Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

Income tax and GST deductions

Decision date | Rā o te Whakatau: 3 May 2024

Issue date | Rā Tuku: 15 October 2024

TDS 24/19

DISCLAIMER | Kupu Whakatūpato

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

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

For more information refer to the Technical decision summaries guidelines.

Subjects | Kaupapa

Residency; income tax deductions; GST input tax deductions; shortfall penalties

Taxation laws | Ture tāke

The applicable legislation is noted at the start of each issue.

Summary of facts | Whakarāpopoto o Meka

1. The Taxpayer arrived in New Zealand in October 2020 and registered for GST. The Taxpayer left New Zealand permanently in January 2022.
2. The Taxpayer did not file their GST return for the period ended 30 November 2021 by the due date and a default assessment was issued. The Taxpayer subsequently filed the outstanding GST return in March 2022.
3. The Taxpayer also did not file their GST return for the period ended 31 May 2022 by the due date and a default assessment was issued.
4. The Taxpayer filed an income tax return for the year ended 31 March 2022 in April 2022.
5. Following an audit of the Taxpayer, Customer Compliance Services, Inland Revenue (CCS) issued a Notice of Proposed Adjustment (NOPA) proposing to:
    - disallow all GST expenses claimed in the November 2021 GST return and include additional income in the default assessment for the May 2022 GST return;
    - impose shortfall penalties for gross carelessness for the November 2021 GST return and the May 2022 GST return;
    - disallow all expenses claimed in the income tax return for the year ended 31 March 2022, which were incurred after the Taxpayer left New Zealand; and
    - impose a shortfall penalty for not taking reasonable care for the tax shortfall resulting from the filing of the 2022 income tax return.
6. The Taxpayer emailed CCS rejecting the NOPA. CCS advised the Taxpayer that their email did not meet the requirements of a valid Notice of Response (NOR).
7. CCS issued a Statement of Position and the Taxpayer responded with their Statement of Position and the matter was referred to the Tax Counsel Office, Inland Revenue (TCO) for adjudication.

Issues | Take

8. The main issues considered in this dispute were:

- When was the Taxpayer resident in New Zealand
- Whether the Taxpayer was entitled to income tax deductions as a non-resident.
- Whether the Taxpayer was entitled to GST input tax deductions for the November 2021 period.
- Whether shortfall penalties for gross carelessness, reduced by 50% for previous compliant behaviour, applied to the tax positions taken by the Taxpayer in filing the GST return for the period ended 30 November 2021 and for not filing the GST return for the period ended 31 May 2022. Alternatively, did shortfall penalties for not taking reasonable care apply to those periods.
- Whether shortfall penalties for not taking reasonable care, reduced by 50% for previous compliant behaviour, apply to the tax position taken by the Taxpayer in filing their 2022 income tax return.

9. There were also preliminary issues concerning, firstly, which GST assessments were in dispute and, secondly, whether the Taxpayer's NOR was valid.

Decisions | Whakatau

10. TCO concluded that:

- The Taxpayer was resident in New Zealand until the date of departure from the country in January 2022.
- The Taxpayer was not entitled to deduct expenses incurred outside New Zealand from the date of departure from the country in January 2022 to 31 March 2022 for the income year ended 31 March 2022.
- The Taxpayer was not entitled to input tax deductions for the GST period ended 30 November 2021.
- The Taxpayer was liable for shortfall penalties for gross carelessness for tax positions taken in relation to both GST periods in dispute, reduced by 50% under s 141FB of the TAA for previous compliant behaviour.
- The Taxpayer was not liable for a shortfall penalty for not taking reasonable care in respect of the tax shortfall for the income year ended 31 March 2022.

Reasons for decisions | Pūnga o ngā whakatau

Preliminary Issue 1 | Take tōmua tuatahi: Which GST assessments were in dispute

11. The Taxpayer did not file their GST return for the period ended 30 November 2021 by the due date and a default assessment was issued. Subsequently the Taxpayer filed the GST return for the period ended 30 November 2021 in March 2022.

12. CCS issued a NOPA in respect of the GST period ended 30 November 2021 proposing to disallow the GST input tax deductions claimed in the return. The NOPA started the disputes resolution process, and the November 2021 GST period was part of the dispute.

13. The Taxpayer did not file the GST return for the period ended 31 May 2022. A default assessment was issued in respect of this period. To start a dispute in a period where a default assessment has been issued by the Commissioner, a taxpayer must file the applicable return and also issue a NOPA in accordance with s 89D(2) of the Tax Administration Act 1994. The Taxpayer did not file the GST return for the period ended 31 May 2022 or issue a NOPA. Therefore, they cannot dispute or challenge the default assessment for the period ended 31 May 2022. The GST return for the period ended 31 May 2022 was not part of the dispute.

Preliminary Issue 2 | Take tōmua tuarua: Was the NOR valid

14. TCO considered that the Taxpayer's email rejecting the NOPA was not a valid NOR as it did not meet the requirements of s 89G(2) of the Tax Administration Act 1994 (TAA 1994).

