

**IN THE HIGH COURT OF NEW ZEALAND  
WELLINGTON REGISTRY**

**CIV-2009-485-000593**

IN THE MATTER OF      an Appeal under s 26A of the Taxation  
Review Authority's Act 1994

BETWEEN                      COMMISSIONER OF INLAND  
REVENUE  
Appellant

AND                              TRUSTEES IN THE MANGAHEIA  
TRUST AND TRUSTEES IN THE TE  
MATA PROPERTY  
Respondent

Hearing:            13-14 July 2009

Appearances: T G H Smith and B L Orr for Appellant  
B D Gray QC and D D Martin for Respondents

Judgment:        29 July 2009

In accordance with r 11.5 I direct the Registrar to endorse this judgment with the delivery time of 10.00 am on the 29th day of July 2009.

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**RESERVED JUDGMENT OF GENDALL J**

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[1] This is an appeal against a decision of the Taxation Review Authority (Judge P F Barber) that the Commissioner of Inland Revenue had acted incorrectly in disallowing GST input tax claimed by trustees of two trusts for fees for legal services arising out of the course of protracted litigation concerning a number of trusts. That litigation is known as the "*Kain & Ors v Hutton & Ors* [2008] 3 NZLR 589" litigation.

[2] Very substantial legal costs arose and the trustees received and paid tax invoices for legal services in a very significant sum, the GST content being in the region of \$500,000.

[3] The Authority identified the key issue being whether the legal services acquired (and the fees paid) by the trusts were for the principal purpose of making taxable supplies. Judge Barber concluded that they were and that the Commissioner had therefore acted incorrectly in disallowing the GST input tax claim.

[4] The Commissioner brings this appeal on the basis that the Authority was wrong, contending that the legal fees and services were not acquired for the principal purpose of making taxable supplies, and that the Authority erred in law by reading down the “principal purpose” test required under s 3A(1)(a) of the Act.

### **Background**

[5] The trusts are two of a number of family trusts created by members of an extended family from the Hawkes’ Bay area. In terms of GST registration one trust carries on a taxable activity of commercial property operation and development and the other carries on the taxable activity of sheep and beef farming. The trusts owned land, through various corporate entities, and in their own right, and had done so for many years. The capital assets were worth many millions of dollars. Apart from business activities in the form of leasing land, it was also used for the purpose of bailment of stock, breeding and fattening stock. That had been the case for many years. Because of income the trusts received from services provided they were acquired to account to the Commissioner for the GST content over an extended period. The legal and other fees, the GST component of which is at issue in these proceedings, arose in the course of High Court, Court of Appeal and Supreme Court proceedings.

[6] The background facts are extensively set out in the judgment of Panckhurst J in the High Court (HC CHCH M198/00 18 November 2005) and further summarised in the Court of Appeal judgment [2007] NZCA 199 and Supreme Court judgment [2008] NZSC 61. Litigation commenced in 1999 when some beneficiaries brought

an application in the High Court in Christchurch seeking information from the trustees and by and large succeeded. Thereafter, proceedings were brought seeking removal of certain trustees, allegations being made that one trustee might or had acted so as to minimise the inheritances and benefit of others in the extended family. It was alleged that a member of the family had secured the appointment of trustees sympathetic to his views at the expense of fiduciary obligations owed to others.

[7] Initially, damages were sought from the trusts and directions in respect of invested assets, although identification of the issues was complicated and remained clouded. Panckhurst J in the High Court said:

“Even at the end of the hearing I remain concerned about identification of the issues which required resolution.”

Nevertheless, in a general way the proceedings related to allegations as to the trustees’ management of the substantial assets held by each of the trusts.

[8] When delivering the costs decision Panckhurst J ordered that the trustees’ legal costs be indemnified from trust assets which, the respondents contend, is a telling illustration that the actions of the trustees were deemed to be proper in acting in their capacity as trustees in resisting the proceedings.

### **Statutory provisions**

[9] The relevant sections of the GST Act 1985 are as follows:

- Section 20(3)(a)(i) provides for the deduction of “input tax” by a GST registered person.

#### **20 Calculation of tax payable**

...

