The Evolution of Construing "Tax Avoidance Arrangement"

Lola Kalolaine Hua Fusitu'a

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Primary Supervisor: Nigel Smith

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Attestation of Authorship

"I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person, nor material which to a substantial extent has been submitted for the award of any other degree or diploma of a university or other institution of higher learning."

Lola K, H. Fusitu'a

Signed: Lola K. H. Fusitu'a

Abstract

Tax avoidance is a problem in every modern tax system, specifically when businesses and personal transactions are overwhelmed by the impact of high tax rates. In the case of Duke of Westminster (1936), the courts had traditionally permitted taxpayers to diminish their tax liabilities. There are two ways to escape paying taxable liability: one is tax avoidance, which is legal and the other is tax evasion, which is illegal. The form approach, instead of the substance approach, was traditionally applied by the courts in tax cases and an arrangement was allowed, whether tax avoidance was or was not the purpose of the arrangement. When an arrangement involves an "anti-avoidance" section, the courts usually disregard the condition of tax avoidance arrangement. Tax mitigation is one example of this rule. There are two "anti-avoidance" sections in the Income Tax Act 1994: specific anti-avoidance provision and general anti-avoidance provision. Tax avoidance arrangement is affirmed in the case of McGukian and the Commissioner. Part IVA is the current anti-avoidance provision of Australia income tax legislation. It is applicable when a tax advantage is gained from the arrangement by the taxpayer. There are a few federal taxes (e.g. FBT, superannuation guarantee charge and income tax etc.) that have been falsely avoided from being paid and have been found as crimes under the Crimes Act 1980. Trying to avoid tax on a tax haven income is a crime. A general anti-avoidance provision is applicable when a taxpayer has received an advantage in association with the arrangement that was committed. It is important to examine all corners of a tax planning

scheme for possible tax benefits. Tax benefits have amendments propositions and the reasonable test will be amended. The Income Tax Assessment Act 1891 was the first income tax act in New Zealand and during the 20th century, there were other acts that followed at different times: the Land and Income Tax Act 1923, the Land and Income Tax Act 1954, the Income Tax Act 1976, and the Income Tax Act 1994. Goods and Services Tax Act was first introduced on 1 October 1986. Both sections 76 of the Goods and Services Tax Act 1985 and BG 1 of the Income Tax Act 2004 contain the same wordings. Section OB 1 of the Income Tax Act defines tax avoidance arrangement. Section 76(8) defines "tax avoidance". Section BG 1 is designed to counteract the tax avoidance arrangement. The definition of arrangement contains three elements: agreement, contract and plan or understanding. The definition of tax avoidance raises doubts in the case of BNZI where tax avoidance existed in downstream transactions. Tax mitigation and tax avoidance are distinguished but may not solve all problems globally. Case K52 (1988) 10 NZTC 426 is another example of a tax avoidance arrangement. The interpretation problems of the Act (s 99) can be ameliorated by a succinct analysis of the scheme of the legislation and the purpose of the legislation.

1 Introduction

The courts of New Zealand, Australia and the United Kingdom are working together to interpret "tax avoidance arrangement" to apply in different cases in order to defeat the gurus in taxation who attempt to avoid taxable liabilities. One example of this interpretation is in the case of CIR v BNZ

Investments Ltd [2002] 1 NZLR 450, where a taxpayer escaped millions of dollars in taxable liabilities because "arrangement" was interpreted as one that "requires a consensus or meeting of minds". On the other hand, the Privy Council in Peterson v CIR (2005) 22 NZTC 19,098; [2005] UKPC 5, the Law Lords with the majority ruled (at pp 19,108-19,109, para 34) that their Lordships "do not consider that the arrangement requires a consensus or meeting of minds, the taxpayer need not be a party to the arrangement and in their view, he need not be privy to its details either".

The purpose of this writing is to review how "tax avoidance arrangement" has been interpreted in the last few centuries and today. Traditionally, the courts supported taxpayers who minimised their taxable liabilities but then their behaviour gradually changed into a careful observation of tax avoidance on a case-by-case basis. Traditionally, the form approach was adopted in courts and the courts sustained any arrangement even though it may have been intended for tax avoidance. Sham transactions were completely ignored by the courts.

The history of the general avoidance provision first started with the Land, Income Tax Assessment Act 1891 before s 99 of the Tax Administration Act 1994 and s BG 1 of the Income Tax Act 1994. The purpose of s BG 1 is to address matters relating to "every tax avoidance arrangement is void as against the Commissioner for income tax". There were no major changes during the time of these enactments. There is a little or no difference between the definition of arrangement and tax avoidance. Now the meaning of the word "arrangement", needs the

presence of "a contract, agreement, plan or understanding between two or more parties which may or may not be enforceable and includes all the steps or transactions by which it is carried into effect".

Furthermore, the scheme and purpose approach may not provide the solution to whole range of interpretation problems that may emerge but it seems in many situations to head in the direction of solving the interpretation problems in the tax arena. The committee's reports, debates and discussions from Parliament and the guidelines for interpretation by Inland Revenue will help in the interpretation of the statute that is under discussion.

This writing contains ten parts and it starts from Part 1-Tax Planning, Part 2-Traditional Approach of the Courts, Part 3-Contemporary Approach, Part 4-Introduction to PT IVA, Part 5-Introduction of GST, Part 6-Anti-Avoidance Provisions, Part 7-Sections BG 1, GB 1 and GZ 1, Part 8-Choice principles, Part 9-The Commissioner's Power, Part 10-Binding Ruling; Conclusion and Area for further research.

2 Literature Review

The literature quoted in this research was sourced from AUT (Auckland University of Technology). Online services and websites such as CCH (Commerce Clearing House) New Zealand and Australia Limited and Brookers were utilised. Also a textbook titled *Income Tax in New Zealand* (2004) by Garth Harris, Chris Ohms, Casey Plunket, Audrey Sharp and Nigel Smith is used. The majority of this writing is based on CCH website.

There are no external resources involved in this research.

3 Discussion

4 PART 1: Tax Planning

4.1 Tax planning considered

Every modern tax system faces the problem of tax avoidance, particularly when tax rates are high and the impact appears to have a substantial effect on business and personal transactions. Traditionally, the courts seemed to accept that the taxpayer had a legal right to minimise his or her liability to pay tax. Lord Tomlin in IR Commrs v Duke of Westminster [1936] AC 1 at p 19 noted:[1]

> ``*Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it would otherwise be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he can not be compelled to pay the increased tax."*

Gradually, the court's behaviour has changed towards tax avoidance and taxpayer's right to minimise his or her liability to pay tax. The change is based on a case-by-case basis if the scheme and purpose of tax statutory in question permits the taxpayer "to order his or her affairs to act in such manner".[2]

4.2 Tax avoidance and tax evasion

Tax avoidance is legal as a means of minimising one's tax liability. Tax evasion is an arrangement that hides or rejects a taxable liability that is already incurred. These two terms, tax avoidance and tax

evasion, should be contrasted clearly. Tax evasion concerns a taxpayer that does not pay the tax that the law applies to his or her income and intentionally filing a false return or not paying the tax at the due date. On the other hand, tax avoidance is subject to Acts that permit a taxpayer to arrange his or her affairs to avoid paying a liability to tax. This theory presumes that after the completion of the arrangement there is no more liability existed to pay or hide or reject.[3]

In Phillips v Foster & Hansen (trustees of the RGJ Trust) (1991) 13 NZTC 8,088, it was suspected that a party to a contract to buy shares would assist the other party on a tax evasion then the contract was then void. The assertion was an attempt to prevent the contract from settling the payment for the shares.[4]

A Mr. Phillips, in that case, purchased shares in Pacer Kerridge Ltd, a division of a cinema chain, from the trustees of the RGJ Trust. According to the conditions of the contract, Mr Phillips was given a mortgage by the trustees, on a portion of the shares, as security for the unpaid balance, to the value of five instalments. The value of the shares was $12 million to be paid by instalments. When the unpaid balance of $2.5 million, which is the third instalment was due, the trustees demanded an amount of $6.5 million, which is the total amount owed by Mr Phillips. Mr Phillips asserted that the contract had no power, as the arrangement before and up to that action was set up to hide the interest incurred from the instalments and to assist RGJ trustees' tax evasion.[5]

The Court of Appeal observed that there was no unlawful action on deed for the sale and purchase of shares and even the preceding memorandum on terms of settlement. The arrangement and documents showed no possibility of deceiving the Revenue. The ratification of the past accrual system assured that all incomes from those financial arrangements, whatever type they adopt, pay tax at a rate that matches the incomes on the conditions of the arrangement. The trustees had not prevented to pay any tax liability or had tried to hide any liability.[6]

The only allegation, during the discussions of the arrangement, was the trustees' proposition of non-disclosure of the full details to the Inland Revenue Department and not to pay the right amount of tax incurred from the instalments.[7]

4.3 The basic issue — "substance" or "form"

In tax avoidance cases, the court faces a fundamental problem when making decisions about whether to consider only the legitimate form of the transaction or also to consider the financial consequences of the transaction. Subject to the second approach, consideration is centred on whether the financial purposes are achieved by way of falsifying tax records. If the case is found to be for that reason, the result of that event is ignored for tax purposes.[8]

In cases that involve tax avoidance, acknowledging the intentions of Parliament and the courts, is crucial. The foundation of the Income Tax Act 1994 means that the court's decision on arrangements must have regard to tax purposes, subject to the

scheme and purpose of the legislation.[9]

Traditionally, in tax cases, the courts have applied the form approach and sustained a taxpayer's arrangement even if tax avoidance is the intention of the arrangement. Recently, this concept has been confirmed in the United Kingdom and a few of the Commonwealth countries. This will be discussed later in Part 2 and Part 3.[10]

The court can only ignore a tax avoidance arrangement when an "anti-avoidance" provision is involved. The Income Tax Act 1994 includes a number of anti-avoidance provisions. These are divided into two classes: specific anti-avoidance provision and general anti-avoidance provision, s BG 1. Specific anti-avoidance provision is only applicable to a specific transaction where the result is specifically identified. Section BG 1, the general anti-avoidance provision, is applicable to all arrangements in relation to tax avoidance purposes and is not limited only to specific transactions. This part will be discussed in Part 6.[11]

5 PART 2: Traditional Approach of the Court

5.1 Traditional approach

Traditionally, on tax cases, the courts have applied the form approach and have sustained an arrangement by a taxpayer even if the intention is to avoid paying tax. This approach is illustrated in the case of IR Commrs v Duke of Westminster [1936] AC 1, which will be discussed on para 5.2.[12]

The legal form of a transaction is still recognised in court, while at the same time, the court is still

required to carefully examine the legal right and duties formed by the parties to find out the correct form of the transaction in question. However, if a transaction is a sham, it is required to be rejected. This approach is considered in the rulings of Richardson J when, on p 61,276 in Buckley & Young Ltd v C of IR at NZTC, he stated that:[13]

> ``*While the nomenclature used by the parties is not decisive, it is the legal rights and duties created by the transaction into which the parties entered and as ascertained by ordinary legal principles, taking into account surrounding circumstances, that must be determined. Thus, while it is legitimate to take into account surrounding circumstances and to refuse to be blinded by terms employed in documents, the documents themselves may be brushed aside only if and to the extent that they are shams...."*

In Finnigan v C of IR (1995) 17 NZTC 12,170, Richardson J gave a statement about the appropriate approach to be implemented, at p 12,173:[14]

> ``*The legal principles governing the characterisation of transactions and payments made under transactions are well settled. Parties are free to choose whatever lawful arrangements will suit their purpose. The true nature of their transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. That does not turn on an assessment of the broad substance of the transaction or of the overall economic consequences to the parties or of legal consequences, which would follow from an alternative course, which they could have adopted but chose not to do. It is the legal character of the transactions that is actually entered into and the legal steps, which are, followed which are decisive. The only exceptions to those principles are where the essential*

> *genuineness of the transaction is challenged and sham is established and where there is a statutory provision such as a s [BG 1] of the Income Tax Act [1994] mandating a broader or different approach which applies in the circumstances of the particular case".*

Finnigan's case reflects the concept of "off-set" in association with a loan made to the taxpayer. The High Court had the impression that the loan had been settled effectively at the time the taxpayer gave the lender some shares. The Court of Appeal rejected the analysis of the situation. None of the parties had made the off-set and they had no intention of making it happen.[15]

Richardson J in NZI Bank Ltd v Euro-National Corporation Ltd (1992) 6 NZCLC 67,913; [1992] 3 NZLR 528, pointed out that a sham may be located in two circumstances. Richardson J, after outlining the traditional approach, states (NZCLC at pp 67,925-6; NZLR at p 539) that: [16]

> *``A document may be brushed aside if and to the extent that it is a sham in two situations. The first is where the document does not reflect the true agreement between the parties in which case the cloak is removed and recognition is given to their common intentions. The second is where the document was bona-fide in inception but the parties have departed from their initial agreement while leaving the original documentation to stand unaltered. Once it is established that a transaction is not a sham its legal effect will be respected. For recent discussions in this Court it is sufficient to refer to Re Securitibank Ltd (No 2) [1978] 2 NZLR 136, Buckley & Young Ltd v C of IR (1978) 3 NZTC 61,271; [1978] 2 NZLR 485, Marac Finance Ltd v Virtue [1981] 1 NZLR 586, Mills v Dowdall [1983] NZLR 154 and Marac*

Life Assurance Ltd v C of IR (1986) 8 NZTC 5,086; [1986] 1 NZLR 694."

