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The Principal Purpose Test for the GST Input Tax: Is a Wide Interpretation Justified?

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In CIR v Trustees in the Mangaheia Trust, the High Court adopted the most generous possible interpretation of the principal purpose test for the GST input tax. While the statute requires purchases to relate to "the making of taxable supplies", Gendall J relaxed that requirement in order to allow input tax for purchases that merely relate to the taxpayer's taxable activity. If correct, this reasoning would permit input tax claims that were not previously thought to be deductible. This article examines previous decisions on the scope and application of the principal purpose test, and compares the requirements for deduction of the GST input tax with those of the equivalent provision in the Australian GST regime and the General Permission in s DA 1Income Tax Act 2007. This comparison demonstrates that not all supplies made by a taxpayer are subject to GST and not all expenditure relating to that taxable activity can be claimed as an input tax credit. Accordingly, the wide interpretation of principal purpose adopted in Mangaheia Trust must be doubted.

1.0 INTRODUCTION

In its first decision for more than a decade to consider the principal purpose test, the High Court applied the widest and most generous possible interpretation of when taxpayers may deduct the GST input tax. In *CIR v Trustees in the Mangaheia Trust and Trustees in the Te Mata Property*, Gendall J held that input tax could be claimed on legal fees paid by trustees defending allegations of mal-administration by beneficiaries. While it was acknowledged that those fees would not lead to any specific taxable supplies, the Court found that "there is no difference between stating that the nexus should be with the 'making of taxable supplies' or with the 'taxable activity' per se."

On that reasoning, virtually any expenditure relating to a taxable activity can be deducted for GST, which would have the effect of allowing input tax claims that were not previously thought to be permitted. Unfortunately, that wide interpretation is not supported by the wording of the statute.

The principal purpose test in s 3AGoods and Services Tax Act 1985 (GSTA 1985) is fundamental to the operation of the GST system. It is the threshold by which GST-registered persons determine what input tax may be claimed. It serves the same function as the General Permission in s DA 1Income Tax Act 2007 (ITA 2007). However, the author submits that there are many significant differences in the operation of the principal purpose test and the General Permission.

[(2010) Vol 16:1 NZJTLP 85, 86] This article examines the scope and application of the principle purpose test and compares it to the requirements for deductibility under the ITA 2007. It discusses previous cases applying the principal purpose test to determine how the test has been applied. Finally, the article considers the policy and reasoning of Gendall J's judgment in *Mangaheia* to determine whether the generous interpretation of principal purpose is correct.

2.0 THE PRINCIPAL PURPOSE TEST

The GSTA 1985 permits a registered person to claim an input tax deduction from output tax only for supplies "acquired for the principal purpose of making taxable supplies". Supplies not acquired for that principal purpose do not meet the definition of "input tax" and, therefore, cannot be claimed.

"Input tax" is defined in s 3A GSTA 1985. It encompasses GST paid on purchases from another registered person, customs GST charged on imports and deemed GST attributed on the purchase of a second-hand good. Whatever the nature of the transaction, the GST input tax may only be claimed as a deduction by a registered person on "goods and services acquired for the principal purpose of making taxable supplies." The onus is therefore on the registered person to establish that each acquisition was for the

principal purpose of making its supplies and not for some other purpose.

The principal purpose test created by the definition of "input tax" in s 3A GSTA 1985 involves two factors. First, what was the purpose or purposes for which the registered person acquired the goods or services? Second, which of those purposes was the principal purpose? The statutory wording suggests that there will be only one principal purpose and, where purposes are mixed, one must prevail.

2.1 How to Determine the Taxpayer's Purpose?

The learned authors of the *New Zealand Goods and Services Tax Guide* state that:

> "'Purpose' means the object or the end which the taxpayer has in mind or view. It is not synonymous with motive or intention."

The author agrees with that interpretation, supported as it is by a large body of case law. "Purpose", in the income tax framework, has been given two different interpretations, depending upon the context:

- **[(2010) Vol 16:1 NZJTLP 85, 87]** In ss CB 4 and CB 6 ITA 2007, regarding personal property or land acquired for the purpose or intention of resale, the Court has adopted a purely subjective interpretation; and
- In s BG 1 ITA 2007, regarding the purpose or effect of a tax avoidance arrangement, the Court has adopted a purely objective interpretation.

However, in *CIR v Haenga* Richardson J allowed for the possibility that "purpose" may have some hybrid meaning between the purely objective or purely subjective interpretations outlined above. His Honour felt that such a meaning might be required where the statutory scheme permits an interpretation other than the two alternatives outlined above:

> "In other statutory settings it may be necessary to adopt an intermediate position between the subjective purposes in the mind of the particular taxpayer concerned on the one hand and the purposes as objectively appearing from his acts or omissions on the other."

The early decisions of the Taxation Review Authority (TRA) interpreting the "input tax" principal purpose test preferred a purely objective test. For instance, in *Case M106* Judge Bathgate concluded that the stricter interpretation of purpose found in anti-avoidance provisions was more in step with the transactional nature of GST.

> "There is a need to attribute a purpose to the acquisition in order to determine whether the value of that supply is deductible, or whether a credit can be given to it under the GST system. The charging and assessment of GST could not, practically, '… hinge on the identification of what was actually in the mind of the particular taxpayer at the time', to determine what output tax is payable and what input tax credit is receivable. … the word 'purpose' in the operation of the Act, and in the particular parts mentioned, is to be given an objective meaning. It is to be determined objectively, from the activities of the taxpayer in relation to the supply of goods and services and the acquisition of goods and services relative to that supply. Input tax receipts should usually bear some sort of relationship to output tax payments."

By referring to the self-enforcing nature of the GSTA 1985, Judge Bathgate asserted that an objective interpretation of purpose was required to ensure that the GSTA 1985 was not subject to the vagaries of individual taxpayers. In effect, Judge Bathgate was attempting to take the definition of "input tax" beyond the personal motives of any individual. This interpretation was specifically endorsed by the **[(2010) Vol 16:1 NZJTLP 85, 88]** High Court in *CIR v Morris*. Likewise, in *Case P5* Judge Barber considered that purpose, in most practical instances, is established by reference to the use to which the supplies acquired were put.

A detailed consideration of the meaning of "purpose" can be found in *CIR v BNZ Investment Advisory Services Ltd*, a case that was

cited in *Mangaheia Trust*. That case concerned whether expenditure by an investment advisor for the dual purpose of deriving income from both taxable and exempt financial supplies could be claimed as input tax. From the evidence, BNZ was deriving approximately 90 percent of its income from its exempt supplies and a mere 10 percent from its taxable supplies. Nevertheless, the company sought to claim all its expenditure on the grounds that all were acquired for the principal purpose of making its taxable supplies.

While much of the decision focused upon questions of fact, the High Court was required to determine whether the taxpayer's stated purpose of undertaking the expenditure to further its taxable supplies could be accepted in the face of such a mismatch in the income derived from that expenditure. Doogue J plumped firmly for a test of purpose viewed in the light of the taxpayer's conduct as a whole. Without expressly favouring any earlier decisions on this point, his Honour pointed out that the taxpayer's purpose should be viewed in light of the end that it seeks to achieve:

> "[The parties] agreed that purpose is the object which the taxpayer has in mind or in view. It is not synonymous with intention or motive."

