Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

GST input tax deductions and output tax liability

Decision date | Rā o te Whakatau: 16 March 2023

Issue date | Rā Tuku: 16 June 2023

TDS 23/08

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Subjects | Kaupapa

Goods and Services Tax: Whether the Taxpayer was eligible to claim input tax deductions. Whether the Taxpayer was liable for output tax. Whether the Taxpayer was liable for shortfall penalties.

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer is a company and provided accounting and tax advisory services to clients.
2. Customer and Compliance Services, Inland Revenue (CCS) sought to disallow input tax deductions claimed by the Taxpayer relating to goods and services provided to it in connection with client matters where the clients were removed from the New Zealand register of companies (Companies Register) when the Taxpayer worked on their matters.
3. CCS also sought to disallow input tax deductions claimed for goods and services for which the Taxpayer did not hold the required tax invoices and for goods and services provided to it in relation to a property that it leased.
4. In addition, CCS claimed that an amount the Taxpayer had received was consideration for a taxable supply in respect of which it was accountable for output tax.
5. CCS sought to impose shortfall penalties for gross carelessness or, alternatively, not taking reasonable care, in either case reduced by 50% for previous behaviour.
6. The Taxpayer did not accept the proposed adjustments by CCS and the matter was referred to the Tax Counsel Office for adjudication.

Issues | Take

7. The main issues considered in this dispute were:
    - Whether the Taxpayer was entitled to the disputed input tax deductions;
    - Whether the Taxpayer was liable for output tax in relation to an amount it received;

- Whether the Taxpayer is liable for shortfall penalties for gross carelessness or, alternatively, shortfall penalties for not taking reasonable care, in either case reduced by 50% for previous behaviour;
- Whether the Commissioner is time barred from amending the Taxpayer's assessment for the taxable period ended 30 September 2018.

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

Decisions | Whakatau

9. TCO decided:

- The Taxpayer was not entitled to any disputed input tax deductions for which it had failed to show it held the required tax invoices. These include disputed input tax deductions for which tax invoices had been provided, but the invoices did not show the Taxpayer as the recipient of the supply.
- The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with client matters where the clients were removed from the New Zealand register of companies (Companies Register) when the Taxpayer worked on their matters.
- The Taxpayer was entitled to disputed input tax deductions to the extent they related to goods and services provided to it in connection with client matters where the clients were on the Companies Register when the Taxpayer worked on their matters, and where it held the required tax invoices or tax invoices were not required because the supplies were made for $50 or less.
- The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with a property it leased.
- The Taxpayer was liable for output tax on an amount it received.
- The Taxpayer was liable for shortfall penalties for gross carelessness, reduced by 50% for previous behaviour.
- The Commissioner is not time barred from amending the Taxpayer's GST assessment for the taxable period ended 30 September 2018.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary issue | Take tōmua: Onus and Standard of Proof

Onus of proof

10. The onus of proof in civil proceedings[1] is on the taxpayer, except for shortfall penalties for evasion or similar act, or obstruction.[2] The taxpayer must prove that an assessment is wrong, why it is wrong, and by how much it is wrong.[3]

Standard of proof

11. The standard of proof in civil proceedings is the balance of probabilities.[4] This standard is met if it is proved that a matter is more probable than not.

Issue 1 | Take tuatahi: Input tax

12. This issue concerns whether the Taxpayer was entitled to the disputed input tax deductions. CCS argued that the input tax deductions were not allowed because the Taxpayer did not acquire the goods and services to which the input tax deductions relate or use them in making taxable supplies. The Taxpayer argued that it acquired the goods and services and used them in making taxable supplies.

13. For a GST registered person to deduct GST input tax:

- They must have acquired the goods and services to which the input tax relates.
- The goods and services must have been used for, or available for use in, making taxable supplies.
- Tax invoice requirements must have been met.

[1] Challenge proceedings (i.e., the proceedings that would follow if this dispute proceeds to the Taxation Review Authority or a court) are civil proceedings.