The issue in the case of NZI Bank is about the company law, where a company had illegitimately offered financial assistance to purchase its own shares. Richardson J's observation may be expected to reach these circumstances in taxation.[17]

The court of appeal in Attorney-General v Equiticorp Industries Group Ltd (in stat man) (1996) 7 NZCLC 261,064 also ignored the Crown's contentions that the legal position of an arrangement should be rejected by the court and concentrate on the "substance of the matter". The court also said, "that two separate contracts could not be regarded as one transaction".[18]

These two approaches will be discussed more in para 5.3 and para 5.4.[19]

5.2 Duke of Westminster case

The issue in the case of IR Commrs v Duke of Westminster [1936] AC 1, was that the actual transaction entered into by the taxpayer should be the focus of attention, according to the House of Lords. The details were that the Duke had made an agreement that he would pay his gardener an annuity (pension or allowance), in which case, it could be claimed as deduction for tax purposes, whereas the gardener's wages were not deductible. This form of transaction was not accepted by the Revenue, and it was decided that the Duke should be taxed on the substance of the transaction, which was, that the payment of the annuity should be treated as a payment of salary or wages. The Crown's claim of the substance doctrine was clearly rejected by the

House of Lords. Lord Tomlin [1936] AC at pp 19-20 recognised the reality of the substance doctrine but then went on to say:[20]

> ``*This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled and the supposed doctrine given its quietus the better it will be for all concerned, for the doctrine seems to involve substituting 'the uncertain and crooked cord of discretion' for 'the golden and straight met wand of the law', 4 Inst 41. Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."*

Lord Russell of Killowen agreed with this observation and stated [1936] AC at pp 24-25 that:[21]

> ``*I confess that I view with disfavour the doctrine that in taxation cases the subject is to be taxed if, in accordance with a Court's view of what it considers the substance of the transaction, the Court thinks that the case falls within the contemplation or spirit of the statute ... If all that is meant by the doctrine is that having once ascertained the legal rights of the parties you may disregard mere nomenclature and decide the question of taxability or non taxability in accordance with the legal rights, well and good. That is what this House did in the case of Secretary of State in Council*

> *of India v Scoble (1903) 4 TC 618, that and no more. If, on the other hand, that doctrine means that you may brush aside deeds, disregard the legal rights and liabilities arising under a contract between parties, and decide the question of taxability or non taxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine."*

The rulings in Duke of Westminster and the required approach have been recognised in New Zealand as proper law.[22]

In the case of C of IR v Europa Oil (NZ) Ltd 70 ATC 6012; [1971] NZLR 641, it illustrated the rejection of the substance approach. The issue in the case was if the taxpayer company's deduction for its trading stock is minimised by the advantage that returns to the company, then the Commissioner's rejection of the claim would result in a discount. The Privy Council's decision was that the company's deduction should be minimised to that level and held that "it is not legitimate in this branch of the case ... to disregard the separate corporate entities or the nature of the contracts made and to tax Europa on the substantial or economic or business character of what was done". In Re Securitibank Ltd (No 2) [1978] 2 NZLR 136, a similar decision was held by the Court of Appeal, that the court must assure the real character of the transaction by reflecting on the legal nature of the agreement that incorporated the transaction. During Richardson J judgement ([1978] 2 NZLR at pp 167-168) he held that:[23]

> *1) ``It is well settled that, where documents have been drawn to define the relationship of persons involved in a business operation,*

the true nature of the transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out (Helby v Matthews [1895] AC 471; IR Commrs v Duke of Westminster [1936] AC 1; Commrs of IR v Wesleyan & General Assurance Society (1946) 30 TC 11). As Lord Tomlin said in the Duke of Westminster case:

2) *'... the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles...'([1936] AC 1, 20-21).*

3) *It is the legal character of the transaction which is decisive, not the overall economic consequences to the parties (C of IR v Europa Oil (NZ) Ltd [1971] NZLR 641, 648-649; [1971] AC 760, 771-772; Europa Oil (NZ) Ltd v C of IR [1976] 1 NZLR 546, 553; [1976] 1 WLR 464, 472)."*

The Court of Appeal returned to this topic in Buckley & Young Ltd v C of IR that Richardson J, during his judgement, mentioned the observation of Lord Russell of Killowen as stated above and gave a brief of the position (3 NZTC at p 61,276) as stated below:[24]

> ``*While the nomenclature used by the parties is not decisive, it is the legal rights and duties created by the transaction into which the parties entered and as ascertained by ordinary legal principles, taking into account surrounding circumstances, that must be determined. Thus, while it is legitimate to take into account surrounding circumstances and to refuse to be blinded by terms employed in documents, the documents themselves may be brushed aside only if and to the*

> *extent that they are shams, in the sense of not being bona fide in inception or of not having been acted upon...."*

In Buckley & Young Ltd v C of IR, the case is significant for the fact that part of the documentation about the retirement of the company's director was rejected by the Court of Appeal because such part was not the parties' real purpose. The part in question involved the director's appointment to become the company's tax consultant at the amount of $6,000 salary. The rejection was based on the ground that there was no intention that the director would work as a tax consultant. The findings of the Court of Appeal were that the company's expenditure including the $6,000 salary was to get a restrictive covenant and for an unsatisfactory employee's retirement protection.[25]

The issue in Mills v Dowdall [1983] NZLR 154 was whether the conveyance of property transactions be considered "as a gift for matrimonial property purposes where there was an intention that the purchase price should be forgiven". The Court of Appeal stressed that the answer should examine the legitimate nature of the transaction that was really happening. Richardson J [1983] NZLR at pp 159-160 held that:[26]

> *``It frequently happens that the same result in a business sense can be attained by two different legal transactions. The parties are free to choose whatever lawful arrangements will suit their purposes. The true nature of their transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. Not on an assessment of the broad substance of the transaction measured by the results intended and*

achieved; or of the overall economic consequences to the parties..."

5.3 Determining the form of the transaction

The court had considered the legal character or the form of a transaction in all the cases discussed above and so as its legitimate nature by taking into account the entire contractual arrangement and other situations the courts see fit. Richardson J in Mills v Dowdall [1983] NZLR 154 at pp 159-169 explained how the court would determine the real legitimate manner of a transaction or groups of transactions.[27]

First, is to carefully take into account the legitimate arrangements that were actually happening in order to find out the real character of a transaction. The evaluation of the result of the broad substance that was aimed for and succeeded was excluded or the whole financial results to the groups; or the legitimate results from taking a different path they could have taken if they decided to do that. The forms that were taken could be rejected "as mere machinery" on the grounds that the groups' plans were succeeded. Determination of the form is based on two grounds: to observe the legitimate nature of the transaction that has actually been entered into and to record the legitimate steps that have been followed.[28]

Secondly, the entire contractual agreement must be taken into account and if the contract contains many complicated or interconnected agreements, the whole arrangement must be considered together and only one can be read to represent the others. For instance, the Privy Council, in both cases of C of IR v Europa Oil (NZ) Ltd 70 ATC 6012; [1971] NZLR 641 and Europa Oil (NZ) Ltd v C of IR (No 2)

(1976) 2 NZTC 61,066 [1976] 1 NZLR 546, said that "application of the deduction provisions of s 111 of the 1954 Act was determined on an analysis of a whole series of linked agreements. It was not confined to a consideration of the relevant purchase contract under which orders for the supply of petroleum were made and the expenses in question were incurred".[29]

A requirement should be included. The contracts, even though they are interconnected, should be looked at individually. The Crown, in the case of Attorney-General v Equiticorp Industries Group Ltd (in stat man) (1996) 7 NZCLC 261, contended that two contracts entered into on the same day should be treated as individual elements of the same transaction. The sale of shares owned by the Crown in New Zealand Steel was one contract and the other contract was with the sharebroker that sought buyers for shares of Equiticorp to replace the New Zealand Steel shares. The Crown's argument was rejected by McKay J and held (at p 261,071) that:[30]

> ``*Even if one were to accept the proposition that the two contracts were inter-related in the sense that one would not have been entered into without the other, this would not enable them to be regarded as a single transaction. The position is quite different where two documents, neither of which would be entered into without the other, are made between the same parties at the same time. In such a case, the true intention of the parties must be ascertained from construction of the documents to ascertain whether there is one contract or two. If the documents show that separate contracts were intended, they will take effect accordingly. Here the parties are different, and the Crown accepts that they are separate contracts.*

> *It says they are inter-related, and are part of one transaction. That may be true, if one uses the word transaction in its wider sense, but it does not enable the Court to ignore their separate nature."*

The Crown sought to lift the corporate veil in which the court went on to decline the argument.[31]

The group's discussion when determining the form of the transaction seemed to have limited meanings. The Court of Appeal in Buckley & Young Ltd v C of IR (1978) 3 NZTC 61,271 at p 61,276 mentioned this topic in the following words:[32]

> ``*The inquiry is not concerned with what was in the minds of some or all of the parties at an earlier negotiating stage in relation to an inchoate transaction, or with the surrounding circumstances at the earlier time. The motives of the negotiators and the relative significance attached by them, or some of them, to various factors at the outset of negotiations are not necessarily reflected in the agreement that is eventually reached. Moreover, transactions evolve in the course of negotiations and their character may change. There are sound reasons for refusing to admit evidence of negotiations or of the views and intentions of the parties which do not appear from the concluded agreements."*

Likewise to any association with marketing of the transaction (Marac Life Assurance Ltd v C of IR (1986) 8 NZTC 5,086, at p 5089):[33]

> ``*... the true nature of the contract must be determined by reference to its fundamental features, not by the manner of its commercial marketing."*

The language of the contract must contain the meaning that is referred to and what the court thinks and after referring to the appropriate facts that are

known to the parties when they were contracted. The words used are the starting point: Tag Pacific Ltd v The Habitat Group Ltd (1999) 19 NZTC 15,069 at p 15,073. The court must give effect to a contract if the words are clear and it is prohibited to use the background when seeking for an alternative meaning. Benjamin Developments Ltd v Robt Jones (Pacific) Ltd [1994] 3 NZLR 189 at p 203 per Hardie Boys J.[34]

Thirdly, it is permissible to provide evidence in the attempt to comprehend the setting of the agreement. Giving evidence does not change the oral or written agreement but only to locate where the transaction first started. It is only the appropriate circumstances that existed at the time the transaction under examination was entered into that should be considered. Any conditions existed before that time should be disregarded. Any late action of the groups towards a transaction is generally prohibited to be included in ascertaining the legal characters of a transaction. The Privy Council in Ashton v C of IR (1975) 2 NZTC 61,030 at p 61,034 at p 61,034 commented on this point.[35]

5.4 Sham

Sham is defined as "a transaction set up to conceal the true intention of the parties". In the eyes of law it is basically unsuccessful, therefore, a section like s BG 1 is not needed to knock down cases like these.[36]

A typical meaning of sham was used in Snook v London & West Riding Investments Ltd [1967] 1 All ER 518 where Diplock L J at p 528 stated that:[37]

> ``*I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the Court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities ... that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations, which they give the appearance of creating. No unexpressed intentions of a 'shammer' affect the rights of a party whom he deceived."*

Richardson J in Mills v Dowdall [1983] NZLR 154 explained the notion of sham as circumstances in which the "essential genuineness of the transaction is challenged".[38]

Sham was observed to exist in that case in two circumstances:[39]

1) *"where the documents do not reflect the true agreement between the parties;*
2) *where the documents are bona fide in inception but the parties have departed from their initial agreement while leaving the original documentation to stand unaltered".*

The case of Jacques v FC of T (1924) 34 CLR 328 has found that a sham does not require s BG 1 to strike it down that Isaacs J (at p 358) held that:[40]

> ``*... a sham transaction is inherently worthless and needs no enactment to nullify it."*

Consequently, a similar concept was adopted in Hancock v FC of T (1961) 12 ATD 312, at p 328 and Newton v FC of T (1958) 11 ATD 187, at p 225.[41]

In Withey v C of IR (1998) 18 NZTC 13,606, a separate concept was adopted. In this case, it is about using the "JG Russell template" where a group of tax loss companies purchased the shares of a profitable company. The profitable company paid the management fee that the loss group charged. The fee was the same amount as the purchase price, less a fee and then was paid to the former shareholders of the profitable company for selling the shares. This transaction was found to be a scheme in which s BG 1 is applied to strike it down. More discussion about this later on.[42]

When the profitable company prepared its account for the year ending 31 March 1987, it contained a $96,000 administration fee, which absorbed the entire company's profit for the same year. Baragwanath J observed that the template was included in the agreements and also the management agreement was not accounted for until early 1988. His Honour found the transaction for the year to 31 March 1987 a sham.[43]

Baragwanath J held that the discovery of sham had raised two questions. The first was whether the company's profit for the year should be adjusted to the company and the second was whether s BG 1 would apply to assess the shareholders personally. In applying the last approach, Baragwanath (at p 13,615) held that:[44]

> ``*In New Zealand, however, the definition of the term 'arrangement' is not limited to transactions, which have an effect in law. On the contrary by s 99(1):*
>
> *'For the purposes of this section —*
>
> *"Arrangement" means any contract, agreement, plan or understanding whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect: ...' (Emphasis added).*
>
> *I see no reason either verbal or of policy to withhold from the operation of s 99 a purported transaction, which is relied upon by a taxpayer as effective, but which on analysis turns out to be a sham. If an effective contract can be rendered absolutely void by s 99(2) and entail reconstruction under s 99(3) to counteract the tax advantage obtained by a person therefrom or thereunder, a fortiori the s 99(3) should be available to deal with a sham constructed to avoid tax. The principle omne majus continet in se minus — the greater includes the less — applied by Richardson J in Goldsbro v Walker (1993) 4 NZBLC 102,946 at pp 102,954, 102, 955; [1993] 1 NZLR 394 at p 404 justifies the inclusion within 'contract, agreement, plan, or understanding' within the meaning of s 99 of something which is represented to the Commissioner to be such, even if the representation turns out to be false."*

It is not possible to reconcile this observation with what it states on s BG 1 "that a tax avoidance arrangement is void as against the Commissioner". There is nothing to void in a sham's case. In addition, his Honour's observation is hard to reconcile with his earlier approach in another case of JG Russell template: Miller v C of IR; McDougall v C of IR (1997) 18 NZTC 13,001. In that case, after referring to the judgement of Isaacs J in Jacque's case, including the view stated above, as of s 99 of

the 1976 Act (at p 13,027), Baragwanath J observed that:[45]

> *"I am satisfied that s 99 is not at all on the same hierarchical level as sections such as 104, 188 and, as will appear, s 191. It is a section that deals with transactions altogether lawful in terms of the general law and the general provisions of the Income Tax Act but which nevertheless infringe its terms. Section 99 does concern reality and the lawfulness, but in a sense quite different from the general provisions. It begins to bite when their operation is complete."*

This comment is coherent in relation to the defensive character of s BG 1. The function of the provision is to ascertain that other sections of the Act are functioning according to the intention of Parliament. There are no other sections that a case of a worthless sham will get around them.[46]

The case of Australian Mutual Provident Society v Prisk (1987) 9 NZTC 6,015 is about the establishment of a company to provide a management work to professional partnerships and the partners would become employees to provide services needed in which these services would create a tax deduction on the partners' accounts. The High Court said that the arrangement did not form a sham. The groups intended to form a superannuation scheme as was required by the employer and employee relationship of the service company and the partners. Based on that point, the groups had not done any action that did not match the facts and intended to mislead a third person and the court continued to say "that the partners were in an employment relationship".[47]

The case of Stone [2001] BTC 78 (CA) is about an English ruling on a scheme that involved a document that had one component a sham and was confirmed a sham up to the end despite the other component being clear from a sham.[48]

The case addresses a document which executed two transactions: one which was a sham and the other which was not. Arden LJ said that there was no rule of "all or nothing" that demanded all groups connected to a document to have the purpose that it would not take effect as it was written in the document. Moreover, any sort of rule was irrelevant when more than one transaction was executed in a document.[49]

In reviewing the statements associated with shams, his Honour said that:[50]

1) *"64. An inquiry as to whether an act or document is a sham requires careful analysis of the facts and the following points emerge from the authorities.*
2) *65. First, in the case of a document, the court is not restricted to examining the four corners of the document. It may examine external evidence. This will include the parties' explanations and circumstantial evidence, such as evidence of the subsequent conduct of the parties.*
3) *66. Second, as the passage from [Snook v London and West Riding Investments Ltd [1967] 1 All ER 518] makes clear, the test of intention is subjective. The parties must have intended to create different rights and obligations from those appearing from (say) the relevant document, and in addition, they must have intended to give a false impression of those rights and obligations to third parties.*