Having determined the meaning of purpose, Doogue J felt that it was not necessary on the facts to rule on whether that purpose must be determined on an objective or subjective basis. Rather, on the evidence, Doogue J determined what he considered to be the only realistic purpose, which apparently ignored the taxpayer's stated purpose in favour of an objective view of the outcomes of its conduct.

This decision was followed and applied by both the High Court and the Court of Appeal in *Norfolk Apartments Ltd v CIR*. There, a construction firm sought to claim inputs on the purchase of land to be used for the construction of a GST-exempt retirement village. The company claimed that certain operations of the village by the company would attract GST and, therefore, the purchase of land and construction of the village should be seen as giving rise to these post-construction taxable supplies.

The High Court rejected this argument on the facts. Robertson J found that these post-construction supplies were too insignificant to outweigh the fees gained from the GST-exempt supply of the entire retirement complex. While determining that the evidence regarding the taxpayer's subjective purpose **[(2010) Vol 16:1 NZJTLP 85, 89]** must be heard, he gave it little weight. His Honour stated that "on my assessment of the evidence [the taxpayer's stated purpose] flies in the face of reality to argue to the contrary."

Robertson J's decision was upheld by the Court of Appeal. While the appeal focused mainly on the facts regarding the extent of the taxable and exempt supplies made by the construction company, the Court did not interfere with the reasoning of the High Court, which must therefore be presumed to be correct.

By contrast, in *Coveney v CIR*, after considering the evidence as a whole Fraser J found the taxpayer had the necessary principal purpose. This finding was confirmed on appeal.

However, in neither of those cases did the Court of Appeal expressly favour either a subjective or an objective test of a taxpayer's purpose, presumably on the basis that neither extreme is appropriate. Rather, the Court appears to prefer to weigh the purpose asserted by the taxpayer against an objective assessment of the reasonableness of that stated purpose in the light of the surrounding facts. In this way, a hybrid interpretation has been adopted which, while accepting the relevance of the taxpayer's stated purpose, is careful to weigh this evidence against objective factors.

The most commonly quoted passage on what constitutes the taxpayer's principal purpose is the High Court decision in *Wairakei Court Ltd v CIR*. That case contains a full analysis of what it now considers to be "settled" law on this point. There, Chisholm J expressed a clear preference for a mixed test for determining a taxpayer's purpose:

> "Within a GST context the following features of the principal purpose test seem to be relatively well settled:
>
> "(1) Purpose is a reference to the object that the taxpayer had in mind or in view. This is not synonymous with intention or motive. Moreover, care must be taken to avoid confusing the means by which the taxpayer achieves its purpose with the purpose itself: *C of IR v BNZ Investment Advisory Services Limited*(1994) 16 NZTC 11,111; *Norfolk Apartments Limited v C of IR*(1995) 17 NZTC 12,003 (HC) and (1995) 17 NZTC 12,212 (CA).
>
> "(2) The principal purpose is the main, primary or fundamental purpose. This does not equate with a more than 50% test: *BNZ Investment Advisory Services Limited; Norfolk Apartments*.
>
> "(3) Where the taxpayer is a company its purpose is to be determined by examining the collective purpose of those in

control: *C of IR v National Distributors Limited*(1989) 11 NZTC 6,346.

"(4) The principal purpose is to be ascertained as at the time the goods and services were acquired: *National Distributors Limited* and *Case M53*(1990) 12 NZTC 2,312.

"(5) The focus should be on individual supplies: *Norfolk* at p 12,006."

In drawing up this list, Chisholm J appears to have confirmed that the mixed test of purpose should be adopted. Accordingly, a taxpayer's purpose should be determined by comparing their stated purpose **[(2010) Vol 16:1 NZJTLP 85, 90]** against their actions or the outcomes of those actions. As Richardson J stated in *National Distributors Ltd*, a taxpayer's actions speak louder than words.

This hybrid interpretation of purpose seems both reasonable and to conform to the policy of the GSTA 1985. A purely objective test would lead to unnecessary interference in a taxpayer's commercial affairs by measuring the reasonableness of their inputs without regard to the taxpayer's actual motives. Such an interpretation would be contrary to the largely self-regulating nature of the Act.

By contrast, a purely subjective test would be too open for abuse. Unless a taxpayer's stated purpose could be measured against their subsequent actions, the Act would be unreasonably generous. This point was made by the Supreme Court in *Glenharrow Holdings Ltd v CIR* with regard to the interpretation of the general anti-avoidance provision in s 76 GSTA 1985. The Court decided that an objective test of the purpose of the arrangement was warranted in order to prevent a difficult subjective review of the state of mind of the participants:

"[W]hether or not a particular arrangement constitutes tax avoidance should not depend on difficult judgments about what the taxpayer had in mind. If it did, a scheme which was void, if devised and implemented by one taxpayer, could be immune from s 76 if developed by another."

This mixed test of purpose has been favoured by the Commissioner in *Tax Information Bulletin*, Vol 7 No 13 (May 1996). The Departmental policy on the appropriate test of a taxpayer's purpose of acquisition concludes:

"The Commissioner considers that it is a mixed test, ie, it is a subjective test to the extent that it is the taxpayer's purpose that is under examination. However, the objectively ascertainable actions of the taxpayer and other facts surrounding the claim are relevant to see if the stated purpose bears this out in fact."

Unfortunately, even using an objective test, there is still no firm consensus as to how a taxpayer's purpose should be determined. Should it be decided by:

- The manner in which the goods and services are used?
- The financial results achieved by that use?
- The motive of the taxpayer in adopting that use?

Whether purpose can be equated with "use", "application" or "turnover" has proven surprisingly difficult. Rather, different cases appear to adopt each of those alternatives and no clear line of reasoning has emerged. Generally, Courts have adopted a hybrid test of purpose whereby the subjective evidence of the taxpayer is set against an objective analysis of their conduct.

2.2 Measuring a Taxpayer's "Principal" Purpose

In most cases, a taxpayer will have only a single or overwhelming purpose when acquiring goods or services. There will be little need to distinguish between different or competing purposes. However, in **[(2010) Vol 16:1 NZJTLP 85, 91]** some instances, a taxpayer may have conflicting purposes which must be weighed in order to determine which is the principal purpose and, therefore,

measured under the Act.

In contrast to the difficulty in determining how a taxpayer's purpose should be determined, there has been little argument over how to weigh differing purposes to measure which was principal. The first detailed analysis of how different purposes should be weighed was given by Judge Willy in *Case P62*. While that decision was soundly overturned on appeal, his Honour's analysis of how the principal purpose should be determined was not challenged. Judge Willy stated:

> "[A] principal purpose … need [not] be a purpose which is greater than all of the others or in terms of a percentage 50% or more of the total purpose. To the contrary, a taxpayer may have a complex of purposes and the one which is held on the facts to be the principal purpose may simply be the greater among a number. It is in my view not helpful to endeavour to express the extent to which it was greater as a percentage. All that is necessary is for the Court to make the finding of fact that the particular purpose at issue was the 'principal purpose'."

This helpful analysis was generally adopted in the High Court by Doogue J. There the parties sought to express their own interpretations of "principal": the Commissioner arguing for "main or primary or fundamental purpose", while the taxpayer argued for "more than half":

> "So far as the word 'principal' is concerned, there was a difference in approach between the parties, although in the context of this case little probably turns upon it. The Commissioner approached the meaning of that term in the context of such cases as *C of IR v Mitchell*(1986) 8 NZTC 5,181 and *General Motors New Zealand Ltd v Taylor*(1983) 6 NZTC 61,880 and submitted that the word 'principal' should be interpreted as 'main or primary or fundamental purpose'. The taxpayer does not take issue with that approach but had submitted to the TRA and in this Court that the meaning of 'principal' was 'more than half'. The TRA had not adopted that approach, and I do not think it appropriate to do so. I prefer to adopt the approach put to me by the Commissioner that the word 'principal' should be interpreted as main or primary or fundamental purpose."

