case N54 (1991) 13 NZTC 3,427 (TRA)

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Case Q20 (1993) 15 NZTC 5,108 (TRA)

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Case W4 (2003) 21 NZTC 11,034 (TRA)

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Hammond v Walesby and Paramount Graphics Limited (1986) 8 NZTC 5,185 (HC)

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R v Rowley (No 2) [2012] NZHC 1778

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Rogerson v CIR (2005) 22 NZTC 19,260 (HC)

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Other references | Tohutoro anō

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IS 26/09: Shortfall penalties – reductions and other matters
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IS 26/06: Shortfall penalty for gross carelessness
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Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Bill (Officials' Report to the Finance and Expenditure Committee on Submissions on the Bill, 19 February 2001)

IS 26/09: Shortfall penalties – reductions and other matters

Issued | Tukuna: 27 March 2026

This interpretation statement is relevant where the Commissioner imposes a shortfall penalty for not taking reasonable care (s 141A), an unacceptable tax position (s 141B), gross carelessness (s 141C), an abusive tax position (s 141D), or evasion or similar act (s 141E). It discusses when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, and the assessment, payment and disputing of shortfall penalties.

All legislative references are to the Tax Administration Act 1994 unless otherwise stated.

REPLACES | WHAKAKAPIA

- **IS0053:** Shortfall penalty for not taking reasonable care (October 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)
- **IS0055**: Shortfall penalty – Unacceptable interpretation and unacceptable tax position (April 2005) *Tax Information Bulletin* Vol 17, No 9 (November 2005)
- **IS0060:** Shortfall penalty for gross carelessness ((August 2004) *Tax Information Bulletin* 168-104 Vol 16, No 8 (September 2004): 10
- **IS0061:** Shortfall penalty for abusive tax position (December 2005) *Tax Information Bulletin* Vol 18, No 1 (February 2006)
- **IS0062:** Shortfall penalty – evasion (November 2006) *Tax Information Bulletin* Vol 18, No 11 (December 2006)

Introduction | Whakataki

1. This interpretation statement provides guidance on matters that arise when the Commissioner imposes one of the following shortfall penalties:
    - not taking reasonable care – 20% penalty (s 141A);
    - an unacceptable tax position – 20% penalty (s 141B);
    - gross carelessness – 40% penalty (s 141C);
    - an abusive tax position – 100% penalty (s 141D); and
    - evasion or similar act – 150% penalty (s 141E).
2. It discusses when a shortfall penalty is reduced (or increased), what happens when a taxpayer could be liable for more than one penalty, the assessment, payment and disputing of shortfall penalties.
3. It does not address when a shortfall penalty will be imposed, which is considered in:
    - **IS 26/03**: **Shortfall penalties – requirements for a "tax position" and a "tax shortfall"**;
    - **IS 26/04**: **Shortfall penalty for not taking reasonable care**;
    - **IS 26/05**: **Shortfall penalty for taking an unacceptable tax position**;
    - **IS 26/06**: **Shortfall penalty for gross carelessness**;
    - **IS 26/07**: **Shortfall penalty for taking an abusive tax position**; and
    - **IS 26/08**: **Shortfall penalty for evasion or a similar act**.

Summary | Whakarāpopoto

4. In summary, this interpretation statement explains the following matters:

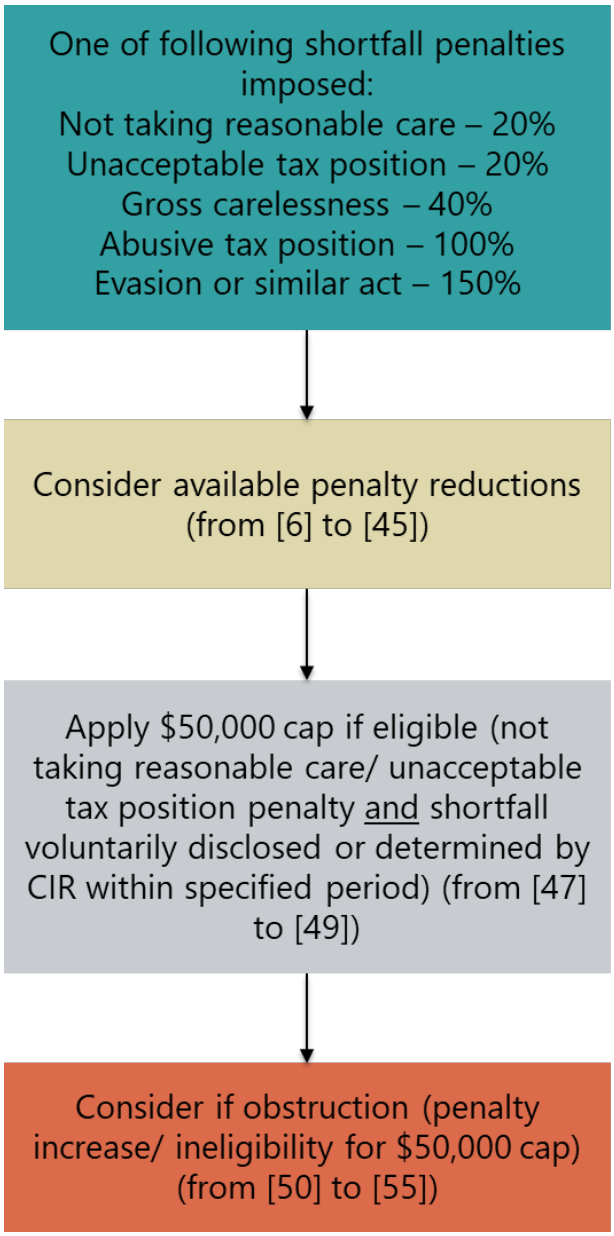
- In several situations the shortfall penalty payable by a taxpayer is reduced.
- The level of reduction ranges from 40% to 100%.
- The level of reduction available depends on the type of shortfall penalty imposed and the behaviour and actions of the taxpayer.
- A shortfall penalty can be subject to a 25% increase if the taxpayer obstructs the Commissioner in determining the correct tax position.[1]
- A taxpayer is liable to only one shortfall penalty for each tax shortfall. If a taxpayer could be liable for more than one shortfall penalty, the highest shortfall penalty will be imposed.[2]
- The Commissioner may make and amend an assessment of a shortfall penalty in the same way as they would make or amend an assessment of the tax to which the penalty relates, but does so separately from the tax.[3]
- Generally, a shortfall penalty is due and payable on the date the Commissioner notifies the taxpayer the penalty is due and payable.[4]
- A taxpayer may use a tax loss to pay a shortfall penalty imposed on an income tax liability.[5] A taxpayer may not use tax pooling to pay a shortfall penalty.[6]
- A taxpayer may dispute an assessment of a shortfall penalty in the same way as they dispute other tax assessments.

1 Section 141K.
2 Section 149(2) and (3).
3 Section 94A.
4 Section 142B.
5 Section IW 1 of the Income Tax Act 2007.
6 Section RP 17B of the Income Tax Act 2007.

Analysis | Tātari

5. This flowchart sets out the high level steps in determining the amount of shortfall penalty a taxpayer will pay. It also identifies the paragraphs where each step is discussed in more detail in this statement.

Figure | Hoahoa 1 – Determining the shortfall penalty amount payable



Reduction of shortfall penalties for previous behaviour

6. Under s 141FB a shortfall penalty is reduced by 50% where a taxpayer has good past compliance. To qualify for the reduction, a taxpayer must not have been:

- convicted of a "disqualifying offence"; or
- liable for a "disqualifying penalty".

7. A disqualifying offence is either of the following:

   - An offence under any of the following provisions if the conviction was on or after 26 March 2003 and before the taxpayer takes the tax position to which the current penalty relates:
     - s 143A (knowledge offences);
     - s 143B (evasion or similar offence);
     - s 143F (offence in relation to inquiries);
     - s 143G (offence in relation to court orders);
     - s 143H (obstruction); and
     - s 145 (penalties for offences for which no specific penalty imposed); and
   - An absolute or strict liability offence under s 143 relating to the same tax type as the current penalty if the conviction was:
     - within the past 2 years, where the current penalty relates to the taxpayer's application of the PAYE rules, FBT, GST or RWT; or
     - within the past 4 years, where the current penalty relates to other tax types; and
     - before the taxpayer took the tax position to which the current penalty relates.

8. What constitutes a disqualifying penalty depends on the type of shortfall penalty the taxpayer is currently liable for. Broadly, a disqualifying penalty is an earlier shortfall penalty of a similar nature, and for the same type of tax, as the current penalty. A disqualifying penalty can prevent a taxpayer from receiving a reduction for previous behaviour and usually applies if the earlier penalty was not reduced for voluntary disclosure and happened within a recent timeframe.

9. Where the current shortfall penalty is for **not taking reasonable care** or **taking an unacceptable tax position**, a disqualifying penalty is a shortfall penalty of any sort that:

   - relates to the same tax type as the current penalty;
   - is not reduced for voluntary disclosure; and
   - relates to a tax position taken within the past:
     - 2 years, where the current penalty relates to the taxpayer's application of the PAYE rules, FBT, GST, or RWT; or
     - 4 years, where the current penalty relates to other tax types.[7]

10. Where the current shortfall penalty is for **gross carelessness** or **taking an abusive tax position**, a "disqualifying penalty" is a shortfall penalty for evasion or a similar act, gross carelessness or taking an abusive tax position that:

    - relates to the same tax type as the current penalty;
    - is not reduced for voluntary disclosure; and
    - relates to a tax position taken within the past:
      - 2 years, where the current penalty relates to the taxpayer's application of the PAYE rules, FBT, GST, or RWT, or
      - 4 years, where the current penalty relates to other tax types. [8]

11. Where the current shortfall penalty is for **evasion**, a disqualifying penalty is a shortfall penalty for evasion or a similar act that:

    - relates to the same tax type as the current penalty;
    - is not reduced for voluntary disclosure; and
    - relates to a tax position taken on or after 26 March 2003 and before the date the taxpayer takes the tax position to which the current penalty relates. [9]

7 See the definition of disqualifying penalty in s 141FB(3)(b)(i), (ii)(B),(iii) and (iv). Where the current shortfall penalty is for taking an unacceptable tax position the penalty will relate to income tax only (and excluding withholding-type taxes such as PAYE, FBT, and RWT).

8 See the definition of disqualifying penalty in s 141FB(3)(b)(i), (ii)(A), (iii) and (iv).

9 See the definition of disqualifying penalty in s 141FB(3)(a)(i)-(iv).

12. Accordingly, a previous shortfall penalty reduced for voluntary disclosure will not prevent a current shortfall penalty being reduced under s 141FB.

13. The reduction for previous behaviour applies separately for each tax type, such as FBT, income tax and GST. A penalty relating to one tax type does not preclude a reduction if the current penalty relates to a different tax type. Example | Tauira 1 and Example | Tauira 2 illustrate how a reduction for previous behaviour applies where a taxpayer has had a previous shortfall penalty of the same or different tax type. Example | Tauira 3 illustrates a situation where a taxpayer's previous shortfall penalty is not a disqualifying penalty.

14. A shortfall penalty relating to a tax shortfall identified at the same time as the tax shortfall to which the current penalty relates is not disqualifying if the:

    - Commissioner becomes aware of both tax shortfalls in a single investigation or voluntary disclosure; and
    - the taxpayer:
        - takes the tax positions on the same date; and/or
        - has not been liable for a shortfall penalty in the past 2 years (where the current penalty relates to the taxpayer's application of the PAYE rules, FBT, GST, or RWT) or 4 years for other tax types.[10]

15. Example | Tauira 4 illustrates a situation where tax shortfalls are identified at the same time.

Example | Tauira 1 – Previous shortfall penalty of different tax type

Facts

During an audit, a GST shortfall is found that warrants the imposition of a shortfall penalty for not taking reasonable care. Two years ago, the taxpayer was liable for an unacceptable tax position shortfall penalty relating to an income tax shortfall.

Outcome

Penalty reduced by 50% for previous behaviour.

The previous unacceptable tax position shortfall penalty relates to an income tax shortfall; that is, a different tax type from the current penalty, which relates to a GST shortfall. Accordingly, the previous shortfall penalty does not prevent the current shortfall penalty for not taking reasonable care being reduced by 50% for previous behaviour.

Example | Tauira 2 – Previous shortfall penalty of same tax type

Facts

During an audit, an income tax shortfall is found that warrants the imposition of a shortfall penalty for not taking reasonable care. Two years ago, the taxpayer was liable for an unacceptable tax position shortfall penalty relating to an income tax shortfall that was not reduced for voluntary disclosure.

Outcome

Penalty not reduced for previous behaviour.

As there was another shortfall penalty for the same tax type imposed within the past 4 years (that is, income tax) and the current shortfall penalty is for not taking reasonable care, the current shortfall penalty for not taking reasonable care is not reduced by 50% for previous behaviour.

10 Section 141FB(5).

Example | Tauira 3 – Previous shortfall penalty not a type that is a disqualifying penalty

Facts

During an audit, an FBT shortfall is found that warrants the imposition of a shortfall penalty for gross carelessness. One year ago, the taxpayer was liable for a shortfall penalty for not taking reasonable care in relation to an FBT shortfall.

Outcome

Penalty reduced by 50% for previous behaviour.

Even though both shortfall penalties relate to the same tax type (that is, FBT), because the previous shortfall penalty was for not taking reasonable care, the previous shortfall penalty does not prevent the current shortfall penalty for gross carelessness being reduced by 50% for previous behaviour.

Example | Tauira 4 – Tax shortfalls identified at the same time

Facts

An investigation finds a taxpayer incorrectly claimed income tax deductions for capital improvements and excessive motor vehicle expenses. The Commissioner forms the view the taxpayer is liable for a shortfall penalty for not taking reasonable care for each tax shortfall.

The taxpayer has not previously been liable for a shortfall penalty or convicted of an offence under the Act.

Outcome

Each shortfall penalty is determined as if the taxpayer is not liable for the others. Each shortfall penalty is reduced by 50% for previous behaviour.

16. The Commissioner applies any previous behaviour reduction a taxpayer is entitled to after any reduction under s 141G for voluntary disclosure (discussed from [18]), s 141I for a temporary shortfall (discussed from [32]) or s 141H for disclosure of a tax position (discussed from [27]).

17. For more on the reduction for previous behaviour in s 141FB, see **SPS 06/03: Reduction of shortfall penalties for previous behaviour**.[11]

Reduction in penalty for voluntary disclosure of the tax shortfall

18. Under s 141G, a shortfall penalty may be reduced if, in the Commissioner's opinion, the taxpayer makes a full voluntary disclosure to the Commissioner of all the details of the tax shortfall. The factors the Commissioner considers in determining whether a taxpayer has made a full voluntary disclosure are summarised at [25].

19. When voluntarily disclosing a tax shortfall under s 141G, a taxpayer is informing the Commissioner they consider the tax position taken is incorrect and requesting their tax be reassessed based on the correct position.

20. Disclosure must be made:

    - before the taxpayer is first notified of a pending audit or investigation (pre-notification disclosure);[12] or
    - after the taxpayer has been notified of a pending audit or investigation but before the audit or investigation has started (post-notification disclosure).[13]

11 SPS 06/03: Reduction of shortfall penalties for previous behaviour (standard practice statement, Inland Revenue, June 2006).

12 Section 141G(1)(a).

13 Section 141G(1)(b).

21. A taxpayer is deemed to have been notified of a pending tax audit or investigation if any of the following people have been notified:
    - the taxpayer;
    - an officer of the taxpayer;
    - a shareholder of the taxpayer, if the taxpayer is a close company;
    - a tax adviser acting for the taxpayer;
    - a partner in partnership with the taxpayer; or
    - a person acting for or on behalf of or as a fiduciary of the taxpayer.
22. An audit or investigation starts at the earlier of the:
    - end of the first interview an Inland Revenue officer has with the taxpayer or the taxpayer's representative, after the taxpayer receives the notice of the audit or investigation; or
    - time when:
        - an Inland Revenue officer inspects the taxpayer's information (including books or records) after the taxpayer receives the notice of the audit or investigation; and
        - the taxpayer is notified of the inspection.
23. The Commissioner's practice for notifying taxpayers of a pending audit or investigation or advising them of when an audit or investigation has begun is set out in **SPS 16/03: Notification of a pending audit or investigation**.[14]
24. The level of reduction for a voluntary disclosure depends on the type of shortfall penalty imposed and whether it is a pre-notification or post-notification disclosure. Table | Tūtohi 1 sets out the various reduction percentages for voluntary disclosure that can apply.

Table | Tūtohi 1 – Voluntary disclosure reduction percentages

Reduction type	Reduction percentage for each penalty type				
	Not taking reasonable care	Unacceptable tax position	Gross carelessness	Abusive tax position	Evasion
Pre-notification voluntary disclosure: s 141G(1)(a)	100%	100%	75%	75%	75%
Post-notification voluntary disclosure: s 141G(1)(b)	40%	40%	40%	40%	40%

25. The factors the Commissioner considers to determine whether a taxpayer has made a full voluntary disclosure of all details of a tax shortfall are outlined in **SPS 19/02: Voluntary disclosures**.[15] In summary, a clear statement by the taxpayer of all the details of the tax shortfall is required. As a minimum, the Commissioner requires the disclosure of:
    - sufficient details for the Commissioner to satisfactorily identify the taxpayer (name, trade name, IRD number) and confirm their contact details (postal address, contact telephone number(s), email address);
    - the tax periods and tax type involved;
    - an explanation as to why the tax shortfall occurred;
    - sufficient detail of the tax shortfall, including its amount, and full details of the facts and circumstances leading to the tax shortfall to enable the Commissioner to make a correct assessment of the tax shortfall; and
    - any further information necessary for the Commissioner to make a correct assessment.
26. For more on the reduction of shortfall penalties under s 141G, see SPS 19/02.

14 SPS 16/03: Notification of a pending audit or investigation (standard practice statement, Inland Revenue, June 2016).

15 SPS 19/02: Voluntary disclosures (standard practice statement, Inland Revenue, March 2019). See also *Vitasovich v CIR* [2017] NZHC 1,501, (2017) 28 NZTC 23-028, at [36].

Reduction for disclosure of a tax position

27. Under s 141H a shortfall penalty payable by a taxpayer under s 141B (an unacceptable tax position) or s 141D (an abusive tax position) may be reduced by 75%, if, in the Commissioner's opinion, the taxpayer makes adequate disclosure of the tax position at the time they take it. This reduction applies to only these two shortfall penalties.

28. This disclosure differs from the voluntary disclosure under s 141G (discussed from [18]). Disclosure under **s 141G** is of a tax shortfall made at some point **after the taxpayer has taken a tax position**. Disclosure under s **141H** is of a tax position made **at the time the tax position is taken**. A taxpayer might disclose a tax position at the time the tax position is taken for various reasons. For example, the taxpayer might be unsure of the correctness of the position, disagree with the Commissioner's view or adopt a conservative position out of caution or due to materiality. By disclosing the tax position they will be entitled to a reduced penalty if the tax position is later found to be not "about as likely as not to be correct" (an acceptable tax position).[16]

29. If a tax return is provided, the taxpayer takes the tax position at the time it provides the return containing its tax position. If no tax return is provided, the taxpayer takes the tax position on the due date for providing the tax return for the return period.[17]

30. Disclosure under s 141H must be "adequate", which appears a lesser standard than "full voluntary disclosure" required under s 141G. However, for the disclosure to be effective, the taxpayer must provide full and relevant arguments for the tax position they have taken.[18] For adequate disclosure, the Commissioner requires:[19]

    - the taxpayer's details (name, trade name, IRD number, address, date of birth, contact telephone and contact times);
    - an overview of the position taken;
    - interpretation of case law on the subject, contents of any tax opinions, legal articles and related material;
    - any relevant Inland Revenue public ruling;
    - a calculation, if necessary, to show the position and how it was arrived at; and
    - a declaration by and the signature of the taxpayer.