4) *67. Third, the fact that the act or document is uncommercial, or even artificial, does not mean that it is a sham. A distinction is to be drawn between the situation where parties make an agreement, which is unfavourable to one of them or artificial and a situation where they intend some other arrangement to bind them. In the former situation, they intend the agreement to take effect according to its tenor. In the latter situation, the agreement is not to bind their relationship.*
5) *68. Fourth, the fact that parties subsequently depart from an agreement does not necessarily mean that they never intended the agreement to be effective and binding. The proper conclusion to draw may be that they agreed to vary their agreement and that they have become bound by the agreement as varied: see for example Garnac Grain Co Inc v HMF Faure & Fairclough Ltd [1966] 1 QB 650, at pp. 683-684 per Diplock L J,*
6) *69. Fifth, the intention must be a common intention: see Snook's case, above."*

6 PART 3: Contemporary Approach

6.1 Discussion of Contemporary Approach

It has been discussed in the traditional approach (at Part 2 (para 5.1) how the courts have taken in a form approach in tax cases and have sustained a taxpayer's arrangement even if the intention or aim "of those arrangements is to avoid tax".[51]

A chain of cases in the United Kingdom (WT Ramsay Ltd v Commrs of IR (1981) 54 TC 101; [1981] 1 All ER 865; [1982] AC 300, IR Commrs v Burmah Oil Co Ltd [1982] BTC 56 and Furniss (HMIT) v Dawson; Murdoch (HMIT) v Dawson [1984] BTC 71) shows that this traditional approach

may be changed by letting the court rejects any component of a transaction entered into by a taxpayer when there is no business or commercial intention besides tax avoidance. The principle of "fiscal nullity" seems to merge only with the form of the transaction entered into. The House of Lords in its later ruling in Craven (HMIT) v White [1988] BTC 268 validated the traditional approach whereas their Lordships in IR Commrs v McGuckian [1997] BTC 346 applied the Ramsay approach by considering the transaction's substance.[52]

Nevertheless, the House of Lords apply the principles of the court's role to constantly ascertain the legitimate character of transactions under scrutiny and then applies to them the suitable legislation. The House of Lords in Westmoreland Investments Limited v MacNiven (HMIT) [2001] BTC 44 held that "Ramsay did not enunciate any new legal principle". The ultimate question is often about the construing of specific legislated sections and its relevance to the case. Construing any legislated sections includes a useful approach to the legislature and its interpretation. The courts take into account the intention of the words to succeed when finding the Parliament's intention for that legislation.[53]

In the case of Citibank Investments Ltd v Griffin (HMIT) [2000] BTC 324, another English case, it illustrates that a commercial transaction that involves no artificial steps entered into for tax purposes will be irrelevant to the fiscal nullity doctrine outlined in Ramsay by the House of Lords.[54]

These cases were discussed in the Duke of Westminster approach at Part 2 para 5.2.[55]

Australian courts have applied the traditional approach and ignored the proposal, independently of Craven (HMIT) v White, "that there might ever be a fiscal nullity concept". Further details about Australia's view will be discussed at para 6.9.[56]

The fiscal nullity principle is yet to be part of New Zealand law but the matter is still considered by the New Zealand courts. Nevertheless, in C of IR v Auckland Harbour Board, the Privy Council found that s BG 1, the general anti-avoidance provision, had done some work that is now replaced by the approach from the Ramsay case. Further details about this matter will be discussed at para 6.8.[57]

6.2 United Kingdom courts approach

Traditionally, the courts in the United Kingdom have applied the doctrine from Duke of Westminster (IR Commrs v Duke of Westminster [1936] AC 1) and taken the form approach in tax cases. They have sustained a taxpayer's arrangement even if the intention was tax avoidance (refer to Part 2 (para 5.1). Nevertheless, in a chain of cases a serious restriction was caused by this theory.[58]

The House of Lords in these three related cases (WT Ramsay Ltd v IR Commrs (1981) 54 TC 101; [1981] 1 All ER 865, IR Commrs v Burmah Oil Co Ltd [1982] BTC 56 and Furniss (HMIT) v Dawson; Murdoch (HMIT); Dawson [1984] BTC 71) seemed to change the doctrine in the case of Duke of Westminster by allowing the court to reject any portion of a "transaction entered into by a taxpayer

when that step has no business or commercial" intention besides avoiding tax. The fiscal nullity principle seemed to create a theory at common-law similar to the function of s BG 1 of the Income Tax Act 1994. Another English case, Citibank Investments Ltd v Griffin (HMIT) [2000] BTC 324 illustrated that a commercial transaction without artificial steps entered into for tax purposes will not be affected by the fiscal nullity doctrine outlined in the Ramsay case by the House of Lords. The last ruling in the case of Westmoreland Investments Ltd v MacNiven (HMIT) [2001] BTC 44 supports this matter as House of Lords classified Ramsay as helpful in construing the legislative. The legitimate character of the transaction in question, which is applied to the legislated sections, is constantly significant.[59]

The House of Lords in Craven (HMIT) v White [1988] BTC 268 affirmed the traditional approach as the correct one. Nevertheless, their decisions in IR Commrs v McGuckian [1997] BTC 346, favoured the Ramsay approach.[60]

6.3 MacNiven

The taxpayer, in MacNiven, Westmoreland Investment Ltd, which belonged to the Electricity Supply Pension Scheme (ELPS) trustees, was an approved superannuation scheme which was exempt from income tax. ELPS lent some money to Westmoreland to invest on some properties. Westmoreland incurred huge losses. Westmoreland properties were liquidated in which the company ended with no assets and owed so much to ELPS, a £40 million sum owed with interest included. Companies with established losses are deductible at

the time. This loss, under s 338 of the Income and Corporation Taxes Act 1988 (U. K.), is deductible only when paid. ELPS again lent Westmoreland the money to pay for the interest that was accrued. Westmoreland paid the interest after tax and on the same day, this interest was exempt from tax and ELPS could reclaim the amount from the Inland Revenue. A buyer for the shares was found and these transactions were caused by the loan that was owed by Westmoreland.[61]

The House of Lords agreed that the settlement of the debt and the interest were genuine and were eligible to "paid" for the purposes of s 338. This was the result despite there being no business purpose and each step in the transaction was predetermined and was aimed to receive tax benefits. It was not a wrong doing to lend money to the borrower to settle the interest that was owed to the lender. "Paid" was a legal concept and was not aimed to have a commercial definition. Lord Hope of Craighead clarified this matter at p 63-64.[62]

> ``*... the question, which has to be resolved, depends on the meaning of the words used in the statute, which are said to allow the deduction. It is one of statutory interpretation. I would approach it without any preconceived notions as to whether this is a case of tax mitigation or of tax avoidance. The only relevant questions are: (1) the question of law: what is the meaning of the words used by the statute? And (2) the question of fact: does the transaction, stripped of any steps that are artificial and should be ignored, fall within the meaning of those words?"*

There are many words in tax laws that have legitimate perceptions with no wider commercial

definition that their Lordships were differentiated from the legislative language, which is an issue that the Parliament is aimed to have a commercial definition. The Ramsay doctrine was irrelevant in these later cases according to their Lordships. Lord Hoffmann continued to say that "although a word may have a 'recognised legal meaning', the legislative context may show that it is in fact being used to refer to a broader commercial concept".[63]

The Ramsay case and the case of Duke of Westminster were reconciled by Lord Hoffman. There were difficulties in the reconciliation of the two cases that Lord Tomlin's statement had clarified "that the court could not ignore 'the legal position' and have regard to 'the substance of the matter'". Lord Hoffman clarified at p 54 that:[64]

> *``If 'the legal position' is that the tax is imposed by reference to a legally defined concept, such as stamp duty payable on a document which constitutes a conveyance on sale, the court cannot tax a transaction which uses no such document on the ground that it achieves the same economic effect. On the other hand, if the legal position is that tax is imposed by reference to a commercial concept, then to have regard to the business 'substance' of the matter is not to ignore the legal position but to give effect to it."*

In the case of Burmah, Lord Brightman observed that the "inserted steps are to be disregarded for fiscal purposes". Lord Hoffman construed this statement to mean "that the steps should be disregarded for the purpose of applying the relevant fiscal concept". It did not mean to consider the transaction as it never happened for tax purposes. In Burmah's case, Lord Hoffmann observed that the

case decided "that the statutory concept of a loss accruing upon a disposal has a business meaning and that the "disposal" and "loss" suffered by Burmah did not fall within it ". His Honour's observation, by referring to the MacNiven case, at p 60:[65]

> *``To apply this reasoning to the present case, it would be necessary to construe the concept of payment in section 338 as having some business meaning other than the simple discharge of a debt. Otherwise one is not giving effect to the statutory language."*

The Ramsay doctrine is applicable to a transaction, which is artificial according to Lord Hutton. Understanding to pay the interest, according to this case, Westmoreland faced the financial burden which is caused by a deduction and that was what Parliament wanted to happen.[66]

6.4 Citibank Investments Ltd v Griffin

The case of Citibank Investments Ltd v Griffin (HMIT) [2000] BTC 324, (an English case) illustrates a commercial transaction that has no artificial steps entered into for tax purposes in which case it falls outside the scope of the fiscal nullity doctrine that is outlined by the House of Lords in WT Ramsay Ltd v IR Commrs (1981) 54 TC 101; [1982] AC 300.[67]

The taxpayer wanted to invest money, in December 1994, to create a capital return in April 1996. Two options were purchased with the same exercise date with intention of creating a predetermined return when started. Each option was purchased on its fair market value and each option was entered into under the normal principles. Under the Taxation of Chargeable Gains Act 1992 each individual option

was a "qualifying option and liable to pay capital tax;" and not income under schedule D. according to the Income and Corporation Taxes Act 1988. The Revenue wanted to treat the interests on the loan as income because there was one composite transaction.[68]

The issues are in two parts:[69]

1) *"Whether the two option contracts constituted a single composite transaction."*
2) *"Whether Furniss v Dawson [1984] BTC 71; [1984] AC 474 was an exhaustive test."*

The appeal was rejected by the High Court. First, the following cases WT Ramsay Ltd v IR Commrs (1981) 54 TC 101 [1982] AC 300, Furniss v Dawson and Craven v White [1988] BTC 268; [1989] AC 389 had provided the sources for the argument that the options had created one composite transaction. Before a chain of transactions was liable to be taxed as one composite transaction, the following requirements must be met first:[70]

1) *"that a series of transactions was pre-ordained; or*
2) *that it had no purpose but tax mitigation;*
3) *that there was no practical likelihood that the events would not take place in the order ordained; and*
4) *that the events did take place as ordained."*

Based on the facts, the special Commissioner had confirmed that the situation (3) was irrelevant and an appeal was unnecessary. It appeared that the situation (2) was irrelevant because the investor had only made a bad investment and then attempted to

escape the current taxable liability. Furthermore, every step entered into contained a business purpose. These options, based on these reasons, were not one composite transaction therefore they should be individually taxed according to the decision already made by the special Commissioner.[71]

Secondly, based on the rule, there was no basic rule available to be applied on these kinds of transactions, with obvious commercial purposes, no artificial steps and a full market value was applied under the common principles. The theory from Ramsay prohibited genuine transactions like the two options to be completely altered if the above situations were not satisfied.[72]

6.5 The development of the fiscal nullity doctrine

The taxpayer in the case of WT Ramsay Ltd v IR Commrs produced a profit that was liable to capital gains tax. A ready-made scheme was already set up to create an allowable loss that was purchased by the taxpayer with the intention of avoiding the capital gains tax. There was a quick timetable to be followed with the scheme, such as few steps to be followed, documents to be implemented and costs to be paid. After a few attempts applying the scheme, the taxpayer paid a fee and the cost of expenses to the promoter and his financial status stayed the same as it was before. The scheme's efficiency was criticised by the Crown and he argued that the scheme should be ignored because it was "artificial and fiscally ineffective" that it was approved by the House of Lords.[73]

Lord Wilberforce, who read the majority decision, concluded that the taxpayer was trying to counteract a loss that was not included in the statutory in question. In analysing the details of the scheme, his Lordship noted that the steps that followed were set up to generate not a gain or even a loss. The steps were cancelling each other out, that after a few days the taxpayer would return to the same position where he had started and the fees and expenses that were paid were not counted. Lord Wilberforce, 54 TC at p 187, said that:[74]

> ``*The capital gains tax was created to operate in the real world, not that of make belief. As I said in Aberdeen Construction Group Ltd v Commrs of IR (1978) 52 TC 281, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function."*

Lord Wilberforce made important remarks concerning what action the courts should consider, in cases that involved tax avoidance.[75]

1. *"A taxpayer was only to be taxed if the legislation clearly indicated that this was the case.*
2. *"A taxpayer was entitled to reduce his or her affairs so as to reduce tax.*
3. *"Even if the purpose or object of a transaction was to avoid tax this did not invalidate a transaction unless an anti-avoidance provision applied.*
4. *"If a document or transaction was genuine and not a sham in the*

> *traditional sense the court had to adhere to the form of the transaction following the Duke of Westminster concept."*

The court should follow the form of the transaction in accordance with the concept adopted in the Duke of Westminster, if a document or transaction is not a sham but is genuine.[76]

Lord Wilberforce decided that "it would be quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which produced the loss, that being entirely dependent upon, and merely a reflection of the gain. The true view, regarding the scheme as a whole, is to find that there was neither a gain nor a loss, and I so conclude" (at p 189).[77]

With approval, Lord Fraser of Tullybelton said that there was no loss created by the scheme with the intention of capital gains tax. His Lordship also agreed with the Crown that the whole scheme should be considered as a single transaction. Each step should not be considered individually because each step related closely to each other and created a component of one scheme. The pre-determined scheme was bought by the taxpayer because it was set up to create a loss to equal the gain that was already made and that loss became available as allowable deduction for the purposes of capital gains tax. The court, based on the law, must consider the scheme as a whole in situations like this according to his Lordship. The important element of the scheme, in this case, was that the taxpayer did not incur any loss. Moreover, the taxpayer was not required to produce any money besides the fee even though there was a big amount of money involved in debiting and crediting the taxpayer, which is part of

the scheme's conditions. The scheme did not create a loss in consideration of it as a whole.[78]

Lord Fraser of Tullybelton continued to say that he did not mean "that the legal form of the transaction should be disregarded in favour of its supposed substances". His Lordship said nothing to contradict the rulings in Duke of Westminster.[79]

The case of WT Ramsay Ltd v IR of Commrs (1981) 54 TC 101 was referred to by the House of Lords in IR Commrs v Burmah Oil Co Ltd and said that there was no allowable capital loss created by the pre-determined scheme with the intention of creating a capital gains tax. The taxpayer, in that case, owed £160 million in bad debts and it was not deductible for the purposes of capital gains tax as there was no security on the debt. The scheme was set up to change the loss into a deductible loss. The scheme was unsuccessful due to no real loss created by it according to the House of Lords.[80]

Lord Fraser, who read the final decision of the majority, said there was no real loss created by the scheme in question. His Lordship considered the scheme to be in the same class as Ramsay because the loss that both cases wanted to counteract had emerged from a chain of transactions that had no self-regulating financial consequences besides the loss that was created. In referring to Ramsay [1982] BTC at p 64, he observed that:[81]

> ``*If the argument for Burmah is right, this would be one more case in which the taxpayer had achieved the apparently magic result of creating a tax loss that was not a real loss. In my opinion they have not achieved that result because, in the same way as in*

> *Ramsay's case, when the scheme was carried through to completion there was no real loss and no loss in the sense contemplated by the legislation."*