This conclusion was adopted by Robertson J in *Norfolk Apartments Ltd* and also later by Chisholm J in *Wairakei Court Ltd*. This interpretation is undoubtedly correct. While not necessarily dominant (in the sense of being greater than all others combined), the principal purpose must be the main or primary purpose, larger than any single other. This approach allows the Court to measure individual purposes against each other to determine which is more influential. It does not require the Court to weigh a single purpose against combined alternatives or to provide artificial percentages to these competing purposes. It must simply determine which is the most significant of all competing purposes.

2.3 [(2010) Vol 16:1 NZJTLP 85, 92] Timing – When is the Principal Purpose Test Measured?

A taxpayer may have two competing purposes, one of which is immediate, the other is long-term. Which of those purposes is the principal purpose? The answer may easily change depending upon whether the test is applied to the immediate or long-term purpose.

This temporal issue has generally been addressed only in passing. In *BNZ Investment Advisory Services Ltd*, Doogue J expressly declined to be drawn into a discussion on when the principal purpose must be determined:

> "I have been invited on behalf of the Commissioner to look at other aspects of the case such as the nature of the services supplied by the taxpayer, whether the Act has a short term or long term direction, and the imbalance between the input tax and the output tax of the taxpayer if the TRA's decision is upheld. I do not find it necessary to traverse those aspects of the Commissioner's argument. In particular, I do not find it helpful to try to analyse the Act as one having short term or long term consequences."

In *Norfolk Apartments Ltd v CIR*, Robertson J addressed the issue briefly. Having ruled that the taxpayer did not, at the time they acquired the goods in question, have the principal purpose of making taxable supplies, his Honour rejected as a question of fact that the taxpayer's purpose may have subsequently changed. However, in doing so, Robertson J appears to have ruled that the time for determining a taxpayer's purpose was solely at the time of acquisition. Any subsequent change in purpose would not be considered under s 3A GSTA 1985 but must be addressed under the adjustment provisions in ss 21 to 21G GSTA 1985.

This interpretation was endorsed by Chisholm J in *Wairakei*. However, in reaching the decision in that case, Chisholm J discussed at some length the possibility that a taxpayer's principal purpose may take some time to be achieved:

> "… there could be dangers and an element of unreality in attempting to apply a test involving a relatively rigid temporal cut-off point, especially in situations where an ultimate purpose depends on a series of interwoven factors. My conclusion is that when determining the principal purpose it is necessary to make an overall evaluation of all relevant purposes. While the evaluation needs to be made on the basis that the principal purpose is to be ascertained at the time the goods and services were acquired, this does not mean that purposes which will not be fulfilled until some time in the future should be automatically ruled out. In some cases it may be possible to achieve the principal purpose within the taxation period under consideration while in other cases achievement of the principal purpose may be much more distant in time. Each case will depend on its own facts."

Despite this reasoning, Chisholm J accepted that the time for measuring the purpose (even if only later achieved) was at the time of acquisition. This conclusion appears correct in light of both the wording of the section and the scheme of the Act. Section 3A GSTA 1985 requires the goods and services to be "acquired for the principal purpose of making taxable supplies". Reference to the purpose of the taxpayer relating to the acquisition of the goods or services implies that the time at which that purpose will be measured is the time at which the goods are acquired. The acquisition and purpose should be measured together, in the same taxable period. Later changes in purpose would not fall within s 3A GSTA 1985.

[(2010) Vol 16:1 NZJTLP 85, 93] This interpretation is reinforced by the wide application of the timing provision in s 9(1) GSTA 1985, which determines when a supply takes place under the Act. Presumably this provision, which applies to determine when an input credit is available to the taxpayer, must also crystallise the taxpayer's purpose at that time.

Under the scheme of the Act, if a taxpayer's principal purpose was other than making taxable supplies at the time of acquisition, no input credit is available. However, if that purpose later changes, the statute provides an input credit by way of a subsequent deemed supply of those goods or services. While the adjustment provisions expressly provide for changes in "application", they must invariable apply to instances when the taxpayers changed purpose is eventually realised by the subsequent application of those goods or services to making taxable supplies – as was the taxpayer's original (although long-term) intention.

3.0 COMPARISON WITH THE INCOME TAX

From a review of the above cases, it is apparent that not all input tax paid by a registered person may be claimed for GST purposes. As noted by Judge Bathgate in *Case N27*, it is not mere registration that entitles a taxpayer to input tax. Rather, only tax paid on goods and services acquired for the principal purpose of making taxable supplies may be claimed.

In this way, the principal purpose test mirrors the General Permission in s DA 1 ITA 2007. However, there are some crucial differences between the two provisions.

First, the general permission incorporates two limbs of deduction, permitting deductibility for expenses incurred both for:

- Deriving assessable income, and
- Carrying on a business for the purpose of deriving assessable income.

The difference in meaning between the two limbs was addressed in *New Zealand Co-operative Dairy Company Ltd v CIR (No 2)*. There, a large trading company held valuable property assets from which it derived little income. The Commissioner alleged that the expenditure incurred in holding the property arose not for the purpose of deriving income but because of the expectation of substantial capital gains from the eventual sale.

The High Court considered that a distinction had to be made between the two limbs of deductibility, and that expenses may be incurred in running a business that do not generate any income. On that basis, the High Court concluded that none of the expenditure met the requirement for deductibility under the first limb. However, it found that the expenses were generally deductible under the second limb for the years in which the property was integrated into the company's business.

The Court of Appeal confirmed the distinction in the scope and application of the two limbs of deductibility. It agreed that the expenses did not generate any assessable income and, therefore, failed to meet the requirement for deductibility under the first limb. Nevertheless, the Court concluded that **[(2010) Vol 16:1 NZJTLP 85, 94]** the expenses were incurred as part of the company's wider business operations and, therefore, were fully deductible in all the years under the second limb.

This distinction may have little practical effect for income tax but has important implications for GST. The principal purpose test permits deduction of input tax only for input tax incurred in "making taxable supplies": the equivalent of "deriving assessable income". The principal purpose test has no second limb permitting deduction of input tax incurred in carrying on a taxable activity. Accordingly, the distinction between the two limbs drawn in *New Zealand Co-operative Dairy Company* provides guidance as to how the single ground for GST input tax should be interpreted.

Second, s DA 1 ITA 2007 has been interpreted to require a nexus between the item of expenditure and the income derived or business operated by the taxpayer. This interpretation requires the taxpayer to establish the nexus as a question of fact.

The standard required for deductibility of income tax expenditure was almost definitively prescribed in *Banks v CIR*. There, the Court of Appeal found that expenses incurred by a taxpayer need to have "the necessary relationship, both with the taxpayer concerned and with the gaining or producing of assessable income". When determining whether the expenditure has the required nexus, Richardson J stated:

> "It then becomes a matter of degree, and so a question of fact, to determine whether there is a sufficient relationship between the expenditure and what it provided, or sought to provide, on the one hand, and the income earning process, on the other, to fall within the words of the section."