[2] Section 149A(2) of the TAA.

[3] *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA); *Beckham v CIR* (2008) 23 NZTC 22,066 (CA).

[4] Section 149A(1) of the TAA; *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Birkdale Service Station Ltd v CIR* (1999) 19 NZTC 15,493 (HC;); *Case X16* (2005) 22 NZTC 12,216; *Case Y3* (2007) 23 NZTC 13,028.

14. These requirements are cumulative; to deduct input tax all of them must be met. They are strict requirements.[5]

15. TCO concluded that the Taxpayer was not entitled to any disputed input tax deductions for which it has failed to show it held the required tax invoices because input tax deductions cannot be made where the required tax invoices are not held.

16. The Taxpayer's entitlement to input tax deductions relating to goods and services provided to it in connection with client matters differed depending on whether the clients were companies removed from, or on, the Companies Register when the Taxpayer worked on their matters.

17. The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with client matters where the clients were removed from the Companies Register when the Taxpayer worked on their matters because:

    - The Taxpayer acquired the goods and services outright. It has not shown that it acquired them on behalf of clients, as an agent.
    - However, the Taxpayer has not shown that the goods and services were used for making taxable supplies:
        - Section 20A of the GSTA (Goods and services tax incurred relating to determination of liability to tax) did not apply to deem client-related goods and services to have been used for making taxable supplies. To the extent that the goods and services related to the Taxpayer's client tax matters, the Taxpayer has not shown that it had challenged or appealed against an assessment or determination made in relation to the same matters. Nor has it shown its clients had incurred expenditure on such matters.
        - The goods and services were insufficiently connected to the making of taxable supplies. The Taxpayer cannot have been making supplies to clients that were removed from the Companies Register when it worked on their matters because the companies did not exist, and the likelihood of the removed companies being restored to the register was remote.

18. The Taxpayer was entitled to disputed input tax deductions to the extent they related to goods and services provided to it in connection with client matters, where the clients were on the Companies Register when the Taxpayer worked on their matters, and where it held the required tax invoices or tax invoices were not required, because:

[5] *Case 1/2012* (2012) 25 NZTC 1-013.

- The Taxpayer acquired the goods and services outright. It has not shown that it acquired them on behalf of clients as an agent.
- The goods and services were used for making taxable supplies.
    - For the same reasons outlined above, s 20A of the GSTA did not apply to deem the goods and services to have been used for making taxable supplies.
    - However, the Taxpayer was making taxable supplies and the goods and services it acquired were sufficiently connected with the making of those supplies. Where the Taxpayer had issued invoices for its services, the general time of supply rule applied to deem the supplies to have been made when the invoices were issued. Where the Taxpayer had not issued invoices, the Taxpayer's supplies were associated supplies deemed to have been made when the services were performed. This is based on evidence the Taxpayer was associated with its clients which the Taxpayer has not disproved.

19. The Taxpayer was not entitled to disputed input tax deductions relating to goods and services provided to it in connection with a property it leased because:
    - The Taxpayer acquired the goods and services. The Taxpayer had shown that it leased the property and was required to acquire goods and services to meet its obligations under the lease.
    - However, the Taxpayer had not shown the goods and services were used for making taxable supplies. The Taxpayer used the house and out-buildings on the property for making both taxable and exempt supplies. However, it claimed a deduction for the total input tax charged on the goods and services without excluding any amount for the exempt use. Nor had it sufficiently shown the area of the house and out-buildings that were used for making taxable supplies or the actual time it used the areas for making taxable supplies. Without this information it was not possible to estimate the extent to which the goods and services were used for making taxable supplies.

Issue 2 | Take tuarua: Output tax

20. This issue concerns whether the Taxpayer was liable for output tax on an amount it received.

21. Section 20 deals with a registered person's obligation to calculate tax payable for each taxable period. A registered person must calculate the tax that is payable for each

taxable period that applies to the person. For this purpose, output tax must be attributed to a taxable period. Output tax is tax charged on supplies made by the person in the course of their taxable activity. Subject to some exceptions which are not relevant for this issue, a person who is registered on the payments basis must attribute output tax to a taxable period to the extent that payment for the supply the output tax relates to is received in the period.