Lord Diplock arrived in a conclusion similar to Lord Fraser and said that Ramsay allowed the court to reject "circular book entries and look at the end result". The taxpayer, in this situation, had not experienced a real loss as stated in the provisions of the statute.[82]

Even though the judgements in both the Ramsay and Burmah cases were described based on the form of the transaction applied by the taxpayer and were outside the legislation's principles (despite the purpose was tax avoidance), the judgement of the House of Lords in Furniss (HMIT) v Dawson made the situation uncertain. In brief, the case was about the sale of the taxpayer's shares in a private family company in which the taxpayer was liable to pay capital gains tax. He entered into a scheme in order to avoid this tax liability by swapping over his shares for shares in a specially incorporated holding company in which the company sold the taxpayer's shares to the final buyer. The transaction involved two steps: first was the swap over of the shares and second was the purchasing of the shares in which case the first step was outside the capital gains statutory provisions while the straight sale of the shares would be subject to the capital gains legislation.[83]

The scheme was unsuccessful according to the House of Lords because the form of the transaction, (although it contained two individual steps) could be rejected and the taxpayer should be regarded as if his shares were sold straight to the final buyer. Lord

Brightman, who read the majority decision, held [1984] BTC at p 83 that:[84]

> ``*My Lords, in my opinion the rationale of the new approach is this. In a pre-planned tax saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step seriatim. In a contractual case, the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results. For example, equitable interests may pass when the contract for sale is signed. In many cases, equity will regard that as done which is contracted to be done. Ramsay says that the fiscal result is to be no different if the several steps are preordained rather than precontracted."*

Lord Brightman continued and said that the Ramsay rule was relevant although the scheme was not under a binding contract: "[the] fiscal result cannot be avoided because the preordained series of steps are found in an informal arrangement instead of in a binding contract" ([1984] BTC at p 83). Lord Brightman pointed out two requirements while affirming the elements of the Ramsay rule. "First, there must be a preordained series of transactions or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e., business) end. Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax "— not no business effect". His Lordship said that if these two elements were present, the added steps

would be ignored for fiscal intentions. The end-result must be examined by the court. His Honour continued to say that the proper tax to be applied to the end-result would rely on the appropriate provisions of tax legislation applied.[85]

In the Furniss (HMIT) v Dawson judgement it seemed to be a significant expansion of the category of the transaction that was entitled to be struck down subject to Ramsay. The House of Lords, in Ramsay, rejected the success of scheme with a tax avoidance document without permanent fiscal or business value. This is contradictory to the scheme that was discussed in Furniss v Dawson, which contained a real business transaction. Their lordships acknowledged the court's authority to reject only transactions with tax avoidance purposes.[86]

6.6 Craven (HMIT) v White

Even though, in Furniss, the House of Lords seemed to strike down the transaction by the taxpayer for the purposes of tax avoidance, the House of Lords in a later judgement in Craven (HMIT) v White clarified the position. The House of Lords, in that case, analysed a similar scheme to Furniss. In Craven, however, the House of Lords was ready to sustain the same transaction that had been struck down in Furniss. Lord Oliver, who read the decision of the majority, verified that Ramsay, Burmah and Furniss did not produce any legal principle that would nullify any transaction that had no intention besides tax avoidance. His Lordship at [1988] BTC p 294 held that:[87]

> ``*My Lords, for my part I find myself unable to accept that Furniss either established or can properly be used to*

> *support a general proposition that any transaction which is effected for the purpose of avoiding tax ... [is] to be treated as ... having no independent effect ..."*

His Lordship described Furniss on the basis that the series of events were carefully arranged and implemented so that it could be considered as one whole transaction. In Furniss, the transference of the taxpayer's shares to the holding company and the final sale of the shares to the buyer were connected and implemented so closely that it could be considered as one transfer from the taxpayer to the buyer. In the existing case, the transfer to the holding company and the sale to the final buyer were happening at two separate times and therefore it could not be considered as a single transaction and as the purposes for tax avoidance were inapplicable, the transactions were successful.[88]

Lord Oliver outlined the situations that must be present if transactions were to combine as it happened in Furniss:[89]

1) *"The series of transactions must be preordained at the time the intermediate transaction was entered into.*
2) *"The transaction must have had no other purpose than tax mitigation.*
3) *"There must have been no practical likelihood that the pre-planned events would not take place in the order ordained so that the intermediate transaction was not even contemplated practically as having independent life.*
4) *"The preordained events must have in fact taken place".*

A similar conclusion to Lord Oliver was reached by Lord Keith and Lord Jauncey.[90]

6.7 IR Commrs v McGuckian

The House of Lords in IR Commrs v McGuckian [1997] BTC 346 said that "the substance of a transaction may be considered if it is a tax avoidance scheme". Lord Steyn observed in a traditional approach (at p 353) that:[91]

> *``While Lord Tomlin's observations in the Duke of Westminster case still point to a material consideration, namely the general liberty of the citizen to arrange his financial affairs as he thinks fit, they have ceased to be canonical as to the consequence of a tax avoidance scheme."*

McGuckian's case is about two shareholders in Ballinamore, an Irish company, whose shares were purchased by Shurltrust, a Guernsey trustee company, in which the beneficiaries of the trust were the taxpayers. In 1979, Mallardchoice was given the right by Shurltrust to any dividend paid by Ballinamore. Shurltrust anticipated funding a capital receipt from dividends to be paid by Ballinamore and in contemplation of a right to future dividends. One of the original shareholders from Ballinamore received this receipt after a consultant's fee was deducted. The shareholder's receipt was adjusted by the Revenue. The Revenue did not apply the Ramsay doctrine but argued in front of the House of Lords that the transaction, sale of the shares, was artificial and was entered into with a dominant purpose of receiving a tax benefit. The truth of the transaction was that the dividend that was paid to Shurltrust by Ballinamore was income of Shurltrust. This analysis was accepted by the House of Lords.[92]

Lord Steyn used some of Ramsay's principles whether "there is a rule precluding court from

examining the substance of the composite tax avoidance scheme". Lord Steyn concluded (at p 353) that:[93]

> ``*The new Ramsay principle was not invented on a juristic basis independent of statute. That would have been indefensible since a court has no power to amend a tax statute. The principle was developed as a matter of statutory construction. That was made clear by Lord Wilberforce in Ramsay and is also made clear in subsequent decisions in this line of authority: see the review in the dissenting speech of Lord Goff of Chieveley in Craven (HMIT) v White [1989] AC 398 at pp. 520-521; [1988] BTC 268 at p 302-303. The new development was not based on a linguistic analysis of the meaning of particular words in a statute. It was founded on a broad purposive interpretation, giving effect to the intention of Parliament. The principle enunciated in Ramsay was therefore based on an orthodox form of statutory interpretation. Moreover, in asserting the power to examine the substance of a composite transaction the House of Lords was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis. Given the reasoning underlying the new approval it is wrong to regard the decisions of the House of Lords since Ramsay as necessarily marking the limit of the law on tax avoidance schemes."*

No doubt McGukian was associated with the tax avoidance scheme. The scheme's intention was to make a capital receipt out of a taxable dividend. McGukian had affirmed the fiscal nullity doctrine from the approach of the United Kingdom towards tax penalties which emerged from tax avoidance schemes. The judgement did not seem to have a scope that was expanded to a transaction that involved a business reason but involved a

characteristic of a tax saving. The analysis of the transaction was under the principles in Duke of Westminster, since the entire transaction was not a tax avoidance scheme.[94]

6.8 The view of fiscal nullity doctrine in New Zealand

In the case of C of IR v Auckland Harbour Board (2001) 20 NZTC 17,008 the Privy Council included the fiscal nullity approach in their judgement. However, while the specific general anti-avoidance provisions were in force, the fiscal nullity approach was not applied in New Zealand. In the Auckland Harbour Board case, however, the Privy Council concluded that this principle was significant in the structure of New Zealand tax legislations and this applied to both the fiscal nullity principle and anti-avoidance tax statute. Their Lordships noted that the general anti-avoidance provisions used to perform a few works in the past and "has nowadays been taken over by the more realistic approach to the construction of taxation acts as exemplified by WT Ramsay Ltd v IR Commrs (p 17,012)". However, their Lordships refused to cause ambiguity on the general tax avoidance provisions effectiveness "as a long stop for the Revenue".[95]

The courts had not completely thought about applying the Ramsay approach in New Zealand law. Blanchard J, in C of IR v BNZ Investments Ltd (2001) 20 NZTC 17,103, noted that the Ramsay approach was not applicable to the transactions in that case even if it was eligible.[96]

The fiscal nullity approach had been applied to a few other cases in the past such as Mills v Dowdall

[1983] NZLR 154. This case concerned a matrimonial property and the issue was if the husband could possess some shares and some land as a gift. The husband was given the land free and the purchase price was left unpaid with the intention that what was owed would be written off at the end. The husband's argument was that because it was a gift, it should be given free. This argument was rejected by the Court of Appeal who said that the transferrence of the property in each case suits the actual given price.[97]

Lord Wilberforce's observation in WT Ramsay Ltd v IR Commrs (1981) 54 TC 101; [1981] 1 All ER 865, was referred to by Cook J. Lord Wilberforce said that the court may examine a group of transactions which are deliberately operated in the same way. His Honour ([1983] NZLR at p 157) said, "I see no reason why that approach would have to be confined to tax cases". Richardson J did not use Ramsay but his Honour emphasised that the observations should have been based on the actual legitimate arrangements that had happened which may have been ignored if a sham was set up or terms of the legislation needed a wider or separate approach. Refer to para 5.1.[98]

The Commissioner in C of IR v Challenge Corporation Ltd (PC) only applied s 99 to counteract a tax-avoidance arrangement that involved purchasing of companies with tax losses. He clearly invalidated the principle of fiscal nullity and its application.[99]

In A Taxpayer v C of IR (1997) 18 NZTC 13,350, the issue was whether the embezzler's stolen money

was assessable income. The Court of Appeal said that since the taxpayer did not earn the money and had no right to it, it was not income.[100]

Tipping J said that income tax liability should be verified by the appropriate legislation and not to follow ideas of fiscal reality that are easily changed, although a different idea may be needed in cases of sham and avoidance. Tipping J, in expanding his analysis held at p 13,366 that:[101]

> ``*Except in cases involving sham or avoidance, taxation issues should be decided on the basis of the legal and equitable rights and obligations deriving from the transaction to which the taxpayer is a party, or the circumstances in which the taxpayer is involved. Taxation issues should not be decided on the basis of the so called economic substance or reality of the transaction, or of the circumstances in which the taxpayer is involved."*

In C of IR v McGuchian (House of Lords, judgment 12 June 1997), Lord Browne-Wilkinson lately observed that:[102]

> *'Liability to tax depends on statutory construction not moral disapproval'.*
>
> *I would venture to expand his Lordship's statement by saying that in New Zealand liability to tax depends not on moral disapproval but on statutory construction applied to legal rights and obligations. In the same case, Lord Steyn cited IR Commrs v Duke of Westminister [1936] AC 1 at p 19, per Lord Tomlin, as authority for the proposition that whatever the substance of the arrangements may have been, their fiscal effect has to be in accordance with the legal rights and obligations they have created. In McGuckian, their Lordships indicated that this 'formalistic' approach was no longer appropriate when examining cases in which tax*

> *avoidance was at issue. No longer was tax law to be regarded as some island of literal interpretation. While fully accepting that to be so in cases of alleged avoidance (as was McGuckian) I consider Lord Tomlin's statement still holds good when the taxation consequences of transactions and circumstances, not said to involve avoidance or sham, are in issue. If tax is to be levied according to whatever is perceived to be the economic substance or reality of the situation, rather than according to the rights and obligations involved, we would be embarking into uncertain waters, and waters as unsound as they would be uncertain. For my part, I am unwilling to see taxpayers placed in such a situation."*

Thomas J observed in Peters v Davison (No 3) (1998) 18 NZTC 14,027 that McGuckian helped to scrutinise matters in taxation cases. The background on this matter is about the appeal of the High Court's decision regarding the rejection of an application for review of some of the commission of inquiry's findings on taxation issues in "the wine box" investigation. The reason for the application was that the Commissioner, head of the inquiry, construed the form and substance principles incorrectly. Thomas J said that the Commissioner at the time could have been aided by the judgement of the House of Lords in McGuckian if it was eligible at the time. Lord Steyn's observation in that case was used by Thomas J, which stated that "the court has the power to examine the substance of a composite transaction (p 14,062)".[103]

Baragwanath J in Miller v C of IR; McDougall v C of IR (1998) 18 NZTC 13,001 said that the principle of fiscal nullity was instituted into English law by

the English courts. His Honour held at p 13,036 that:[104]

> ``*In New Zealand, it is unnecessary for the Courts to develop a concept of 'fiscal nullity' to protect the tax base. (Its application in New Zealand was disclaimed by the Commissioner in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,001 (CA) at pp 5,013, 5,014; also reported as Challenge Corporation Ltd v C of IR [1986] 2 NZLR 513 at p 542. Compare under the former Australian legislation John v FC of T (1989) 166 CLR 417 at pp 434, 435). Until one comes to s [BG 1], a transaction that is not a sham is treated as effective: Re Securitibank Ltd (No 2) [1978] 2 NZLR 136 (CA).*

It has the same result as it contained in the cases of Europa Oil. The general law and s BG 1 of the Income Tax Act are both governed by the strict legal rights approach.[105]

The Commissioner in BNZ Investments Ltd v C of IR (2000) 19 NZTC 15,732 at pp 15,784-15,785, was contended that fiscal nullity could be operated as s 99 of the Income Tax Act 1976. McGechan J disagreed and said that the principle had "*traditionally been applied to taxpayers who had full knowledge of the tax consequences of their transactions*". Justice McGechan considered the principle could not identify a taxpayer who had no knowledge of the transaction in question if he or she was needed because of tax avoidance arrangement subject to s 99.[106]

The Commissioner's argument continued that although fiscal nullity was not applicable in New Zealand, it concerned a careful observation of whole composite transactions involved in which case the

doctrine of the Duke of Westminster was applicable. Application of the total result of the transactions entered into with the Income Tax Act -- an "Olympian view" purpose was the appropriate concept. McGechan J ignored this view and said that it did not agree with C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,219 (PC). Each individual step involved different transactions that had to be checked individually for their different tax liabilities (p 15,801).[107]

The Committee of Experts on Tax Compliance recommended in its February 1999 report (in para 6.42) that regardless of the existence of ss BG 1 and GB 1, an amendment should be made to the Income Tax Act to allow the courts to use common statutory regulations. This would make New Zealand courts obliged to observe fiscal nullity, the common statutory anti-avoidance regulation.[108]

6.9 The view of fiscal nullity doctrine in Australia

In FC of T v Ilbery 81 ATC 4661, even though the principle of fiscal nullity was applied, there was a scheme of interest paid in advance where the taxpayer, made a claim of deduction for the interest paid. The Federal Court said that because the intention of the interest that was paid was for tax benefit protection and not intended to gain or produce an assessable income, the deduction was not allowable. Northrop and Sheppard JJ applied WT Ramsay Ltd v Commrs of IR (1981) 54 TC 101; [1981] 1 All ER 865 and ignored the claim. Their Honours said that what their Lordships had observed in that case suited the Australian law.[109]