The onus is on the taxpayer to establish the required nexus between an expense and the income being derived. However, taxpayers are not required to prove that such a link was the principal purpose of the expenditure, as is required for deductibility of input tax for GST. The situation is quite the contrary. It is common in the income tax for expenditure with a non-principal business purpose to still be fully or partially deductible for income tax purposes.

By contrast, the definition of "input tax" in s 3A GSTA 1985 requires the expense to be the taxpayer's principal purpose. While deduction for income tax need only have some relationship with the taxpayer's income or business, input tax for GST requires a principal relationship with the taxpayer's own taxable supplies. Presumably, the degree of nexus required for GST is therefore greater.

One explanation for the lower standard for deductibility applying to income tax expenditure is the explicit apportionment of expenditure. Section BD 2(1) ITA 1994 allowed the deduction of expenditure " **[(2010) Vol 16:1 NZJTLP 85, 95]** to the extent to which" it was incurred to produce income or run a business. This treatment was made explicit by Richardson J in *Banks*:

> "The second feature of [s BD 2(1) ITA 1994] is that, as has already been noted, the statutory language expressly contemplates apportionment. A deduction is allowed to the extent that the statutory standard of deductibility is met. Furthermore, this is not restricted to expenditure which can be dissected with distinct and severable parts being directly referable to the production of assessable income. It extends to outgoings not capable of such dissection but which service both income earning and other purposes indifferently (*Ronpibon Tin NL v FCT*(1949) 78 CLR 47)."

The ability to apportion expenditure, thereby allowing split purposes to be recognised in the extent of deduction allowed, is precisely what is not permitted under the GSTA 1985. Instead, s 3A GSTA 1985 imposes a single standard against which each acquisition of goods and services will be tested. If goods and services meet that standard, then input tax paid for their acquisition is expressly deductible in full, without further apportionment. Correspondingly, if the goods or services do not meet that standard, input tax cannot be claimed.

But the most significant difference between the test for input tax under GST and deductions for income tax is that the GST regime contains no equivalent of the General Limitation in s DA 2 ITA 2007. The effect of the General Limitation is to prohibit deduction of expenses that, while meeting the nexus test for deductibility under s DA 1 ITA 2007, are nevertheless excluded on some other ground.

Given the absence of a capital / revenue boundary under the GST regime, there is obviously no need for a limitation on claiming input tax on that ground. Likewise, the principal purpose test itself stipulates that the input tax must relate to making taxable

supplies, thereby excluding exempt supplies in a similar manner to the prohibition on deducting expenses incurred in gaining exempt income.

Yet, there is no equivalent provision in GST excluding input tax incurred on private and domestic expenditure. Obviously, supplies acquired principally for that private purpose will not meet the statutory test. But, as with income tax, many expenses have both a commercial and private purpose. For income tax, such expenses meet the nexus test under s DA 1 ITA 2007 but may nevertheless be completely prohibited from deduction under s DA 2 ITA 2007, or apportioned to recognise the different purposes.

A leading application of this limitation is found in the House of Lords decision in *Mallalieu v Drummond*. There, a business suit purchased by a barrister for work purposes had the required nexus to earning assessable income but was nevertheless denied a deduction on the grounds that the income-earning purpose was secondary to the basic private need for clothing.

It is important that, but for the statutory exclusion for private or domestic expenditure, the cost of the clothing would have been fully deductible. On that basis, the author argues that the purchase of business attire would meet the principal purpose test – and absent the specific limitation on claiming / apportioning private and domestic purposes in the GST regime, could not be precluded on that ground. **[(2010) Vol 16:1 NZJTLP 85, 96]** While any private use of that business clothing would give rise to a change of use adjustment, the purchase price of that clothing would appear to be deductible under the principal purpose test.

This omission has been addressed under the equivalent Australian provision, which expressly excludes purchases by a registered person "to the extent that the acquisition is of a private or domestic nature". This additional exclusion has been explained by one leading commentator as follows:

> "It has been suggested that the second negative limb relating to acquisitions of a private or domestic nature is redundant because such acquisitions by their very nature are not acquired in carrying on an enterprise. However, the Commissioner finds the limb useful as extra grounds for the denial of input tax credits for these acquisitions."

The absence of an equivalent exclusion in the New Zealand GSTA 1985 must therefore leave the possibility that items normally excluded as private and domestic might otherwise give rise to an input tax credit. Interestingly, few commentators have recognised this omission. For instance, in a recent article approving of the *Mangaheia* decision, one commentator reasoned:

> "What was probably underlying the appeal by Inland Revenue was the fact that the Taxation Review Authority Judge did not acknowledge that the 'filtering' is really in relation to three, not two, possible uses of acquired goods and services. The first is to make taxable supplies. The second is to make exempt supplies and the third is for private use. The latter two purposes are not sufficient to permit an input tax deduction."

However, that analysis overlooks the fact that there is no express limitation in the GSTA 1985 regarding private use.

4.0 PURPOSE MUST RELATE TO MAKING TAXABLE SUPPLIES

It is significant that the cost of goods or services is only deductible if it relates to the making of taxable supplies, rather than merely the conducting of a taxable activity. This wording was presumably adopted to require a more narrow focus to what may be claimed than might otherwise have applied.

Interestingly, the original Government White Paper proposing the introduction of GST adopted a more relaxed test for input tax whereby goods and services needed only to be acquired "for the purposes of carrying on a taxable activity". But this wider wording was not carried over into the final Act. It must therefore be presumed that Parliament deliberately chose the narrower test requiring a nexus to the making of taxable supplies.

By contrast, Division 11-15 of Australia's A New Tax System (Goods and Services Tax) Act 1999 permits an input tax credit for purchases "to the extent that you acquire it in carrying on your enterprise". Accordingly, unlike s 3A of the New Zealand legislation, it does not require a nexus with the making of taxable supplies by that enterprise.

The narrow New Zealand wording highlights many instances when inputs relate to the operation of a taxable activity but do not directly result in the making of taxable supplies. Such an instance arose in *Case Q43*. There, a company was registered for GST as a property developer. The company's **[(2010) Vol 16:1 NZJTLP 85, 97]** finances foundered and it was placed into receivership. The

receiver realised all the company's assets. During the course of the receivership, the company engaged a barrister to defend certain criminal actions brought by Inland Revenue arising from the earlier fraudulent returns filed by the company. The GST component of the barrister's fee was claimed by the company as input tax.

The TRA found that the barrister's fee did not relate to the making by the company of taxable supplies, as required by the definition of "input tax". The TRA accepted that the receiver had taken over the company's taxable activity and that engaging the barrister was necessary for the purpose of winding up that activity. It also accepted that the winding up of the taxable activity was deemed by s 6(2) GSTA 1985 to be conducted in the course of that activity. However, that alone did not give rise to an input credit.

The services provided by the barrister had to result in the making of taxable supplies in order to come within the section. As the company's activities had already ceased and no further supplies were possible, the services did not meet the statutory criteria. As such, the fees could not give rise to an input tax deduction. Judge Barber in *Case Q43* observed:

> "Due to sec 6(2) the receivership seems to be a part of the objector's taxable activity. A taxable supply is a supply by a registered person in the course or furtherance of a taxable activity. However, the issue here is whether the barrister's fee was for services acquired by the objector for the principal purpose of making taxable supplies. That is the criterion of the definition of 'input tax' "

Applying that reasoning to the facts, his Honour stated:

> "… there does not seem to have been any relationship between the barrister's fee and any future supplies by the objector. … The barrister's fee is not linked to any future supply by the objector …
> "I regard the expenditure on the barrister's fee as being properly in the course of the objector's taxable activity. However, the issue in this case is whether it was expended (or whether the service of the barrister was acquired) for the principal purpose of making taxable supplies. I find that it was not."

