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IN THE SUPREME COURT OF TONGA
APPELLATE JURISDICTION — AM 8 of 2014
NUKU'ALOFA REGISTRY — [Tax Action 1/2013]

BETWEEN: TAXPAYER A

- Appellant

AND : MINISTER OF REVENUE

- Respondent

P. Finnigan with Mrs P. Tupou for the Appellant
M. O'Shannassy for the Respondent

JUDGMENT

[1] In 2013 the Commissioner of Revenue disallowed the taxpayer's claims for depreciation, improvements and refurbishments in relation to a building which she had rented to an overseas diplomatic mission. On 28 February 2013 the taxpayer applied for a review of the Commissioner's decision in accordance with Section 60 of the Revenue Services Administration Act.

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[2] On 26 January 2014 the Tax Tribunal upheld the Commissioner's decision. This is an appeal from the Tribunal pursuant to Section 10 of the Act. The Section confines appeals to questions of law.

[3] The facts, as found by the tribunal and which are not in issue, are principally set out in paragraph [6] of the Tribunal's Ruling as follows:

(a) The taxpayer took out a loan in the amount of $700,000 to build the residence in 2006 for the sole purpose of letting it out;
(b) The residence was first rented in 2007 and has remained rented ever since;
(c) In 2009 the taxpayer took out another very sizeable loan to extend both wings of the house and to renovate the existing structure;
(d) The taxpayer is paying off the loans and no profit has been made, as yet;
(e) Although the taxpayer had previously thought otherwise, she now regards her rental income as business income since her only purpose in building and renting the residence was to make a profit.
(f) Prior to letting the premises she entered into tenancy agreements and she then held quarterly meetings with the tenants to discuss any matters of concern;
(g) Prior to letting the premises they were advertised and potential tenants were interviewed.
(h) Invoices and receipts were issued every three months;

(i) She routinely maintains the premises and when required by the tenant arranges modification to the buildings and landscaping and planting in the compound.

[4] Additionally in paragraph [10] of the Ruling reference is made to the fact that the taxpayer is also the managing director of Royco Amalgamated Co. Ltd a well known company in Tonga with wide-ranging business interests.

[5] In paragraph 6 of the Ruling the Tribunal expressed the central issue before it in the following terms:

> "Whether the [taxpayer] was carrying on the business of renting and thus deriving business income, in which case deduction should have been allowed for depreciation, or whether as the Commissioner contends, the rental derived is simply property income under Section 14 of the [Income Tax Act 2007] and as such not being derived from a business enterprise, there can be no allowance for depreciation".

This formulation of the fundamental question is not disputed.

[6] In paragraphs 27 and 28 of submissions filed on 5 August 2013 Mr. O'Shannassy asserted that "over the years" the Courts have held that a number of indicators are relevant, in "combination and as a whole" in arriving at "a large and general impression" (*Martin v F.C of T* (1953) 90 CLR, 470, 474) that the taxpayer's activities have "commercial

flavour" and should therefore be regarded as a business. The factors are:

(a) Whether the activity has a significant purpose or character;
(b) Whether the taxpayer has more than just an intention to engage in business;
(c) Whether the taxpayer has a purpose of profit as well as a prospect of profit from the activity;
(d) Whether there is repetition and regularity of the activity;
(e) Whether the activity is of the same kind and carried on in similar manner to that of the ordinary trade in that line of business;
(f) Whether the activity is planned, organized and carried on in a businesslike manner such that it is directed at making a profit;
(g) The size, scale and permanency of the activity; and
(h) Whether the activity is better described as a hobby, a form of recreation [or] a sporting activity.

[7] At paragraph 3 of Mrs Tupou's submissions filed on 20 January 2014 these eight considerations were accepted as correctly setting out the principal indicia of business activity and at paragraph [8] of the Ruling the Tribunal generally applied these indicia to the taxpayer's circumstances before concluding that:

"The rental income derived was no more than an incident of the ownership of the property and did not reach that level of sustained

activity or management that could be described as a business operation".

[8] Both Counsel made comprehensive and learned submissions for which I am grateful. In essence Mr O'Shannassy says that no error of law was made by the Tribunal and that the facts were correctly assessed. Mr Finnigan submits that the Tribunal misconstrued the meaning of the legal term "business".

[9] In paragraph [8] of the Ruling already referred to, before listing the indicia set out in paragraph 7 above the Tribunal stated:

> "For the Commissioner, Mr. O'Shannassy acknowledged that, whilst there was no statutory definition of business, there had been considerable discussion in various authorities overseas.
>
> [While] the cases and principles extracted from them are no more than guidelines [the principles which] point to business activity include:
>
> [Indicia (a) to (h) set out in paragraph 7].

[10] The statement that there is no statutory definition of business in the Income Tax Act is not correct. In Section 2 "business" is defined to:

"include any profession, trade, manufacture or undertaking (including an undertaking in the nature of trade) conducted for pecuniary profit, but shall not include employment".

[11] In fine, Mr Finnigan's submission is that by confining itself to the indicia of business and by failing to consider whether the taxpayer's activities might constitute "an undertaking conducted for pecuniary profit" the Tribunal fell into error. The inferences drawn by the Tribunal from the primary facts were, in other words, based on an incorrect legal test and were accordingly erroneous in law.

[12] As is clear from authorities referred to by Mr Finnigan and, in particular *Calkin v CIR* [1934] 1 NZ CR 440, the question whether the taxpayer was engaged in an undertaking conducted for pecuniary profit might result in an answer different from the question whether the indicia suggested that a business simpliciter was being engaged in.

[13] In my view several of the indicia are only of limited relevance and indeed may be misleading in the circumstances which obtain in Tonga. Tonga is a very small country with an economy in the early stages of development. The Tribunal, in paragraph [10] of its Ruling, took the view that with only three tenants over several years and only quarterly meetings with tenants there was insufficient "regular, repetitive or onerous" activity which could fairly be seen to point to business activity. This observation, of course, is relevant to indicia (d), (e), and (f). In my view, however, when the local circumstances and the circumstances of the taxpayer are borne in mind, a rather different conclusion is reached.

Looking at the facts placed before the Tribunal in this way, a business woman will be seen, already actively involved in the family business, already having a home of her own, deciding to lease land and build upon it, a very substantial residence with the sole purpose of letting it out to one of the diplomatic missions or a tenant of a similar kind, for the purpose of profit. Her evidence was that she did not own the land or the house before she took the lease and erected the building and that she had no intention to occupy the residence herself. Given the very small market in Tonga for residences of this type and size, it is not surprising that the business only has one asset. Since it has only one asset the amount of "regular, repetitive and onerous" administration of the asset is perforce limited. On the other hand there seems little doubt that the taxpayer undertook the activity in a "planned, organised and business like" manner with the aim of making a profit.

[14] This is not a case of a taxpayer lucky enough to possess a property and then taking the profits of letting that property out. This is the case of a taxpayer who already had a residential property of her own but who decided to take advantage of the arrival in Tonga of increased overseas diplomatic representation by building accommodation suitable for their needs.

[15] In my opinion the Tribunal erred by not asking itself whether the taxpayer's activities could fairly be regarded as "an undertaking conducted for pecuniary profit". If it had asked that question then, in my view, the answer would clearly have been in the affirmative.

Result: The Appeal is allowed.

I will hear counsel as to costs.

NUKU'ALOFA: 19 September 2014. **CHIEF JUSTICE**

N. Tu'uholoaki

19/9/2014.