- (3) Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period–

- (a) In the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19 of this Act, the amount of the following:
  - (i) input tax in relation to the supply of goods and services (not being a supply of secondhand goods to which section 3A(1)(c) of the ‘input tax’ definition applies, made to that registered person during that taxable period.
- Section 3A(1) defines “input tax”. Section 3A(1)(a) provides:

(1) Input tax, in relation to a registered person, means–

- (a) tax charged under section 8(1) on the supply of goods and services made to that person, being goods and services acquired for the principal purpose of making taxable supplies.
- “Taxable supply” is defined in Section 2:

**taxable supply** means a supply of goods and services in New Zealand that is charged with tax under section 8...”

- Section 8 provides for the imposition of GST:

**“8 Imposition of goods and services tax on supply**

(1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 12.5 percent on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after the 1<sup>st</sup> day of October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.”

In order for a person to make “taxable supplies” therefore, a person must carry on a “taxable activity”, defined in section 6(1)(a) as:

- (1) For the purposes of this Act, the term taxable activity means–
  - (a) Any activity which is carried on continuously or regularly by an person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club.

- Also relevant is Section 57:

**“57 Unincorporated bodies –**

...

- (2) Where an unincorporated body that carries on any taxable activity is registered pursuant to this Act,–
- (a) The members of that body shall not themselves be registered or liable to be registered under this Act in relation to the carrying on of that taxable activity; and
  - (b) Any supply of goods and services made in the course of carrying on that taxable activity shall be deemed for the purposes of this Act to be supplied by that body, and shall be deemed not to be made by any member of that body; and
  - (c) Any supply of goods and services to, or acquisition of goods by, any member of that body acting in the capacity as a member of that body and in the course of carrying on that taxable activity, not being a supply to which paragraph (b) of this subsection applies, shall be deemed for the purposes of this Act to be supplied to or acquired by that body, and shall be deemed not to be supplied to or acquired by that member; and
  - (d) That registration shall be in the name of the body, or where that body is the trustees of a trust, in the name of the trust; and
  - (e) Subject to subsections (3) to (3B), any change of members of that body shall have no effect for the purposes of this Act.

[10] The purpose and effect of these provisions and the overall purpose and operation of the GST regime is discussed by the Supreme Court in *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 359. I set out in full Blanchard J’s analysis of GST:

“[41] Broadly speaking, GST is a type of value-added tax. It is fundamentally an indirect tax levied on transactions with consumers. The legislation envisages that, for a business, over time the net impact will be an impost of GST on the value which the business adds to the goods and services it supplies. GST has been likened to a turnover tax (the outputs are the turnover) but with provision for offsetting deductions (or credits) for the GST content of input costs (the expenses incurred in producing the outputs).

[42] GST replaced New Zealand’s wholesale sales tax system and was introduced as part of the 1980s general programme of economic liberalisation. Reflecting policy work undertaken to ensure that the new regime was as non-distortionary as possible in its attempt to lower average and marginal tax rates, and reduce fiscal deficits, inequities between

taxpayers, and opportunities for avoidance and evasion, GST was intended to be broad based, efficient and neutral. Nevertheless, as the review done in 1999 highlighted, compliance and administration costs preclude perfect neutrality ever being achieved. Tax avoidance opportunities notably remain at the boundaries between taxable and non-taxable transactions and between registered and unregistered persons. Accordingly, a general anti-avoidance provision was considered necessary.

[43] GST utilises the invoice or credit-offset system. Consequently, and differing from other forms of consumption tax, GST is a multi-stage tax imposed on the value added at every stage of the business activity by which goods or services reach the ultimate consumer. It is a tax on final consumption because it is the sum of the value added by firms at each stage of the supply chain that consumers ultimately purchase and consume. Registered persons producing taxable supplies effectively operate as tax collectors on behalf of the government and as such are not themselves subject to GST's economic incidence. That is of course consistent with the neutrality and efficiency of the revenue collection rationales that underlie the Act. The corollary is that registered persons should, by the same token, not obtain unacceptable windfall gains from the regime.