While the facts in that case were described by Judge Barber as "rather unique", the principle upon which it is based is more wide-reaching. As one leading commentator has explained:

> "Overhead and general administrative expenses usually do not relate to a specific output. Whether they meet the 'principal purpose' test is usually to be measured by the turnover of the relevant entity."

There may be many instances where input tax deductions are claimed for goods or services that readily form part of the taxable activity but that do not in themselves assist with the making of taxable supplies. Examples include:

- Light refreshments provided to staff during their work-breaks;
- Pot plants and decoration of a head office building from which no supplies are made directly to the public; and
- **[(2010) Vol 16:1 NZJTLP 85, 98]** Overhead costs for holding annual shareholder meetings.

If interpreted strictly, the requirement for a connection between inputs and the making of taxable supplies could greatly restrict the scope of allowable input deductions.

5.0 THE *MANGAHEIA TRUST* CASE

Mangaheia Trust involved two trusts for members of an extended family. One trust carried on the taxable activity of commercial property development and the other carried on the taxable activity of farming.

Sadly, a dispute arose between different branches of the family regarding the administration of the two trusts. Some of the beneficiaries alleged mismanagement of trust assets and sought removal of the current trustees. Lengthy litigation resulted, during which the trusts incurred substantial legal costs, which were ultimately indemnified from trust assets. The Mangaheia Trust claimed the GST component of the legal fees as input tax. The TRA upheld that claim in *Case Z12* and the Commissioner appealed.

The issue before the High Court was whether the legal fees were incurred for the principal purpose of making taxable supplies, as required under s 3A(1)(a) GSTA 1985. The Commissioner contended that the legal services were obtained for the purpose of defending claims by beneficiaries personally against the trustees, which was unrelated to the taxable activities being carried on by the trusts. As those fees did not relate to the making of taxable supplies, the trusts were not entitled to an input tax credit in relation to the GST component of the legal fees.

This was the first consideration by the High Court of this aspect of the principal purpose test. Many other cases (discussed below) have examined what was the taxpayer's true principal purpose in acquiring goods or services. But none had previously considered whether those supplies actually contributed to the registered person making their own taxable supplies.

In his judgment, Gendall J applied an approach based on whether a "sufficient nexus" existed between the costs incurred and the taxpayer's taxable supplies, and that this was primarily a question of fact. The Court considered that it was inherent in a "sufficient nexus" approach that the purpose must be the principal purpose and that, if the principal purpose was something other than the making of taxable supplies, the conclusion should be that there was an insufficient nexus. His Honour considered that such a test "was a question of fact".

[(2010) Vol 16:1 NZJTLP 85, 99] Gendall J also referred to the widely quoted guidance on the interpretation of the principal purpose test by Chisholm J in *Wairakei Court Ltd v CIR*. Yet, after setting out this test, the judgment never again refers to that reasoning nor expressly applies any of the criteria stipulated in that case.

The Commissioner's case had been that a distinction had to be drawn between:

- The normal operating costs of the trust, which contributed to it making taxable supplies to its customers, and
- The essentially private dealings between the trust and its beneficiaries, which will involve the distribution of funds but not result in the making of taxable supplies.

This argument was summarised by Gendall J:

> "Counsel's contention is that such administration could at best only have an indirect or remote impact on the making of taxable supplies and the money therefore spent on such administration had as its principal purpose some aspect other than the making of taxable supplies. The services were acquired, counsel submit, to resolve issues relating to control of and distribution from trust assets and that:
>
> > 'Such a purpose could be seen as a private purpose, in so far as it was resolving particular disputes between family members or a trust administrative purpose that was distinct from the income producing, or taxable supply, aspects of the trust.' "

Most significantly, Gendall J considered that the statutory requirement for "making taxable supplies" should be read widely. There was no requirement that specific expenditures on which input tax credits were claimed needed to be directly and demonstrably linked to specific resulting products. The Court concluded that to do so would be contrary to the overall "balancing out" effect that the legislation sought to achieve, as explained by the Supreme Court in its summary of the GST regime in *Glenharrow Holdings Ltd v CIR*. Gendall J stated:

> 'taxable activity' per se. Inherent in the definition of a taxable supply is that it must be in the 'course or furtherance of the taxable activity' "

Later, his Honour noted:

> "It is well understood that in terms of claiming for business expenditure the reference to 'making taxable supplies' is to be read widely. But there is no requirement that the specific expenditures on which input tax credits are claimed need in any way to be directly and demonstrably linked to the specific resulting products. That would of course be contrary to the overall 'balancing out' effect which the legislation seeks to achieve. …"… The Commissioner seems to demand a tangible and direct connection between the specific business input (the legal services) and the specific business output in the form of a taxable supply, but in my view this is not what is required under the principal purpose test. …"

[(2010) Vol 16:1 NZJTLP 85, 100] Gendall J does not explain on what basis it is "well understood" that a wide interpretation is required. Certainly, that does not appear to be founded on the previous cases or in the relevant commentaries on the subject. Only *Case T30* adopts a similarly wide interpretation. There, apparently without examining the wording of s 3A GSTA 1985, Judge Willy considered that it should apply also to the taxable activity and not only to the making of taxable supplies:

> "As to whether or not a taxpayer is entitled to an input credit on acquiring goods or services the test is whether or not the principal purpose of the acquisition of the goods or services is in the course of the conduct of some taxable activity."

In *Mangaheia Trust*, Gendall J considered that the TRA was "well aware of the statutory requirement to apply the exact words of the test" – yet by substituting the more relaxed requirement that a supply need only relate to the taxable activity for the statutory requirement that it must relate to the "making of taxable supplies", it appears Gendall J has himself conspicuously failed to "apply the exact words of the test".

One commentator writing with approval of the decision justified it on the grounds:

> "As a general proposition though, action taken to defend capital or protect the business interests of a trust will be costs which are reasonably and necessarily incurred and hence acquisitions for the principal purpose of making taxable supplies."

However, like the reasoning adopted by Gendall J, this analysis is based on an analogy with the criteria for deductibility for income tax and not on the actual wording of the principal purpose test in the GSTA 1985.

The author submits that Gendall J's decision (and the reasoning in *Case T30*) is both bad policy and contrary to the clear wording of the legislation. Furthermore, the reasoning in that decision even appears to be at odds with the income tax treatment of similar administrative expenses.

6.0 COSTS OF INTERNAL DISPUTES NOT GENERALLY DEDUCTIBLE

There are a number of cases involving widely different fact scenarios concluding that the cost of resolving internal disputes over the ownership of income-earning assets are generally not deductible. In the main, these cases are determined on the basis that such squabbles lack sufficient nexus with the deriving of income.