The Federal Court, however, consequently bounced back from that analysis and said that the principle was not applicable in Australia. The case involved was Oakey Abattoir Pty Ltd v FC of T 84 ATC 4718, a case concerning a scheme to avoid tax on unpaid dividends to shareholders subject to Div 7 of Pt III of the Australian Income Tax Assessment Act 1936 (a tax similar to excess retention tax). As it states the principle is not applicable, Fox, Fisher and Beaumont JJ observed at 84 ATC at pp 4,725-4,726 that:[110]

> ``*The Ramsay and Furniss principles should be perceived as no more than rules governing the statutory interpretation of the United Kingdom legislation for the taxation of capital gains. As such, they have no immediate impact upon the Australian Act. Further, given the presence of sec 260 (a matter adverted to in argument and by Lord Wilberforce in Ramsay (at pp 320 and 325 respectively)), and given the doctrine of economic equivalence underlying the approach of the House of Lords, we do not think that this approach affords any useful analogy in the present case."*

Their Honours continued to observe that the arrangement in question was subject to s 260.[111]

Consequent to Craven (HMIT) v White [1988] BTC 268 is the case between John v FC of T 89 ATC 4101 that the High Court of Australia affirmed that the fiscal nullity principle was not applicable in Australia. The High Court, in that case, had two reasons for ignoring this principle. First, the High Court considered (as in Federal Court in Oakey Abattoir Pty Ltd v FC of T) that the Australian legislation had a general anti-avoidance provision already (used to be s 260 as it is now replaced by

Part IVA of the Australian Income Tax Assessment Act 1936) "meant that the court could not create its own concept to cover the same subject-matter". The court held (89 ATC) at p 4,110 that:[112]

> ``*If any such or similar principle is to be applied in relation to the Act, it is one that must be capable of implication consonant with the general rules of statutory construction. One such general rule, expressed in the maxim expressum facit cessare tacitum, is that where there is specific statutory provision on a topic there is no room for implication of any further matter on that same topic. The Act, in s. 260 and now in Pt IVA, makes specific provision on the topic of what may be called tax minimization arrangements and thereby excludes any implication of a further limitation upon that which a taxpayer may or may not do for the purpose of obtaining a taxation advantage."*

Secondly, the High Court observed that the scheme and purpose of the statute did not point out that such a concept was justified. The court observed (89 ATC) at p 4,110 that:[113]

> ``*We should add that on ordinary principles of construction there is no warrant for limiting [the legislation] by reference to the two quite specific ingredients identified by Lord Brightman in Furniss. We would therefore reject the principle of fiscal nullity as one appropriate to be adopted in the construction of the Act generally."*

6.10 Case digests

.*60 Interest paid in advance was not deductible.* In 1982, a taxpayer who was a member of an annuity investment partnership, entered into a complex annuity investment scheme. The partnership was involved in a scheme of purchasing an annuity for

$2.02 million. Under the scheme, the partnership would be eligible to a significant tax deduction in the first five years and in the next five years would be a small deduction, then in the last five years would be a huge taxable amount. The partnership had a loss including interest that the taxpayers had claimed in their portion of the loss as deductions. Judgement was based on the basis that deductibility would rely on the interest being charged throughout its whole 15 year plan. The Administrative Appeals Tribunal's decision was based on the question of fact and said that "the taxpayers did not enter into the scheme with the expectation that the scheme would run its full course. Accordingly, the interest was not deductible to the extent that it exceeded the partnership's assessable income: Fletcher v FC of T 91 ATC 4950 (HC) and Fletcher v FC of T 92 ATC 4611 (Full Federal Court)".[114]

7 PART 4: Introduction to Part IVA

The current general anti-avoidance provision of Australian income tax legislation is Part IVA. Generally, it is applicable when:[115]

1) *"a taxpayer enters into a scheme*
2) *the taxpayer obtains a tax benefit from the scheme*
3) *the circumstances indicate that the obtaining of that tax benefit was a dominant purpose of one of the parties. In the case of s 177EA and 177EB schemes, the relevant purpose must be more than a merely incidental purpose."*

If Part IVA is applicable to a scheme, the Commissioner may ignore the tax advantage, makes assessments and the significant consequences will be enforced.[116]

Part IVA is the "last resort". It is only applicable if a taxpayer's claim is subject to tax legislation. For instance, it is not applicable if the claimed deduction is prohibited subject to the general deduction sections, or if the transaction is subject to a specific anti-avoidance issue. Part IVA is only applicable when those set at different transaction sections are present.[117]

At the time that Part IVA was introduced, it was only applicable to schemes entered into after 27 May 1981. Section 260, the past anti-avoidance section, was replaced by Part IVA. The amendment to Part IVA stretched its reach over time by broadening the variety of tax advantages that it is applicable to. There are starting dates to all those additions.[118]

If the transaction is a sham with no purpose of a legitimate result, the Commissioner will not require Part IVA, as such a transaction is basically unsuccessful (*Jaques* (1924) 34 CLR 328; *Hancock* (1961) 108 CLR 285; *Richard Walter* 96 ATC 4550). Nevertheless, if legal documents are produced to support a transaction, the court must examine the documents carefully to make sure they are not a mere facade or cloak for different transactions before the court decides that the transaction supported by the document was a sham.[119]

7.1 Fiscal nullity doctrine

Part IVA contains the general anti-avoidance provisions in Australia which prohibited the doctrine of fiscal nullity established by the UK courts to capture the artificial tax avoidance arrangement

according to the High Court in (John 89 ATC 4101).[120]

7.2 Criminal sanctions for tax fraud or evasion

The *Crimes (Taxation Offences) Act 1980* produces a few criminal offences associated with falsely avoiding different federal taxes -- particularly income tax, sales tax, GST-related taxes, FBT, petroleum resource rent tax and superannuation guarantee charges. The Act is aimed against the schemes, which are set up to make a company or trust unable to pay tax.[121]

In relation to income tax, it is a crime under this Act to be involved in a scheme with the intention to cover up a company or trust which will, or will likely, escape paying income tax that is already due to be paid (Taxation Offences Act s 5; 13) or is payable in the future. It is also a crime to help, support, advise or encourage someone else to be involved in the scheme (Taxation Offences Act s 6; 7; 13). The highest fine is 10 years imprisonment, a $110,000 fine (1000 penalty units) or both. The person who is found guilty may also be required to reimburse part of or the whole amount of tax involved (Taxation Offences Act s 9; 12; 13). The Act is functioning within its jurisdiction and in a similar manner to other taxes.[122]

7.3 Tax havens

Taxpayers are warned by the ATO of the severe punishment on those who avoid tax using tax havens. The financial dealings between Australian taxpayers and the 38 tax havens specified by the Organisation for Economic Cooperation and

Development (OECD) and Switzerland are looked at by a special task force appointed in Australia.[123]

The schemes that the ATO is targeting are where people apply the secrecy laws of tax haven to cover up assets and income that Australian tax should be paid on. The type of arrangements that attract attention are those which try to:[124]

1) *create deductions in Australia*
2) *avoid tax on tax haven income, or*
3) *provide access to tax haven funds on which no Australian tax has been paid.*

The penalty will be up to 50% of the tax that is being attempted to be avoided, according to the warning from the ATO. Additional information will be found in the booklet *Tax havens and tax administration* and it is on the ATO website (www.ato.gov.au).[125]

7.4 Offshore schemes

Lately, the ATO has carried out an enquiry on particular offshore schemes aimed at producing deductions on false expenses and services payments. There are other cases where assessable income earned offshore was not accounted for in Australia, but then brought back to Australia pretending to be a loan, inheritances and gifts, or through credit and debit cards. Taxpayers who are involved in such schemes are asked by the ATO to tidy up their tax position. In accordance with the *Taxation Ruling* TR 94/6, any voluntary disclosures will reduce the penalties and taxpayers can reach the ATO on 1800 306 377.[126]

7.5 Scope of Part IVA

ITAA36 Pt IVA (s 177A to 177F) is applicable to schemes entered into with the main intention of receiving a tax advantage. Part IVA is not restricted by other sections of ITAA36, ITAA97 or by any sections of the *International Tax Agreements Act 1953.*[127]

When Part IVA was made into law, the Treasurer at the time said that:[128]

1) *``arrangements of a normal business or family kind, including those of a tax planning nature", would be beyond its scope*
2) *Pt IVA is designed to operate against ``blatant, artificial, or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs".*

Regardless of these statements, the wordings of the sections are quite broad. Part IVA's application relies on the Commissioner's power of determination under s 177F, and is only applicable when such a scheme is blatant, artificial or contrived even though it is unsure which schemes match such descriptions. Lately, Part IVA's original function as a general anti-avoidance regime has been fundamentally extended to attack more particular schemes such as withholding tax and franking credit trading.[129]

The income equalisation deposit or farm management deposit arrangements are outside Part IVA's standards.[130]

Trusts and trustees are under the terms of Part IVA although in particular situations they are not

"taxpayers" (*Grollo Nominees* 97 ATC 4585).[131]

Part IVA is also applicable to schemes concerning consolidation according to the Commissioner.[132]

7.6 Is there a scheme?

A scheme must exist in order for the application of general anti-avoidance provisions to start. "Scheme" is defined as "agreement, arrangement, understanding, promise or undertaking whether express or implied and whether legally enforceable or not -- and any scheme, plan, proposal, course of action or course of conduct" (ITAA 36 s 177A). A scheme can be created by a single person planning something solely or together with someone else or with more than two people.[133]

A specific consideration may be required to observe the job of the false entities and their managers. The company directors or shareholders may have planned the scheme for the company involved, or the company involved may be a party itself. Nevertheless, the individual directors may have involved themselves or as the end result of their roles as directors. A serious consideration is required to observe the occupations of the directors that are involved in organising the arrangement.[134]

The same case applies to advisers, especially when the customer lacks knowledge and depends heavily on the advisers' knowledge and expertise. The adviser can possibly be involved in the arrangement in circumstances like these.[135]

When a natural person gives away to a wholly-owned private company an income-producing asset, this is not considered an arrangement under ITAA36

Part IVA. Nevertheless, any other related transactions, transfers or arrangements (whether before or after), in those wider circumstances, Part IVA should be carefully considered when applied. (Taxation Determination TD 95/4).[136]

In any exceptional circumstances, it is possible to identify several arrangements. For example, there may be an arrangement that contains many steps and only a small number of steps may be involved in another arrangement. The High Court in *Peabody* 94 ATC 4663, was referring to the subsequent High Court decision in *Hart* 2004 ATC 4599 and said that "a set of circumstances will not constitute a scheme if they are incapable of standing on their own without being robbed of all practical meaning", the judge continued to say that he was not sure if this was still the case. Unluckily, the three different rulings in *Hart* 2004 ATC 4599 gave no clear guide to the meaning of "scheme" as highlighted by Hill J in *Macquarie Finance* 2004 ATC 4866.[137]

The Commissioner has the power to submit his case in different ways because of the appeals against the determination of Part IVA. If the Commissioner uses a sub-scheme because Part IVA needs it, the Commissioner may depend on it as well. The Commissioner's ability to separate the sub-schemes that are applicable to Part IVA will make it possible to confirm that a scheme is entered into for the whole or main intention of getting a tax advantage.[138]

7.7 Was a tax benefit obtained?

The taxpayer must receive a tax advantage in relation to the scheme before a general anti-avoidance section is applicable. A tax advantage is

received by a taxpayer if:[139]

1) *an amount is not included in the taxpayer's assessable income which would have been, or might reasonably be expected to have been, included if the scheme had not been entered into or carried out (ITAA36 s 177C(1)(a)). The Commissioner interprets this as being satisfied if the effect of the scheme is that an amount is assessable under a different provision, or is differently characterised, thus altering its tax treatment (Taxation Ruling IT 2456). This specifically applies if, instead of deriving ordinary assessable income, a taxpayer makes a capital gain eligible for discount treatment (s 177C(4), (5)). The test prescribed by s 177C(1)(a) does not require that the relevant tax benefit reflect a particular amount not included in the taxable income of another entity. It requires only identification of an amount not included in the taxpayer's assessable income (MacArthur 2003 ATC 4826)*
2) *a deduction is allowable to the taxpayer and the whole or a part of that deduction would not have been, or might reasonably be expected not to have been, allowed if the scheme had not been entered into or carried out (s 177C(1)(b)). The fact that a non-allowable deduction has been wrongly allowed cannot be a tax benefit, even if the time for amendment of that assessment has expired (Vincent 2002 ATC 4742)*
3) *a capital loss is incurred by the taxpayer, and the whole or part of that loss would not have been incurred, or might reasonably be expected not to have been incurred, if the scheme had not been entered into or carried out. The scheme must have been entered into after 3 pm on 29 April 1997(s 177C(1)(ba))*

4) *a foreign tax credit is allowable to the taxpayer, and the whole or part of that credit would not have been allowable, or might reasonably be expected not to have been allowable, if the scheme had not been entered into or carried out. The scheme must have been entered into after 4 pm on 13 August 1998 (s 177C(1)(bb))*
5) *withholding tax is not payable on an amount paid after 7.30 pm on 20 August 1996 in circumstances where the taxpayer would have been, or might reasonably be expected to have been, liable for withholding tax on the amount if the scheme had not been entered into or carried out. The tax benefit in this case is the amount on which withholding tax is not payable (ITAA36 s 177CA), or*
6) *the property of a company is disposed of under a dividend stripping scheme (ITAA36 s 177E:"*

Subject to the franking credit scheme, there is a different section that is applicable to such benefits (ITAA36 s 177EA).[140]

The "reasonable expectation" test mentioned above needs more than a possibility. It contains a forecast of the events that would have taken place if the arrangement had not been inserted and the forecast must be reliable enough to be treated as reasonable (*Peabody* 94 ATC 4663). This may be a dominant obstruction to the Commissioner. For instance, in (*Peabody* 94 ATC 4663) it could not be reasonably finalised that the amount adjusted was going to be received by the taxpayer if the arrangement in question had not been executed. In the same manner, the case *Essenbourne* 2002 ATC 5201 concerned an allowable deduction that was contributed to an employee incentive trust, the Federal Court said that it could not be reasonably

expected that different steps could have been taken by the taxpayer to receive deductions if the arrangement had not been inserted. Nevertheless, this notion of Essenbourne was rejected by the Commissioner and in future court cases this concept will be tested.[141]

These circumstances are assumptions that may not work or may work, which do not seem to have enough support for a reasonable expectation to emerge. In addition, if the arrangement is rejected and no certain result is expected and all other choices are possibilities only, the Commissioner will have a hard time locating a taxpayer who receives a tax advantage. However, if the expected outcome has emerged, the Commissioner should make the adjustment accordingly with the appropriate taxpayer. If the expected outcomes are the same, it is unclear if the Commissioner can pick one and make adjustments based on those circumstances. Hopefully, the ATO can form different adjustments based on different expected outcomes of different taxpayers.[142]

The High Court in *Spotless* 96 ATC 5201 confirmed that, if the arrangement involving a Cook Islands bank had not been inserted, the "reasonable expectation" was that the taxpayers' taxable incomes could have included an amount from an investment of a significant amount in Australia. The truth was that the Commissioner located the interest from the Cook Islands (after the deduction of withholding tax) as tax advantage instead of "hypothetical" interest from Australia. It seemed that the court's analysis had found that the hypothetical interest from Australia matched the tax advantage perfectly.