[44] From a reading of the Act as a whole it is clear that the legislature anticipated that, for a trader in goods and services, there will over time usually be some balancing out or netting off of the GST components of sales and purchases. There will obviously be timing differences. Goods and services will frequently not be both bought and sold in the same GST period, but the Act appears to have been drafted with an anticipation that in the long run, and broadly speaking, appropriate offsetting will occur. In fairness, however, where a cost of acquisition precedes the return from a sale, a deduction is made available in advance of the arrival of that return. Where this occurs there is always the risk that the return which eventuates will not be as great as the cost of acquisition, or there will be a nil return. That is a risk which the Act requires IRD to accept as within a normal range of trading results, in the same way as it is able to take a greater benefit where a return from a business transaction is unusually large. The intent and the application of the Act accommodates such variables. Where transactions are between traders the Act is effectively self-policing because both must account for GST. There is limited opportunity for manipulation if the parties are at arm's length. The consideration they agree upon can be expected to be an open market value as defined in s 4. But if they are associated persons and hence are not at arm's length, there is obvious potential for adoption of an unrealistic value which could create distortion, and the Act therefore requires an accounting on the basis of an open market value, which is either the value the goods or services would normally fetch or as determined by the Commissioner in accordance with a method which provides, as s 4(4) puts it, "a sufficiently objective approximation".

[11] The Act applies to those who are registered who engage in a taxable activity of buying and selling goods and services although if the turnover is less than \$40,000 there is a discretion whether or not to register. In order to be able to claim input tax credits they must be registered and the Act does not have direct application to those who transact as customers without proposing to make taxable supply. Because there

is a credit offset mechanism for input tax, sales between registered persons are tax neutral and obviously as between unregistered persons the regime does not apply to them.

[12] A similar analysis was made by Hill J in the Australian case of *H P Mercantile Pty Ltd v FC of T* [2005] FCAFC 126; (2005) 219 ALR 591.

[13] In the present case the trusts must charge those to whom they provide taxable supplies with GST, and account to the Commissioner for that output tax that it receives from customers. So too, the legal firms and practitioners, valuers, accountants and others, who are registered persons and provide taxable supplies or services to the trust, received GST payments from them. The only issue is whether the trusts can claim a corresponding credit for the input tax in respect of those services. Such will be available to the trusts as registered entities provided that services on which the GST has been charged were acquired for the primary or principal purpose of making taxable supplies, with that test being, as all parties accept, a question of fact.

[14] At issue in these proceedings is whether that test is met in respect of the legal costs incurred by the trusts during the course of the litigation.

### **The Authority's decision**

[15] Pivotal to Judge Barber's decision was the finding that each trust acquired the legal services for the principal purpose of making taxable supplies, and he concluded:

- (1) In terms of GST registration, both trusts were carrying out "taxable activities" – the TM Property Trust's taxable activity being commercial property operation and development; the M Trust taxable activity being of sheep and beef farming;
- (2) The trusts had "acquired" the relevant services;

(3) Whether the trusts had acquired the legal services for the “principal purpose of making taxable supplies” was essentially a factual enquiry. In considering this question Judge Barber’s views were:

- Unless the litigation was resolved, the respective taxable activities of the trusts were likely to collapse or at least it was likely that they would be adversely affected in terms of good trading relations;
- The trustees needed to resolve the litigation to protect the respective taxable activities of the trusts;
- The litigation costs incurred did not extend beyond what would be regarded as the “normal administration of a trust”. Judge Barber said:

“My experience as a trustee is that any grievance of a beneficiary must be resolved to prevent retarding or destruction of the enterprise of the trust; to prevent continuance of unproductive costs to the trust, and to enable fair fulfilment of the trusts.”

- There was a sufficient nexus between the expenditure and the proper operation of the taxable activities of the trusts;
- The extent of a taxable activity does not require a restrictive approach, and management of trustee duties and obligations is part of the trust’s taxable activity as is the protection and promotion of beneficiaries’ interests in relation to the business outcomes of the trust.
- The legal expenses were incurred for two main reasons:
  1. The family arrangements which had been put in place over the years involved a complex structure with many different entities and inconsistencies. Rearrangement of those

structures was seen as necessary by various family members.

2. There had been a breakdown in family relationships which necessitated recourse to the Courts. The resolution of the dispute was a difficult exercise, and made even more because extensive reorganisation of the complex family trust structure was required.

Judge Barber was of the view that “a taxpayer is entitled to have complicated family trust structures” and expenses concerned with “questions of trusteeship, the correct ownership of various assets, and the restructuring of a group of entities to achieve various perceived benefits...[are] aspects integral to smoothly operating the trusts’ business”.