For instance, in *Case H100* the TRA considered that all costs relating to a matrimonial dispute over the ownership of income-producing assets was not deductible. The assets would continue to generate that income regardless of which spouse owned them after the separation. Accordingly, the costs of resolving that dispute had no nexus with the derivation of that income. Judge Barber explained:

> " **[(2010) Vol 16:1 NZJTLP 85, 101]** Although there is a link between the expenditure and the objector's income earning

> process of investing in assets, I find that link is not direct or strong enough in degree to provide deductibility for the expenditure. … There must be an inquiry into the degree of connection between income-related activities and the asset or advantage sought to be gained by the expenditure. The income-related activities must be of sufficient and practical relevance."I find that the objector's air fares and legal expenses were not incurred in gaining or producing assessable income. …"

The same result on similar facts was reached in *Case F122*, where Judge Barber concluded:

> "[T]he point is that O made the payment in response to his matrimonial obligations rather than for reasons connected with the gaining or producing of income. …"… there is a lack of nexus in terms of s 104 and *Banks*' case between the expenditure on interest and O's income earning process as a farmer. …"

In the corporate context, the Courts have also drawn a clear distinction between expenses incurred in battling over the ownership of a business and its assets, and the operation of that business to derive income. In *John Fairfax & Sons Pty Ltd v FCT*, the taxpayer was engaged in a takeover battle with another company over the ownership and control of a third company that the taxpayer desired to merge with its own operations. The taxpayer incurred legal costs in proceedings undertaken to confirm the taxpayer's title to certain shares in the third company. The High Court of Australia held that the litigation was exclusively concerned with the organisation and structure of the profit-earning enterprise rather than the operation of the enterprise. The expenditure therefore lacked the nexus with deriving income required for deductibility.

To similar effect is *IRC v Appuhamy*, where the Privy Council held that no deduction was available for the cost of settling a dispute over profit entitlements from a business. Their Honours concluded that the litigation would not have affected the profits of the business one way or the other but would have affected only the owners' shares of them. The legal expenses could not therefore be said to have been expended in the production of profits.

Perhaps the case most directly on point with *Mangaheia Trust* is *Case L53*. There, the taxpayer was a beneficiary under a trust established pursuant to the will of a deceased relative. She attempted to deduct a proportion of the legal costs incurred in defending a testamentary promise claim against part of that estate.

The TRA denied the deduction on the grounds **[(2010) Vol 16:1 NZJTLP 85, 102]** the legal expenses were incurred in determining who was entitled to the money and had no nexus with the gaining or producing of assessable income. The trust's income was generated from its assets and not by the litigation. Judge Barber concluded:

> "The legal expenses were incurred in determining who was entitled to the money secured by the mortgage. The Court case had no nexus with the gaining or producing of assessable income. It was merely concerned with whether or not income had been earned and to whom it (and the capital) had belonged. … The legal costs incurred by the trustees, and, in effect, on behalf of the beneficiaries – because their distributions were at risk of reduction – were incurred to ascertain the ownership of a capital asset of the estate. True, a decision on that issue effected the ownership of income which had, in the meantime, accrued on that capital asset. However, the legal expenses were incurred in relation to ascertaining the ownership of a capital asset and not in relation to or in the course of any income earning process."

The author submits that these decisions are correct. Disputes over the ownership of assets lack sufficient nexus with their use in deriving assessable income. The outcome of that litigation may enrich one of the parties but does nothing to increase the income generated from those assets. These decisions can be contrasted with the reasoning in *Mangaheia Trust*, where Gendall J stated:

> "In this case, as part of the trusts' taxable activity, the obligations of the trustees included [the] protection of the capital and business interests of the trusts. Defending the claims brought against the trustees was part of business activities with costs incurred being reasonable and commercially necessary."

The author submits that this reasoning confused the trustees' obligations to their beneficiaries with the separate conduct of the trust's commercial activity of making taxable supplies, which remained unaffected by the litigation. Accordingly, the correctness of Gendall J's reasoning on this point must be doubted.

7.0 THE SCOPE OF A TAXABLE ACTIVITY DETERMINES THE PRINCIPAL PURPOSE

If Gendall J's interpretation of the principal purpose test is correct, and all expenditure with sufficient nexus to the registered person's taxable activity may be claimed as input tax, this raises the question of how close must be the relationship with that taxable activity? The scope of a registered person's taxable activity was first addressed in *Case K55*. In that case, a GST-registered farmer traded in his old farm vehicle, purchased prior to the implementation of GST, as part-payment for the purchase of a replacement. The farmer returned no output tax on the value of the trade-in vehicle. The issue before the TRA was whether the sale took place **[(2010) Vol 16:1 NZJTLP 85, 103]** in the course or furtherance of the farmer's taxable activity, as required for taxability under s 8(1) GSTA 1985.

Judge Bathgate ruled that the supply of the farm vehicle took place in the furtherance of the farming activity. Whether a supply is made in the course of a taxable activity is a question of fact and degree. To support his conclusion, his Honour drew an analogy with the investigation undertaken when determining whether an item of expenditure meets the nexus test for deductibility:

> "'In the course or furtherance of' a taxable activity' is not an altogether different concept from the income tax situation of '… in gaining or producing' the assessable income. It may be that to discover whether a supply is in the course or furtherance of a taxable activity some discernible nexus should be apparent between the activity and the supply. It would not appear inappropriate. As on the application of s 104 of the Income Tax Act, it is a question of fact and degree as to whether a supply is in the course or furtherance of a taxable activity carried on by the person concerned. There must obviously be a discernible relationship between the supply and the activity in the form of a nexus for the supply to be in the course or furtherance of the activity."

However, GST does not apply to all supplies by registered persons. This was demonstrated in the Court of Appeal decisions in *CIR v New Zealand Refining Co Ltd* and *Chatham Islands Enterprise Trust v CIR*. Those cases were resolved on the grounds that payment of compensation or settlement of trust funds was unrelated to any supply made by the recipient and, therefore, did not meet the requirements to impose GST under s 8(1) GSTA 1985.

In reaching the decision in the *New Zealand Refining Co* case, the Court of Appeal found that a payment to compensate for the loss of a monopoly was not consideration for the supply of goods or services and, therefore, was not received as part of the company's taxable activity:

> "In our view the payments related to the structure or framework within which supplies of services were expected to be made. They were to compensate NZRC for the removal of the protections given by the Support Letters and its exposure to the hot winds of competition. It was compensation directed to the same purpose as the grants which repaid the loans. The payments were received in the course of the taxable activity of NZRC but they were not in consideration for any supply made by it. Accordingly, they were not subject to GST."

The Court does not explain how the payments related to the taxable activity of refining when no supplies were made in order to receive the payment. Nevertheless, because of this lack of relationship, the payment was not received as part of the taxable activity and therefore was not subject to GST.

The Court of Appeal in *Chatham Islands Enterprise Trust* particularly appears to have rejected a wide analysis of what constitutes part of the taxable activity of a trust. There, the Commissioner assessed GST on a community trust for its supposed services of receiving and dispersing money. The Court of Appeal **[(2010) Vol 16:1 NZJTLP 85, 104]** reversed the assessment on the grounds the trustees provided no services in return for the funds settled on the trust, and were doing no more than their equitable duty under the trust deed:

> "[T]he Commissioner appeared not to appreciate the consequences of his argument if it were to be applied to private trusts and their settlors. If the argument were to be accepted it might be very difficult to determine what circumstances did or did not amount to an inducement of the activities of a family trust."

That judgment appears to require a distinction to be drawn between the commercial activities of a trust, for which it may be GST

registered, and the internal obligations imposed on the trustees regarding the trust property, which would fall outside the GST net. It is a distinction that Gendall J in *Mangaheia Trust* appears to have ignored.