31. The information may be provided using the form **Statement in support of a tax position – IR 282**.[20]

Reduction where shortfall is temporary

32. Under s 141I a shortfall penalty must be reduced if and "to the extent" that the tax shortfall is temporary. The penalty applying to all or that part of the tax shortfall that is temporary is reduced by 75%.[21]

33. The use of the words "to the extent" means the section may apply to situations where part of a tax shortfall is temporary.

16 See Taxpayer Compliance, Standards and Penalties 2: Detailed proposals and draft legislation (government discussion document, Inland Revenue, April 1995) at [6.8] and [8.20]–[8.23].

17 See ss 141H(1) and 141B(6).

18 Taxpayer Compliance, Penalties, and Disputes Resolution Bill: Commentary on the Bill (Inland revenue, September 1995) at 11.

19 Section 141H(3), Background – new compliance and penalties rules *Tax Information Bulletin* Vol 8, No 7 (October 1996): 1 at 25 and Statement in support of a tax position – IR 282 (form, Inland Revenue, 2014).

20 Statement in support of a tax position – IR 282 (form, Inland Revenue, 2014).

21 Section 141I(1) and (2).

34. A tax shortfall will be temporary if the Commissioner is satisfied that, because of the taxpayer's actions or by the operation of law or circumstances, the tax shortfall has or will be permanently reversed or corrected within 4 years. Section 141I(3) provides:

> **141I Reduction where temporary shortfall**
>
> ...
>
> (3) A tax shortfall is a temporary tax shortfall for the return period of a tax position if, when the Commissioner considers the assessment of a shortfall penalty, the Commissioner is satisfied that—
>
> (a) the tax shortfall has been or will be, in an earlier or later return period, permanently reversed or corrected—
>
> (i) before the end of the 4-year period beginning after the day on which the taxpayer took the tax position; and
>
> (ii) with the effect that the taxpayer pays or returns for the relevant return periods the correct total amount of tax, not including penalties and interest, in respect of the tax position; and
>
> (iii) as a result of actions taken by the taxpayer or by the operation of law or circumstances; and
>
> (b) no tax shortfall will arise in a later return period in respect of a similar tax position; and
>
> (c) no arrangement exists with the purpose or effect of creating for another return period a tax deferral or advantage related to the tax position.

35. Example | Tauira 5 and Example | Tauira 6 illustrate situations where a tax shortall is permanently reversed or corrected in a later return period.

36. In the case of a timing shortfall (that is, a tax shortfall arising due to a tax position having been taken in the wrong period), the Commissioner will accept the tax shortfall has been permanently reversed if:[22]

- it appears from the taxpayer's actions that steps taken will remedy the tax shortfall; or
- through operation of law or circumstances, the matter will reverse itself.

37. A tax return containing the reversal is not required, provided the Commissioner is satisfied the reversal will be made.

Example | Tauira 5 – Temporary tax shortfall – GST

Facts

A company runs a business that involves purchasing materials from suppliers that are both registered and unregistered for GST purposes.

The company claimed an input tax deduction on secondhand goods purchased from a unregistered person in the taxable period ended 31 March 2025 based on the full purchase price totalling $36,000, when during that period only $5,000 of the total amount was due and paid. The balance of the purchase price ($31,000) was due and paid on 10 April 2025. This is incorrect (in relation to the input tax deduction on $31,000 of the $36,000 purchase price) as an input tax deduction for secondhand goods is only allowed to the extent that payment has been made.

There is a tax shortfall in the taxable period ended 31 March 2025. Assuming a shortfall penalty is applicable on the facts the following outcome arises.

Outcome

Penalty reduced by 75% for a temporary shortfall.

The company was entitled to claim an input tax deduction in relation to the $31,000 in the GST return for the period ended 30 April 2025. The taxpayer, having claimed an input tax deduction for the $31,000 in the previous GST return, did not claim an input tax deduction on that amount in its April return.

The company is allowed a temporary shortfall reduction because Inland Revenue is satisfied that the tax shortfall was permanently reversed in the April return period, and that a similar error will not occur in a later return period.

22 When the Commissioner will accept timing shortfalls have been permanently reversed is explained in INV-231: Temporary shortfall – permanent reversals (standard practice statement, Inland Revenue, September 1999.

Example | Tauira 6 – Temporary tax shortfall – deduction

Facts

A company prepays $60,000 for its advertising for the 2025 income year ($5,000 per month). At balance date the unexpired portion of the expenditure is $20,000. A deduction for the full expense of $60,000 is included in the company's 2025 income tax return. The company's tax position regarding the timing of the deduction is incorrect as $20,000 of the expense is deductible in the 2026 income year.

There is a tax shortfall of $20,000 in 2025. Assuming a shortfall penalty is applicable on the facts the following outcome arises.

Outcome

Penalty reduced by 75% for a temporary shortfall.

The company is allowed a temporary shortfall reduction even though the 2026 income tax return has not been filed because Inland Revenue is satisfied that the tax shortfall will be permanently reversed (the $20,000 of advertising expenditure is deductible in the 2026 income year), and that a similar error will not occur in a later return period.

38. In the case of tax shortfalls where the Commissioner is not satisfied they will be permanently reversed or corrected later, a tax return or other evidence showing the tax shortfall has been permanently reversed or already corrected will be required.

39. In *Brown v CIR*, the taxpayer was unable to show a tax shortfall had been permanently reversed or corrected.[23] The taxpayer was a chartered accountant who claimed income tax deductions for interest he paid to a bank on behalf of a trust. The Taxation Review Authority held the taxpayer was not entitled to the deductions and was liable for a shortfall penalty for not taking reasonable care.[24] The taxpayer argued the penalty should be reduced under s 141I because any tax shortfall was temporary. He said he made the interest payments expecting to be reimbursed and the tax shortfall would be reversed when the trust repaid him.

40. It was decided the taxpayer was not entitled to a temporary shortfall reduction in the penalties under s 141I.[25] The taxpayer had not shown he had a right to be repaid and that the tax shortfalls would be reversed. McKenzie J (in *Brown*) said:

> [6] The Judge held that there was no written agreement between the Trust and the appellant recording the arrangement and that there was no agreement, written or oral, that the Trust would repay the taxpayer. In the light of that factual finding by the [Taxation Review Authority], which is not challenged on this appeal, **there is no contractual obligation on the Trust to pay the taxpayer the amount of the interest which he has paid on its behalf.** …
>
> …
>
> [13] The amount of the penalty under s 141A of the Tax Administration Act 1994 for not taking reasonable care is 20 per cent of the resulting tax shortfall. The Judge held that this was reduced by 50 per cent under s 141FB(2) of that Act. She held that **s 141I of that Act, which applies when a tax shortfall is temporary, did not apply. She rejected a submission that the shortfall is temporary because it will be reversed when the Trust reimburses the appellant. That finding is clearly right. There is no right of reimbursement.** [Emphasis added]

Limitation on reduction of shortfall penalty

41. Under s 141J a shortfall penalty may qualify for reduction for a voluntary disclosure under s 141G, disclosure of a tax position under s 141H **and** s 141I (for a temporary shortfall). In that case, the shortfall penalty is reduced only once.[26]

23 *Brown v CIR* (2014) 26 NZTC 21-089 (HC).

24 *Case 3/2013* (2013) 26 NZTC 2-002 (TRA).

25 At the time, s 141I required the tax shortfall be reversed or corrected before the taxpayer was first notified of a pending audit or investigation. Since 1 April 2008, s 141I has required the tax shortfall to be permanently reversed or corrected within 4 years.

26 Section 141J(2).

42. The shortfall penalty is reduced by 100%, if:
    - the shortfall penalty is for not taking reasonable care[27]or for taking an unacceptable tax position;[28] and
    - the tax shortfall is voluntarily disclosed under s 141G **before** the taxpayer is notified of a pending audit or investigation (a pre-notification disclosure).
43. In all other cases, the penalty is reduced by 75%.[29]
44. This means that if the taxpayer is entitled to a 40% reduction for voluntary disclosure (post-notification) and a 75% temporary shortfall reduction, the temporary shortfall reduction of 75% applies. In this case, because the penalty is not reduced for voluntary disclosure, the penalty may be a "disqualifying penalty" affecting the taxpayer's entitlement to any future shortfall penalty reduction for previous behaviour under s 141FB.[30]
45. However, if the taxpayer is entitled to a 75% reduction for voluntary disclosure (pre-notification disclosure of a shortfall penalty for gross carelessness, an abusive tax position or evasion) and a 75% temporary shortfall reduction, the voluntary disclosure reduction of 75% applies. In this case, because the penalty is reduced for voluntary disclosure, the penalty will not prevent any future shortfall penalty reduction for previous behaviour under s 141FB.

Summary of reductions

46. Table | Tūtohi 2 summarises the percentage reduction for each reduction type discussed above, for each penalty type.

Table | Tūtohi 2 - Percentage reduction for each reduction and penalty type

Reduction type	Reduction percentage for each penalty type				
	Not taking reasonable care	Unacceptable tax position	Gross carelessness	Abusive tax position	Evasion
Previous behaviour: s 141FB	50%	50%	50%	50%	50%
Pre-notification voluntary disclosure: s 141G	100%	100%	75%	75%	75%
Post-notification voluntary disclosure: s 141G	40%	40%	40%	40%	40%
Disclosure of tax position: s 141H	N/A	75%	N/A	75%	N/A
For a temporary shortfall: s 141I	75%	75%	75%	75%	75%

When the penalty may not be more than $50,000

47. Under s 141JAA a shortfall penalty for not taking reasonable care[31] or for taking an unacceptable tax position[32] may not be more than $50,000 if the taxpayer voluntarily discloses the tax shortfall under s 141G (discussed from [18]).[33] The penalty is also capped at $50,000 if the Commissioner determines the tax shortfall within a period after the due date for the return to which the shortfall relates (for example, if an Inland Revenue office identifies the tax shortfall during an audit). The Commissioner must determine the tax shortfall within the later of:
    - 3 months after the due date of the return; and
    - the shorter of one return period and six months.

27 Section 141A.

28 Section 141B.

29 Section 141J(2). Section 141J(2)(a)(i) refers also to taking a tax position involving an unacceptable interpretation of a tax law. This is a reference to the test in s 141B before its amendment by the Taxation (Maori Organisations, Taxpayer Compliance and Miscellaneous Provisions) Act 2003.

30 See [8] to [10].

31 Section 141A.

32 Section 141B.

33 Section 141JAA(1).

48. The $50,000 cap does not apply if the penalty is increased for obstruction under s 141K.[34]

49. This cap does not reduce the shortfall penalty but is a maximum limit on the amount of penalty that is payable. The $50,000 cap applies after the amount of the penalty is determined under s 141A or s 141B and the reduction provisions in ss 141G, 141H (if the shortfall penalty is for taking an unacceptable tax position), 141I and 141J, are applied.

When the penalty may be increased for obstruction

50. Taxpayers must co-operate with Inland Revenue, to the extent required by tax laws, in providing information and facilitating investigations. In *Tauber v CIR*, the Court of Appeal said:[35]

> [32] … As a law enforcement authority the Commissioner must act in maintenance of the law and in the interests of justice, which includes being able to complete investigations in a timely way and without obstruction.

51. A shortfall penalty may be increased by 25% of the tax shortfall if the taxpayer obstructs the Commissioner in determining the taxpayer's correct tax position.[36] The penalty will not be increased if the obstruction is by a third party, eg, a tax agent. However, third parties who obstruct the Commissioner may commit an obstruction offence under s 143H.

52. Obstruction occurs when a taxpayer intentionally, and without justification or lawful excuse, impedes or makes it materially more difficult for the Commissioner to carry out lawful duties.[37]

53. Obstruction may include hiding, destroying or refusing access to records, failing to answer questions, and deliberately delaying providing answers or information to frustrate Inland Revenue inquiries.

54. Obstruction does not include exercising legal rights, such as asserting the right to legal privilege, disputing an assessment or maintaining a different view from Inland Revenue.

55. The onus is on the Commissioner to prove a penalty should be increased for obstruction. The standard of proof is the balance of probabilities.[38] To meet this standard, the Commissioner must show the obstruction was more probable than not.

What happens when the taxpayer could be liable for more than one penalty

56. A taxpayer is liable to only one shortfall penalty for each tax shortfall.[39] If a taxpayer could be liable for more than one shortfall penalty, the highest shortfall penalty is to be imposed.[40]

57. The percentage of the tax shortfall payable as a shortall penalty for an incorrect tax position increases with the degree of culpability.[41] The percentage is 20% of the tax shortfall for not taking reasonable care and for taking an unacceptable tax position, 40% for gross carelessness, 100% for abusive tax positions, and 150% for evasion or similar act.

58. It may not always be clear which penalty should be imposed. For example, when a taxpayer could be liable for a shortfall penalty for not taking reasonable care and for taking an unacceptable tax position (the amount of the penalty is the same). As the shortfall penalty for not taking reasonable care concerns the exercise of care and the unacceptable tax position shortfall penalty concerns whether the tax position taken is one that is objectively about as likely as not to be correct, the circumstances may show whether the taxpayer's lack of care or their interpretation was the more significant factor in the tax shortfall. After considering all the circumstances, the Commissioner will decide which penalty is more appropriately imposed. If there is a dispute, the Commissioner may propose one penalty and propose another in the alternative.

59. Table | Tūtohi 3 sets out the percentage reduction that applies when a combination of reduction types applies to a shortfall penalty imposed.

34 See s 141JAA(2).

35 *Tauber v CIR* (2012) 25 NZTC 20-143 (CA).

36 Section 141K.

37 *Urlich v Police* (1989) 4 CRNZ 144 (HC) at 145, *Goldsmith v Police* (1993) 10 CRNZ 106 (HC), *Highfield v CIR* (2000) 19 NZTC 15,609 (HC), and see also the definition of "obstruct" in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York, 2011).

38 Section 149A(1) and (2)(a).

39 This is except for employers' withholding payment penalties payable under s 141ED.

40 Section 149(3).

41 *Ben Nevis Forestry Ventures Ltd v CIR; Accent Management Ltd v CIR* [2008] NZSC 115, (2009) 24 NZTC 23,188 at [178].

Table | Tūtohi 3 - Percentage reduction for each reduction and penalty type - combination

Combination	Reduction percentage for each penalty type				
	Not taking reasonable care	Unacceptable tax position	Gross carelessness	Abusive tax position	Evasion
Voluntary disclosure (pre-notification): s 141G **and** Temporary shortfall: ss 141I and 141J	100%	100%	75%	75%	75%
Voluntary disclosure (post-notification): s 141G **and** Temporary shortfall: ss 141I and 141J	75%	75%	75%	75%	75%
Voluntary disclosure (pre-notification): s 141G **and** Previous behaviour: s 141FB	100%	100%	75% then 50%	75% then 50%	75% then 50%
Voluntary disclosure (post-notification): s 141G **and** Previous behaviour: s 141FB	40% then 50%	40% then 50%	40% then 50%	40% then 50%	40% then 50%
Voluntary disclosure (pre-notification): s 141G **and** Temporary shortfall: ss 141I and I41J **and** Previous behaviour: s 141FB	100%	100%	75% then 50%	75% then 50%	75% then 50%
Voluntary disclosure (post-notification): s 141G **and** Temporary shortfall: ss 141I and 141J **and** Previous behaviour: s 141FB	75% then 50%	75% then 50%	75% then 50%	75% then 50%	75% then 50%
Temporary shortfall: s 141I **and** Previous behaviour: s 141FB	75% then 50%	75% then 50%	75% then 50%	75% then 50%	75% then 50%
Disclosure of a tax position: s 141H **and** Temporary shortfall: s 141I **and** Previous behaviour: s 141FB	N/A*	75% then 50%	N/A*	75% then 50%	N/A*

* Section 141H does not apply (but see temporary shortfall and previous behaviour combination)

Assessment (formal determination) of the penalty

60. The Commissioner may make and amend an assessment of a shortfall penalty in the same way as they may make or amend an assessment of the tax to which the penalty relates but makes it separately from the tax.[42]

61. The Commissioner may assess the penalty at the same time the tax shortfall adjustments are being determined or finalised.[43] There is no statute bar for an assessment of a shortfall penalty. However, if the underlying tax to which the penalty relates has not been assessed by the statute bar for that tax, no shortfall penalty can be assessed. Broadly, statute bar refers to the 4 year limit on the Commissioner's power to amend income and GST assessments.[44]

62. The Commissioner can impose a shortfall penalty after a taxpayer has been prosecuted. **IS 26/08**: **Shortfall penalty for evasion or a similar act** discusses this ability.

Due date for payment of the penalty

63. Generally, a shortfall penalty is due and payable on the date the Commissioner notifies the taxpayer the penalty is due and payable.[45]

64. Where the tax shortfall is an amount of unpaid tax for which no new due date is set, the due date for payment of the shortfall penalty may not be less than 30 days after the date the Commissioner issues the notice of assessment for the penalty.[46]

Payment of the penalty

65. A taxpayer may use a tax loss to pay a shortfall penalty relating to income tax.[47] How the Commissioner applies s IW 1 of the Income Tax Act 2007, including examples of how to calculate the amount of losses used to pay a shortfall penalty, is set out in **SPS 16/04**: **Payment of shortfall penalty using losses**.[48]

66. A taxpayer may not use tax pooling to pay a shortfall penalty.[49]

Disputing an assessment of the penalty

67. A taxpayer may dispute an assessment of a shortfall penalty in the same way as they may dispute other tax assessments. For more on disputing an assessment (including a shortfall penalty assessment), see **SPS 23/01**: **Disputes process**.[50]

68. When disputing liability for a shortfall penalty for not taking reasonable care, taking an unacceptable tax position, gross carelessness or taking an abusive tax position, the onus is on the taxpayer to establish matters of fact. For a shortfall penalty for evasion, the onus shifts to the Commissioner. In either case, the standard of proof is the balance of probabilities.[51] The evidence required to meet the standard will reflect the seriousness of the circumstances of the case.[52]

42 Section 94A.

43 Section 94A(3). Do the statutory time bar provisions apply to shortfall penalties? (question we've been asked, Inland Revenue, June 2004) explains that s 94A(3) was enacted to allow the Commissioner to proceed with a shortfall penalty proposal without having to wait for the substantive matter to be finally resolved.

44 Do the statutory time bar provisions apply to shortfall penalties? (question we've been asked, Inland Revenue, June 2004).

45 Section 142B.

46 Section 142B(1)(a)(i).

47 Section IW 1 of the Income Tax Act 2007.

48 SPS 16/04: Payment of shortfall penalty using losses (standard practice statement, Inland Revenue, August 2016).

49 Section RP 17B of the Income Tax Act 2007.

50 SPS 23/01: Disputes process Taxation Information Bulletin Vol 35, No 3 April 2023): 48.

51 Section 149A,

52 *Ben Nevis* at [180].