15. However, whether the Taxpayer's email is a valid NOR is a matter for the Taxation Review Authority (TRA) or a court to decide.[1] If the TRA or a court finds that the Taxpayer's rejection email is an invalid NOR, the Taxpayer is deemed to have accepted CCS's proposed adjustments.

[1] *CIR v Alam and Begum* [2009] NZCA 273, (2009) 24 NZTC 23,564; *Riccarton Construction Limited v CIR* (2010) 24 NZTC 24,191 (HC) at 24,202.

Issue 1 | Take tuatahi: When was the Taxpayer resident in New Zealand

16. All references in this part of the summary are to the Income Tax Act 2007 (ITA 2007) unless otherwise stated.

The residency provisions in ITA 2007

17. Section YD 1(2) provides that a person is resident in New Zealand for tax purposes if they have a permanent place of abode (PPOA) in New Zealand. This applies regardless of whether the person also has a PPOA somewhere else or is absent for 325 days. The PPOA test is the overriding residency rule for individuals in New Zealand.

18. Where a person does not have a PPOA in New Zealand the relevant tests are set out in ss YD 1(3), (4), (5), (6) and (8).

19. Under s YD 1(3) and (4) a natural person is a New Zealand resident if they are personally present in New Zealand for more than 183 days in a 12-month period (183-day test). The person is treated as resident from the first of the 183 days.

20. When a person is only resident under the 183-day test they are treated as not resident if they are personally absent from New Zealand for more than 325 days in total in a 12-month period under s YD 1(5). Section YD 1(6) treats the person as not resident from the first of the 325 days.

21. When a person is present in New Zealand for part of a day, such as the day of arrival or departure from New Zealand, they are treated as being present in New Zealand for the entire day pursuant to s YD 1(8).

When did the Taxpayer become a New Zealand resident

22. The Taxpayer did not have a PPOA in New Zealand after they left the country in January 2022. On that basis PPOA was not considered in detail by TCO.

23. The evidence showed that the Taxpayer was personally present in New Zealand more than 183 days after they arrived in New Zealand in October 2020. Therefore, they were resident from the day they arrived in New Zealand under ss YD 1(3), (4) and (8).

24. The Taxpayer left New Zealand in January 2022. New Zealand Customs information showed that the Taxpayer did not return to New Zealand within the 325-day period.

25. Therefore, the Taxpayer was not tax resident in New Zealand from the day after departure in January 2022 and was absent from New Zealand for more than 325 days. Sections YD 1(5), (6) and (8) apply.

Issue 2 | Take tuarua: Was the Taxpayer entitled to income tax deductions as a non-resident?

26. All references in this part of the summary are to the Income Tax Act 2007 unless otherwise stated.

27. Under s DA 1(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 incurred by them in deriving their assessable income.

28. Under s BD 1(5) "assessable income" does not include "non-residents' foreign-sourced income".

29. For income to be "non-residents' foreign-sourced income" of a person the following requirements must be satisfied (s BD 1(4)):

    - The income must be a foreign-sourced amount.
    - The person must be a non-resident when the income is derived.

30. The Taxpayer in their 2022 income tax return claimed expenditure or losses from an online trading platform incurred after the date that they ceased to be a New Zealand tax resident.

31. The online trading platform was run by an overseas company. Once the Taxpayer ceased to be a New Zealand tax resident, income from the overseas company would be classed as non-residents' foreign-sourced income and that would not be assessable income under s BD 1(4). In addition, none of the source rules in s YD 4 applied to make the income derived (or losses sustained) after the Taxpayer ceased being a New Zealand tax resident have a source in New Zealand.

32. It followed then that any expenditure incurred in deriving non-residents' foreign-sourced income cannot meet the general permission under s DA 1 because there was no nexus with the derivation of assessable income. Further, there is a specific limitation under s DA 2(6) that prohibits a deduction for expenditure or loss incurred in deriving non-residents' foreign-sourced income.

33. Therefore, the deductions for expenditure after the date that the Taxpayer ceased to be a New Zealand tax resident should be denied in the income year ended 31 March 2022 because they were incurred in deriving non-residents' foreign-sourced income.

Issue 3 | Take tuatoru: Whether the Taxpayer was entitled to GST input tax deductions for the November 2021 period.

34. All references in this part of the summary are to the Goods and Services Tax Act 1985 (GSTA) unless otherwise specified.

35. To claim GST input tax deductions:

- A person must be GST registered and carrying on a taxable activity.
- The goods and services must have been used for, or available for use in, making taxable supplies.
- Tax invoice requirements must have been met.

36. These requirements are cumulative; to deduct input tax all of them must be met. They are strict requirements.

37. The registered person must hold a tax invoice to claim GST paid on supplies acquired unless the amount of the consideration for the supplies is $50 or less under s 24(5).

38. Even if the other statutory requirements for a deduction from output tax are satisfied, the Commissioner may deny an input tax deduction if the associated tax invoice, debit note, or credit note is not retained (proviso to s 20(2) in accordance with s 75).