Nevertheless, the judgement stated that the Commissioner's assessment did not affect the taxpayers but it was enough for the purposes of ITAA36 Part IVA that an amount that is the same as the interest from the Cook Islands, be included in the taxpayers' taxable incomes.[143]

Tax advantages may emerge unexpectedly because another person has enforced the benefits instead of the person directly involved in the arrangement. It is pertinent to observe all sides of a tax planning arrangement for potential tax advantages. Finding tax advantages in cases that have never occurred made the job hard but they "might reasonably be expected to have occurred" if the tax planning arrangement had not been inserted.[144]

Part IVA, according to the Commissioner, can be used on arrangements concerning discretionary trust distributions despite the fact the trustee's discretion exists. If the arrangement had not been inserted, the determination of what position would have been can be difficult to distinguish. The Full Federal Court, in *Grollo Nominees* 97 ATC 4585, stated that Pt IVA can affect a trustee and even the related tax advantages are enforceable to beneficiaries of the trust.[145]

The ATO judgement in *Ryan* 2004 ATC 2181 agreed that, the missing bizarre characteristics (and under the provision of the personal services to a company being justified in business terms), Part IVA is not applicable in cases of a company, trust, partnership or individual running of a business (together with a personal services business) giving money for retirement pension funds until the final

age limits, or to a retirement fund in relation to the main service provider (*Taxation Determination* TD 2005/29).[146]

7.8 Exclusion of tax benefits arising from making agreements, choices, etc

Part IVA is not applicable to tax advantages received from agreement, choice, declaration, election, selection, notification or option which states in ITAA36 or ITAA97 on the conditions that the significant arrangement was not started with the intention of producing the requirement needed in order to form the appropriate agreement, choice, etc (s 177C(2)). Part IVA is not affected when a taxpayer takes advantage of the option in ITAA97 s 70-45 for using cost price, market selling price or replacement price to value the trading stock on hand at the end of the year.[147]

In cases of tax advantages, which contain capital loss, is an exception but the exemption is not applicable when the loss was the cause of the agreement etc, such as the group company provisions necessitated to the roll over of an asset or the movement of a group company, which extended part of the arrangement.[148]

A taxpayer contended, in one case, that ITAA36 gave him a choice in running his business of whether to be an employee or a consultant to the family company/family trust. The AAT said that the truth that ITAA36 identifies units such as trusts does not mean that choosing the trust for income splitting was "expressly provided for" (*Case* W58 89 ATC 524).[149]

7.9 Tax benefit amendments proposal

The government has pronounced that:[150]

1. *"the concept of ``tax benefit'' will be expanded so that it will apply in a generic way to any reduction or deferral of tax payable, including through tax rebates and credits or losses*
2. *the ``reasonable expectation'' test will be amended to make it easier for it to be applied by the Commissioner. This amendment is designed to counter arguments by taxpayers that if the scheme had not been entered into, no transaction at all would have occurred."*

The two measures follow the proposals made by the Ralph Review of Business Taxation and is applicable to arrangements that have been inserted after the time the appropriate law has entered into Parliament.[151]

7.10 What is the dominant purpose?

The general anti-avoidance provision can only be applied when it is decided that the dominant purpose of getting a tax benefit is the main purpose of carrying out the scheme by the person who entered into it (ITAA36 s 177A(5); 177D). The Commissioner must apply the following eight concepts listed in s 177D when determining the dominant purpose:[152]

1) *"the manner in which the scheme was entered into or carried out. Strictly, this involves a ``hindsight'' assessment, but the ATO will provide its binding private rulings on the potential application of ITAA36 Pt IVA to proposed arrangements, e.g. product rulings*

2) *"the form and substance of the scheme*
3) *"the time at which the scheme was entered into and the length of the period during which it was carried out*
4) *"the income tax result that, but for Pt IVA, would be achieved by the scheme*
5) *"any change in the financial position of the relevant taxpayer that has resulted, will result, or may be reasonably expected to result, from the scheme*
6) *"any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result, or may reasonably be expected to result, from the scheme*
7) *"any other consequence for the relevant taxpayer, or for any person referred to in (6), of the scheme having been entered into or carried out*
8) *"the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in (6)".*

Each of the eight concepts is aimed to find the fact (*Spotless* 96 ATC 5201). The subjective aims of the parties are definitely not decisive and unnecessary (*CC (NSW) Pty Ltd (in liq)* 97 ATC 4123; *Eastern Nitrogen* 2001 ATC 4164, *Vincent* 2002 ATC 4742).[153]

These eight matters are required to be considered but " it is not necessary that they be unbundled from a global consideration of purpose and ``slavishly ticked off"(*Consolidated Press Holdings* 2001 ATC 4343).[154]

The dominant purpose is tested when the arrangement is entered into or carried out and upon the application of the law that is available at the time (Consolidated Press Holdings 2001 ATC 4343). Whether a taxpayer is innocent or ignorant is no excuse.[155]

The relevant dominant purpose does not require to be known by all, a majority, or even any two of the parties to the arrangement in question. It requires any one of them to have the purpose even if the others are not revealed to the purpose by the party. The advisers' objective purposes may affect the parties' entrance into a scheme (*Consolidated Press Holdings* 2001 ATC 4343). It will take into account a promoter's purpose of a scheme and the entities that it controls (*Vincent* 2002 ATC 4742).[156]

The taxpayer who receives the benefit is not always the person with the relevant purpose. However, the taxpayer who receives the benefit does not need to be a party to the scheme at all.[157]

A reasonable business decision on a transaction does not mean that Part IVA is not involved in any dominant purpose to get a tax advantage. The High Court in *Spotless* 96 ATC 5201 rejected that a business and tax decisions are widely different by stating that: ``A particular course of action may be ... both `tax driven' and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether ... [there was a] `dominant purpose' of enabling the taxpayer to obtain a 'tax benefit'". The companies' dominant purpose was to get a tax advantage, the court matched the dominant purpose

with the "most influential, and prevailing or ruling purpose". For instance, when the scheme has three purposes and one of which is to gain a tax advantage. If the influential purpose is to gain a tax advantage and even if it is less than 50% of the overall purpose, the dominant purpose requirement is satisfied.[158]

The High Court in *Hart* 2004 ATC 4599 observed that Part IVA was applicable to a split loan arrangement and rejected a claim by the taxpayer for deduction on the additional interest on the investment loan. According to the split loan arrangement, the loan repayments on a combined home and investment loan can be paid directly to the home loan while the interest on the investment loan is capitalised. The interest on the investment loan is increasing while the interest payable on the home loan is reducing. The dominant purpose of the split loan arrangement was to get a tax advantage according to all five Judges but there was no clear reasoning for the conclusion. An article by Dr Mark Burton and Dr Justin Dabner at *CCH Tax Week* provides a detailed analysis of the decision in *Hart* 2004 ATC 4599.[159]

8 PART 5: Introduction of GST

8.1 History

The taxation of income first started in New Zealand with the relevant Act at the time *Land and Income Tax Assessment Act 1891*. There were few combined Acts that followed this Act at different points in time during the 20th century:[160]

1) "the *Land and Income Tax Act 1923*
2) "the *Land and Income Tax Act 1954*

3) "the *Income Tax Act 1976* (land tax was transferred to a separate Act)
4) "the *Income Tax Act 1994*."

The *Income Tax Act 1994* restructured the law, while the *Income Tax Act 2004* executed the third step of the law rewrite programme. As the complications of the laws have grown bigger over the years after the wars, alterations were made to the manner in which the Income Tax Act and its related Acts have been written and construed. The most obvious alteration has been the additional new material to the Act. Before the mid-1980s, the Act did not have very many provisions in comparison to what it has now. After all these, there was a logically distinctive legislative system.[161]

Since the mid-1980s, the statutory development has majorly displayed the changes to the New Zealand economy. The Government at the time, had established a policy of a wider tax base with lower tax rates, as a result of these changes. *Goods and services tax* was established at the time. The controversial Minister of Finance, Roger Douglas (http://en.wikipedia.org/wiki/David_Caygill. 26/11/08), during the 1988 Budget Statement, stated:[162]

1) *"The long term objectives of our tax reform strategy were identified in the 1984 budget as follows:*
2) *" to introduce a greater degree of equity into the tax and benefit system;*
3) *" to minimise the distortionary impact of the tax system on resource allocation by reducing anomalies and concessions, widening the tax base and lowering marginal rates;*
4) *" to make the tax system more certain and simple."*

8.2 Key features of the GST regime

The main characteristics of the GST regime are briefly outlined below. They are outlined under three titles: Charging GST, Registration and The Practice.[163]

8.2.1 Charging GST

GST is charged on goods and services that are supplied in accordance to the standards written by the law. GST is charged on the supply of goods and not on the actual goods itself. GST is charged on supplies that:[164]

1) *"made "in New Zealand";*
2) *of goods and services;*
3) *on or after 1 October 1986;*
4) *by a registered person;*
5) *in the course or furtherance of a taxable activity;*
6) *not being an exempt supply."*

8.2.2 Registration

Registration for GST is a requirement for most businesses and many other organisations.[165]

8.2.3 Registration is compulsory

Registration must be enforced if a person:[166]

1) *"carries on a "taxable activity" on or after*
2) *1 October 1986 and is not registered; and*
3) *makes (or will make), in the course of all taxable activities, yearly supplies in New Zealand valued at more than $40,000. (Prior to 1 October 2000, the registration threshold was $30,000. Prior to that 1 October 1990, the registration threshold was $24,000."*

Any activity which continues on a non-stop or regular basis and which contains (or is aimed to contain) supplies make to another person for "money" (for example, sales) is widely known as "taxable activity". For instance, retailers, professionals, associations, clubs and charities are carried on taxable activities.[167]

8.2.4 The Practice

Accounting for tax, taxable periods, returns and payment of tax and the calculation of tax payable are the most distinctive rules that control GST in practice.[168]

8.2.5 Accounting for GST

Accounting for GST has used three different methods: the hybrid method, the payment (or cash) basis and the invoice (accruals) basis. The hybrid method includes the output tax accounting on an invoice basis and input tax accounting on a payment basis. Invoice and hybrid bases are the two methods that all persons are allowed to choose. The qualification to use the payments basis is restricted to:[169]

1) *"local authorities and although both non-profit bodies;*
2) *persons whose total value of taxable supplies has not exceeded $1.3 million in the preceding 12 months or is not likely to exceed $1.3 million in the following 12 months (prior to 1 October 2000 the threshold was $1 million; prior to 1 October 1990 the threshold was $500,000); and*
3) *persons who satisfy the Commissioner that it would be appropriate for them to use the payments basis because of the nature, volume and value of their taxable supplies, and the nature of*

their accounting system".

The local authorities are no longer applying the payment basis accounting for GST effective from 1 July 2001. They were granted an extension from 1 July by an Order in Council procedure if the local authorities have problems with the change over to an invoice basis accounting system.[170]

8.3 Anti-avoidance Provision

Section 76 of the Goods and Services Tax Act 1985 included the anti-avoidance provisions. Generally, the provision states "that any tax avoidance arrangement is void as against the Commissioner for tax purposes". The Commissioner's authority is significantly broad that in cases of such sorts, he could make an assessment of a person's tax liability. Section 76's second focus is to establish a particular regulation to invalidate part of the advantages of dividing a taxable activity in order to escape registration obligations.[171]

8.4 Tax Avoidance Arrangement

Section BG 1 of the Income Tax Act 2004 is the replica of the first component of s 76 because both sections state that "a tax avoidance arrangement is void as against the Commissioner". Section OB 1 of the Income Tax Act has defined "tax avoidance arrangement as one that directly or indirectly:[172]

a) has tax avoidance as its purpose or effect, or

b) has tax avoidance as one of its purposes or effects, whether or not another purpose or effect relates to ordinary business or family dealings, if the purpose or effect is not merely incidental."

Section OB 1 of the Income Tax Act 1994 and s 76(8) give the word "arrangement" the same definition, they state that, "it is a contract, agreement, plan or understanding, whether enforceable or unenforceable, íncluding all steps and transactions by which it is carried into effect". Section 76(8) contains the meaning of "tax avoidance" as:[173]

1) *a reduction in the liability of a registered person to pay tax*
2) *a postponement in the liability of a registered person to pay tax*
3) *an increase in the entitlement of a registered person to a refund of tax*
4) *an earlier entitlement of a registered person to a refund of tax, and*
5) *a reduction in the total consideration payable by a person for a supply of goods and services".*

There are similar anti-avoidance provisions to Income Tax Act with case laws that will be significant to construe s 76.[174]

When s 76 was first applied (before its repealed and replacement from 10 October 2000), the Taxation Review Authority in Case W22 (2003) 21 NZTC 11,212 said that a scheme, that was planned to take advantage of the mismatch that happened between an invoice-based and payments-based goods and services, beat the purpose of the Goods and Services Tax Act by letting a taxpayer received a tax reimbursement that was not supposed to be paid out. The Taxation Review Authority observed that the Crown had not received the intended tax because the function of s 76 was prohibited by taking advantage of the mismatches in which public money was spent on the construction of properties worth $80 million.

Subject to s 76 (as it said then), it had to make sure if "an arrangement had been entered into between persons to defeat the intent and application of [the GST Act]". The Taxation Review Authority observed that, although the sort of timing of mismatches in question occurred due to the appropriate interpretation of the implied provision of the GST Act; the broad purpose of the Act was that the amount of input tax reimbursement and the payment of the GST tax payable should be done near to or on the actual time that the transaction had occurred. The timing mismatches that are allowable should be considered as realistic changes from that broad purpose to improve the GST administration and the compliance ramifications. For instance, the accounting for the payments basis is allowed for small businesses with low income that contained only a few transactions. The Taxation Review Authority viewed the Act's purposes and held that it was needed to view all suitable situations when finding what the group's whole purposes were. Every case would rely on its own details but usually the following would be asked in every case:[175]

1) *"The relationship between the parties, including whether they were at arm's length and whether there was collusion in designing the arrangements. (In this case, the relationship between the parties was more social than commercial and the company that was formed was to be no more than a conduit for obtaining the GST input refunds.)*
2) *The significance to the transaction of the GST consequences under consideration. (The timing mismatch was held to be pivotal to the arrangements, the input tax refunds being necessary to fund the taxpayer's deposits, which, in turn,*

were necessary for the vendor companies to purchase and develop the properties.)