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IS 26/08: Shortfall penalty for evasion or a similar act **taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-08**

IS 26/06: Shortfall penalty for gross carelessness **taxtechnical.ird.govt.nz/interpretation-statements/2026/is-26-06**

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IS 26/10: Income tax implications of providing sponsorship

Issued | Tukuna: 20 April 2026

This interpretation statement considers the income tax implications for a business that provides sponsorship to an organisation, event, person or cause, where the taxpayer (the sponsor) intends that the sponsorship will promote or advertise the business. The sponsorship may be provided in the form of money or by providing products or services.

All legislative references in this statement are to the Income Tax Act 2007 (the Act).

REPLACES | WHAKAKAPIA

- **IS3229**: Deductibility of sponsorship expenditure

Summary | Whakarāpopoto

What is "sponsorship"?

1. In this interpretation statement, the term "sponsorship" refers to supporting an organisation, event, person or cause either monetarily or by providing products or services, where the taxpayer (the sponsor) intends that the sponsorship will promote or advertise their business.

When sponsorship expenditure will be deductible

The general permission

2. For sponsorship expenditure to potentially be deductible, the general permission must be satisfied. This means there must be a sufficient nexus or connection between the expenditure and an income-earning process the taxpayer has. If the general permission is satisfied, there are some general limitations to deductibility that may apply (see from [12]).
3. To determine whether the general permission is satisfied, it is necessary to ascertain the true character of the expenditure, and consider the relationship between the advantage the taxpayer was seeking to gain from the expenditure and the taxpayer's income-earning process.
4. Determining the advantage the taxpayer was seeking to gain from the expenditure is a subjective matter. It requires considering the taxpayer's purpose at the time the expenditure was incurred.
5. If no income is derived as a result of the expenditure, this does not necessarily mean the expenditure was not incurred for the purpose of deriving income. Ultimately, a taxpayer's subjective purpose or purposes in incurring expenditure will be a question of fact. Determining the taxpayer's purpose involves an objective analysis of surrounding circumstances, including the effect of the expenditure.
6. In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material to whether expenditure is deductible. That is, deductibility does not depend on the amount of expenditure being "reasonable".
7. Expenditure may be only partly deductible where it is in part incurred for a purpose unrelated to the taxpayer's business or income-earning activity, or when a deduction for part of the expenditure is prohibited.
8. However, the fact that a third party may benefit from expenditure a taxpayer incurs does not necessarily preclude that expenditure from being fully deductible.
9. In a situation where a taxpayer has two or more distinct purposes for making the expenditure, not all of which relate to the taxpayer's business or income-earning activity, apportionment will generally be required. However, in a situation where the third-party benefit is incidental to the purpose relating to the taxpayer's business or income-earning activity, apportionment is not required.

10. The fact there may be some philanthropic motivation for a taxpayer incurring expenditure does not necessarily preclude it from being fully deductible. While there may be some philanthropic motivation for expenditure being incurred, there may often also be a business motivation. If it can be shown that the expenditure is intended to benefit the business, such that the general permission is satisfied, the expenditure will be deductible.[1] For example, if there is promotion and exposure of the business to a relevant market audience.

11. For expenditure to meet the nexus test in the general permission, a taxpayer will need to be able to show it was intended that the business would be promoted or advertised by incurring the expenditure. The following factors may support a taxpayer's contention that this is the case:

    - the specific terms of the sponsorship arrangement (which does not necessarily need to be in writing);
    - the place of the sponsorship arrangement in a coherent marketing strategy;
    - the relationship between the market, or potential market, and the taxpayer's business; and
    - the relationship between the expenditure and the resulting income derived.[2]

Limitations to deductibility

12. If the general permission is satisfied, there are some general limitations to deductibility that may apply. The two general limitations potentially relevant to sponsorship expenditure are the capital limitation and the private limitation.

13. It is also possible that the entertainment expenditure rules (in subpart DD) may apply to reduce the deduction to 50% of what would otherwise be allowed.

The capital limitation

14. The capital limitation denies deductibility to the extent an amount of expenditure or loss is of a capital nature.

15. The following factors are relevant in determining whether expenditure is of a capital nature:

    - the need or occasion that calls for the expenditure;
    - whether the expenditure is recurrent in nature;
    - whether the expenditure creates an identifiable asset;
    - whether the expenditure creates an advantage that is of enduring benefit to the business;
    - whether the expenditure is on the profit-making structure or process;
    - whether the payment is made from fixed or circulating capital; and
    - the treatment of the expenditure under ordinary principles of commercial accounting.

16. In the context of sponsorship expenditure, some of these factors will be more relevant than others. In considering any given circumstances, it is necessary to weigh up the factors to determine whether all or part of the sponsorship expenditure is of a capital nature.

17. If the capital limitation applies to deny deductibility because the taxpayer acquires an asset that is made available for use under a sponsorship arrangement, a deduction for depreciation may be available (see from [26]).

The private limitation

18. The private limitation denies deductibility to the extent an amount of expenditure or loss is of a private or domestic nature.

19. Where a private or domestic benefit arises because this was a purpose of the expenditure, distinct from the business promotion purpose, then apportionment will be necessary. However, where a benefit of a private or domestic nature arises incidentally to the income-earning or business activity of the person incurring the expenditure, apportionment is not required.

1 Subject to any limitations applying – see from [12].

2 It is not normally possible to identify particular income as being derived as a result of particular expenditure, but if it can be shown that the expenditure gave rise to income, that would be a strong supportive factor.

20. A company cannot incur private expenditure, given its separate legal and non-natural person character. However, if a company's expenditure has some private or domestic character in the hands of the recipient, this may be relevant in determining the purpose or purposes of the expenditure and whether the general permission is satisfied.

The entertainment expenditure limitation rule

21. If the entertainment expenditure limitation rule applies, it will reduce the deduction to 50% of what would otherwise be allowed.

22. The limitation rule may apply to expenditure[3] on corporate boxes, holiday accommodation, yachts and other pleasure craft, and the provision of food and drink.

23. There are various circumstances where the limitation rule will not apply, which may be relevant in the context of sponsorship. For example, if the entertainment is sponsored mainly to advertise or promote a taxpayer's business to the public, and the public has the same access to the entertainment as employees, business contacts or people associated with the business. See further from [98].

Expenditure not all used up by the end of an income year

24. If a deduction for expenditure is allowed, it is necessary to consider whether all of the expenditure is 'used up' in the income year. If it is not, this impacts the tax treatment.

25. If some or all of the expenditure is 'unexpired' at the end of the income year (that is, it is not used up – because some relates to future income years), the unexpired portion is included in the taxpayer's income for the year. It is then allowed again as a deduction in the following income year.

Depreciation

26. It may be that a taxpayer provides sponsorship through allowing use of depreciable property (for example, allowing a sports team to use a business-branded motor vehicle owned by the taxpayer on weekends for transport). In this situation, a deduction will be allowed for depreciation. The amount of the depreciation loss is determined under subpart EE.

27. The amount of the depreciation loss allowed as a deduction will depend on whether the depreciable property is wholly used or available for use by the taxpayer in deriving income or in carrying on a business for the purpose of deriving income and whether there is any private use of the depreciable property. If the depreciation deduction needs to be apportioned, how this is done depends on which rules apply – the standard deductibility rules or the mixed-use asset rules.

Sponsorship through providing goods that are trading stock

28. A taxpayer may provide sponsorship by providing goods that are 'trading stock' of a business (property that the business has for the purpose of selling or exchanging in the ordinary course of the business).

29. Where this is the case, the value of the trading stock will be deductible through the trading stock rules.

30. There may be deemed income where the goods that the taxpayer provides are trading stock and the taxpayer disposed of them for less than market value consideration. There will **not** be deemed income where the taxpayer provides the trading stock:

    - in the course of carrying on a business;[4]
    - to a donee organisation;[5] or
    - to a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event.[6]

3 "Expenditure" is specifically defined in the entertainment expenditure rules – see [101].

4 So long as the taxpayer does not provide the trading stock to an associated person or take it for their own use or consumption.

5 Whether or not the taxpayer provides the trading stock in the course of carrying on a business and whether or not the donee organisation is associated with the person providing the trading stock.

6 Whether or not the taxpayer provides the trading stock in the course of carrying on a business.

Sponsorship through providing services

31. A taxpayer may also provide sponsorship by providing services. Where they do this, the costs associated with providing the services will be deductible for the business under the general permission if it can be shown that the sponsorship is intended to benefit the business.

32. If the taxpayer provides the services for no remuneration, no income will arise. But if the sponsor business provides services at a reduced rate, there will be income to the extent the business is remunerated for the services.

Sponsorship of an employee

33. If an employer sponsors an employee (for example, paying their entry fee for an event they will take part in) in return for brand exposure, this may be sponsorship expenditure to which the deductibility principles explained in this statement would be relevant.

34. However, it may simply be the case that the amount is deductible because what the employer provides is employment income for the employee or gives rise to a fringe benefit. In either case, there will be no need to consider any element of 'sponsorship'.

Analysis | Tātari

What is "sponsorship"?

35. In this interpretation statement, the term "sponsorship" refers to supporting an organisation, event, person or cause either monetarily or by providing products or services, where the taxpayer (the sponsor) intends that the sponsorship will promote or advertise their business.

36. If the taxpayer can demonstrate the required degree of nexus or connection between the expenditure and income-earning process because of the promotional or advertising aim of the expenditure, the expenditure is essentially just a form of marketing. However, the fact that a third party may benefit from expenditure may mean the expenditure is not fully deductible.

37. The following discussion covers the deductibility principles that are relevant to whether sponsorship expenditure, or expenses associated with providing sponsorship by providing goods or services, will be deductible, and if so to what extent.

When will sponsorship expenditure be deductible?

There must be a sufficient connection between the expenditure and the income-earning activity or business

38. The first requirement for expenditure to be deductible is that it must be incurred by a person either:

    - in deriving assessable income or excluded income or a combination of the two (s DA 1(1)(a)); or
    - in the course of the person carrying on a business for the purpose of deriving assessable income or excluded income or a combination of the two (s DA 1(1)(b)).

39. This rule is known as the general permission. The general permission is set out in s DA 1:

> **DA 1 General permission**
>
> *Nexus with income*
>
> (1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—
>
> (a) incurred by them in deriving—
>
> (i) their assessable income; or
>
> (ii) their excluded income; or
>
> (iii) a combination of their assessable income and excluded income; or
>
> (b) incurred by them in the course of carrying on a business for the purpose of deriving—
>
> (i) their assessable income; or
>
> (ii) their excluded income; or
>
> (iii) a combination of their assessable income and excluded income.
>
> General permission
>
> (2) Subsection (1) is called the **general permission**.
>
> …

40. This means that to be (potentially) deductible, the expenditure has to have the necessary relationship with the taxpayer and with the gaining or producing of assessable income or with the carrying on of a business for that purpose. In other words, there must be a sufficient nexus between the expenditure and an income-earning process the taxpayer has.

41. If the general permission is satisfied, there are some general limitations (in s DA 2) to deductibility that may apply. Of relevance to sponsorship, this includes that deductions are denied to the extent expenditure is:

- of a capital nature (this is known as the capital limitation) – discussed from [67]; or
- of a private or domestic nature (this is known as the private limitation) – discussed from [89].

42. It is also possible that the entertainment expenditure rules (in subpart DD) may apply to further restrict the deduction that would otherwise be allowed. See from [98].

The nexus requirement under the general permission

43. The degree of nexus, or connection, required to satisfy each of the two limbs of deductibility (s DA 1(1)(a) and s DA 1(1)(b)) is the same. But what the expenditure must have a sufficient nexus with is different. For the first limb, the required nexus is between the expenditure and the deriving of income,[7] and for the second limb it is between the expenditure and the carrying on of a business for the purpose of deriving income[8] (*NRS Media Holdings v CIR* (2018) 28 NZTC 23,079 (CA)).

44. To determine whether there is a sufficient nexus between expenditure and an income-earning process the taxpayer has, it is necessary to ascertain the true character of the expenditure, and consider the relationship between the advantage the taxpayer was seeking to gain from the expenditure and the taxpayer's income-earning process. See, for example, *CIR v Banks* [1978] 2 NZLR 472 (CA) and *Buckley & Young Ltd v CIR* [1978] 2 NZLR 485 (CA). The character of the receipt in the hands of the recipient is not determinative (*Regent Oil Co Ltd v Strick* [1965] 3 All ER 174 (HL)).

45. Determining the advantage the taxpayer was seeking to gain from the expenditure is a subjective matter. It requires considering the taxpayer's purpose at the time they incurred the expenditure (*CIR v National Distributors Ltd* (1989) 11 NZTC 6,346 (CA)). If it transpires that no income is derived as a result of the expenditure, this does not necessarily mean the expenditure was not incurred for the purpose of deriving income. Ultimately, a taxpayer's subjective purpose or purposes in incurring expenditure will be a question of fact. Determining the taxpayer's purpose involves an objective analysis of surrounding circumstances, including the effect of the expenditure (*National Distributors*).

7 Assessable income, excluded income, or a combination of the two.

8 Again, assessable income, excluded income, or a combination of the two.

The amount of the expenditure is generally not relevant

46. The amount of expenditure is not material. That is, deductibility does not depend on the amount of expenditure being "reasonable" (see, for example, *Europa Oil (NZ) Limited v CIR (No. 2)*; *CIR v Europa Oil (NZ) Limited (No. 2)* (1976) 2 NZTC 61,066 (PC); and *Ronpibon Tin NL & Tongkah Compound NL v FCT* (1949) 78 CLR 47 (HCA)). As noted in *Ronpibon Tin* (at 60):

> It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent.

47. In the absence of associated party or avoidance concerns, the quantum of the expenditure is not material to whether expenditure is deductible. The expenditure will be deductible,[9] provided it is directed to income-earning or business ends.

A third party benefitting from the expenditure does not necessarily impact deductibility

48. The words "to the extent to which" in s DA 1 contemplate apportionment, in terms of how much expenditure may be deductible. For example, expenditure may be only partly deductible where the taxpayer incurs it in part for a purpose unrelated to their business or income-earning activity, or when a deduction for part of the expenditure is prohibited.

49. However, the fact that a third party may benefit from expenditure a taxpayer incurs does not necessarily preclude that expenditure from being fully deductible. For example, in *Usher's Wiltshire Brewery Ltd v Bruce* [1915] AC 433 (KB), Lord Atkinson considered that a brewery company's expenditure on repair and maintenance of tied houses (where the publicans (lessees of the premises) were required to buy all beers, wines and spirits from the brewery company only) was wholly and exclusively for the brewery company's trade, even though it benefitted the publicans incidentally.

50. In a situation where a taxpayer has two or more distinct purposes for making the expenditure, not all of which relate to their business or income-earning activity, apportionment will generally be required. However, based on the approach in *Usher's*, it is considered that in a situation where the third-party benefit is incidental to the purpose relating to the taxpayer's business or income-earning activity, apportionment is not required.

Philanthropy being a motivation for incurring the expenditure does not necessarily impact deductibility

51. The fact there may be some philanthropic motivation behind the expenditure does not necessarily preclude it from being fully deductible.

52. It is common for businesses, especially large corporations, to give back to the community through expenditure, providing trading stock, or providing services. While there may be some philanthropic motivation for this, there may often also be a business motivation. For instance, if it is done in part for the purpose of the business reputation and profile, as being **seen to be** doing good or giving back to the community is intended to be beneficial to the business in terms of being an attractive employer, attracting business, attracting investment, or enabling access to different sources of funding or better costs of funding. If it can be shown that the expenditure is intended to benefit the business in this way, the general permission will be satisfied.

53. For example, many businesses (large corporates in particular) publish annual ESG[10] or sustainability reports, which may mean they can show that this 'social good' activity is done for the purposes of the business, such that the expenditure satisfies the general permission and is deductible. The fact there may also be some philanthropic motivation will not preclude deductibility.

54. Even if it cannot be shown that ESG-type expenditure satisfies the general permission, if the expenditure is a "charitable or other public benefit gift"[11] made by a company to a "donee organisation"[12] it will be deductible under s DB 41 (subject to the limit in s DB 41(3) – which is that the deduction for the total of all gifts in an income year is limited to what the company's net income would be in the absence of s DB 41).

9 Subject to any limitations applying – see from [65].

10 ESG (environmental, social and governance) is a framework used to assess a company or organisation's operations in terms of environmental, social and governance factors.

11 Defined in s YA 1 and s LD 3.

12 Defined in s YA 1 (see [138]).

Factors that will help show a sufficient connection between sponsorship expenditure and the income-earning activity or business

55. For expenditure to come within the definition of "sponsorship" used in this statement, and so *prima facie* meet the nexus test in the general permission, a taxpayer needs to be able to show that in incurring the expenditure they **intended that the business would be promoted or advertised**. Promoting or advertising the business to a relevant market or potential market for the purpose of gaining or producing income would demonstrate that there is the degree of nexus or connection between the expenditure and the income-earning process that the general permission requires. The following factors may support a taxpayer's contention that this is the case:

    - **The specific terms of the sponsorship arrangement.**

      For example, is there a specific requirement for the recipient to promote the taxpayer's business? If so, what is the extent and prominence of the business exposure specified in the agreement?

      A sponsorship arrangement or agreement does not necessarily need to be in writing.
    - **The place of the sponsorship arrangement in a coherent marketing strategy.**

      For example, if a business's market research has identified that potential customers frequently attend cultural events, then part of its marketing strategy may be to sponsor such events in return for having its name and products promoted during the event.
    - **The relationship between the market, or potential market, and the taxpayer's business.**

      For example, market exposure at a tennis tournament that is directly related to the business of a sports equipment retailer.
    - **The relationship between the expenditure and the resulting income derived.**

      While it is not normally possible to identify particular income as having been derived as a result of particular expenditure, if it can be shown that the expenditure resulted in income being derived, that would be a strong supporting factor.

56. The South African case *ITC 696* (1950) 17 SATC 86 (HC) is an example of where sponsorship expenditure was held to be incurred in deriving income. In this case, a company that dealt in agricultural equipment purchased some footballs printed with words associated with the equipment in which the company traded. The company gave the footballs to various school football clubs. It also acquired two silver trophies engraved with its name and the names of various pieces of equipment in which it traded. The company gave these trophies to agricultural societies. The court held that the expenditure incurred on the footballs and trophies was deductible. Newton Thompson J commented (at 87):

    > I am satisfied that this expenditure is for advertisement purposes, that it has that effect; that it assists in selling articles in which the appellant deals; that it is incurred in the production of income …

57. The evidence supporting the deductibility of the expenditure was described as follows by Mr Galbraith (at 91):

    > … the company annually incurs expenditure on advertising the agricultural implements in which it deals. This advertising takes various forms, such as circulating pamphlets, distributing calendars, pocket-books, copper ash-trays, etc. It never takes the form of press advertising because the potential and actual customers of the company are too few to warrant advertising in newspapers.

58. This description illustrates that provision of the footballs and trophies fit within the company's marketing strategy, which included advertising on various articles to be distributed.

59. The taxpayer in *Case P16* (1992) 14 NZTC 4,107 (TRA) was a national courier that acquired and raced a Jaguar motor car that was marked with the company's logo. This case illustrates that evidence of a relationship between the potential market exposure from the expenditure and the taxpayer's business will support a contention that the expenditure is deductible. It also illustrates that the amount of expenditure is not necessarily relevant to whether the expenditure is deductible. In response to the company's contention that the racing promotion was intended to associate the company with speed and efficiency, Keane J stated (at 4,114):

    > … the company's decision was inherently logical from a business perspective, and the related steps taken wholly explicable from that perspective even if the level of expenditure ultimately incurred was greater than was first anticipated.