39. In addition, s 149A of the TAA 1994 places the onus of proof on the taxpayer and not the Commissioner. Case law confirms this approach.[2] The onus is on the taxpayer to show that an assessment is wrong and why it is wrong.

40. The courts have also held that the standard of proof needed is the balance of probabilities.[3]

41. The Taxpayer did not have tax invoices which were required for an input tax deduction or copies of the relevant invoices or any factual evidence about what made up the claim for purchases or even whether an amount was incurred. The Taxpayer stated that the relevant records were lost. The Taxpayer had not made any attempt obtain copies of the tax invoices, or to provide the GST workings which were prepared after departure from New Zealand.

[2] *Case V17* (2002) 20 NZTC 10,192; *Accent Management Ltd v CIR* (2005) 22 NZTC 19,027 (HC); *Vinelight Nominees Ltd v CIR* (No 2) (2005) 22 NZTC 19,519 (HC).

[3] *Yew v CIR* (1984) 6 NZTC 61,710 (CA); *Case Y3* (2007) 23 NZTC 13,028; *Case X16* (2005) 22 NZTC 12,216.

42. There was no evidence that any of the purchases were for $50 or less but, even if they were, the required information was not provided or held to enable an input tax deduction. The Commissioner can, in rare circumstances, exercise his discretion that a tax invoice was not required if there was sufficient evidence to establish an audit trail under s 24(6)(b). That evidence did not exist in the dispute and the Commissioner did not exercise his discretion before the GST return was filed. Given the lack of tax invoices and lack of evidence about the expenses the Taxpayer was not entitled to input tax deductions.

43. Therefore, it was concluded that the Taxpayer was not entitled to any input tax deductions in respect of the GST return period ended 30 November 2021.

Issue 4 | Take tuawhā: Shortfall penalty for gross carelessness

44. All references in this part of the summary are to the Tax Administration Act 1994 (TAA) unless otherwise stated.

45. Section 141C imposes a shortfall penalty for gross carelessness on a taxpayer if the following requirements are satisfied:[4]

- 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 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.[5]
- 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.[6]

[4] 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).

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

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

- A person who takes reasonable care is not grossly careless.[7]

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

47. TCO concluded that a reasonable person in the Taxpayer's position would have foreseen the risk of a tax shortfall by claiming the input tax deductions in their GST return for the GST period ended 30 November 2021 because:

- The law was relatively straightforward that tax invoices were needed. The Taxpayer was also given advice by CCS when they registered for GST that expenses on meals and home to work travel were personal and not claimable.
- Given the misplaced tax invoices, it appears the Taxpayer filed their GST return with very limited information as to their expenses. There had not been any attempt to cross check with their bank statements or to obtain replacement tax invoices. In addition, the Taxpayer had received guidance from Inland Revenue about claiming expenses. It was considered that the Taxpayer showed a complete disregard for the consequences of making input tax claims without sufficient records or connection to making of taxable supplies and was grossly careless.
- The Taxpayer was also liable for not taking reasonable care under s 141A for the same reasons. However, the higher penalty for gross carelessness applied, reduced by 50% for previously compliant behaviour (ss 141C, 141FB and 149).

48. In respect of the GST return for the period ended 31 May 2022 TCO concluded that a reasonable person in the Taxpayer's position would have foreseen the risk of a tax shortfall arising as a result of not filing the return because:

- The value of supplies made by the Taxpayer during the period was sufficiently large to be material. The Taxpayer would have been aware that they received payments for consulting services. These payments were subject to GST but no return containing the output tax had been filed.
- The law was not complicated. The Taxpayer had been contacted shortly after they registered for GST and had been informed of their GST obligations. The GST return was never filed despite repeated reminders from Inland Revenue. The Taxpayer had ample opportunity to find tax invoices or get copies, but this did not occur.

[7] *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.

- The Taxpayer would also be liable for not taking reasonable care under for the same reasons. However, the higher penalty for gross carelessness applied, reduced by 50% for previously compliant behaviour.

Issue 5 | Take tuarima: Shortfall penalty for not taking reasonable care

49. All references in this part of the summary are to the Tax Administration Act 1994 unless otherwise stated.

50. Section 141A imposes a shortfall penalty for not taking reasonable care on a taxpayer if the following requirements are satisfied:[8]

- The taxpayer has taken a tax position.
- Taking the tax position has resulted in a tax shortfall.
- The taxpayer has not taken reasonable care in taking the taxpayer's tax position:[9]
  - 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.[10]

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

[8] 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).

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

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

52. TCO concluded that the Taxpayer took reasonable care in taking their tax position in respect of the 2022 income year because:

- They took steps that a reasonable person in their circumstances would have taken to confirm their residence status at the time they filed their income tax return for the period ended 31 March 2022 because they consulted Inland Revenue's published guidance.
- It appeared that the Taxpayer did not appreciate that once 325 days had elapsed, they would be retrospectively treated as a non-resident from the day after they left New Zealand.
- The losses were actually incurred and supported by evidence from the online trading platform they were using.