3) *Whether the arrangement was explicable in ordinary commercial terms if the GST component was abstracted. (If the input tax refund was removed from the equation, the arrangements were wholly inexplicable in commercial terms and could not and did not come to fruition.)*
4) *The way that the arrangements defeated the intent and application of the GST Act. (The arrangements exploited timing mismatches to defeat the intent of the GST Act "to tax transactions at the time they are entered into", with public money being paid out for use by the parties but no money being paid in to the Crown.)*
5) *The identity, relevant experience and financial probity of the parties. (The taxpayer's original proprietor had no relevant business experience and no resources remotely capable of meeting the financial obligations undertaken.")*

The Taxation Review Authority viewed the group's whole purpose "to defeat the Act" as essential to the use of s 76 and held that the provision would be relevant to "where the only tenable explanation for the way in which an 'arrangement' is constructed to avoid paying goods and services output tax which would otherwise be and it was in payable or to obtain an input deduction which would not otherwise be payable".[176]

The High Court said that the Taxation Review Authority's decision about the achievement of "tax advantage" was pointless. Section 76 did not mean that a "tax advantage" must be present in order for the Commissioner to negate a scheme. When the

Commissioner had accepted that there was a scheme entered into, for the purpose of beating the intent and application of the Act, he is obligated to negate the scheme and make an assessment of tax refundable or tax payable for the registered person involved in the scheme. The tax advantage in question can emerge only when there is an assessment to be made after a ruling that the scheme was subject to s 76. This is not applicable to the first finding.[177]

The High Court also rejected the Taxation Review Authority's view that it is a requirement that there must be evidence of intention to defraud the Act. The taxpayer's appeal was granted by the Court of Appeal.[178]

Section 76 of the GST Act 1985 has been replaced by s 76 of the Taxation (GST and Miscellaneous Provisions) Act 2000.[179]

9 PART 6: Anti-avoidance provisions

9.1 General anti-avoidance provision

The Income Tax Act includes a substantial range of anti-avoidance provisions to counteract tax avoidance. There are two types available. The first type is the specific anti-avoidance provision that is only applicable to particular transactions where the penalties are specified exactly. The second, is the provision of general anti-avoidance, s BG 1, which intends to strike down for tax purposes, the schemes with intentions to avoid tax. This provision is not applicable only to any particular transactions and is not relevant only to any specific provisions of the Act. The Privy Council had declared that the purpose of s BG 1 is directed to business

transactions inside the tax boundary, while on the other hand, it has been constructed either purposely or not in a manner that a careful examination will find that they are outside the boundary instead: C of IR v Auckland Harbour Board (2001) 20 NZTC 17,008 at p 17,012.[180]

The Privy Council, in that case, repeated the law, that the Commissioner of Inland Revenue does not have discretion to utilise anti-avoidance provisions to amend the legislative Act. In announcing the court's decision, Lord Hoffman held at p 17,012: "It would amount to the imposition of tax by administrative discretion instead of by law".[181]

The Privy Council in the case of Auckland Harbour Board, ignored the Commissioner's allegation that he had discretion to convert an overrule standard of market value into the accrual rules under the anti-avoidance provisions, although this rule was not included in the legislation's provisions. The Privy Council, on the other hand, also rejected the Commissioner's proposition about the use of the accrual general anti-avoidance provisions to establish what was known as another essential exemption or requirement to the accrual rules instead of charging the right tax, under the concept of the accruals administration, in the Auckland Harbour Board.[182]

Section BG 1 is fundamentally recognised by the rule that the person involved in a scheme for the purpose of avoiding tax, may have not met his or her responsibility required by the Act. This is if the responsibility may have relied on the scheme being relevant to the intent of the income tax.[183]

9.2 Specific anti-avoidance provision

In the tax Act, there are numerous provisions that are applicable to particular transactions and their consequences are clearly stated. For instance, the legal transfer of the right to income or the payment for a property that produces income for less than the time stated in the Act in accordance with s FC 11, is that the consequences is being the transferor or the settlor that has obtain the income.[184]

There are other examples such as transactions that are not clear but are identified and the Commissioner has discretion to choose which provisions of the section is applicable. For instance, s GD 3 specifies that if the Commissioner thinks that a relative is employed by or in partnership with the taxpayer and such person has received a huge amount of salary than normal or is paid an excessive amount of profit, the Commissioner may for tax purposes divide the cash or profits between the groups in such portions that the Commissioner thinks as fair. Listed below are some of the vital specific anti-avoidance provisions:[185]

1) *"the second proviso to s CB 4(1) (e), withdrawing the exemption for the business income of a charity where a related party benefits;*
2) *s CF 3(8), excluding from the exemption for distributions of capital gains paid on a liquidation of a company amounts realised on the disposal of an asset to a related party;*
3) *s FB 3, in relation to the disposal of trading stock;*
4) *s FB 4, in relation to the disposal of trading stock together with other business assets;*
5) *s FC 6(8), in relation to disposal of a*

lease asset by an associated person of the lessee under a specified lease;

6) *s FC 11 (repealed with effect from 1 April 1998), in relation to assignments of income or settlements of property for less than seven years".*

10 PART 7: Sections BG 1, GB 1, and GZ 1

10.1 Sections BG 1, GB 1, and GZ 1

Section BG 1 is generally pointed out that "a tax avoidance arrangement is void as against the Commissioner for income tax purposes". There are other provisions that must be observed as if they were included within s BG 1 and these are:[186]

a) **Arrangement**[187] *means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect".*

b) **Liability**[188] *in the definition of tax avoidance, includes a potential or prospective liability to future income tax*

c) **Tax avoidance**[189] includes—

d) *directly or indirectly altering the incidence of any income tax:*

e) *directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:*

f) *directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax".*

g) **Tax avoidance arrangement**[190] *means an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—*

h) has tax avoidance as its purpose or effect; or

i) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental".

The Commissioner's general power, **GB** 1 states:[191]

> *"The Commissioner may adjust the taxable income of a person affected by the arrangement in a way the Commissioner thinks appropriate, in order to counteract a tax advantage obtained by the person from or under the arrangement".*

Section OB 1 has been repealed and replaced by s YA 1 of the 2007 Income Tax Act and s GB 1 has been repealed and replaced by s GA 1 of the 2007 Income Tax Act.[192]

Section 99 of the 1976 Act contained the following provisions. There was a distinctive type of writing style taken in the 1994 Act, which caused the basic elements of the anti-avoidance provisions to be allocated into different sections of the Act. The rewrite style of s 99 into many other parts was the same style as in the 1994 Act by splitting the definitions from the essential provisions.[193]

Section BB 9 of the 1995/96 and 1996/97 income years was the copy of s BG 1. When the core provisions of the 1994 Act first rewritten, s BB 9 was repealed and replaced by s BG 1.[194]

Section BB 3(1) emphasised the importance of s BG 1. According to the language used in s BB 3(1), a person may not have met his or her responsibilities stated in the Act if the person is

involved in a tax avoidance arrangement and meeting the responsibilities is relied on the scheme still available for the purposes of income tax.[195]

Section BG 1 is a general anti-avoidance provision because its application is not restricted to a particular kind of transaction or it only associates with other specific parts or a part of the Act.[196]

Section GZ 1 is involved with arrangements that are planned before 1 October 1974 and also at this date the "old" and "new" s 108 of the 1954 Act was split up.[197]

In BNZ Investments Ltd v C of IR (2000) 19 NZTC 15,732, the High Court applied to most substantial tax avoidance cases, the issues outlined above. The case is about a "redeemable preference share" transaction that would earn a predetermined tax-free dividend. The construction of the transaction was meticulous with the intention to exploit the existing tax legislation. The consequent transactions wherein the amount of investment was collected, escaped the New Zealand tax liability because it was implemented by the Capital Markets Ltd, a member of the Fay Richwhite Group, together with other companies. BNZ Investments Ltd (BNZI) collected a large amount of tax-free profit from this investment, than if it was not done this way. The taxpayer's income for the years 1989-1993 was assessed by the Commissioner to a total amount of $135 million. An amount of $44 million of tax liability was owed in addition to any interest incurred.[198]

The court held that BNZI was not involved in any arrangement for tax avoidance. McGechan J

observes that "a tax avoidance arrangement requires a "conscious involvement of a taxpayer" (i.e. mutuality) and some form of agreement or acceptance, albeit implied from conduct or otherwise tacit, to be involved in transactions giving rise to avoidance advantages". In his view, the BNZI transactions are distinctive in characters, they had no basis into the forming the downstream tax avoidance and definitely did not show any sign that tax avoidance would happen.[199]

10.2 History

Section 99 came into existence

Harris, Ohms, Plunket, Sharp & Smith (2004, 1066-1067) explains that it is significant to look at the former general anti-avoidance before s 99 of TAA 1994 and s BG 1 of the ITA 1994. It stresses that s 40 Land, Income Tax Assessment Act 1891 was the first general avoidance provision written and it was the first time that land and income tax were merged in one Act. Not much alteration happened during this enactment. It stated:[200]

> *"Every covenant or agreement heretofore be made or hereafter to be made between landlord and tenant, mortgagor and mortgagee, or between any other persons, altering or attempting to alter the nature of the estate or interest in any land or mortgage for the purpose of defeating or in any other manner evading the payment of tax imposed under this Act, or which shall be in any manner contrary to the true intent of this Act, or calculated to prevent its operation in any respect, shall, so far as regards any such covenant or agreement, be void and or no effect as between the parties thereto".*

This section emphasises that there would be no success for any person who will engage in any covenant or agreement with the intention to avoid paying tax by changing the nature of an estate or interest in land. Land and Income Tax Assessment Act 1900 s 82 replaced s 40 and it states:[201]

> *"Every contract, agreement, or arrangement made or entered into, in writing or verbally, either before or after the commencement of this Act, shall be of absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way directly or indirectly altering the incidence of any tax, or relieving any person from liability to pay any tax or make any return, or defeating, evading, or avoiding any duty or liability imposed or land person by this Act, or preventing the operation of this Act in any respect".*

In addition, Harris et al (2004) says that s 82 "is properly regarded as parent of the ensuing series of general avoidance provision found in the legislation". This section will void "any arrangement so far as it had the purpose or effect of, among other things, altering the incidence of, providing relief from, or avoiding, income tax". Another two sections were written in the same terms as s 82: first was s 103 Land and Income Tax Assessment Act 1908 and second was s 162 Land and Income Tax Act 1916 but the word "avoiding" tax was completely left out. Both Land and Income Tax Act 1923 s 170 and Land and Income Tax Act 1954 s 108 were written the same as s 170 but the words "land tax" were removed. Land and Income Tax Amendment Act (No 2) 1968 s 16 was later amended to s 108 to insert "that any arrangement is void as against the Commissioner for income tax

purposes". After the amendment, this is s 108 beforehand and it stated:[202]

> *"Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from liability to pay such tax."*

Land and Income Tax Amendment Act (No 2) 1968 s 8 has added a new provision in 1974 as Land and Income Tax Act 1954 s 108. Section 108 was repealed and replaced by s 99 which later became s 99 ITA 1976. There were no major changes during this enactment (pp 1067-1068).[203]

The Income Tax Act 1976 replaced the 1954 Act, and s 99 contained the anti-avoidance provision. When the Income Tax Act 1994 started, s BB 9 contained the general anti-avoidance provision and from 1 April 1997, s BG 1 became the general anti-avoidance provision.[204]

10.3 Function of s BG 1

Section BG 1 states that:

> ``*A tax avoidance arrangement is void as against the Commissioner for income tax".*

The Privy Council in O'Neil v C of IR (2001) 20 NZTC 17,051 observed that the Commissioner has no discretion when deciding if an arrangement is for tax avoidance or not (at p 17,059).[205]

Baragwanath J in Miller v C of IR; McDougall v C of IR (1998) 18 NZTC 13,001 also depended on the

previous description of s BG 1, and did not need assistance from somewhere else. The Commissioner has nothing to provide in order to activate the result of an arrangement to void as against the Commissioner. That result is produced by the legislation (at p 13,047). The Report of the Committee of Experts on Tax Compliance had the same view at para 6.43 that on 23 February 1999, the report was made public.[206]

The following is supplied by s BG 1(2):[207]

> ``*The Commissioner, in accordance with Part G (avoidance and non-market transactions), may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement".*

The definition of "liability" is included in the definition of "tax avoidance" and it stated in s OB 1 as:[208]

> ``*a potential or prospective liability to future income tax".*

The meaning of "tax avoidance arrangement" is stated in s OB 1 as:[209]

> *a) ``An arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—*
> *b) has tax avoidance as its purpose or effect; or*
> *c) has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the purpose or effect is not merely incidental."*

The meaning of "tax avoidance" is stated in s OB 1 as:[210]

> *a) directly or indirectly altering the incidence of any income tax;*
> *b) directly or indirectly relieving any person from liability to pay income tax;*
> *c) directly or indirectly avoiding, reducing or postponing any liability to income tax."*

The Court of Appeal in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,001 agreed that the Income Tax Act 1976, s 99 (the current s BG 1):[211]

> *"should be perceived legislatively as an essential pillar of the tax system, designed to protect the tax base and the general body of taxpayers from what are considered to be unacceptable tax avoidance devices. It is a general yardstick by which the line between legitimate tax planning and improper tax avoidance is to be drawn".*

The Privy Council has lately made a remark about the importance of the common law doctrine of fiscal nullity to be applied in beating down tax avoidance schemes.[212]

In the Commissioner's policy statement on s 99, it pointed out that:[213]

> *"s 99 was designed to protect the integrity of the tax system from tax-avoidance devices implemented to frustrate it. Its function is to protect the liability for income tax established under other provisions of the Act."*

10.4 The Structure of ss BG 1 and GB 1

The structure of ss BG 1 and GB 1 is summarised below.[214]

Sections BG 1 and GB 1 have two different functions:[215]

1) *There are criteria that must be met in order for a scheme to be void and these are outlined by s BG 1.*
2) *The Commissioner has the power to restructure a taxpayer's account to cancel out any tax benefit received, this is contained in s GB 1.*

These two steps are included in the Commissioner's policy statement on s 99 (currently ss BG 1, GB 1, GZ 1).[216]

10.5 The criteria of s BG 1

Eichelbaum CJ in *Hadlee and Sydney Bridge Nominees Ltd* v *C of IR* (1991) 13 NZTC 8,116, observed at 11 NZTC p 6,171 that:[217]

1) ``*The elements that must exist for sec 99 to apply are: There has to be an 'arrangement' within the meaning of the section;*
2) *The purpose or effect, or one purpose or effect [not being merely incidental], of such arrangement must be 'tax avoidance' as defined ...*
3) *That purpose or effect must not be 'a merely incidental' purpose or effect."*

These steps are cumulative, that is, all three issues must exist in order for the general anti-avoidance provisions to apply.[218]

10.6 Definition of arrangement

For the functions of ss BG 1, GB 1 and GZ 1, s OB 1 defines the meaning of "arrangement" to contain "any contract, agreement, plan, or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect". The accruals rules contain the same definition for the purpose of financial arrangements.[219]

The former section, before the re-draft into its existing form, was applicable to "every contract, agreement or arrangement". Section 260 of the Australian Income Tax Assessment Act 1936 contained the same wordings. The High Court in Bell v FC of T (1953) 10 ATD 164; 87 CLR 548 analysed the three words "contract", "agreement" and "arrangement", and construed them increasingly wider. The High Court, while examining the definition of "arrangement", held at 87 CLR p 573 that:[220]

> ``*... it may be said that the word 'arrangement' is the third in a series which as regards comprehensiveness is an ascending series, and that the word extends beyond contracts and agreements so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect. The case of Jaques v FC of T itself, and the later case of Clarke v FC of T, illustrate the application of the word. It is true that, as Isaacs J observed [in Jaques' case], the word does not include a conveyance or transfer of property as such; but as the cases cited show, under the section a conveyance or transfer of property may be void as against the Commissioner as being part of a wider course of action which constitutes an arrangement in the relevant sense of the word."*