60. There was also evidence of a direct relationship between the sponsorship expenditure and the taxpayer's income, as the taxpayer could show that business turnover had increased markedly as a result of the racing promotion. This supported Keane J's conclusion that the related revenue expenditure was deductible.[13]

61. In the Australian Board of Review case, *Case F67* (1974) 74 ATC 397 (TBR), evidence that the potential market that could be reached as a result of the expenditure had a relationship to the taxpayer's business supported a conclusion that the expenditure was deductible. This case concerned a consulting engineer who also derived commission income as the sole representative of several foreign boat designers in Australia. To promote commission sales, the taxpayer had a power boat built to one of the designs for which he was the Australian representative. He had the names of his business and of the designer painted on the hull, along with his address and phone number. The boat was then raced. No commission sales were made in the income year in question, but this did not preclude deductibility of the revenue expenditure. In addition, the relatively high cost involved did not stop the Board of Review from finding that the revenue expenditure was deductible.

62. In *Cliffs International Inc v FCT* (1985) 85 ATC 4374 (WASC), the court held that sponsorship expenditure was deductible on the basis of evidence showing that the sponsorship arrangement was part of a coherent marketing strategy, and the market exposure from the expenditure had a relationship with the taxpayer's business. In this case, the taxpayer contributed to the annual running of a golf tournament in which their joint venture partners and key Japanese customers participated. In finding that the sponsorship expenditure was deductible, Kennedy J stated (at 4,392):

> This event was a carefully planned annual function, which was specifically directed to enhancing the relationship between the Robe River joint venture and its customers in Japan, being six of the major steel mills. It was the only formal social function held each year and was carefully adapted to the nature of the Japanese business. It was attended by senior executives from Cliffs, whilst Mitsui & Co was represented by the highest ranking personnel within its iron ore department, together with one of its corporate executive vice presidents. Each of the mills was represented by its highest ranking purchasing officer and two or three of his subordinates. The day was meticulously planned, so that those whom it was desired to bring together for business reasons were brought together. The day concluded with formal speeches of goodwill and presentations.

63. The issue of the relationship between the expenditure and the resulting income was referred to in *ITC 696*, but in that case the majority of the court gave little weight to the absence of any supporting evidence (at 92):

> With regard to this expenditure being too remote from the income to be an allowable deduction, I consider that it can fairly be stated that it is normally impossible to connect any particular sales with any particular advertising, though many companies go to considerable lengths in an endeavour to ascertain which media of advertisements produce the best results.

64. The issue of the remoteness of sponsorship expenditure from income derived was also referred to in the Canadian case *No 511 v MNR* (1959) 58 DTC 307 (TAB). In this case, the taxpayer was in the lumber business, and sponsored a local baseball team with the intention of building up its declining sales through promoting its name and products. In this case, it was considered that the fact the sponsorship was not direct advertising (in contrast to traditional forms of advertising, such as in newspapers or on signs, billboards, radio or television) was not sufficient to preclude deductibility. It was noted that sponsorship of sports events was a method of advertising which businesses often now use, and there was evidence that by sponsoring the baseball team the company in this case intended to advertise itself in order to improve its profits.

Example | Tauira 1 – Expenditure fully deductible; incurred solely for business promotion

Andrew is a sole trader who operates a motor mechanic business. He sponsors the local tennis club. Under the terms of the sponsorship agreement, which covers the year to 31 March, Andrew agrees to pay an upfront sum of $3,000 towards the club's running costs. In return, the club agrees to display Andrew's business logo on all uniforms, bags and vehicles that the club uses during the year.

The expenditure Andrew incurs will be fully deductible. The requirement for the club to display Andrew's business logo and name on its uniforms and other items indicates that Andrew incurred the expenditure to promote his business. It is therefore deductible because there is the necessary connection between the expenditure and the carrying on of the business to derive income.

13 As noted at [55], it is not normally possible to identify particular income as having been derived as a result of particular expenditure, but if it can be shown that the expenditure resulted in income being derived, that would be a strong supporting factor.

Example | Tauira 2 – Expenditure not deductible; while donation resulted in some business promotion, that was not a purpose for which the expenditure was incurred, or was only incidental to other purposes

Elizabeth operates a business in Wellington as a sole trader. She gives $500 to the boarding school her son attends in Auckland, in the name of her business. She makes no stipulations about how the school is to use the money or that her business is to be promoted in return for the payment. Her business's name subsequently appears in a list of donors on the back page of the school's annual magazine. In all, the page lists 20 donors, and does not distinguish Elizabeth's business name in any way from the other 19 donors.

The $500 is not deductible under s DA 1. Elizabeth made no stipulation that her business be promoted. Although an element of business promotion arose when her business name appeared in the magazine, that is not determinative, unless Elizabeth can show that such promotion was a purpose of the expenditure. While every case must be considered on its particular facts, it is considered that here any marketing exposure resulting from the business name appearing on the back page of an annual school magazine is likely to be minimal as the business is one of 20 donors listed and is given no more prominence than the names of the other donors. This supports the view that there was no business promotion purpose for the expenditure, or if there was that it is incidental to other purposes (eg, private reasons) for making the payment. In addition, the fact that Elizabeth's son's school is in Auckland is likely to mean there would be little, if any, promotional impact in respect of her business which operates in Wellington. Therefore, based on an objective analysis of the surrounding circumstances, it is considered that the expenditure does not have the required nexus with the earning of Elizabeth's business's income.

While the $500 is not deductible, a donation tax credit may be available under s LD 1.

Limitations to deductibility

65. As noted at [41], if the general permission is satisfied, it is then necessary to consider whether any of the general limitations to deductibility (in s DA 2) apply. The two general limitations potentially relevant to sponsorship expenditure are the capital limitation and the private limitation. These are discussed, in the context of sponsorship expenditure, below – the capital limitation first (from [67]) and then the private limitation (from [89]).

66. As noted at [42], it is also possible that the entertainment expenditure rules (in subpart DD) may apply to reduce the deduction to 50% of would otherwise be allowed. Those rules are discussed from [98].

The capital limitation

67. In addition to the words in s DA 1 (the general permission) requiring apportionment, the capital limitation (s DA 2(1)) also requires apportionment, denying deductibility "to the extent" an amount of expenditure or loss is of a capital nature. Section DA 2(1) provides:

> **DA 2 General limitations**
>
> *Capital limitation*
>
> (1) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a capital nature. This rule is called the **capital limitation**.
>
> ...

68. Case law establishes that the following factors are relevant in determining whether expenditure is of a capital nature:

- **The need or occasion that calls for the expenditure.**

  This involves considering what prompted or made it necessary for the taxpayer to incur the expenditure and whether the surrounding circumstances and ultimate objective of the expenditure support a capital or revenue classification.

- **Whether the expenditure is recurrent in nature.**

  If expenditure is recurrent, this may indicate it is of a revenue nature, whereas if expenditure is one-off this may indicate it is of a capital nature. However, whether expenditure is recurrent or one-off is not determinative. This factor is closely aligned with the previous one; expenditure that is an ordinary incident of carrying on a business may be of a revenue nature whether it is one-off or recurrent.

- **Whether the expenditure creates an identifiable asset.**

  Expenditure will be of a capital nature if the taxpayer acquires an identifiable capital asset through the expenditure.

- **Whether the expenditure creates an advantage that is of enduring benefit to the business.**

  This is similar to the previous factor. If the taxpayer acquires an enduring advantage through the expenditure, the expenditure is likely to be of a capital nature. This factor is often linked to the question of recurrence. However, an enduring benefit is to be distinguished from a situation where the expenditure merely relieves the taxpayer from making revenue payments for a period of time.

- **Whether the expenditure is on the profit-making structure or process.**

  This factor is about distinguishing between expenditure that relates to the business's structure (that is, expenditure incurred on establishing, replacing or enlarging the profit-making structure of the business) and expenditure that relates to the business's operation (that is, expenditure incurred as part of the process by which the business's structure operates).

  This factor is often linked to the identifiable asset and enduring advantage factors. Combining those factors enables the correct classification to be made. For example, expenditure made as an ordinary incident of the business, to maintain the profit-making structure, is likely to be of a revenue nature despite relating to the profit-making structure. On the other hand, expenditure made to enable the business to operate differently is likely to be of a capital nature, despite relating to the profit-making process.

- **Whether the payment is made from fixed or circulating capital.**

  Expenditure made from fixed capital (that is, capital on which the taxpayer seeks a return through the business's operation) is more likely to be of a capital nature. Expenditure made from circulating capital (that is, capital that returns to the business as a result of the business's operation) is more likely to be of a revenue nature. The courts do not give much weight to this factor, as it is easy for a business to choose whether to finance an asset, say, from fixed or circulating capital, irrespective of the nature of the asset financed.

- **The treatment of the expenditure under ordinary principles of commercial accounting.**

  How expenditure is classified according to ordinary commercial accounting principles may support the classification made from applying the other factors. However, accounting classification is not usually determinative, as tax and accounting have different aims and may differ in their treatments.

(See, for example, *Sun Newspapers Limited and Another v FCT* (1938) 61 CLR 317 (HCA); *BP Australia Limited v FCT* (1965) 14 ATD 1 (PC), *CIR v L D Nathan & Co Limited* [1972] NZLR 209 (CA), *Buckley & Young*; *CIR v McKenzies New Zealand* (1988) 10 NZTC 5,233 (CA); *Christchurch Press Company Limited v CIR* (1993) 15 NZTC 10,206 (HC); *CIR v Wattie* (1998) 18 NZTC 13,991 (PC); *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001 (CA); and *Birkdale Service Station Ltd v CIR* (2000) 19 NZTC 15,981 (CA)).

69. In the context of sponsorship expenditure, some of these factors will be more relevant than others. In relation to any given circumstances, it is necessary to weigh up the factors to determine whether all or part of the sponsorship expenditure is of a capital nature.

70. Some examples from case law that illustrate how these considerations may be relevant to sponsorship expenditure are discussed below.

The need or occasion that calls for the expenditure

71. This factor is likely to be of limited use in the context of sponsorship expenditure, where in many cases the principal reason or need for incurring the expenditure is to promote or advertise the business. This would indicate that the expenditure is not of a capital nature, but is not enough on its own to support that classification.

72. However, this factor may indicate the expenditure is capital where, for instance, the business promotion relates to establishing a market for a new business. That said, in that situation, the expenditure is unlikely to have satisfied the general permission in the first place, being preliminary expenditure (prior to a business existing) rather than expenditure incurred in the course of carrying on a business (*Calkin v CIR* (1984) 6 NZTC 61,781 (CA)).

Recurrence

73. Whether sponsorship expenditure is recurrent is, by itself, unlikely to be determinative of whether the expenditure is of a revenue or capital nature. Sometimes sponsorship expenditure will be only one-off (for example, a once-only sponsorship of a sports event). Other times it will be recurrent (for example, regularly sponsoring the sports event).

74. An example of circumstances where recurrence would have supported a finding of sponsorship expenditure being of a revenue nature, had it been at issue, is *Cliffs International* (see [62]). In that case, the golf tournament was held annually.

75. An example of once-only sponsorship expenditure nonetheless being of a revenue nature is *ITC 696* (see from [56]). While the expenditure on the trophies was one-off, the majority considered that the expenditure was of a revenue nature. While this finding was principally based on the fact that no enduring asset was acquired by the company, since it divested itself of the ownership of the trophies, it nevertheless indicates that recurrence is not determinative.

76. Expenditure that is an ordinary incident of carrying on a business may be of a revenue nature whether it is one-off or recurrent. In the context of sponsorship expenditure, it is considered that not much weight should be placed on whether the expenditure is recurrent. This is because a taxpayer's business promotion purpose, necessary to establish that the expenditure satisfies the general permission, would likely be sufficient to show that the expenditure was an ordinary incident of business.

An identifiable asset

77. One of the factors most likely to be relevant in considering the capital limitation in the context of sponsorship expenditure is whether the expenditure results in an identifiable asset that the taxpayer owns. If it does, the capital limitation is likely to apply. However, if the expenditure is on an asset that the taxpayer divests itself of, the capital limitation is unlikely to apply.

78. This is illustrated in the majority decision in *ITC 696*, where the expenditure was not considered to be capital. As discussed from [56], in this case the taxpayer purchased footballs and trophies and branded them with the company's name and the names of various pieces of agricultural equipment in which it traded. The taxpayer gave the footballs and trophies to football clubs and agricultural societies, respectively. The majority of the court distinguished the taxpayer's circumstances from cases where the taxpayer retained an identifiable asset and therefore the expenditure incurred to acquire the asset was held to be of a capital nature (*ITC 217* (1931) 6 SATC 137 (HC) and *ITC 469* (1940) 11 SATC 261 (HC)). The majority in *ITC 696* stated (at 93):

> In my opinion this case is clearly distinguishable. Appellant company purchased cups and immediately presented them to agricultural societies, **thereby divesting itself of ownership. It had no asset as a result of this advertising expenditure** …
>
> [Emphasis added]

Example | Tauira 3 – Capital limitation does not apply; no enduring asset as the taxpayer does not own the asset

Andrew from Example 1, on page 15, also agrees to reimburse the tennis club for the purchase of its van provided his business logo is prominently displayed on the van.

Although the van is a capital item, the capital limitation does not apply as Andrew does not own the van. Therefore, no enduring asset results to Andrew from this expenditure. Andrew is, in effect, paying for the promotion of his business on the van.

However, if Andrew purchased the van and retained ownership of it, using it in his business and allowing the club to use it on weekends, the capital limitation would apply. This is because the expenditure in this scenario would result in Andrew owning an enduring asset (the van). In this situation, depreciation deductions will be allowed – see from [112].

Example | Tauira 4 – Capital limitation does not apply; the taxpayer does not retain an enduring asset

Jacob Jones runs a sporting goods store called Jones' Sports. Jones' Sports sponsors an annual soccer competition for the three local primary schools, to be named the Jones Competition. Jacob believes that the sponsorship arrangement will result in increased sales for the business.

Jones' Sports purchases soccer balls and goals branded with the business name and provides these to each school. Jones' Sports also purchases a trophy to be presented to the winner of the competition. The trophy is labelled "Jones Competition sponsored by Jones' Sports", and each year the trophy is to be engraved with the winner's name. Jones' Sports incurs a total of $5,000 in the first year of this arrangement.

Here, there is a relationship between Jacob's business and the sponsorship, both being related to sport. Even though it may be impossible to identify what sales, if any, resulted from the sponsorship arrangement, Jacob's contention that the expenditure was incurred in order to increase sales is reasonable as the equipment and trophy carry the business name so create brand recognition and advertising. Therefore, the expenditure satisfies the general permission.

The expenditure does not result in Jones' Sports owning an identifiable asset, so the capital limitation does not apply to preclude deductibility of the expenditure.

Enduring advantage

79. Any expenditure to obtain long-term advertising merely relieves the taxpayer from making revenue payments for a period of time. It is not considered that this type of 'enduring advantage' is of a capital nature (*Anglo-Persian Oil Co Ltd v Dale* (1931) 16 TC 253 (KB)). However, if not all the expenditure is 'used up' in the income year, the portion that relates to future income years may need to be brought back in as income (see from [106]).

80. If sponsorship expenditure results in an enduring advantage of branding or goodwill, it is considered that gaining this advantage is intrinsically linked to the business exposure itself. The advantage is not one that results from the business's prior operation (in contrast to goodwill acquired when the business is purchased, which would be a capital asset). Although the advantage may endure beyond the end of the sponsorship agreement, this is no different from ordinary advertising. In both cases, any 'branding' benefit gained will usually dissipate rapidly unless the exposure or advertising is repeated in order to maintain it. For this reason, it is considered that any incremental contribution to long-term goodwill or brand value is properly regarded as incidental, because similar increments can be achieved in other ways such as through ordinary advertising, giveaways to customers, good customer service, and product quality. Therefore, it is considered that the expenditure on it is of a revenue nature and the capital prohibition will not apply. This conclusion is in line with the majority judgment in *ITC 696* (at 92):

> There is little doubt that the benefit of this advertising was not confined to the year of assessment, but the same can probably be said about most advertising except in connection with special "bargain sales". With regular advertising in various forms it is normally impossible to state when and for how long any benefit may be received and if, to be allowable as a deduction, its effect must be confined to the year of assessment, it appears to me that very little advertising expenditure could be allowed as a deduction. **I am of the opinion that all successful advertising must inevitably tend to increase the goodwill of the advertiser or of the merchandise advertised, but I am unable to agree that, therefore, such advertising becomes expenditure of a capital nature.**
>
> [Emphasis added]

Profit-making structure or profit-making process

81. This factor is about distinguishing between expenditure relating to the business's profit-making structure and that relating to the business's operation.

82. As noted at [68], this factor is often linked to the identifiable asset and enduring advantage factors. As such, in the context of sponsorship expenditure, this test would not appear to add anything to the analyses of those other factors.

83. The business promotion aspect of sponsorship expenditure, as it is defined in this statement, would appear ordinarily to be related to the profit-making process rather than to the profit-making structure. The principal exception would be where a taxpayer acquires an identifiable asset as a result of expending the money. In that case, the sponsorship expenditure enhances the profit-making structure and so the capital limitation would apply.

Whether the payment is made from fixed or circulating capital

84. As noted at [68], the courts do not give much weight to this factor, as it is easy for a business to choose whether to finance an asset, say, from fixed capital or circulating capital, irrespective of the nature of the asset financed. Similarly, a business may finance sponsorship expenditure from either fixed or circulating capital, without changing its inherent nature by doing so. Therefore, it is considered that this test is unhelpful in this context.

The treatment of the expenditure under ordinary principles of commercial accounting

85. Sponsorship and promotional expenditure would ordinarily be classified as being of a revenue nature according to generally accepted accounting practice. This supports treating sponsorship expenditure as deductible. However, as noted at [68], this test is not usually determinative, as tax and accounting have different aims and may therefore differ in their treatments.

86. Nevertheless, in the context of sponsorship expenditure, if for some reason a taxpayer treated such expenditure as being of a capital nature for accounting purposes, there may be some grounds for analysing whether the taxpayer should follow that accounting classification for tax purposes.

Conclusion – capital limitation

87. The factors that the courts have developed to distinguish between capital and revenue expenditure are not necessarily all relevant in the context of sponsorship expenditure. Of the various factors, the identifiable asset test is likely to be the most important. While the question of whether there is an enduring advantage also appears relevant, frequently the nature of the enduring benefit resulting from sponsorship expenditure will not warrant a capital classification because the benefit is intrinsically linked to the means of exposure.

88. If the capital limitation applies to deny deductibility because the taxpayer has acquired an asset that is made available for use under a sponsorship arrangement, a deduction for depreciation may be available – see from [112].

The private limitation

89. The private limitation (s DA 2(2)) also requires apportionment, denying deductibility "to the extent" an amount of expenditure or loss is of a private or domestic nature. Section DA 2(2) provides:

> **DA 2 General limitations**
>
> …
>
> *Private limitation*
>
> (2) A person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature. This rule is called the **private limitation**.
>
> …

90. An outgoing is of a private nature if it is referable to living as an individual member of society. Domestic expenses are those relating to the household or family unit. (*CIR v Haenga* (1985) 7 NZTC 5,198 (CA)).

91. Where a private or domestic benefit arises because this was a purpose of the expenditure, distinct from the business promotion purpose, then apportionment will be necessary. However, based on the approach in *Usher's*, it is considered that where a benefit of a private or domestic nature arises **incidentally** to the income-earning or business activity of the person incurring the expenditure, apportionment is not required.