22. The Taxpayer was registered on the payments basis. Consequently, the Taxpayer was required to attribute output tax charged on services supplied in the course of the Taxpayer's taxable activity to the taxable period in which payment for the services was received.

23. CCS argued that the payment was a payment for services, whereas the Taxpayer argued that it was a loan repayment and as loan repayments are exempt from GST the Taxpayer was not required to include the payment in its return.

24. TCO decided that the Taxpayer had not met the onus of proving that CCS's proposed adjustment including output tax on the amount it received was wrong. The Taxpayer had endeavoured to do this by showing that the payment was a loan repayment. However, the Taxpayer had not provided any documentary evidence of a loan having been made. Also, the debtors' schedule that the Taxpayer provided was inconsistent with the payment having been a loan repayment, as was the Taxpayer's return for the 31 March 2019 taxable period. Those items supported a conclusion that the payment was a payment of fees.

Issue 3 | Take tuatoru: Shortfall penalties

25. This issue concerns with whether the Taxpayer was liable for shortfall penalties for gross carelessness or, in the alternative, shortfall penalties for not taking reasonable care. In either case, CCS accepted the penalties would be reduced by 50% for previous behaviour. For this issue all legislative references are to the Tax Administration Act 1994 (TAA) unless stated otherwise.

26. CCS argued that the Taxpayer was liable for shortfall penalties for gross carelessness or, in the alternative, shortfall penalties for not taking reasonable care (in either case, reduced by 50% for previous behaviour). The Taxpayer argued that it was not liable for shortfall penalties for gross carelessness or shortfall penalties for not taking reasonable care.

Gross carelessness

27. Section 141C of the TAA imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:[6]

- The taxpayer has taken a tax position.
- Taking the tax position has resulted in a tax shortfall.
- The taxpayer has been grossly careless in taking the taxpayer's tax position. Gross carelessness means doing or not doing something in a way that, in all of the circumstances, suggests or implies a complete or high level of disregard for the consequences (s 141C(3)):
  - Gross carelessness is characterised by conduct which creates a high risk of a tax shortfall occurring where that risk and its consequences would have been foreseen by a reasonable person in the circumstances.[7]
  - The test for gross carelessness is not whether the taxpayer actually foresaw the probability that their act or omission would cause a tax shortfall but whether a reasonable person would have foreseen that probability. Whether the taxpayer has acted intentionally is not a consideration.[8]
  - A person who takes reasonable care is not grossly careless.[9]

28. The penalty payable for gross carelessness is 40% of the resulting tax shortfall.

Not taking reasonable care

29. Section 141A imposes a shortfall penalty for not taking reasonable care on a taxpayer if the following requirements are satisfied:[10]

- The taxpayer has taken a tax position.
- Taking the tax position has resulted in a tax shortfall.

[6] The shortfall penalty for gross carelessness is considered in the Interpretation Statement: Shortfall Penalty for Gross Carelessness as published in *Tax Information Bulletin* Vol 16, No 8 (September 2004).

[7] *Case W4* (2003) 21 NZTC 11,034 at [44].

[8] *Case W4* at [60]; *Case 9/2014* (2014) 26 NZTC 2-019 at [88].

[9] *Case W4*; *Re Carlaw and FCT* 95 ATC 2166 (AAT); *Re Sparks and FCT* [2000] AATA 28 and see also *Pech v Tilgals* [1994] ATC 4206.

[10] The shortfall penalty for not taking reasonable care is considered in the Interpretation Statement: Shortfall penalty for not taking reasonable care as published in *Tax Information Bulletin* Vol 17, No 9 (November 2005).