- At the time the trusts acquired the legal services from Chapman Tripp, there was no doubt as to what the object or end in view was. It was simply to defend the allegations made against the trusts by the Kains so as to preserve the trusts’ economic income-earning potential and their assets as trustees as required to do as a matter of law. The legal costs were simply “overhead costs” incurred as part of the ordinary administration and management of the trusts.

[16] The parties are agreed that it is a question of fact whether the services were acquired for the principal purpose of making taxable supplies.

[17] In the course of his decision, Judge Barber made observations, which are challenged by the Commissioner in this appeal. They were:

### *Nature of trustees' roles*

Judge Barber discussed the nature of a “trustee” at [34] and [35] of the decision. He said:

“[34] Given that a trustee’s principal legal functions are to give effect to the terms of a trust and to preserve its assets for the benefit of beneficiaries of the trust as a whole then, in reality, virtually everything a trustee does *intra vires* is related to the management and administration of the trust. This is because, whether the trustee’s conduct involves investing trust moneys, running a business activity, or making distributions, those acts directly relate to the trust fund and the trust’s economic affairs.

[35] A trustee has no legal authority to do anything unrelated to a trust’s economic and other activities. His or her role is confined always to acting in the best interests of the trust. That is the same position for the director of a company. His or her role is confined to acting in the best interests of that company as a matter of law, as is also the position of any other fiduciary acting on behalf of other persons.”

### *‘Principal purpose’ test as a ‘filter’*

Judge Barber made some general comments as to the role of the ‘principal purpose’ test. He said at [39]:

“If the scheme and structure of the GST Act is designed to ensure that a person carrying on a taxable or economic activity gets to deduct and claim back all the GST-inclusive costs acquired as part of carrying on that activity in order to avoid that person being a consumer, then the question remains what role the principal purpose test in s 3A(1)(a) was intended to serve? Clearly, its only role is to operate as a filter between the making of taxable and exempt supplies, because it is only ‘*exempt supplies*’ which are precluded from the scope of the GST tax base.”

[18] Finally, Judge Barber considered the final requirement which the trusts had to satisfy in order to claim the GST input tax on the legal costs in the relevant GST periods, which was whether they held “*tax invoices*” in respect of those claims. He concluded (at [112]) that the invoices satisfied all the necessary statutory requirements to support the deductions of GST input tax in terms of s 20(2) of the GST Act. The relevant invoices from Chapman Tripp and other services provides constituted tax invoices for the purposes of s 25(3).

## **The appellant's argument**

[19] Counsel contends that the Authority's approach to the "principal purpose" test was fundamentally flawed. The Commissioner says that the Authority was wrong to say s 3A(1)(a) operates as a "filter" between the making of taxable and exempt supplies. The Commission submits this comment indicates that the Judge made an error of law. The effect of the decision was to:

- embark on a paradigm shift from the previous case law on s 3A(1)(a);
- deny the ordinary meaning of the words "principal purpose";
- deny the "principal purpose" test of any real purpose itself and undermined the scheme of the GST Act.

[20] The Commission says that the correct conclusion is that the legal services were *not* acquired by the trusts for the "principal purpose of making taxable supplies", being services obtained for the purpose of defending claims by beneficiaries personally against the trustee(s) unrelated to the taxable activities being carried out, and that therefore the trusts are not entitled to an input tax credit in relation to the GST component of the legal fees charged.

## **Discussion**

### *Principal purpose test*

[21] Did Judge Barber err in his approach to an application of the "principal purpose" test set down in s 3A(1)(a)? It is only if the trusts can say that the legal services were acquired "for the principal purpose of making taxable supplies" that they are entitled to a tax credit under the Act.

[22] Both counsel agree that "purpose" in this context is that set out by Chisholm J in *Wairakei Court Limited v Commissioner of Inland Revenue* (1999) 19 NZTC 15,202. At page 15,206. Chisholm J identified the following principles:

“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: *CIR v BNZ Investment Advisory Services Limited* (1994) 16 NZTC 11,111; *Norfolk Apartments Limited v CIR* (1995) 17 NZTC 12,003 (HC) and 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.”