92. A number of Taxation Review Authority cases have involved situations where someone (usually an employee of the taxpayer) gained private enjoyment from the sponsorship expenditure. Those and some other Taxation Review Authority cases aside, the Commissioner does not consider that a company can incur private expenditure, given its separate legal and non-natural person character. However, if expenditure of a company has some private or domestic character in the hands of the recipient, this may be relevant in determining the purpose or purposes of the expenditure and whether the general permission is satisfied (see from [38]). In addition, if the person benefitting from the expenditure is a shareholder and/or employee of the company it will be necessary to consider whether there is a dividend, fringe benefit, or a payment that is to be treated as salary or wages. For companies, the discussion below may be helpful in determining whether a third-party benefit is incidental to a business objective, and so whether the general permission requires apportionment (see [48] to [49]).

93. In *Case L7* (1989) 11 NZTC 1,052 (TRA), the taxpayer was a radiator manufacture and repair company whose principal was interested in go-kart racing. The company decided to become involved in go-kart racing as a means of promoting the business. The go-kart displayed the name of the company, the principal drove the go-kart, the pit crew (company employees) wore company colours, and the company was promoted on a billboard at the racetrack and in the racing programme.

94. The issue before the Taxation Review Authority was whether the associated expenditure should be apportioned between business promotion (deductible) and private enjoyment (no deduction allowed). Barber DJ concluded that the expenditure was fully deductible, as the private enjoyment was purely incidental, stating (at 1,055):

> I agree with the submission of Mr Nation, that the fact that Mr S obtained substantial enjoyment from the kart racing is not a significant factor in deciding whether or not the expenses incurred in that activity should be tax deductible. In my view, the issue is whether the expenditure is bona fide advertising expenditure in character, or is wholly or partly expenditure in the pursuance of go kart racing as a sport or recreational pastime. That factual issue pivots on the credibility of the evidence. I accept Mr S as an honest witness. I find that although he enjoyed his involvement in kart racing and had previously been quite strongly interested in racing in general, he made a calculated decision to boost his business enterprise by participating in kart racing with a high business profile. He sought business contacts in the motor trade and work from those contacts and from the general public. I am satisfied that these aims were achieved, and continue to be retained, in a substantial manner. I do not suggest that advertising must have good results to be deductible. I appreciate that, after much consideration, the respondent took the view that there were two equal factors in relation to the advertising expenditure, namely, the obtaining of personal pleasure in go kart racing and the attracting of business from that activity. **On the evidence which I have heard, I find on the balance of probability that the business expended money on go-kart racing predominantly to advertise the business and that any private intentions or purposes of Mr S were quite incidental to the predominant objective of business expansion.** In other words, I am satisfied that there was a sufficient link between the expenditure and the income earning process of the radiator manufacturing and repair business, with regard to the entire expenditure and not merely to 50% of it.
>
> [Emphasis added]

95. The same approach was taken in *Case P16* (discussed at [59]), where the company's principal was interested in car racing. In that case, Keane J held that he saw no reason to elevate the principal's private enjoyment of racing the car to the status of a competing purpose.

96. In *Case M131* (1990) 12 NZTC 2,850 (TRA), Bathgate DJ approved of the approach in *Case L7*. The taxpayer in this case owned a building business that had a substantial connection, both business and private, with the horse racing industry. To maintain and extend the business relationship, the taxpayer purchased and raced a horse and sponsored several races in return for the business name appearing on the race books of the races sponsored. While the horse was raced under the names of the individual owners, it was soon identified with the company. The percentage of income that the company derived from the racing industry increased following the increased promotional activity. While the deductibility of the sponsorship expenditure was not at issue in this case, in relation to remaining revenue expenditure, Bathgate DJ held that the statutory nexus was satisfied and that the element of private enjoyment was incidental to the main purpose of business promotion.

97. It is important to note that the decisions in these cases were based on the particular facts. In each case, there was evidence that the decision to promote and advertise the business was the purpose for which the expenditure was incurred, and any private purposes were incidental to that objective. A different conclusion could well be reached on different facts. For example, if someone had been engaged in a particular pastime and then decided to start funding it through their business with some signage or other promotion, it would be necessary to closely consider whether there was a genuine business purpose for the expenditure and, if there was, whether there was also a non-incidental private purpose for the expenditure. Relevant considerations in this regard may include the connection between what the taxpayer incurred the expenditure on and the business or the market they were targeting, the marketing strategy of the business, and the anticipated or actual financial results (see further [55]).

Example | Tauira 5 – Expenditure only partly deductible; apportionment required because private advantage not just incidental to business purposes

Bruce is a builder, in business as a sole trader, trading as Bruce Builders. He agrees to build a new gym at his daughter's school (an elite private school) in return for an annual 50% discount on school fees for the entire time his daughter attends the school.

The school will provide the materials, but Bruce will supply the labour (himself and three of his employees). The school agrees that while the gym is being built Bruce can erect signage on the construction site stating that Bruce Builders is constructing the gym. After the construction is completed, the school will display a prominent plaque on the front of the gym stating that Bruce Builders constructed it.

Does the prohibition for expenditure of a private or domestic nature apply to the expenditure Bruce incurs on staff wages in relation to the construction of the gym?

Bruce incurred the expenditure on his staff's wages during the period of construction in the course of carrying on his business for the purpose of deriving his gross income, as there is a business promotion purpose, with signage and a permanent plaque agreed as part of the arrangement.

However, another purpose Bruce had in incurring the expenditure was to obtain the 50% discount on his daughter's school fees. This advantage that he seeks is of a private nature.

On these facts, it is not considered that this private advantage was just incidental to the business promotion that Bruce contemplated in entering into the arrangement with the school. Therefore, it would be necessary to apportion the expenditure between the private and business promotion purposes he had in incurring the expenditure, with the portion relating to the private benefit being non-deductible. The burden of proof is on Bruce to show what part of the expenditure was deductible.

Alternative facts: Instead of being a sole trader, Bruce operates through a company, Bruce Builders Ltd. Bruce is a shareholder-employee of the company. The company negotiated the agreement to build the gym in return for the discount on Bruce's daughter's school fees.

In this case, Bruce Builders Ltd can choose to treat the benefit of the discounted school fees as either a fringe benefit or a dividend, for the reasons below.

The discount on the school fees would be an unclassified benefit under the fringe benefit tax rules. This is because the benefit (the discount) is provided to Bruce, an employee of the company, through an arrangement made between the employer (the company) and another person (the school). On these facts it is not considered that the company's purpose or object of the benefit of reduced school fees being provided to Bruce is just incidental to the business promotion purpose. The benefit is therefore treated as having been provided by the employer (the company) (s CX 2(2)).[14]

If a company provides a non-cash benefit to an employee who holds shares in the company (which is the case here, because the company is treated as having provided the benefit), the benefit is treated as having been provided in connection with the employment (s CX 17(1)).

The company may generally choose (under s CX 17(2)) to treat the benefit as a fringe benefit or a dividend.[15] If the company makes no election, the benefit is treated as a fringe benefit. If the company chooses to treat the benefit as a dividend, it is a dividend (s CD 20) and the fringe benefit tax rules do not apply (s CX 17(2)).

14 See further **BR Pub 14/10: Fringe benefit tax – Provision of benefits by third parties – section CX 2(2)**.

15 The exception to this in s DG 2(4) is not relevant here.

Example | Tauira 6 – Expenditure fully deductible; apportionment not required because private enjoyment just incidental to business purposes

A firm, AAA Accounting, has entered into an agreement with the national opera company, under which the firm will cover the cost to the opera company of financing the orchestra that accompanies the operas. In return, the opera company will prominently display the words "proudly sponsored by AAA Accounting" on the buildings where its operas are performed, on all concert programmes it sells, and in all advertisements for its operas.

AAA Accounting's purpose in entering into the agreement was to provide exposure of its business to influential members of the audience, as confirmed in its marketing plan. A survey that it had commissioned showed that a significant proportion of opera attendees were individuals from whom the firm sought business, being people who were of high net worth or who were influential in the corporate and government sectors. Based on the results of the survey, AAA Accounting considered that the exposure it gained from sponsoring the opera company would attract these people or their businesses as clients.

In the opera company's annual report, the managing director referred to the agreement with AAA Accounting and noted that two of the three partners in the firm had personally had a long association with opera, being "opera lovers" themselves.

Although AAA Accounting is not in a business related to opera, it obtains business exposure through the agreement, reaching a target audience it has identified in its marketing plan as being desirable. While the private enjoyment of opera by two of the three partners in the firm may arguably indicate that the expenditure was also incurred for private purposes, it is considered that the rationale for the sponsorship given in the marketing plan shows that the expenditure was incurred for business purposes and any private enjoyment will be incidental to the business purpose of incurring the expenditure.

The entertainment expenditure rules

98. The entertainment expenditure rules (in subpart DD) may need to be considered if, in deriving income, a person incurs expenditure on entertainment that provides both a 'private' and a business benefit.

99. Under these rules, a deduction for expenditure on certain specified types of entertainment may be reduced to 50% of the amount that would otherwise have been allowed. This is known as the "limitation rule" (s DD 1).

100. The expenditure the limitation rule may apply to is expenditure on:

- corporate boxes;
- holiday accommodation;
- yachts and other pleasure craft; and
- the provision of food and drink, on or off the business premises.

101. "Expenditure" is specifically defined in the entertainment expenditure rules (s DD 1(7)). It includes: an amount of depreciation loss; expenditure or loss on running costs, maintenance and similar; and incidental expenditure on things such as hireage of crockery, glassware or utensils, waiting staff, and music or other entertainment provided in association with the types of entertainment listed at [100].

102. The limitation rule will not apply in various circumstances. Most relevantly in the context of expenditure that may be considered to be 'sponsorship', this includes in the following situations:

- Where the entertainment is sponsored mainly to advertise or promote a taxpayer's business, goods, or services to the public, provided that the public has the same access to this as the taxpayer's employees, business contacts or people associated with the business.
- Where the entertainment is merely an incidental part of:
  - a trade display mainly held to advertise or promote a business, goods, or service; and/or
  - a function open to the public and mainly held to advertise or promote a business, goods, or services.
- Where the expenditure is on samples that are provided (to someone who is not an employee or associated person) for promotion or advertising purposes.
- Where the expenditure is on entertainment provided to a person who is reviewing the entertainment for a book, magazine, paper, or other medium of communication.

- Where the expenditure is on entertainment provided to members of the public for charitable purposes.
- Where the expenditure is on entertainment that is either income of the person who consumes it or a fringe benefit to which fringe benefit tax applies.

103. The entertainment expenditure rules do not apply to expenditure incurred in relation to private use of an asset that the mixed-use asset rules apply to (s DG 2(2)).

104. The entertainment expenditure rules are not the focus of this statement, as most expenditure that falls within the term "sponsorship", as used in this statement, will not be within the specific types of expenditure the limitation rule may apply to, or will be within one of the circumstances where the limitation rule will not apply. But Example 7 illustrates a situation where sponsorship would be subject to the limitation rule.

105. For further information on the entertainment expenditure rules see Inland Revenue's website (**Entertainment expenses**) and **IR268: Entertainment expenses** (which can be downloaded from the "Entertainment expenses" webpage).

Example | Tauira 7 – Entertainment limitation rule applies to limit deductibility to 50% of what would otherwise be allowed

Jules and Nate have a fitness and nutrition business. They provide catered lunch to a local sports club for the players and opposition players when the club hosts home games, to promote their business to this pool of clients and potential clients.

The expenditure the business incurs in providing the catering is expenditure on food provided off the business premises. It may therefore be subject to the entertainment expenditure limitation rule. In this case it is, as none of the exclusions from the limitation rule apply. In particular (as they are the potentially relevant exclusions here):

- The exclusion in s DD 5(1) (*sponsored promotions*) does not apply. This is because the entertainment is not sponsored mainly to advertise or promote a taxpayer's business, goods, or services to the public, but rather to a particular pool of clients and potential clients, and the public does not have the same access to the entertainment (the food provided) as the clients and potential clients (business contacts) the food is provided to.
- The exclusion in s DD 6(2) (*entertainment for charitable purposes*) does not apply. This is because the entertainment is not provided to members of the public for charitable purposes.

The limitation rule therefore applies and 50% of the cost of the catering is deductible.

Treatment of expenditure that is not used up by the end of an income year

106. Even if a deduction for expenditure is allowed under the general permission in s DA 1 and is not prohibited by any of the general limitations in s DA 2, it is necessary to consider whether all of the expenditure is 'used up' in the income year. If it is not, this impacts the tax treatment.

107. Section EA 3 applies where a deduction for expenditure has been allowed under the Act, but some or all of it is 'unexpired' (that is, not used up) at the end of the income year. Essentially, the unexpired portion of expenditure is the portion that relates to future income years.

108. There are some exclusions from s EA 3 (see EA 3(2) and certain circumstances where a taxpayer is excused from complying with s EA 3 (see **DET E12: Persons excused from complying with section EA 3 of the Income Tax Act 2007**). Most relevantly in the context of sponsorship, DET E12 may mean s EA 3 does not need to be complied with in respect of expenditure on the cost of advertising (which "sponsorship", as defined in this statement, is a form of).

109. If s EA 3 applies, and the taxpayer is not excused from complying with it, any "unexpired portion" of the expenditure at the end of the income year is included in the taxpayer's income for the year and then allowed again as a deduction in the following income year.

110. Where the expenditure relates to the purchase of goods, the current-year deduction is effectively restricted to goods used in that year in deriving income. Where the expenditure relates to a payment for services, the current-year deduction is effectively restricted to the amount incurred on services performed in that year. Where the expenditure relates to a chose in action,[16] the deduction is deferred for the portion relating to the unexpired part of the period that the chose is enforceable.

16 A right to something that does not confer possession of a tangible object, which can be enforced. In the context of sponsorship, an example is the right to have business advertising displayed somewhere.

111. The mechanism in s EA 3 effectively means the deduction is spread over the sponsorship term to which it relates. This generally aligns with standard accounting treatment, so no additional tax adjustments would typically be required.

Example | Tauira 8 – Adding back expenditure not 'used up' at the end of the income year

Joey owns and operates a restaurant. He enters into a sponsorship agreement with the local brass band. Under the agreement, Joey agrees to pay $9,000 upfront towards the band's running costs for the next 3 years in return for having the name of his restaurant displayed prominently on the drums for that period.

As a result of the expenditure, Joey acquires a chose in action consisting of the right to have his restaurant name displayed on the drums for the 3-year period. Therefore, the unexpired portion of the expenditure at the end of the income year will be the portion of the $9,000 that relates to the unexpired part of the 3-year period in respect of which the chose in action is enforceable.

For example, if a full 12 months under the agreement falls within the first income year, the unexpired portion will be $6,000 (the amount that relates to the 2 years remaining under the agreement). The $9,000 expenditure will be deductible in the income year, but the restaurant must include the $6,000 unexpired portion in its income for the year (so the net effect is a $3,000 deduction for the first year). The $6,000 will be allowed as a deduction in the following income year, with the unexpired portion at the end of that year ($3,000) added back in as income. This effectively means the $9,000 deduction is spread over the 3-year sponsorship term to which it relates.

Joey would not be excused from complying with s EA 3 under DET E12, because one of the requirements of the determination is that the length of time between the balance date for the income year and the subsequent expiry date of the expenditure does not exceed the relevant specified time period. In the case of expenditure on the cost of advertising, the time period between the balance date and the expiry of the expenditure cannot be more than 6 months. That is not the case here.

Example | Tauira 9 – Adding back expenditure not 'used up' at the end of the income year

PQR Ltd pays a local trust $3 million toward the cost of construction of a swimming complex, in return for naming rights for a 10-year period. PQR pays the $3 million in one lump sum in the current income year.

The company gains business exposure through the expenditure, in that its name appears on the complex. Therefore, PQR Ltd is allowed a deduction for $3 million in the income year in which it incurs the expenditure.

Any enduring advantage from the expenditure, namely business exposure for a 10-year period, is of the same nature as advertising, and so is revenue in nature. The fact that the expenditure is made in a lump sum does not change its revenue character; it merely relieves the company from making revenue payments throughout the 10-year period. Therefore the capital limitation does not apply to preclude the expenditure being deductible.

However, the right to the exposure through the naming rights is a chose in action that continues to be enforceable beyond the income year. The period of enforceability is the 10-year period for which the naming rights are granted. Therefore, s EA 3 applies to require PQR Ltd to include the unexpired portion of the expenditure in its income at the end of each income year until there is no longer any unexpired portion.

The unexpired portion at the end of each income year will be the amount of the $3 million expenditure that relates to the unexpired part of the 10-year period in respect of which the chose in action is enforceable. For example, if at the end of the current income year, the naming rights have been in place for 6 months and so 9½ years remain, the unexpired portion will be $2,850,000 (95% of the $3 million expenditure, because the 9½ years remaining is 95% of the 10-year period). PQR Ltd must include this amount in its income for the current income year, but it will be allowed as a deduction in the next income year. At the end of that next year, the unexpired period will be 8½ years and so PQR Ltd must include $2,550,000 in its income in that income year. And so on until the 10-year period has expired.

PQR Ltd would not be excused from complying with s EA 3 under DET E12, because one of the requirements of the determination is that the unexpired portion of the expenditure together with all other unexpired portions of expenditure of the same type does not exceed the relevant specified maximum total amount. In the case of expenditure on the cost of advertising, the maximum total amount of unexpired expenditure of that type is $14,000. That is not the case here, as even at the start of the last year, the unexpired expenditure (for this advertising alone – let alone any other advertising) will be 6 months' worth of the $3 million (so $150,000).

Depreciation

112. It may be that a taxpayer provides sponsorship through allowing use of depreciable property[17] (for example, allowing a sports team to use a business-branded motor vehicle owned by the taxpayer on weekends for transport). In this situation, a deduction will be allowed for depreciation. The amount of the depreciation loss is determined under subpart EE.

113. The amount of the depreciation loss allowed as a deduction will depend on whether the depreciable property is used or available for use by the taxpayer in deriving income or in carrying on a business for the purpose of deriving income and whether there is any private or other non-income-earning use of the depreciable property. If the depreciation deduction needs to be apportioned, how this is done depends on which rules apply.

Apportionment of depreciation under the standard deductibility rules

114. If the standard deductibility rules apply, the amount of depreciation loss that can be deducted cannot be more than the amount calculated under the formula in s EE 50. Under the formula, depreciation loss deductions would be disallowed in respect of any days on which the asset is used or available for use that are not "qualifying use days". Qualifying use days are days an asset is used or available for use for income-earning or in a way that is subject to fringe benefit tax.

115. So, for example, if there is private or other non-income-earning use of an asset on a particular day and the asset is not used or available for use for income-earning on that day, the formula in s EE 50 will determine the maximum amount of the depreciation loss that is deductible.

116. If there are days there is private use of the asset but it is also used or available for use for income-earning, the depreciation loss will still need to be apportioned between income-earning use and private use, because of the private limitation (s DA 2(2)).

Apportionment of depreciation under the mixed-use asset rules

117. If the mixed-use asset rules apply, they override the formula in s EE 50 and the private limitation.[18] The mixed-use asset rules set out a specific formula[19] to reduce available deductions on account of private use.

118. Land, aircraft, and ships, boats or other similar watercraft may be subject to the mixed-use asset rules. This will generally be the case if the asset is:

- used in the income year to derive income;
- used privately in the income year; and
- unused for at least 62 days in the income year.[20]

119. Assets can move in or out of the rules from year to year, so whether the rules apply needs to be tested for each income year.