- The taxpayer has not taken reasonable care in taking the taxpayer's tax position:[11]
    - The test of "reasonable care" is whether a reasonable person in the taxpayer's circumstances would have foreseen a tax shortfall as a reasonable probability. It is not a question of whether the taxpayer actually foresaw the probability.
    - Taking reasonable care includes exercising reasonable diligence to determine the correctness of a return. It also includes keeping adequate books and records to properly substantiate a return and generally making a reasonable attempt to comply with the tax law.
    - The "reasonable care" test does not require the commitment of unlimited time and money or other resources. The effort required of the taxpayer is commensurate with the reasonable person in the taxpayer's circumstances.[12]

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

Application

31. TCO concluded that the Taxpayer was liable for shortfall penalties for gross carelessness because:
    - The Taxpayer took tax positions that were not correct.
    - It was likely that there was resulting tax shortfalls in all the taxable periods in dispute.
    - The Taxpayer was grossly careless when it took its tax positions. A reasonable person in the Taxpayer's position would have:
        - Known tax invoices were required and foreseen the risk of tax shortfalls if input tax deductions were claimed without them. By claiming input tax deductions without the required tax invoices, the Taxpayer showed a high level of disregard for the consequences.
        - Appreciated there was an insufficient nexus between goods and services acquired in connection with clients removed from the Companies Register when it worked on their matters and the making of any taxable supplies (given the companies did not exist and the likelihood of the removed

[11] *Case W4* (2003) 21 NZTC 11,034.

[12] See also *Case W3* (2003) 21 NZTC 11,014 and *TRA 007/12* [2014] NZTRA 08, (2014) 26 NZTC 2-018.

companies being restored to the register was remote) and foreseen the risk of tax shortfalls if input tax deductions were claimed.

- Known that the supply of accommodation in any dwelling is an exempt supply and foreseen the risk of tax shortfalls if all the input tax charged on the goods and services provided to it in connection with the leased property was deducted without excluding any amount for the residential use.
- Foreseen the risk of a tax shortfall where the available documentary evidence recorded the amount it received as consideration for a taxable supply and not a loan repayment.

32. The requirements for shortfall penalties for not taking reasonable care were also met. However, shortfall penalties for gross carelessness should be imposed because they are the higher penalty.

Issue 4 | Take tuawhā: Time bar

33. All statutory references for this issue to the TAA unless otherwise stated.

34. The issue concerns whether s 108A prohibited the Commissioner from increasing the assessment for the Taxpayer's September 2018 GST period (September Period).

35. The Taxpayer argued that the September Period became time barred on 31 October 2022 because the due date for payment of tax owing for the period occurred on 28 October 2018.

36. CCS argued that the time bar applied from 31 March 2023 because that was the day that was four years from the end of the GST return period in which the Taxpayer provided its return for the September Period.

37. TCO analysed the law as laid out by s 108A and concluded:

- A GST assessment becomes time barred when four years have passed from the end of the GST return period in which a return for the assessed period was provided.
- The GST return period will be the "taxable period" the day the return was provided falls into.
- A registered person's taxable period is determined by reference to the frequency with which the person files returns under s 15(1) (either monthly, bi-monthly or 6-monthly) and each such period will end on the last day of a month.

- Tax payable for a taxable period must be paid on the 28th day of the month following the end of the taxable period, provided the following month is not December or January. If the following month is December, tax must be paid no later than 15 January and if the month following is April, tax must be paid no later than 7 May.

38. Based on this, TCO concluded that the Commissioner was not time barred from amending the Taxpayer's GST assessment for the taxable period ended 30 September 2018 because:

- Under s 108A(1) of the TAA the Commissioner is prohibited from increasing an assessment if four years have passed from the end of "the GST return period" in which a return for the assessed period is provided.
- The Taxpayer filed a return for the taxable period ended 30 September 2018 on 18 October 2018, in the GST return period ended 31 March 2019.
- The taxable period ended 30 September 2018 becomes time-barred when 4 years have passed from 31 March 2019 (the end of the GST return period); that is, from 1 April 2023.