### **Sufficient nexus approach to s 3A(1)(a)**

[23] The “sufficient nexus” approach to ascertaining the “principal purpose” has been used on a number of occasions. It is an eminently sensible way of approaching the test, in my view, because if there is an *insufficient* nexus between the acquisition of goods or services in the making of taxable supplies, then logically it could not follow that the goods or services were acquired “*for the principal purpose* of making taxable supplies”. It is not contested that in any given case whether or not this nexus exists must be a question of fact. While some cases refer to the need for there to be a sufficient nexus between goods/services acquired and the “*taxable activity*”, there is no difference between stating that the nexus should be with the “making of taxable supplies” or with the “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”. Reference was made by counsel for the Commissioner of three decisions of the Authority involving claims for input GST tax on legal fees.

[24] In Case *Q43* (1993) 15 NZTC 5,208 the Authority considered whether a barrister’s fee for defending an objector against a prosecution, actually for offences under the GST Act, were for services acquired for the principal purpose of making

taxable supplies where the taxpayer had carried on business as a property developer.

The Authority said:

“Another way of stating the issue is whether there was a sufficient nexus between the objector’s incurring the barrister’s fee and the objector’s business activity.”

An important factual feature was that when legal fees were incurred the taxpayer was in receivership and had ceased making taxable supplies. This point was determinative because the objector, although still operative, would not be making any more taxable supplies. It could not logically be said therefore that the fee was incurred to make taxable supplies.

[25] In Case *U30* (2000) 19 NZTC 9,286 the Authority rejected a claim for input tax arising out of legal services for defending a criminal prosecution. The Authority held the expenditure was not “intimately connected” with the carrying on of business or the production of income. There, the taxpayer’s activity was the selling of cannabis. However, the legal fees were not incurred for that activity. The Authority concluded on the facts that the legal services were to achieve the best possible outcome in respect of criminal charges laid against the objector, that purpose being quite indirect to the continuing of taxable supplies of cannabis.

[26] On the facts in Case *W3* (2003) 21 NZTC 11,014 however the Authority found for a taxpayer in assessing whether costs incurred on legal fees met the principal purpose test. There the Authority found that it did “not think that the fees paid to protect the disputant’s business and/or business reputation are too ‘indirect’ to be a business input...”.

[27] These decisions demonstrate one way of approaching the factual inquiry required under s 3A(1)(a). To establish whether the services were required for the “principal purpose” of making taxable supplies may be to ask whether there is sufficient nexus between the services acquired and the making of the taxable supplies. It is inherent in a “sufficient nexus” approach that the purpose must be the *principal* purpose – if the principal purpose was something other than the making of taxable supplies then the conclusion should be there was insufficient nexus.

[28] Whilst the Commissioner does not dispute the correct approach is to ask whether there is sufficient nexus between the acquisition of goods/services and the making of taxable supplies, counsel submits that a proper factual inquiry would have compelled the conclusion that there was not such sufficient nexus. Counsel argues the Authority was wrong to “conflate all trust activity with the making of taxable supplies” and that much of the administration of a trust, whether a GST registered trust or not, inevitably relates to the “private” distribution of assets to its beneficiaries rather than making taxable supplies to ultimate customers. 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.”

[29] Counsel for the Commissioner criticised Judge Barber’s comments in relation to trustees in the operation of the relevant provisions relating to GST where he said at [34]:

“Given that a trustee’s principal legal functions are to give effect to the terms of a trust and to preserve its assets for the benefit of beneficiaries of the trust as a whole then, in reality, virtually everything a trustee does *intra vires* is related to the management and administration of the trust. This is because, whether the trustee’s conduct involves investing trust moneys, running a business activity, or making distributions, those acts directly relate to the trust fund and the trust’s economic affairs.”

[30] There is some force in this criticism. Even if it may usually be correct to say that “in reality” where the registered person is a trust, then virtually anything a trustee (and therefore pursuant to s 57, the trust) does *intra vires* might meet the “principal purpose” test, what remains to be required in every case is a factual inquiry, and I do not consider it appropriate to suggest that a presumptive approach should be taken where the registered person is a trust. There may be circumstances where the “principal purpose” threshold is not met, even though a trustee acts *intra vires*. But in each case, regard has to be had to the terms of the trust deed, the

taxable activity and the exact nature of the trustee's actions so as to establish on the facts whether the requisite test has been satisfied.