120. There are some exclusions from the mixed-use asset rules that may apply. Relevantly for present purposes, an asset is excluded from the operation of the rules if all of the following criteria are met:[21]

- the private use of the asset is minor;
- the main use of the asset is use in a business that is not a rental or charter business; and
- for a company or a trustee of a trust, the use of the asset places an obligation on the company or the trustee, as applicable, to pay fringe benefit tax or income tax.

121. Private use, for the purposes of the mixed-use asset rules, includes use of an asset by a natural person who is associated with the owner of the asset.[22] This means that for the purposes of the mixed-use asset rule, there can be private use of an asset owned by a company. For example, if there is use of the asset by a natural person that has a voting interest of 25% or more in a company (in which case the person and the company will be associated).[23]

17 Defined in ss YA 1 and EE 6.
18 Section DG 8(3).
19 Set out in s DG 9.
20 Or, if the asset is typically used only on working days, if it is unused for at least 62 working days in the income year (s DG 3).
21 Section DG 3(4).
22 Section DG 4.
23 Section YB 3.

122. A day on which a fringe benefit tax liability arises is an income-earning day for the purposes of the mixed-use asset apportionment formula,[24] so will not reduce the level of deductibility. However, if a company shareholder is also an employee of the company, and a non-cash benefit is provided to the person in circumstances where s CX 17 applies, the company must choose to treat the benefit as a dividend, and no liability to pay fringe benefit tax arises.[25] Therefore, days on which the shareholder-employee uses the asset may be "counted days" for the purposes of the mixed-use asset apportionment formula, and reduce the level of deductibility. However, if a day is an income-earning day it is not a "counted day". So, for example, if there is private use of an asset on a day that is also an income-earning day, that day will not count towards reducing the level of deductibility.

123. Example | Tauira 10 illustrates how the mixed-use asset rules may apply to limit the allowable depreciation deduction.

124. For detailed information on the mixed-use asset rules, see: **Special report on mixed-use assets** (Inland Revenue, 2013).

Example | Tauira 10 – Depreciation loss fully deductible; while there is a third-party benefit, the asset is still used in deriving income or carrying on a business to derive income

Paul owns and operates a plant nursery. He purchases a van on which he displays his business name prominently. He makes the van available to the local garden society on weekends, but retains ownership of it and uses it for business purposes during the week.

The cost of the van is not deductible because of the capital limitation. However, a deduction for depreciation will be allowed.

In this case, a question arises as to whether the van is wholly or only partly used or available for use by Paul in carrying on his business for the purposes of deriving income. If it is only partly used or available for use in this way because the garden society members use it on weekends, those days would not be 'qualifying use days' for depreciation, so the allowable depreciation loss would need to be reduced accordingly (s EE 50).

It could be thought that when the van was being used by the garden society members, it would not be used or available for use by Paul for business purposes and that, therefore, s EE 50 would apply to limit the depreciation deduction otherwise available. However, because Paul's business name is prominently displayed on the van, this provides business exposure. In addition, the garden society members are a potential market for Paul's plant nursery business. Therefore, it is considered that the van is being used for business purposes, even when it is being used by the garden society members. As such, s EE 50 does not apply to limit the deduction available for depreciation.

Example | Tauira 11 – Depreciation loss partially deductible under the mixed-use asset rules

John is a shareholder-employee of ABC Ltd, a marine products supplier. He has a 100% voting interest in the company. Racing yachts is a hobby of John's. ABC Ltd decides to advertise and promote the business by purchasing a yacht that John will race. The yacht cost $100,000, and ABC Ltd has the hull sign-written with the company's name and logo. The yacht is docked at the local marina. John uses it on weekends and races it in various yachting competitions, creating brand exposure for the business to other yachties in the area the business operates. The yacht is used by John on 100 days in the income year in question. ABC Ltd charters the yacht for corporate events on 25 days in the income year in question.

The cost of the yacht is not deductible, but a depreciation deduction will be allowed

The cost of the yacht is not deductible because of the capital limitation. However, a deduction for depreciation will be allowed. This is because the company's name is displayed on the yacht, and its business of supplying marine products is promoted when the yacht is used and when it is docked at the marina. In addition, it is chartered during the income year. The yacht is therefore used or available for use in deriving income or carrying on a business for the purpose of deriving income.

24 Section DG 9(3)(b)(iii).

25 Section DG 2(4) (if the mixed-use asset rules do not apply, the company may choose to treat the benefit as a fringe benefit or as a dividend).

The fact that John enjoys yachting does not necessarily reduce the amount of depreciation deduction that is allowed. To determine the extent to which the depreciation deduction is allowed, it is necessary to consider whether the mixed-use asset rules or the standard deductibility rules apply. The mixed-use asset rules override the formula in the depreciation rules (s EE 50) for determining the amount of depreciation allowed for assets partly used to derive income. As such, the mixed-use asset rules are considered first below.

Do the mixed-use asset rules apply?

On these facts, the mixed-use asset rules in subpart DG apply to the yacht. This is because:

- the rules can apply to boats (that cost or had a market value when acquired of more than $50,000);
- the rules can apply to close companies (which ABC Ltd is, because it has five or fewer natural persons whose voting interest in the company is more than 50%);[26]
- the yacht is actively used in the income year to derive income, when it is chartered;
- the yacht is used privately in the income year (John's use of the yacht is "private use" for the purposes of the rules, because he is a natural person associated with the company); and
- the yacht is unused for at least 62 days in the income year.

No exclusion from the mixed-use asset rules applies. The potentially relevant exclusion, mentioned at [120], requires the private use to be minor, and the main use of the asset to be in a business that is not a rental or charter business. That is not the case here. There are 100 private use days (when John uses the yacht), which is more than 'minor' private use.

As the yacht is within the mixed-use asset rules, it is then necessary to consider the apportionment formula in s DG 9, to determine what level of deduction is allowed.

How much of the depreciation deduction is allowed under the mixed-use asset rules?

The days the yacht is chartered are "income-earning days" for the purposes of the apportionment formula in the mixed-use asset rules.

However, the days John uses the yacht are not considered "income-earning days". This is because income-earning days in the formula are (broadly) "days in the income year for which the person derives income from the use of the asset".[27] While there is advertising exposure of ABC Ltd's business when John sails the yacht, there is no income that can be identified as having been derived from this use of the yacht. This is supported by the definition of "use" of an asset in the mixed-use asset rules, being "the active use of the asset for its intended purpose".[28] While John is actively using the asset for its intended purpose (sailing), the company derives no identifiable income from this. Any income it may ultimately derive as a result of the advertising exposure is not income it derives from the active use of the yacht.

Days on which a fringe benefit tax liability arises are included in the formula as "income-earning days". However, as discussed below, because John is a shareholder-employee, his use of the yacht is a dividend and the fringe benefit tax rules do not apply. The days John uses the yacht are therefore not included as "income-earning days" on the basis that a fringe benefit tax liability arises for those days, as it does not.

Under the formula in s DG 9, 20% of the depreciation loss for the year is deductible (25 income-earning days / 125 counted days).

The formula in the depreciation rules (s EE 50) for determining the amount of depreciation allowed for assets partly used to derive income is not relevant. This is because the yacht is within the mixed-use asset rules, which override s EE 50.

26 Section DG 3(3) and the definition of "close company" in s YA 1.

27 Section DG 9(3)(b).

28 Section DG 3(7).

The entertainment expenditure rules

Expenditure on yachts or other pleasure craft may be subject to the entertainment expenditure limitation rule. As noted at [101], expenditure is defined for the purposes of the entertainment expenditure rules as including an amount of depreciation loss. However, in this case the limitation rule does not apply. This is because:

- The depreciation loss that is deductible relates to the 25 days the yacht is chartered for corporate events. The exclusion in s DD 5(1) (*sponsored promotions*) applies. This is because the expenditure (the depreciation loss) is on entertainment that is sponsored mainly to advertise or promote ABC Ltd's business, and business contacts, employees and associated parties of ABC Ltd do not have greater opportunity to enjoy the entertainment (ie, charter the yacht) than the general public.
- The depreciation loss does not relate to the days John uses the yacht. As these are "private use" days for the purposes of the mixed-use asset rules, the apportionment under those rules results in there being no depreciation loss deduction allowed in respect of those days. Further, s DG 2(3) confirms that the entertainment expenditure rules do not apply to expenditure incurred in relation to the private use of an asset that the mixed-use asset rules apply to.

Other considerations because John is a shareholder-employee

Because John is a shareholder-employee of the company, there are fringe benefit and dividend implications to consider.

If a company provides a non-cash benefit to an employee who holds shares in the company, in circumstances where s CX 17 applies, the benefit is treated as having been provided in connection with the employment. The company may generally choose to treat the benefit as a fringe benefit or a dividend. If the company makes no election, the benefit is treated as a fringe benefit. If the company chooses to treat the benefit as a dividend, the fringe benefit tax rules do not apply. (Section CX 17).

However, as noted at [122], if the mixed-use asset rules apply and a non-cash benefit is provided to a shareholder-employee of a company in circumstances where s CX 17 applies, the company **must** choose to treat the benefit as a dividend. That is the case here. The benefit (John's use of the yacht) is therefore a dividend.

If John were an employee but not a shareholder in the company, whether his use of the yacht is a fringe benefit would depend on whether it is considered to be in connection with his employment. This would be the case if John's employment is at least a substantial reason for the benefit (use of the yacht) being provided. For further information see: **The meaning of "benefit" for FBT purposes** *Tax Information Bulletin* Vol 18, No 2 (March 2006): 26.

Sponsorship through providing goods that are trading stock

125. A taxpayer may provide sponsorship by providing goods that are 'trading stock' of the business (property that the business has for the purpose of selling or exchanging in the ordinary course of the business).

The value of the trading stock is deductible

126. Where this is the case, the value of the trading stock will be deductible through the trading stock rules (s DB 49). Section DB 49 supplements the general permission,[29] which means the general permission does not need to be satisfied for the deduction to be allowed.[30]

29 Section DB 49(5).

30 Section DA 3(1).

Will there be deemed income where the goods provided are trading stock?

127. It is then necessary to consider whether s GC 1 will apply to treat the business as having derived an amount equal to the market value of the trading stock. Section GC 1 provides (relevantly):

> **GC 1 Certain disposals of trading stock at below market value**
>
> *When this section applies*
>
> (1) This section applies when—
>
> (a) a person (**person A**) disposes of trading stock for—
>
> (i) no consideration; or
>
> (ii) an amount that is less than the market value of the trading stock at the time of the disposal; and
>
> (b) 1 or more of the following apply:
>
> (i) the disposal is effected by person A taking the trading stock for their own use or consumption:
>
> (ii) the disposal is not made by person A in the course of carrying on a business for the purpose of deriving their assessable income, or their excluded income, or a combination of their assessable income and excluded income:
>
> (iii) the disposal is to an associated person.
>
> *Market value consideration*
>
> (2) Person A is treated as deriving an amount equal to the market value of the trading stock at the time of the disposal.
>
> …
>
> *Exclusions*
>
> (5) This section does not apply to a disposal of trading stock—
>
> (a) to a donee organisation:
>
> …
>
> (c) by a person to another person, who is not associated with them, for use by the other person in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event:
>
> …

Is the disposal one to which s GC 1 may apply?

128. Section GC 1 may potentially apply where a business disposes of trading stock for no consideration or for less than market value consideration. In the context of sponsorship through providing goods that are trading stock, it is likely that this criterion will be met. However, that is not necessarily always the case, as the value of the business promotion or exposure agreed as part of the arrangement may be equal to or exceed the market value of the trading stock. If that is the case, s GC 1 will not apply, and the discussion below will not need to be considered.

129. If the trading stock is disposed of for no consideration or for less than market value consideration, it will be necessary to consider whether the disposal is:

- effected by the trading stock owner taking the trading stock for their own use or consumption;
- not made in the course of carrying on a business for the purpose of deriving income; or
- to an associated person.

130. In any of those situations, s GC 1 will apply, unless an exclusion is available.

131. Two exclusions from s GC 1 may be relevant in the context of sponsorship expenditure. These are where the trading stock is disposed of to:

- a donee organisation; or
- a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event.

132. The upshot of the requirements for s GC 1 to potentially apply and the exclusions from the provision is that s GC 1 **will not apply** to sponsorship through providing trading stock where the trading stock is provided:

- in the course of carrying on a business (so long as the trading stock is not provided to an associated person or taken by the trading stock owner for their own use or consumption);

- to a donee organisation (whether or not the trading stock is provided in the course of carrying on a business and whether or not the donee organisation is associated with the person providing the trading stock); or
- to a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event (whether or not the trading stock is provided in the course of carrying on a business).

Section GC 1 will apply where the trading stock owner takes the stock for their own use or consumption

133. Section GC 1 will apply where the trading stock owner takes the stock for their own use or consumption. This is unlikely to occur in the context of sponsorship expenditure. However, it could arise in some circumstances where it could be the case, as illustrated in the following example.

Example | Tauira 12 – Trading stock taken for own use; market value consideration treated as being derived and must be included as income

Tony is a sole trader running a business selling skateboards and streetwear, which he operates through an Instagram account and linked online shop. Tony skateboards at the local park most weekends and competes at amateur skateboarding competitions around the country each year. When he needs a new board, he takes one that is his trading stock, for his own use. A sticker on the board displays Tony's Instagram account name and a QR code that, when scanned, directs to the Instagram account.

There is arguably some element of 'sponsorship' here as Tony is supporting his own sporting endeavours while also getting some promotional benefit from other skateboarders seeing the sticker on his board.

However, Tony takes the board for no consideration and for his own use. If a taxpayer takes trading stock for their own use or consumption for less than market value, s GC 1 will apply,[31] even if it could be considered a disposal made in the course of carrying on a business to derive income. As such, s GC 1 will apply to treat Tony as having derived an amount equal to the market value of the board. Tony must include that amount in his income.

Section GC 1 will generally not apply if the trading stock is disposed of in the course of carrying on a business for the purpose of deriving income

134. If the taxpayer does **not** make the disposal of the trading stock for sponsorship purposes in the course of carrying on a business for the purpose of deriving income,[32] s GC 1 may apply. Conversely, if the taxpayer can show that the trading stock **was** provided in the course of carrying on a business for the purpose of deriving income, s GC 1 will generally not apply. The only exceptions to this are where the trading stock, while disposed of in the course of carrying on a business, is provided to an associated person or taken by the trading stock owner for their own use or consumption.

135. The discussion in this statement about the general permission is relevant to whether the taxpayer provides trading stock in the course of carrying on a business. While the provision of trading stock is not 'expenditure', the discussion about the degree of nexus or connection is equally relevant to whether there is a sufficient connection between the provision of the trading stock and the carrying on of the business for the purpose of deriving income.

136. If the taxpayer can show it was intended that the business would be promoted by providing the trading stock, s GC 1 will not apply.[33] The factors set out at [55] will similarly be relevant to whether a taxpayer can show a business promotion purpose in the context of sponsorship through the provision of trading stock.

31 Unless an exclusion applies – which is not the case here (see [132]).

32 Whether assessable income, excluded income, or a combination of the two.

33 Provided that the trading stock is not provided to an associated person or taken by the trading stock owner for their own use or consumption.

Example | Tauira 13 – Trading stock disposed of in the course of carrying on business to derive income, so no market value consideration treated as being derived

CC Cosmetics Ltd provides make-up (trading stock of the company) to a make-up artist who is a social media influencer with a very large following, who regularly showcases and reviews new products in her social media posts.

As the influencer regularly reviews and discusses new cosmetics on her channels, CC Cosmetics Ltd anticipates that the influencer will review the products on her social media. The company is confident the influencer will love the products, so her posts will create positive publicity for the company and its cosmetics.

In this scenario, CC Cosmetics Ltd would be disposing of the trading stock in the course of carrying on the business, as it provides the trading stock seeking publicity or promotion of the business to a relevant audience. This is the case even though the company does not have a formal agreement with the influencer to review the products on her social media. The company reasonably anticipates the influencer will review the products on her social media channels.

As such, s GC 1 will not apply and CC Cosmetics Ltd will not be treated as having derived income from disposing of the products to the influencer.

The value of the trading stock provided to the social media influencer will be deductible through the trading stock rules (s DB 49).

Example | Tauira 14 – Trading stock disposed of to an associated person; market value consideration treated as being derived and must be included as income

The same facts apply as in Example 1 on page 41, with the exception that Tony is not a sole trader, but instead runs his business through a company in which he is the sole shareholder and has a 100% voting interest.

Section GC 1 will apply here even if it could be argued that because the sticker on Tony's board gives some promotional benefit, the company is providing the trading stock to Tony in the course of carrying on its business for the purpose of deriving income. This is because the company is disposing of the trading stock to an associated person. Tony and the company are associated persons under s YB 3.[34]

Section GC 1 will treat Tony's company as having derived an amount equal to the market value of the board. The company must include that amount in its income.

Section GC 1 will not apply if the recipient of the trading stock is a donee organisation

137. If the taxpayer provides trading stock to a donee organisation, s GC 1 will not apply. This is the case whether or not the trading stock is provided in the course of carrying on a business (though, in the context of sponsorship, often it will be). It is also the case whether or not the donee organisation is associated with the person providing the trading stock.

138. "Donee organisation" is defined in s YA 1 as follows:

> **YA 1 Definitions**
>
> In this Act, unless the context requires otherwise,—
>
> ...
>
> **donee organisation** means an entity described in section LD 3(2) (Meaning of charitable or other public benefit gift) or listed in schedule 32 (Recipients of charitable or other public benefit gifts)

139. Most relevantly for the purposes of this statement, donee organisations include:

- societies, institutions, associations, organisations, or trusts that are not carried on for the private pecuniary profit of an individual, and whose funds are applied wholly or mainly to charitable, benevolent, philanthropic or cultural purposes within New Zealand; and
- funds established and maintained exclusively for the purpose of providing money for one or more of the purposes described above.

34 See the definition of "associated person" in s YA 1 and the tests of association in ss YB 1 to YB 16.

Example | Tauira 15 – Trading stock disposed of to a donee organisation (and in the course of carrying on business to derive income), so no market value consideration treated as being derived

A supermarket provides a local high school rowing club with sausages, bread, onions and condiments (trading stock of the company) for a fundraising sausage sizzle.

The rowing club agrees to hang signage at the event, thanking the supermarket for its support and displaying the supermarket's logo.

Sporting purposes are not necessarily charitable, but when directed to young people or schools they take on an educational element and are considered charitable.[35]

Section GC 1 will not apply and the supermarket will not be treated as having derived income from disposing of the trading stock to the rowing club, as the club is a donee organisation. This is the case whether or not the supermarket can show that it provided the trading stock in the course of carrying on its business for the purposes of deriving income (which may depend on whether there is any agreed promotion as part of the arrangement – which in this case there is in any event).

Section GC 1 will not apply where trading stock is disposed of in certain adverse event situations

140. If a taxpayer provides trading stock to a non-associated person for their use in a farming, agricultural, or fishing business that is affected by a self-assessed adverse event, s GC 1 will not apply. This is the case whether or not the trading stock is provided in the course of carrying on a business.