8.0 CONCLUSION

The GSTA 1985 applies an "all or nothing" approach to the claiming of input credits. The definition of "input tax" in s 3A GSTA 1985 allows an unapportioned input credit for the full cost of goods or services acquired for the principal purpose of making taxable supplies. For consistency reasons, the Courts have favoured a hybrid test to determine a taxpayer's principal purpose. However, all cases prior to *Mangaheia Trust* have recognised the restriction that input tax must relate to the making of taxable supplies, not merely to the taxpayer's taxable activity. Not all supplies made by a taxpayer are subject to GST and not all expenditure relating to that taxable activity gives rise to an input tax credit. The wide interpretation of principal purpose adopted by Gendall J must therefore be doubted.

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FOOTNOTES

1 *CIR v Trustees in the Mangaheia Trust*(2009) 24 NZTC 23,711 (HC).

2 See n 1, p 23,719, para 23.

3 In calculating the registered person's GST liability under s 20(3) GSTA 1985. The person must also hold the requisite tax invoice, pursuant to s 20(2) GSTA 1985.

4 Section 3A GSTA 1985.

5 Although such expenses may give rise to an input tax adjustment under ss 21E to 21H GSTA 1985.

6 Charged by that supplier under s 8(1) GSTA 1985.

7 Imposed under s 12 GSTA 1985.

8 Under s 20(3) GSTA 1985.

9 In this regard, the test for input credits under s 3A(2) GSTA 1985 is similar to that applied for taxability under the second limb of s CD 4Income Tax Act 1994 (ITA 1994) (now s CB 4 ITA 2007), which applies only to the taxpayer's dominant purpose: see *CIR v National Distributors Ltd*[1989] 3 NZLR 661; (1989) 11 NZTC 6,346; (1989) 13 TRNZ 671 (CA).

10 A McKenzie (Consulting Editor), *New Zealand Goods and Services Tax Guide*, (Auckland, CCH, 2010, Looseleaf), para 27-300.

11 Per Richardson J in *CIR v Haenga*[1986] 1 NZLR 119; (1985) 7 NZTC 5,198; (1985) 9 TRNZ 41 (CA).

12
For instance, see *Plimmer v CIR*[1958] NZLR 147 (SC); *CIR v Walker*[1963] NZLR 339 (CA); and *Morrow v CIR*(1989) 11 NZTC 6,053; (1989) 12 TRNZ 501 (HC).

13
For instance, see *Newton v FCT*[1958] HCA 31; (1958) 98 CLR 1; [1958] AC 450; [1958] 2 All ER 759 (PC); *CIR v Ashton*[1974] 2 NZLR 321; (1974) 1 NZTC 61,161 (CA); and *Ben Nevis Forestry Ventures Ltd v CIR*[2008] NZSC 115; [2009] 2 NZLR 289; (2009) 24 NZTC 23,188 (SC).

14 *CIR v Haenga*[1986] 1 NZLR 119; (1985) 7 NZTC 5,198; (1985) 9 TRNZ 41 (CA).

15 See n 14, p 125; p 5,204; p 47.

16 *Case M106*(1990) 12 NZTC 2,674; also reported as *Case 74*(1990) 15 TRNZ 84 (TRA).

17 See n 16, pp 2,678-2,679; p 89.

18 *CIR v Morris*[1998] 1 NZLR 344; (1998) 18 NZTC 13,385 (HC).

19 *Case P5*(1992) 14 NZTC 4,034; also reported as *Case 59*(1991) 16 TRNZ 492 (TRA).

20 See the discussion below on whether the use to which the goods or services were put should determine the principal purpose of the supply.

21 *CIR v BNZ Investment Advisory Services Ltd*(1994) 16 NZTC 11,111 (HC). It was an appeal from *Case P62*(1992) 14 NZTC 4,427; also reported as *Case 64*(1992) 17 TRNZ 245 (TRA).

22 See n 21, p 11,115.

23 His Honour found that "it does not seem to me important whether an objective, subjective or some other intermediate position should be taken." (see n 21, p 11,115).

24 *Norfollk Apartments Ltd v CIR*(1995) 17 NZTC 12,003; (1994) 19 TRNZ 218 (HC).

25 See n 24, p 12,007; p 224.

26 *Norfolk Apartments Ltd v CIR*(1995) 17 NZTC 12,212; (1995) 19 TRNZ 759 (CA).

27 *Coveney v CIR*[1995] 1 NZLR 90; (1994) 16 NZTC 11,328; (1994) 19 TRNZ 13 (HC).

28 *CIR v Coveney*(1995) 17 NZTC 12,193; (1995) 19 TRNZ 705 (CA).

29 *Wairakei Court Ltd v CIR*(1999) 19 NZTC 15,202 (HC).

30 See n 29, p 15,206.

31 *CIR v National Distributors Ltd*[1989] 3 NZLR 661; (1989) 11 NZTC 6,346; (1989) 13 TRNZ 671 (CA).

32 *Glenharrow Holdings Ltd v CIR*[2008] NZSC 116; [2009] 2 NZLR 359; (2009) 24 NZTC 23,236 (SC).

33 See n 32, p 376; p 23,244, para 35.

34 Inland Revenue, "Homestays – GST Treatment", (1996) Vol 7:13 *Tax Information Bulletin* 5, p 8.

35 *Case P62*(1992) 14 NZTC 4,427; also reported as *Case 64*(1992) 17 TRNZ 245 (TRA).

36 See n 35, p 4,443; p 265.

37 *CIR v BNZ Investment Advisory Services Ltd*(1994) 16 NZTC 11,111; (1994) 18 TRNZ 569 (HC).

38 See n 37, p 11,115; p 574.

39 *Norfolk Apartments Ltd v CIR*(1995) 17 NZTC 12,003; (1994) 19 TRNZ 218 (HC); and *Norfolk Apartments Ltd v CIR*(1995) 17 NZTC 12,212; (1995) 19 TRNZ 759 (CA).

40 *Wairakei Court Ltd v CIR*(1999) 19 NZTC 15,202 (HC).

41 *CIR v BNZ Investment Advisory Services Ltd*(1994) 16 NZTC 11,111, 11,116; (1994) 18 TRNZ 569, 576 (HC).

42 *Norfolk Apartments Ltd v CIR*(1995) 17 NZTC 12,003; (1994) 19 TRNZ 218 (HC).

43 *Wairakei Court Ltd v CIR*(1999) 19 NZTC 15,202, 15,207 (HC).

44 *Case N27*(1991) 13 NZTC 3,229, 3,239; also reported as *Case 8*(1991) 15 TRNZ 635, 645 (TRA).

45 *New Zealand Co-operative Dairy Company Ltd v CIR (No 2)*(1989) 11 NZTC 6,066 (HC).

46 *New Zealand Co-operative Dairy Company Ltd v CIR*(1990) 12 NZTC 7,128; (1990) 14 TRNZ 521 (CA).

47 See *CIR v Banks*[1978] 2 NZLR 472; (1978) 3 NZTC 61,236; (1978) 2 TRNZ 323 (CA); and *Buckley & Young Ltd v CIR*[1978] 2 NZLR 485; (1978) 3 NZTC 61,271; (1978) 2 TRNZ 485 (CA).

48 The onus of proving the nexus between the expenditure and the taxpayer's income or business, as with all items of fact, falls on the taxpayer by virtue of s 13Taxation Review Authorities Act 1994.

49 *CIR v Banks*, n 47, per Richardson J.