[31] 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. As was said in *Glenharrow* at [44]:

"[44] ...Goods and services will frequently not be both bought and sold in the same GST period, but the Act appears to have been drafted with an anticipation that in the long run, and broadly speaking, appropriate offsetting will occur."

[32] A simple example was put forward by counsel for the respondents, namely the situation where input tax credits are claimed on supplies such as tea and coffee used by employees in a taxable activity business, those goods being purchased for "the principal purpose of making taxable supplies".

[33] I do not agree with the submission advanced on behalf of the Commissioner that the Authority never addressed the need for some nexus between the expenditure on the services and the commercial property operation and development and stock activities. 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. Judge Barber found at [77] that there was a sufficient nexus between the expenditure and the proper operation of the taxable activities, with the legal costs incurred as part of the ordinary administration and management of leasing and farming activities. The circumstances and all the evidence entitled him to make the finding that the "object or view" in acquiring the legal services from Chapman Tripp was:

"[107] ...simply to defend the allegations made against the Trust by the Kains so as to preserve the trusts' economic income-earning potential and their assets as trustees are required to do as a matter of law"

and to conclude as he did that the principle purpose test was accordingly met for each of the trusts.

[34] A reading of a decision as a whole leaves no doubt that Judge Barber was well aware of the statutory requirement to apply the exact words of the test.

[35] Further criticism of the decision related to the Judge's reference to the role of the principal purpose test being as a "filter". At [39] of his decision, the Judge said:

[39] If the scheme and structure of the GST Act is designed to ensure that a person carrying on a taxable or economic activity gets to deduct and claim back all the GST-inclusive costs acquired as part of carrying on that activity in order to avoid that person being a consumer, then the question remains what role the principal purpose test in s 3A(1)(a) was intended to serve? Clearly, its only role is to operate as a filter between the making of taxable and exempt supplies, because it is only '*exempt supplies*' which are precluded from the scope of the GST tax base."

Counsel for the Commissioner submitted that this extract demonstrates Judge Barber's approach to the principal purpose test was fundamentally flawed.

[36] The reference to there being a "filter" was not entirely apt. The principal purpose test has to be met before the GST on services and supplies can be claimed as input tax. It could simply be described as a "gateway" or essential criterion. I agree, however, with the submissions made by counsel for the respondents, that the issue is one of semantics and I do not accept that Judge Barber, given his experience as a Taxation Review Authority, suddenly took it upon himself to embark upon a "paradigm shift" from what is a well settled and understood area of GST tax law. The Judge's comments did not in any way divert or prevent the Authority from applying the exact language of the principal purpose test to the evidence and it is clear that the Authority required the trusts to demonstrate a close connection between the legal services, the trusts' taxable activities and the making of taxable supplies.

[37] The reference to a "filter" is ambiguous, but reading the decision as a whole, there is no doubt that Judge Barber's decision does not involve any departure from the ordinary meaning of the words "principal purpose". A restrictive approach is not required in assessing the extent of the taxable activity. In this case, as part of the trusts' taxable activity, the obligations of the trustees included to 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 direction by the High Court Judge that the trustees be reimbursed their expenses from the assets of the trust supports that view.

[38] I agree with Judge Barber that there was nothing special about the legal services to distinguish them from other services which the trustees had to incur not only from time to time but in the contesting litigation. The Commissioner, having allowed fees for accounting and valuation services by the trustees, in my view can hardly now justifiably claim that input tax in respect of legal services arising out of the same litigation be disallowed. Although counsel says the distinction is that the accounting and valuation fees were (and often are) allowed because they do not amount to large sums – even though strictly speaking the Commissioner’s view is that they are not claimable – is a somewhat hollow submission and there can be no distinction in principle.

## **Conclusion**

[39] I accept the respondents’ argument that the Authority was correct in its conclusion on the facts, and the law, the trusts were entitled to deduct the GST input tax charge to those entities on legal services supplied for the purpose of the litigation.

[40] The appeal fails and is dismissed. The respondents are entitled to costs, which are fixed on a Category 2B basis, together with reasonable disbursements, including counsel’s travel and accommodation expenses. I certify for second counsel.

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**J W Gendall J**

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