141. "Self-assessed adverse event" is defined in s YA 1 as follows:

> **YA 1 Definitions**
>
> In this Act, unless the context requires otherwise,—
>
> ...
>
> **self-assessed adverse event**, for a person and a farming, agricultural, or fishing business of the person, means an event that—
>
> (a) is 1 of the following:
>
> (i) drought, fire, flood, or some other natural event:
>
> (ii) disease or sickness of livestock; and
>
> (b) materially affects the business; and
>
> (c) is described, together with the effect on the business, by the person in a statutory declaration given to the Commissioner

142. It is important to note that to fall within this exclusion from s GC 1, the trading stock must have been disposed of to the recipient for their use in a farming, agricultural, or fishing business. General philanthropy through donating trading stock in adverse events will not fall within this exclusion (for example, if a supermarket provides groceries to families affected by a flood). However, if there are both philanthropic and promotional / business reputation purposes behind the trading stock being provided, it may be that the trading stock is provided in the course of carrying on a business (for example, the supermarket chain promotes its assistance by way of advertising aimed at encouraging customers to shop at the supermarket).

35 *Laws of New Zealand* Charities (online ed, accessed 3 July 2025) at [51]. Also, for more information, search for "sports and charity" on **charities.govt.nz**. Note, for gifts of money to be eligible for a donation tax credit, the requirements of s LD 3 must be met, which will not be the case for all organisations with charitable purposes.

Example | Tauira 16 – Market value consideration will not be treated as being derived if there is a "self-assessed adverse event" or the trading stock is provided in the course of carrying on a business to derive income

In the immediate aftermath of a natural disaster, a farm supply shop provides hay (trading stock of the business) to affected farmers for use in their farming business, to feed their stock.

It is possible that s GC 1 will not apply in this situation. This will not be a disposal of trading stock to a donee organisation (as the hay is given directly to people in the community who need it). It is also unlikely to be a disposal made in the course of carrying on a business (as there is unlikely to be any business promotion). However, the provision of the trading stock may potentially fall within the exclusion in s GC 1(5)(c).

On these facts, the trading stock the supply shop disposes of is for the farmers who receive it to use in their farming businesses. For the exclusion from s GC 1 to apply, the farmer recipients would need to provide the Commissioner with a statutory declaration containing the required information for it to be a "self-assessed adverse event" as defined in s YA 1 (see [141]).

Otherwise, s GC 1 would likely apply, and the farm supply shop would be treated as having derived income from disposing of the trading stock (the hay) to the affected farmers.

If the self-assessed adverse event exclusion does not apply, s GC 1 would nonetheless not apply if the farm supply shop could show that it has provided the trading stock to the affected farmers in the course of carrying on its business for the purposes of deriving income. This would be the case if the shop could show that while there was some philanthropic purpose for providing the hay, another purpose was to gain the benefit of promotion and exposure of the business to a relevant market audience.

There may be various motivations for a business donating trading stock. There being some philanthropic or community–minded motivation does not preclude the donation nonetheless being in the course of carrying on the business. Whether this is the case will be highly fact specific.

Sponsorship through providing services

143. Another way that a taxpayer may provide sponsorship is through providing services. Where a business does this, the costs associated with providing the services will be deductible under the general permission if the taxpayer can show that the sponsorship is intended to benefit the business (for example, through promotion or brand recognition).

144. To the extent the services are provided for no remuneration, there will be no income arising to the sponsoring business. But if the business provides services at a reduced rate, there will be income to the extent the business is remunerated for the services.

Example | Tauira 17 – Sponsorship through providing services; expenditure in providing the services is deductible

Dave is a cricket coach who provides one-on-one coaching. He provides an annual emerging player scholarship in conjunction with a cricket club. The person awarded the scholarship receives 10 hours of free coaching with Dave.

Dave's coaching business receives market exposure through the advertising for the scholarship, which is the reason Dave has entered into the scholarship arrangement with the club.

Dave incurs some expenditure in providing the free coaching (for petrol travelling to the coaching sessions and net hire). This expenditure is deductible, as Dave incurs it in providing the free coaching that he does in order for his business to benefit from the market exposure it gets from the scholarship advertising.

Dave is not remunerated at all for providing the coaching, so he has no income from this. If under the scholarship Dave provided 10 hours of coaching at a 50% discount, the reduced remuneration Dave receives for the coaching would be income.

Sponsorship of an employee

145. There may be occasions where an employer sponsors an employee, monetarily or through providing goods or services, in return for brand exposure (eg, on clothing the employee wears at the event, on equipment the employee uses at the event, or in some other way such as through signage or in the event programme). For example, an employer may sponsor an employee to take part in a sporting event by paying their entry fee, or by providing goods (for example, sporting equipment) or services (for example, a garage providing free servicing to an employee who has a sports car they race).

146. These may be other instances of sponsorship expenditure, to which the deductibility principles explained earlier in this statement would be relevant.

147. That may be the case. However, it may simply be that the amount is deductible because what the employer provides is employment income for the employee or gives rise to a fringe benefit. In either case, there will be no need to consider any element of 'sponsorship'.

148. It may be that the sponsorship provided is neither employment income nor a fringe benefit. For example, if the garage referred to at [145] sponsored the driver because of their ranking, talent, and the relevance to the business of the market exposure, and would have offered the sponsorship regardless of whether they also happened to be an employee. In that case, the employment would not be a substantial reason for providing the benefit, so it would not be provided in connection with the employee's employment. In that situation, the deductibility of the associated costs of providing the sponsorship would be determined in accordance with the deductibility principles explained in this statement.

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QUESTION WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 26/01: GST – Registered members of unregistered unincorporated bodies

Issued | Tukuna: 22 April 2206

This Question We've Been Asked considers whether a member of an unincorporated body who is registered for GST can claim input tax deductions for expenditure incurred by the unincorporated body if the unincorporated body is not itself registered for GST. It also considers whether members can claim input tax deductions for contributions they make to the unincorporated body.

Key provisions | Whakaratonga tāpua

Goods and Services Tax Act 1985 – ss 2 ("flow-through joint venture", "ordinary joint venture", "person", "unincorporated body"), 3 ("contributory scheme", "participatory security"), 3A, 6, 8, 20(3C), 51, 57.

Question | Pātai

Where an unincorporated body is not liable to or does not register for GST:

1) **Can individual members claim input tax deductions for their share of the cost incurred by the unincorporated body?**
2) **Can individual members claim input tax deductions for their contributions to the unincorporated body?**

Answer | Whakautu

Question 1

No. An input tax deduction can be claimed only by the person who acquired the goods and services. An unincorporated body is treated as a person for GST purposes and is the person who acquired the goods and services, even if the unincorporated body is not registered for GST.

Question 2

In most cases, No. The members of an unincorporated body will also not be able to claim an input tax deduction for contributions made to the unincorporated body in most cases. Where the contributions are made to establish a new unincorporated body, they are not made in exchange for a supply. Where contributions are made to acquire an interest in an existing unincorporated body from another member, there is a supply. However, the new member will be able to claim an input tax deduction only if the:

- **existing member makes that supply in the course or furtherance of their own separate taxable activity; and**
- **new member acquires the supply for use in making taxable supplies in the course or furtherance of their own separate taxable activity; and**
- **interest is not an exempt supply of a participatory security in a contributory scheme.**[1]

1 Note that the supply of a participatory security can also be zero-rated in some circumstances under s 20F. However, that is unlikely to be the case in the circumstances covered by this QWBA.

Explanation | Whakamaramatanga

1. The Commissioner has been asked whether members of an unincorporated body who are registered for GST can claim an input tax deduction for:

   - their share of costs incurred by the unincorporated body; or
   - their contributions to the unincorporated body

   if the unincorporated body is not separately registered for GST.

2. An unincorporated body includes a partnership, an ordinary joint venture and the trustees of a trust. It also includes other groups of persons if the group is sufficiently organised. An unincorporated body does not include a flow-through joint venture. Different rules apply to flow-through joint ventures. This item does not apply to flow-through joint ventures.

3. Where an unincorporated body that carries on a taxable activity is registered, the members of that body cannot be registered or liable to register in relation to the body's taxable activity. Where an unincorporated body is not carrying on a taxable activity or is not registered for GST purposes the legislation does not prevent a member from registering for GST. However, the member can still become a registered person only if they are carrying on a taxable activity. In determining whether a member is carrying on a taxable activity, it is necessary to look at the member's activities separately from the activities of any unincorporated body they are a member of. This is because, where activities are carried on collectively by a group of persons, the "person" who is carrying on those activities is the unincorporated body and not any of the members individually.

4. A member who is registered for GST, is not able to claim input tax deductions for goods and services acquired by the unincorporated body. That is because the individual members are not the "person" that acquired those goods and services.

5. A member who is registered for GST is also unlikely to be able to claim an input tax deduction for contributions they make to the unincorporated body. This is because the contributions are unlikely to be consideration for any supply. Input tax deductions are allowed only where the:

   - contribution is made for an interest in an existing unincorporated body; and
   - person receives, in exchange for their contribution, a supply of an interest in that body (being a chose in action) from an existing member of that body who is registered for GST and making that supply in the course or furtherance of their own separate taxable activity; and
   - interest is not a participatory security in a contributory scheme; and
   - person acquired that interest for use in making their own separate taxable supplies.

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

7. Examples | Tauira illustrating the principles discussed are at [43].

What is an unincorporated body?

8. An "unincorporated body" is defined as an unincorporated body of persons, including a partnership, an ordinary joint venture and the trustees of a trust (s 2). An unincorporated body does not include a flow-through joint venture. The definition is inclusive, such that a body that does not fit within the description of a partnership, an ordinary joint venture or the trustees of a trust could still be an unincorporated body for the purposes of the definition (*Case U19* (1999) 19 NZTC 9,186).

Who can register for GST?

9. A person becomes liable to be registered for GST where the total value of supplies made in New Zealand in the course of carrying on all taxable activities exceeds $60,000 (s 51(1)). A person may also become registered where they satisfy the Commissioner that they are carrying on, or intend to carry on, any taxable activity (s 51(3)).

10. A taxable activity is (s 6(1)):
    - any activity carried on continuously or regularly by any person, whether or not for a pecuniary profit; and
    - involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration.[2]
11. A taxable activity does not include any activity carried on essentially as a private recreational pursuit or hobby (s 6(3)). (See for example, *Question We've Been Asked QB 17/04: Goods and Services Tax – Whether a racing syndicate can be a registered person* (Wellington, Inland Revenue, May 2017), where the Commissioner concluded that where a racing syndicate's activity is limited to the ownership (or leasing) and racing of horses, the essence of the activity will most often be the personal interest or pleasure derived from seeing the horse compete in, and potentially win, races, meaning it will be a hobby.)
12. If an unincorporated body of persons is carrying on an activity that is a taxable activity, the unincorporated body will be the "person" that can register (see the definition of "person" in s 2 and *Case U19*).

Can a member of an unincorporated body register for the activity?

13. Where an unincorporated body that carries on a taxable activity is registered, the members of that body cannot themselves be registered or liable to be registered for the body's taxable activity (s 57(2)(a)).
14. Where an unincorporated body is not carrying on a taxable activity or is not registered for GST purposes, s 57 will not apply to stop a member from being able to register. However, a member will still be able to register only if they satisfy the relevant requirements. This means the member, as a separate "person", needs to be carrying on a taxable activity.
15. In determining whether the member is carrying on a taxable activity it is necessary to look at the member's activities separately from the activities of any unincorporated body they are a member of. This is because, where activities are carried on collectively by a group of persons, the "person" who is carrying on those activities is the unincorporated body and not any of the members individually.
16. It is possible that the member's separate taxable activity could be connected to the unincorporated body's activity. For example, a horse trainer could be simultaneously a member of a racing syndicate and paid by that syndicate to train the horse. In that case, however, it is the member's training activities that form their taxable activity, not all the activities of the racing syndicate.
17. A member could also be a registered person due to entirely unrelated or peripherally related activities they carry on separately from the unincorporated body.
18. As for the unincorporated body, a member is unable to register if their only activities are carried on essentially as a private recreational pursuit or hobby.

Can registered members claim input tax deductions for costs incurred by the unincorporated body?

19. Input tax is the GST charged on supplies of goods or services acquired by a person (ss 3A(1)(a) and 8(1)).
20. A registered person is entitled to claim deductions for input tax when calculating the amount of GST that must be paid for each taxable period (s 20). A registered person is allowed a deduction:
    - for input tax in relation to a supply of goods and services made to that registered person; but
    - only to the extent to which the goods or services are used for, or are available for use in, making taxable supplies (s 20(3C)).
21. The reference to making taxable supplies refers to the member's individual taxable supplies (*Case T10* (1997) 18 NZTC 8,055).
22. The fact that an unincorporated body is not registered does not change the fact that it is a separate person for GST purposes. Therefore, costs incurred by the unincorporated body relate to goods and services the unincorporated body acquired. Given the members did not acquire the relevant goods and services for GST purposes, the members are not entitled to claim input tax deductions for their share of the unincorporated body's costs.

2 For more information on the concept of a taxable activity see *IS 25/21: GST - taxable activity* (Wellington, Inland Revenue, October 2025).

Can registered members claim input tax deductions for contributions to the unincorporated body?

23. A person is able to claim input tax deductions for contributions they make to an unincorporated body only if the:

    - payments are consideration for a supply (but not an exempt supply) of goods or services made to the member in the course or furtherance of the supplier's taxable activity (such that GST can be charged on the supply); and
    - goods or services are used by the member in making their own taxable supplies.

    Given these requirements, the Commissioner considers it will be rare for a person to be able to claim an input tax deduction for contributions they make to an unincorporated body.

24. This will be the case whether or not the unincorporated body is registered for GST.

Can input tax deductions be claimed for an initial contribution?

25. In many cases, a member of an unincorporated body will make an initial contribution to become a member of that body. When a person becomes a member of an unincorporated body, they obtain certain rights and agree to certain obligations.

26. Various levels of formality will exist for this bundle of rights depending on the nature of the unincorporated body. For example, the law recognises that a share in a partnership is a fractional interest in the future profits of the partnership business and in a surplus of assets over liabilities on a winding up. The partner does not have title to specific partnership property but has a beneficial interest in the entirety of the partnership assets and in each and every particular asset of the partnership (*Hadlee and Sydney Bridge Nominees Ltd v CIR* (1991) 13 NZTC 8,116 (CA)).

27. While less formal than a partnership, many clubs and syndicates that are unincorporated bodies also have detailed rules setting out the rights and obligations of the members, including the members' rights to any property belonging to the body. At the other end of the spectrum, an ordinary joint venture can be entered into in a reasonably informal way, where parties who co-own property agree to manage it in a certain way with a certain purpose in mind.

28. The law expressly recognises that a partnership interest is a chose in action (which is a service for GST purposes (s 2)). While the rights and obligations attaching to an ordinary joint venture or other types of unincorporated bodies such as clubs or syndicates are less formal, the Commissioner considers that those bundles of rights still amount to a chose in action.

29. Whether an initial contribution is consideration for the supply of an interest in an unincorporated body will depend on whether the unincorporated body already exists, or whether it is being newly formed from the initial contributions of the members:

    - Where members make initial contributions to a newly formed unincorporated body there are no existing interests in the body to be supplied. Instead, the formation of the unincorporated body by way of the initial contributions creates the interests. In this case, the new members will not have received any supply.
    - Where a new member makes an initial contribution to an existing unincorporated body, 100% of the interests in the body are already owned by the existing members. Therefore, in exchange for their initial contribution, a new member will receive a supply of an interest in the body from the existing members.

30. These conclusions are consistent with the Commissioner's view set out in *Question We've Been Asked QB 16/04: Goods and Services Tax – GST treatment of partnership capital contributions* (Wellington, Inland Revenue, June 2016). The Commissioner considers that outcome will be the same for all unincorporated bodies.

31. If there is no supply, there will be no GST charged, and so no input tax deduction will be allowed. If there is a supply, input tax deductions will only be allowed where:

    - the exiting member(s) supplying the interest is registered for GST and making that supply in the course or furtherance of their own separate taxable activity (such that GST can be charged on the supply); and
    - the interest is not a participatory security in a contributory scheme (discussed below); and
    - the person acquired the interest in the body for use in making their own separate taxable supplies (discussed further from [40]).

Is there an exempt supply of a participatory security?

32. Input tax cannot be claimed for exempt supplies. Exempt supplies include various actions relating to a "participatory security" (including issuing, transferring ownership, varying, or paying an amount in respect of the security), which is a financial service (s 3).

33. A participatory security is an interest or right to participate in any capital, assets, earnings or other property of any person where that interest or right forms part of a "contributory scheme" (s 3(2)). A contributory scheme is a scheme or arrangement that involves the investment of money where (s 3(2)):

    - the investor acquires or may acquire an interest in or right in respect of property; and
    - that interest or right will be used or exercised in conjunction with any other interest or right in respect of property acquired in similar circumstances; but
    - does not include such a scheme if it has five or fewer investors, provided neither the manager of the scheme nor any associated person of the manager is the manager of another scheme.

34. "Participation" involves some form of sharing with others even if only with the promoter of the scheme (*R v Smith* (1991) 5 NZCLC 67,120 (HC)). The term "investment" in the definition of "contributory scheme" should be read broadly as including any investment of money in the hope of some kind of return, whether in money or otherwise (*Culverden Retirement Village v Registrar of Companies* [1997] 1 NZLR 257 (PC)).

35. Where an unincorporated body meets these requirements, the supply of an interest in the unincorporated body by a member of the unincorporated body to a new or existing member of the unincorporated body is an exempt supply of a financial service and no input tax deduction is allowed. This is consistent *with Question We've Been Asked QB 14/03: GST – Transfer of interest in a partnership* (Wellington, Inland Revenue, 2014).

Can input tax deductions be claimed for ongoing payments?

36. Members of unincorporated bodies will often also make ongoing contributions to cover the costs incurred by the body. Whether these payments are consideration for a supply of goods or services depends on the nature of the agreements entered into.

37. If the member's interest in the unincorporated body does not change because of the further payments, then the member does not receive any supply in exchange for their payment. Instead, the member will simply be contributing capital to the unincorporated body to enable it to acquire the goods and services it requires to carry on its activity. This view is also consistent with the view expressed in *Question We've Been Asked QB 16/04*: *Goods and Services Tax – GST treatment of partnership capital contributions* (Wellington, Inland Revenue, June 2016).

38. If the member's share in the unincorporated body increases as a result of the payments or the terms of the agreement are such that the payment is a further instalment toward the acquisition of the member's original share in or membership of the unincorporated body, then the payment is consideration for the further supply of the interest in the unincorporated body.

39. As for the initial contributions, if there is no supply, then no input tax deduction is allowed. If there is a supply, then an input tax deduction is allowed only if the requirements set out at [31] are satisfied.

If there is a supply, is it for use or available for use in making taxable supplies?

40. In most cases, payments made by members of an unincorporated body will be for a supply by a person who is not registered for GST, be for an exempt supply, being the issue of a participatory security, or will not relate to a supply at all. However, it is possible the payment could be in exchange for a supply that is not an exempt supply.

41. If a member who is registered for GST purposes receives a taxable supply that is not an exempt supply of a participatory security in exchange for their contributions to the unincorporated body they can claim an input tax deduction only to the extent to which the goods or services are used for or are available for use in making taxable supplies (s 20(3C)).

42. Whether this is satisfied will depend on the nature of the member's taxable activity and will be a question of fact in each situation. A registered member may use their interest in an unincorporated body in making their taxable supplies if the member holds the interest in the unincorporated body as part of their separate taxable activity. Alternatively, a member could carry on a taxable activity of buying and selling interests in unincorporated bodies. If the member's taxable activity is not related to the activities carried on by the unincorporated body, it is unlikely they will be able to argue that their interest in the unincorporated body is for use in making their taxable supplies. The Commissioner considers that it will be rare for a member to be able to claim an input tax deduction for the acquisition of an interest in an unincorporated body, particularly where the body itself is unregistered.