50 *CIR v Banks*, n 47, p 478; p 61,242; p 330.

51 See *Magna Alloys & Research Pty Ltd v FCT*[1980] FCA 150; (1980) 49 FLR 183; 33 ALR 213; 11 ATR 276; 80 ATC 4542 (FCA). There, the company and its directors were co-charged with criminal offences relating to the company's trading activity. The company incurred legal fees defending both itself and the directors personally. These fees were fully deductible despite the finding by Deane and Fisher JJ that the expenses were primarily motivated by the desire to protect the directors personally.

52 *CIR v Banks*, n 47, pp 476-477; p 61,241; p 328.

53 See *Coveney v CIR*(1995) 17 NZTC 12,193; (1995) 19 TRNZ 705 (CA).

54 Adjustments may arise under ss 21 to 21G GSTA 1985 for a subsequent change in use of the goods or services dealt with.

55 For example, see *Case K55*(1988) 10 NZTC 453; also reported as *Case 6*(1988) 12 TRNZ 107 (TRA).

56 *Mallalieu v Drummond*[1983] 2 AC 861; [1983] 3 WLR 409; [1983] BTC 380 (HL).

57 See Division 11-15(2)(B) A New Tax System (Goods and Services Tax) Act 1999 (Aust).

58 R Krever, *GST Legislation Plus*, (Pyrmont, Thomson, 2008), Chapter 2.2.

59 J Coleman, "GST – The Principal Purpose Test", (2009) Issue 23 *Taxation Today* 6, p 8.

60 *Case Q43*(1993) 15 NZTC 5,208; also reported as *Case 28*(1993) 17 TRNZ 855 (TRA).

61 See n 60, pp 5,213-5,214; p 861.

62 See n 60, pp 5,214-5,215; p 862.

63 See n 60, p 5,412; p 862.

64 A McKenzie, *GST – A Practical Guide*, (Auckland, CCH, 2008, 8th edition), pp 211-217, para 1003.

65
This example was used by Gendall J in *CIR v Trustees in the Mangaheia Trust*(2009) 24 NZTC 23,711, 23,720, para 32 (HC).

66
Example courtesy of Allan Bullot, a GST Partner at Deloitte.

67 See the substantive litigation reported as *Kain v Hutton*[2008] NZSC 61; [2008] 3 NZLR 589 (SC).

68 *Case Z12*(2009) 24 NZTC 14,142 (TRA).

69 Strangely, the Commissioner permitted input tax claims for a number of other expenses incurred by the Trust during the litigation, including accounting and valuation fees. The Commissioner justified this inconsistent treatment on the basis that those other expenses were insignificant but Gendall J found that justification a "hollow submission" [*CIR v Trustees in the Mangaheia Trust*(2009) 24 NZTC 23,711, 23,721, para 38 (HC)] and appears to have, at least partly, relied on this concession in reaching his decision.

70 *CIR v Trustees in the Mangaheia Trust*(2009) 24 NZTC 23,711, 23,718-23,719, para 23 (HC).

71 See n 70, p 23,716, para 13.

72 *Wairakei Court Ltd v CIR*(1999) 19 NZTC 15,202 (HC).

73 See n 70, p 23,719, para 28.

74 *Glenharrow Holdings Ltd v CIR*[2008] NZSC 116; [2009] 2 NZLR 359; (2009) 24 NZTC 23,236 (SC).

75 See n 70, p 23,719, para 23.

76 See n 70, p 23,720, paras 31 to 33.

77 *Case T30*(1997) 18 NZTC 8,211 (TRA).

78 See n 77, p 8,215.

79 *CIR v Trustees in the Mangaheia Trust*(2009) 24 NZTC 23,711, 23,720, para 34 (HC).

80 J Coleman, "GST – The Principal Purpose Test", (2009) Issue 23 *Taxation Today* 6, p 8.

81 *Case H100*(1986) 8 NZTC 680; also reported as *Case 36*(1986) 10 TRNZ 267 (TRA).

82 See n 81, pp 681-682; p 268.

83 *Case F122*(1984) 6 NZTC 60,152; also reported as *Case 4*(1984) 8 TRNZ 33 (TRA).

84 See n 83, pp 60,155-60,156; p 37.

85 *John Fairfax and Sons Pty Ltd v FCT*[1959] HCA 4; [1958-1959] 101 CLR 30; [1959] ALR 267; (1959) 11 ATD 510 (HCA).

86 *IRC v Appuhamy*[1963] AC 127; [1962] 3 WLR 1425; [1963] 1 All ER 69 (PC).

87 *Case L53*(1989) 11 NZTC 1,304; also reported as *Case 21*(1989) 13 TRNZ 192 (TRA).

88 See n 87, p 1,306; p 194.

89 *CIR v Trustees in the Mangaheia Trust*(2009) 24 NZTC 23,711, 23,721, para 37 (HC).

90 It is beyond this article to examine the definition and requirements of what constitutes a taxable activity, as defined in s 6 GSTA 1985. A good analysis of the individual elements necessary to comply with that definition can be found in A McKenzie, *GST – A Practical Guide*, (Auckland, CCH, 2008, 8th edition), 277-288, para 1301.

91 *Case K55*(1988) 10 NZTC 453; also reported as *Case 6*(1988) 12 TRNZ 107 (TRA).

92 See n 91, p 457. The "nexus test" was developed by the Court of Appeal in *CIR v Banks*[1978] 2 NZLR 472; (1978) 3 NZTC 61,236; (1978) 2 TRNZ 323 (CA), and *Buckley & Young Ltd v CIR*[1978] 2 NZLR 485; (1978) 3 NZTC 61,271; (1978) 2 TRNZ 485 (CA). In the former case, Richardson J stated at p 476; p 61,240; p 328: "The deduction is available only where expenditure has the necessary relationship, both with the taxpayer concerned and with the gaining or producing of his assessable income. Relationship with the taxpayer is not, in itself, sufficient, as the prohibition of a deduction for capital expenditure (s 112(1)(a)) and private and domestic expenditure (s 112(1)(i)) makes clear. There must be the statutory nexus between the particular expenditure and the assessable income of the taxpayer claiming the deduction."

93 GST will not apply to any payment not made in connection with the supply of goods or services, as required under the elements of s 8(1) GSTA 1985. The narrow scope of this section was subsequently reversed by the enactment of s 5(6D) GSTA 1985 whereby all subsidies and grants paid "*in relation to or in respect of*" a person's taxable activities are deemed to be made in respect of the supply of goods and services. However, payments that are not subsidies or grants do not automatically come within the scope of the recipient's taxable activity.

94 *CIR v New Zealand Refining Co Ltd*(1997) 18 NZTC 13,187 (CA).

95 *Chatham Islands Enterprise Trust v CIR*[1999] 2 NZLR 388; (1999) 19 NZTC 15,075 (CA).

96 See the clear reasoning of Blanchard J on behalf of the Court of Appeal in *Chatham Islands* that: "The Trust is not making a supply of anything to the settlor in exchange for, or induced by, the payments; it is the recipient of an endowment to be held upon the terms of the deed. Nor can it, consistently with well-established principles, be said that the Trust is performing services for its beneficiaries in return for a consideration provided by the settlor." (n 95, p 393; p 15,079)

97 See n 94, p 13,194.

98 *Chatham Islands Enterprise Trust v CIR*[1999] 2 NZLR 388, 393; (1999) 19 NZTC 15,075, 15,079, para 19 (CA).