Examples | Tauira

43. Examples | Tauira 1–3 illustrate the principles discussed above.

Example 1 – Fudge-making partnership

Sarah and Aroha enjoy experimenting with making different flavours of fudge. Their friends and family love the fudge and encourage Sarah and Aroha to start making it to sell.

Sarah and Aroha decide to establish a partnership to enter into this business venture. They are successful in arranging to have their fudge sold at a couple of local tourist shops.

Fudge sales are less than $60,000 per year so Sarah and Aroha decide not to register the partnership for GST. However, Aroha is an accountant and is registered for GST in her own name for her accountancy business. Aroha wants to know if she can claim input tax deductions for her share of the fudge-making expenses in her GST returns.

Aroha cannot claim input tax deductions for fudge-making expenses. They relate to goods and services acquired by the partnership for its taxable activity of making and selling fudge, not to Aroha's accounting activities. Aroha also cannot claim an input tax deduction for her initial contribution to acquire a share of the fudge-making partnership because that contribution was made to establish a new partnership.

Example 2 – Bloodstock venture

Jack is a bloodstock breeder and trainer. He sees a promising colt at the Karaka yearling sales that he is interested in buying to race and, potentially, breed from in the future. Jack contacts Jenna, who is also a bloodstock breeder, and Dinesh, who is a doctor but has other interests in bloodstock, and they agree to form an ordinary joint venture to acquire the colt together for the initial purpose of racing.

The parties decide not to register the ordinary joint venture for GST. Instead, Jack, Jenna and Dinesh want to know whether they can claim input tax deductions for their expenditure in relation to the colt in their personal GST returns.

Jack, Jenna and Dinesh cannot claim input tax deductions for the expenditure relating to the colt in their personal returns. That expenditure relates to goods and services acquired by the ordinary joint venture not by Jack, Jenna and Dinesh individually. They also cannot claim input tax deductions for the initial contributions because they were made to establish a new joint venture.

Example 3 – Vintage car syndicate

Manu is a mechanic who loves vintage cars. She hears about a local syndicate that pools money to invest in vintage cars and travels around the country to rallies. Manu invests in the syndicate. At the time Manu invests, the syndicate has 10 members.

The activities of the syndicate are sporadic and more in the nature of a recreation or hobby. Therefore, the syndicate cannot register for GST.

Manu wants to know whether she can claim an input tax deduction for her contributions to the syndicate in her returns for her mechanic business.

Manu cannot claim an input tax deduction in respect of her initial contribution. Manu's initial contribution is likely to have been consideration for a supply of an interest in the syndicate. However, it will be an exempt supply of a participatory security in a contributory scheme. In addition, none of the other members making the supply are registered for GST, and Manu did not acquire the interest in the syndicate for use in making taxable supplies in the course or furtherance of her mechanic business.

Manu will also not be able to claim any input tax deductions for her ongoing contributions because they are not made in exchange for a supply.

References | Tohutoro

Legislative references | Tohutoro whakatureture

Goods and Services Tax Act 1985 – ss 2 ("flow-through joint venture", "ordinary joint venture", "person", "unincorporated body"), 3 ("contributory scheme", "participatory security") 3A, 6, 8, 20, 51, 57

Partnership Law Act 2019 – ss s 7(1), 8(1), 12(1)

Case References

Anglesea Buildings Partnership v CIR (1987) 9 NZTC 6,181 (HC)

Case P70 (1992) 14 NZTC 4,469

Case T10 (1997) 18 NZTC 8,055

Case U19 (1999) 19 NZTC 9,186

Commerce Commission v Fletcher Challenge Ltd [1989] 2 NZLR 554 (HC)

Commercial Factors Ltd v Scenic Hotel Group Ltd [2019] NZHC 2370

Culverden Retirement Village v Registrar of Companies [1997] 1 NZLR 257 (PC)

Hadlee and Sydney Bridge Nominees Ltd v CIR (1991) 13 NZTC 8,116 (CA)

McElwee v CIR (1988) 10 NZTC 5,181 (HC)

R v Smith (1991) 5 NZCLC 67,120 (HC)

Taunton Syndicate v CIR (1982) 5 NZTC 61,106 (HC)

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Other references | Tohutoro anō

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www.taxtechnical.ird.govt.nz/en/questions-we-ve-been-asked/2017/qb-1704-goods-and-services-tax-whether-a-racing-syndicate-can-be-a-registered-person

LEGAL DECISION – CASE SUMMARIES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

CSUM 26/02: Disputant's claim struck out due to failure to follow the disputes process

Decision date: 13 March 2026

Case

A v CIR [2026] NZTCRA 01

Legislative References

Tax Administration Act 1994, ss 14F, 14G, 89AB, 89H, 89I, 89K, 113, 138B, 138C, 138D, 138E, and 138H.

Taxation Review Authorities Act 1994, s 21A.

Legal terms

Not applicable

Legal Services Solicitors

Charles Walmsley

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Summary

The disputant filed a challenge proceeding against tax assessments where the disputant had failed to issue a Notice of Response (**NOR**) within the response period and, later, had failed to challenge the Commissioner's refusal to treat a late NOR as having been issued within time. The disputant's claim was struck out as the TCRA had no jurisdiction to hear the claim as the statutory preconditions for commencing a challenge were not met.

Impact

The decision reconfirms that the TCRA has limited jurisdiction. Where the statutory gateways that enable jurisdiction are not met, a claim will be struck out.

Facts

On 8 March 2018, the Commissioner issued a Notice of Proposed Adjustment (**NOPA**) proposing adjustments to the disputant's income tax assessments for the 2014 to 2016 income tax years and to impose shortfall penalties. The NOPA was delivered by courier to the recorded contact address of the disputant.

The disputant did not issue a NOR within the two-month response period. As a result, in April 2019, the Commissioner issued notices of assessment on the basis that the disputant was deemed to have accepted the proposed adjustments.

On 22 May 2020, the disputant, through a lawyer, issued an out of time NOR and requested that the Commissioner treat the NOR as having been issued within the response period on the basis of exceptional circumstances under s 89K of the TAA. The exceptional circumstances relied on being the fact that the disputant's son had received the NOPA and not passed it on.

On 10 June 2020, the Commissioner refused to treat the NOR as having been issued within the response period (**the Refusal Notice**). The disputant did not challenge the Refusal Notice within the two-month period stipulated in s 89K(6) of the TAA.

On 19 July 2024, the Australian Tax Office issued a notice (**the ATO notice**) advising the disputant that a foreign revenue claim had been registered in respect of her New Zealand tax debt.

In May 2025, the disputant became aware of the ATO notice.

On 13 June 2025, the disputant asked the Commissioner to reassess her tax assessments.

On 21 July 2025, the Commissioner declined to make the reassessments. After further correspondence, on 12 August 2025, the Commissioner again declined to make the reassessments.

On 24 September 2025, the disputant filed a notice of claim in the TCRA. The claim expressed an appealed against the Commissioner's refusal to reopen the tax dispute.

Issues

- Whether the proceeding should be struck out under s 138H of the TAA.
- In the alternative, whether the proceeding should be struck out under s 21A of the Taxation Review Authorities Act 1994.

Decision

The disputant argued that she had not been validly served with the NOPA. The Authority held that s 14F of the TAA permitted the Commissioner to communicate by delivery to a person's contact address. The evidence for the Commissioner was that the NOPA was sent to the address recorded for the disputant. The disputant had not produced any evidence to establish that she had notified the Commissioner of a different contact address. The Authority accepted that the disputant may not have opened or reviewed the NOPA promptly, as she was residing overseas. However, the Authority was satisfied that the NOPA had been posted to the disputant's contact address, which was treated as having been given in accordance with s 14F(6) of the TAA.

Having failed to issue a NOR within the response period, the disputant was deemed to accept the proposed adjustments. In the circumstances, the statutory precondition to commencing a challenge under s 138B of the TAA was not met.

The Authority considered whether an extension of time could be granted to challenge the Refusal Notice. The Authority determined that there was no evidence of exceptional circumstances that provided for a reasonable justification for not challenging the Refusal Notice within time. The Authority noted that the disputant had been legally represented at the time the Refusal Notice was issued and the disputant had not identified any circumstance operating during the following two-month period that prevented her from filing a challenge. The Authority also held that a delay of five years in commencing a proceeding "cannot be said to have been commenced as soon as reasonably practicable after the cessation of any alleged impediment in the disputant's circumstances."

In so far as the disputant's claim may be advanced as an appeal against the Commissioner's refusal to amend assessments in 2025, the Authority held that such decisions are excluded from being subject to challenge under s 138E(1)(e)(iv) of the TAA.

In so far as the disputant raised issues of service and procedural fairness, the Authority held that they do not provide for a basis for a challenge. The Authority's jurisdiction is limited and is contingent upon satisfaction of the statutory gateways.

The Authority concluded that it had no jurisdiction to hear the claim, therefore the proceeding was struck out.

CSUM 26/03: Taxpayers' appeal against evasion shortfall penalties dismissed

Decision date: 26 March 2026

Case

Abdullah Safi & Ors v Commissioner of Inland Revenue **[2026] NZHC 745**

Legislative References

Tax Administration Act 1994, ss 141E and 149A; Taxation Review Authorities Act 1994, s 26A; High Court Rules 2016, r 20.18

Legal terms

Shortfall penalties; evasion; onus of proof; Working for Families Tax Credits; foreign-sourced funds; remittances; credibility; records (books and accounts)

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Summary

Six appellants (four brothers and two brothers-in-law) appealed a Taxation and Charities Review Authority (**Authority**) decision upholding the Commissioner of Inland Revenue's (**Commissioner**) assessments and imposition of evasion shortfall penalties. The appellants abandoned their appeal against the underlying income tax and Working for Families Tax Credits (**WfFTC**) reassessments, leaving only an appeal on whether the Commissioner had proved evasion for the purposes of s 141E. The High Court held that the Commissioner had the onus of proving that in taking their respective tax positions, each appellant intentionally avoided the payment of income tax in circumstances where he knew he was or may be under an obligation to pay. The Judge upheld the Authority's findings that the absence of records and implausible explanations given, meant that the evasion shortfall penalties were correctly imposed, and the appeal was dismissed.

Impact

The High Court confirmed that, where taxpayers appeal the correctness of a tax assessment and the imposition of an evasion shortfall penalty and later abandon the appeal against the underlying tax assessments, the Commissioner does not need to prove the existence or quantum of the tax shortfall for evasion shortfall penalties. Instead, the Commissioner need only establish the taxpayer's evasive intent in relation to that shortfall. In this case, the entire shortfall arose from evasion.

More broadly, the decision highlights the importance of meeting record-keeping obligations (including in relation to foreign sourced remittances) and that in the absence of adequate books and records, courts may accept adverse credibility findings and draw inferences from patterns of receipts and lifestyle against returned income.

Facts

The appellants operated a New Zealand vehicle dismantling/export business (through Western 4x4 Dismantlers NZ Ltd and later AKA Holdings Ltd) supplying parts to a related United Arab Emirates business (Al Munasib Used Auto Spare Parts TR LLC). Over the relevant years, substantial funds were remitted from the Al Munasib bank account to the appellants and associated family trusts (over $6.4m during the years in issue; approximately $19.4m over 2006 to 2018).

Despite the remittances, the appellants filed relatively modest income tax returns and received WfFTC. The Commissioner reassessed the appellants to include the remittances as income, repay overpaid tax credits, and imposed evasion shortfall penalties. The appellants claimed the remittances were proceeds of overseas land/timber sales and loans, using Al Munasib's account as a conduit.

Issues

The appeal proceeded exclusively on the correctness of the Authority's decision as to the appellants' respective liabilities to pay shortfall penalties on the necessary ground that in taking their tax positions, they "evade[d] the assessment or payment of tax".

As such, the sole issue was whether the Commissioner proved (on the balance of probabilities) that, in taking their relevant tax positions, each appellant 'evaded the assessment or payment of tax' for the purposes of Tax Administration Act 1994, s 141E(1)(a), so as to be liable for evasion shortfall penalties.

Decision

The High Court held the Commissioner must prove intentional evasion by the appellants' when taking their tax positions; it was not necessary to re-litigate the underlying assessments once the appellants abandoned that aspect of the appeal. The Court was satisfied that the evidence, including the scale and pattern of remittances from Al Munasib, the lack of proper accounting records, and the Authority's credibility findings, proved the appellants intentionally avoided paying income tax in circumstances where they knew they were, or may have been, under an obligation to pay tax on the remittances.

Onus on the Commissioner for evasion shortfall penalties

The appellants argued that the onus reverses for the purposes of the evasion shortfall penalties and the Commissioner must prove the Afghani and Pakistani transactions did not happen as they had described. The Commissioner argued that the appellants' explanations for their receipts "are plainly fabrications" and "the only logical inference from the totality of the evidence" is the appellants either deliberately breached or were reckless as to their tax obligations.

The argument on appeal focused on the reliability of the evidence as to the land, timber and loan transactions said to have been conducted in Afghanistan and Pakistan and resulting in remittances to Al Munasib.

The Court held that it was for the Commissioner to "prove on the balance of probabilities to the requisite standard, that in taking their respective tax positions, each appellant intentionally avoided the payment of due income tax in circumstances indicating to him that he was or may be under some obligation to pay income tax".

Requirement to quantify the amount evaded

The appellants argued the Commissioner was required to quantify and prove the underlying tax shortfall as well as the amount of tax evaded for the purpose of imposing the evasion shortfall penalty.

However, quantification is statutory at "150% of the resulting tax shortfall" and the issue does not arise when, as here, the entirety of the shortfall is said to arise from evasion. Furthermore, the Court had "difficulty conceptualising circumstances in which a shortfall unsuccessfully challenged by the taxpayer under s 149A(2)(b) may require to be proven again by the Commissioner under s 149A(2)(a)".

Conclusion

The Court endorsed the Authority's assessment of the information provided by the appellants:

> While there has been a large volume of information provided, it is riddled with inconsistencies, it was provided late in many instances and has in many cases the appearance of an endeavour to construct an explanation; not the usual task of producing accounting records from contemporaneous records.

The Court noted that it is, of course, a core taxpayer obligation to "keep all necessary information (including books and records) and maintain all necessary accounts or balances required under the tax laws". Justice Jagose stated that the Commissioner's proof that such information probably did not exist at all, adequately reflects the serious nature of the obligation and the consequences of its default.

The Court also gave weight to the Authority's assessment of each appellant's personal circumstances which raised significant doubts that in taking their tax positions, they reasonably considered such was to "correctly determine the amount of tax payable by the taxpayer under the tax laws". Justice Jagose noted the Authority closely engaged with the appellants' presentation of evidence before it and drew multiple inferences from the content and manner of their evidence. As such, it was best placed to assess the veracity of the appellant's evidence, particularly as against the documents proffered to support it.

Justice Jagose concluded that:

> I thus find the appellants' knowledge of their receipt of funds from a trading enterprise—taken together with their knowledge of their obligation to return income to the Commissioner for tax purposes (illustrated by the tax positions they took), and their implausible attribution of those receipts to the contended transactions only when under the Commissioner's scrutiny—establish, at the time of taking their respective tax positions, circumstances indicating to each he was or may be under some obligation to pay income tax in relation to the remittances from Al Munasib. That they did not do so, given the Commissioner's effectively now-unchallenged assessments of income tax liability on those remittances, means the Commissioner has proven on the balance of probabilities to the requisite standard the appellants took those tax positions to evade the assessment or payment of income tax.
>
> As to the appellants' liability to pay evasion shortfall penalties, the Authority did not err.

TECHNICAL DECISION SUMMARY

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS 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).

TDS 26/03: Sale and subdivision of land

Decision date | Rā o te Whakatau: 30 September 2025

Issue date | Rā Tuku: 9 April 2026

Subjects | Kaupapa

This item summarises a private ruling about a sale and subdivision of land, a "lowest price" clause in the sale and purchase agreement, and whether there was any financial arrangement income or loss.

Taxation laws | Ture tāke

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

Summary of facts | Whakarāpopoto o meka

1. The arrangement is an agreement for the sale and purchase of land.
2. The sale was structured as a staged subdivision, with settlement and payment for each lot occurring in eight stages over 8 years.
3. The sale and purchase agreement (SPA) included a "lowest price" clause, stating that the agreed price is the lowest price for tax purposes under s EW 32(3).

Issues | Take

4. The main issue considered in this ruling was whether the consideration payable under the SPA was the "lowest price" for the purposes of s EW 32(3) and, therefore, whether there was any financial arrangement income under subpart EW.

Decisions | Whakatau

5. The Tax Counsel Office (TCO) decided that the value of the land for the purposes of s EW 32(3) was the purchase price agreed in the SPA. Therefore, there was no financial arrangement income or loss under subpart EW.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Financial arrangement and lowest price

Financial arrangement

6. TCO concluded that the SPA was a "financial arrangement" as defined in s EW 3. This was due to the deferred settlement and payment structure, where both parties promised to provide money or money's worth (property) in the future.
7. The SPA was not an "excepted financial arrangement" under s EW 5. This was because it was not a private or domestic agreement for the sale and purchase of property or services.

8. The SPA was not for private or domestic purposes, the purchase price was above the statutory threshold, and settlement was not within 365 days. Therefore, it was also not a "short-term agreement for sale and purchase".

Application of s EW 32(3) – "lowest price"

9. Where an agreement for the sale and purchase of property or services is a financial arrangement, s EW 32 applies to calculate the amount of consideration paid in property (the land) for the purposes of the financial arrangements rules. If the amount determined by s EW 32 is less than the amount paid in money, the taxpayer is treated as deriving financial arrangement interest income.

10. Essentially s EW 32(3) provides that the value of property in a financial arrangement is the lowest price the parties would have agreed on if payment had been required in full at the time the first right in the property was transferred. This provision is designed to isolate any interest component in deferred settlement arrangements.

11. The determination of the lowest price, and thus the interest component of a deferred property settlement, is a matter of negotiation between the parties. As confirmed in *Lyttelton Port Company Ltd v Commissioner of Inland Revenue* (1996) 17 NZTC 12,556, this is a subjective test. The Commissioner will not impute interest where it is genuinely agreed between the parties that no interest will be paid.

12. There was nothing to suggest that the lowest price clause set out by the parties in the SPA was other than a genuine agreement. The lowest price clause reflected the fact that payment and settlement of each lot occurred at the same time. No interest should be imputed because economically a buyer would not pay the full purchase price on day one for land delivered in eight lots over 8 years.

13. Inland Revenue may consider objective facts to determine whether or not the parties have genuinely agreed to the price they assert. However, there was nothing to suggest on the facts of the arrangement and considering the specific terms of the SPA that an interest component had been disguised.

Conclusion

14. TCO concluded that the SPA was a financial arrangement, but the value of the land for the purposes of s EW 32(3) was the purchase price as agreed in the SPA.

15. Therefore, there was no financial arrangement income or loss under subpart EW.

REGULAR CONTRIBUTORS TO THE TIB

Tax Counsel Office

The Tax Counsel Office (TCO) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The TCO also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

Legal Services

Legal Services manages all disputed tax litigation and associated challenges to Inland Revenue's investigative and assessment process including declaratory judgment and judicial review litigation. They contribute the legal decisions and case notes on recent tax decisions made by the Taxation Review Authority and the courts.

Technical Standards

Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

Policy

Policy advises the Government on all aspects of tax policy and on social policy measures that interact with the tax system. They contribute information about new legislation and policy issues as well as Orders in Council.