The Privy Council in Newton v FC of T (1958) 11 ATD 442 made the following remarks at p 445 that:[221]

> ``*Their Lordships are of opinion that the word 'arrangement' is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons — a plan arranged between them, which may not be*

> *enforceable at law. But it must in this section comprehend, not only the initial plan, but also all the transactions by which it is carried into effect — all the transactions, that is, which have the effect of avoiding taxation, be they conveyances, transfers or anything else. It would be useless for the commissioner to avoid the arrangement and leave the transactions still standing."*

Looking at the descriptions of the word "arrangement" in a subpart that is the same as the New Zealand's previous subpart of tax avoidance, it looks as if *there is a minimal difference or nothing between the definition of the word* used in that subpart and the meaning of the word as in the new subpart. *The meaning of the word now needs the presence of "a contract, agreement, plan or understanding between two or more parties which may or may not be enforceable and includes all the steps or transactions by which it is carried into effect".*[222]

Eichelbaum CJ in Hadlee and Sydney Bridge Nominees Ltd v C of IR (1989) 11 NZTC 6,155 repeated Newton with favour and held that the concept applied in the case was relevant under s 99 of the Income Tax Act 1976, (currently ss BG 1, GB 1 and GZ 1). In the Court of Appeal, Cooke P in Hadlee and Sydney Bridge Nominees Ltd v C of IR at p 8,121 accepted this.[223]

The High Court, in BNZ Investments Ltd v C of IR (2000) 19 NZTC 15,732, held that the general anti-avoidance section (in this case, s 99 of the Income Tax Act 1976) was inapplicable because under s 99, BNZ Investments Ltd (BNZI) was not involved in the arrangement. The Court of Appeal agreed with the judgment and pointed out that the *arrangement*

needed *"a consensus or meeting of the minds, as to what is to be done:* C of IR v BNZ Investments Ltd (2001) 20 NZTC 17,103 at 17,117 (para [50])".[224]

In 1989, BNZI was involved in a four investment transactions that engaged in obtaining "Redeemable Preference Share" (RPS) in a special-purpose companies. This was a tax-free dividend with a prearranged fixed amount. The money from BNZI was placed overseas by the special-purpose companies with the intention to earn interest. The last transactions were carefully planned to avoid the existing tax law. The Capital Markets Ltd., a member of the Fay Richwhite Group, implemented the funds in a chain of companies in order to escape the New Zealand tax levied on their earnings. BNZI had earned a huge amount of tax-free profit from its investment. The Winebox inquiry named the transactions as MCN (mandatory convertible note) transactions and Alasdair/ Fenstanton transactions.[225]

The Commissioner reassessed the taxpayer's earnings for the years 1989-1993 for an amount exceeding $135 million with another $44 million owed in tax and with any interest incurred. Such assessments were based on the assumptions that a tax avoidance arrangement was undertaken and the Income Tax Act 1976 s 99(3) was applicable to recharacterise the alleged exempt dividend income on the investments and any interest incurred that was liable to tax.[226]

The Commissioner contended that the Redeemable Preference Share (RPS) transactions that BNZI were involved, were just one component in each of the four predetermined transactions. These transactions

executed an agreement to put the bank's money with a different bank to collect interest and to pay a part of that interest as tax-free dividends to BNZI. Moreover, the predetermined set of transactions were entered into the deposit transaction for no business purposes but to circumvent the income tax and then divide the money received from the transactions between the promoter of the avoidance plan and BNZI.[227]

The counsel for the Commissioner did not depend completely on the fiscal nullity doctrine in Ramsay and McGuckian. Nevertheless, it was mentioned in support of disagreement about the correct approach under s 99 to view the whole transactions that were included in the agreement.[228]

The taxpayer's counsel argued that tax avoidance was an "incidental" aim of the downstream agreement. Each downstream transaction was legal and successful in the way they were structured, therefore, s 99 was not suitable. Tax avoidance was irrelevant because any tax liability incurred was inapplicable towards the downstream transactions as the entities were overseas and the case of Europa Oil (NZ) Ltd v C of IR (No 2) [1976] 1 NZLR 546 (PC) (also reported as Europa Oil (NZ) Ltd v C of IR (No 2); C of IR v Europa Oil (NZ) Ltd (No 2) (1976) 2 NZTC 61,066 was referred to.[229]

The following is a list of legal issues to observe:[230]

1) *"the composition of the relevant arrangement in terms of s 99;*
2) *whether BNZI was affected for tax-avoidance purposes by tax avoidance present in downstream transactions;*

3) *if the relevant arrangement did include BNZI, whether it was a tax-avoidance arrangement as defined under s 99;*
4) *with respect to the MCN transactions, whether there was no tax avoidance because certain entities involved in the overall transaction had a New Zealand tax liability;*
5) *if there was tax avoidance, the appropriateness of the Commissioner's reconstruction against the taxpayer; and*
6) *whether use-of-money interest under former s 398A of the Income Tax Act 1976 could be imposed."*

McGechan J. held that BNZI was not included in any arrangement to avoid tax. His Honour ignored the Commissioner's principal argument that "a "composite" transaction of interdependent transactions would amount to an "arrangement" in itself, independently of questions of notice or knowledge". *The court said that "a s 99 "arrangement" requires conscious involvement (i.e., mutuality*) before a taxpayer can be said to be a party to an arrangement and there must be some form of agreement or acceptance, implied from conduct or otherwise tacit, to be involved in transactions giving rise to avoidance advantages".[231]

Any suspicion that specific details actually occurred or were even detected or understood, does not suggest a participation in a "contract, plan, agreement or understanding". McGechan J said at p 15, 791, *" To know is not necessarily to 'arrange'. More is required"*. Nevertheless, he observed that it was possible to get caught in a situation where tax avoidance arrangement exists. He explained three circumstances where the final judgement had found the taxpayer's course of action included

"understanding" in connection with the downstream tax avoidance proceedings:[232]

1) *"when the downstream counterparty can fairly assume the taxpayer is aware of a tax-avoidance risk;*
2) *when the taxpayer exhibits wilful blindness to downstream tax avoidance; and*
3) *if the taxpayer suspects or knows that downstream avoidance advantages will occur."*

Justice McGechan explained the following circumstances at p 15,791:[233]

a) *``[1] If, for example, there are factual matters which point to an interconnected downstream scheme at risk of avoidance under s 99, and the downstream counterparty is correspondingly justified in assuming the taxpayer is aware of those matters and is comfortable with any such risk, there may be room in some cases for a factual finding the transaction proceeded on the basis of a tacit 'understanding' those downstream matters would occur. The situation in that way could move past mere suspicion, or even knowledge, to one of 'mutuality', albeit tacit.*
b) *[2.] The same will follow, of course, in Nelsonian cases of wilful blindness. A taxpayer who deliberately refuses to see the obvious, but proceeds with a transaction in which the obvious occurs downstream, readily enough could be held to be part of at least an 'understanding' to that effect. A taxpayer who actually knows all the details, and proceeds nevertheless, is of course at equal or greater risk. [...]*
c) *[3.] There may well be no enforceable contract in relation to downstream activity but the s 99(1) definition is not so limited...If the*

taxpayer suspects or knows such downstream activities 'i.e., avoidance advantages] will occur, and proceeds nevertheless with upstream activities which cause that outcome, a taxpayer in appropriate factual circumstances may come to be regarded as involved in at least an 'understanding' to that effect, whatever smokescreens may be attempted....

d) I accept it may be possible, depending on facts in individual cases, for a taxpayer's notice of avoidance activity downstream, and a taxpayer's conduct implying acceptance of such activity, to be treated as at least an 'understanding' in relation to such downstream matters, so providing the necessary downstream mutuality. In such latter factual situations, there would then be one composite transaction, comprising both upstream and downstream elements. The question will always be highly fact specific."

Returning to the BNZI case, Justice McGechan decided that BNZI had the right to consider the redeemable preference share investment as a proper investment, and may be the tax losses were considered as excluded from s 99. The characteristics recognised were:[234]

a) "lack of exact knowledge;

b) an inability for commercial reasons to enquire as to accuracy of understandings;

c) the passage of redeemable preference share proceed through the Cook Islands tax haven company; and

d) tax and general indemnities negotiated;"

He observed that, they were not reasons for starting a suspected downstream tax avoidance and surely did not create an understanding that avoidance

would happen. The suggestion about "suspicion or knowledge" did not expand to defeat the obvious truth. The redeemable preference share transactions were treated by BNZI as normal transactions that were excluded from s 99.[235]

Truly, the rest of the matters should not be considered based on this judgement but because the events were chosen as a test case, Justice McGechan replied to all matters arising:[236]

1) *"Assuming a tax-avoidance arrangement, his Honour ruled that with regard to the MCN transactions, no tax avoidance would have occurred given the liability of two "downstream" entities to tax under the accruals rules. However, the Alasdair/Fenstanton transactions did have the requisite purpose or effect of tax avoidance under s 99(2).*
2) *The appropriateness of the Commissioner's reconstruction against BNZI.*
3) *Use-of-money interest under former s 398A of the Income Tax Act 1976 would have applied."*

The Commissioner launched an appeal (C of IR v BNZ Investments Ltd (2001) 20 NZTC 17,103) based on the grounds stated below:[237]

1) *"a taxpayer who enters into interdependent transactions which may involve tax avoidance is subject to s 99 if it later turns out that avoidance is in fact undertaken, whether or not the taxpayer understood that avoidance might occur;*
2) *a taxpayer who does not know precisely how tax advantages may arise from a transaction but expressly decides to authorise*

> *another person to act on the taxpayer's behalf so as to procure that advantage, effectively makes the other person an agent for tax-avoidance purposes".*

Richardson P, Keith and Tipping JJ agreed that the vital string for *an arrangement is "mutuality as to content" - a meeting of the minds and a consensus must involve and understand what is to be done".* The meeting of the minds was not present on this event. Both downstream and upstream transactions were not involved in any arrangement. Amongst the cases that have been to the New Zealand and Australian Courts because of the GAAP (General Anti-Avoidance Provision), the RPS (Redeemable Preference Share) were looked at "as a far cry from the self-cancelling and circular schemes". *"Tax avoidance arrangements were usually artificial"* according to the House of Lords in *MacNiven v Westmoreland Investments Ltd* [2001] 2 WLR 377; [2001] 1 All ER 865, and the Privy Council in O'Neil v CIR.[238]

Blanchard J judgement supported BNZI and said that the Commissioner could not assess someone only because she/he received money because of an arrangement. This action is outside the definition of arrangement. The money received by BNZI from the Cook Island entities was the dividend and was not under that arrangement.[239]

Richardson P observed at p 17,116 that:[240]

> *1) ``[43] The definition of arrangement closely follows the meaning given to the composite expression 'contract, agreement or arrangement' in Newton and*

other decisions under the former s 108 and its Australian counterpart, s 260 of the Income Tax Assessment Act 1936. In Davis v FC of T (1989) 86 ALR 195 at p 227 Hill J saw the bilaterality requirement as founded in the very nature of the words of s 260, contract, agreement or arrangement. And an arrangement cannot exist in a vacuum. As did the former s 108, s 99 bites on an 'arrangement made or entered into'. It presupposes there are two or more participants who enter into a contract or agreement or plan or understanding. They arrive at an understanding. They reach a consensus.

2) *[44] The crucial issue in this case is the extent of the understanding: how much knowledge is required and how and where the line is to be drawn when it is contended that A has left downstream matters to the decision of B. The inquiry is also relevant under s 99(3), which provides that, if the arrangement is void against the Commissioner, then any person affected by that arrangement can have his or her income adjusted accordingly.*

3) *[45] The words contract, agreement, plan and understanding appear to be in descending order of formality. A contract is more formal than an agreement, and in ordinary usage is usually written while an agreement is generally more formal than a plan, and a plan is more formal or more structured than an understanding. And it is accepted in the definition of arrangement that the contract, agreement, plan or understanding need not be enforceable. Section 99 thus contemplates arrangements*

> *which are binding only in honour."*

In outlining the boundaries to the meaning of the word "arrangement", the decisions of the majority of the judges observed a useful comparison in the legislative of the Commerce Act 1986 aimed at "contracts, arrangements or understanding lessening competition". *"In the context of sec 27 it means no more than a meeting of minds between two or more persons, not amounting to a formal contract, but leading to an agreed course of action". (add on)* Following the discussion of the meaning of arrangement as stated in Apple Fields Ltd v New Zealand Apple and Pear Marketing Board (1991) 3 NZBLC 101,946 at p 101,949; [1991] 1 NZLR 257 at p 261 according to Lord Bridge, and other authorities, Richardson P observed at p 17,117 that: [241]

1) ``*[50] In our view that reasoning is also applicable under s 99. In short, an arrangement involves a consensus, a meeting of minds between parties involving an expectation on the part of each that the other will act in a particular way. The descending order of the terms 'contract, agreement, plan or understanding' suggests that there are descending degrees of enforceability, so that a contract is ordinarily but not necessarily or legally enforceable, as is perhaps an agreement, while a plan or understanding may often not be legally enforceable. The essential thread is mutuality as to content. The meeting of minds embodies an expectation as to future conduct. There is consensus as to what is to be done (p 6).*

2) *[51] The justification for construing the concept of arrangement in that way is that it would be inequitable for a taxpayer who enters into an apparently unobjectionable transaction to be deprived of its rights thereunder merely because, unknown to the taxpayer, the other party intended to meet its obligations under that transaction, or in fact did so, in a legally objectionable way. In that regard the effect at common law of illegality in the performance of a contract by one party, where the other party is not implicated, is of some assistance as an indirect analogy. As stated in Chitty on Contracts, 28th ed 17-011 (p 7):*

3) *But when the contract does not necessarily involve the commission of a legally objectionable act and the legally objectionable intention or purpose of one party is unknown to the other, the latter is not precluded from enforcing the contract...The justification for this result is that it would be inequitable for a person who enters into an apparently unobjectionable contract to be deprived of his rights thereunder merely because the other party had an unlawful object in mind in entering into the contract (p 7).*

4) *[52] In order to avail the Commissioner, the consensus — the meeting of minds — necessary to constitute an arrangement under s 99 must encompass explicitly or implicitly the dimension which actually amounts to tax avoidance; albeit the taxpayer does not have to know that such dimension amounts to tax avoidance. Whether there has been a meeting of minds as to*

what is subsequently done in a particular respect by one party to an arrangement, and whether in answering that question the concept of wilful blindness (discussed by McGechan J — see para [26] above) may provide guidance, will depend on the particular facts (p 7).

5) *[53] In assessing the extent to which the relevant minds have met the following considerations may be helpful. One is the assumption, which each party may be entitled to make, other things being equal, that the other will act consistently with the justified expectations of the first, in relation to the way their common purpose is to be achieved. An unexpected departure from those expectations should not, without more, be regarded as part of the meeting of minds and hence as part of the arrangement.(p 7)*

6) *[54] On the other hand, a commercially realistic approach should be adopted when assessing the extent of the meeting of minds, particularly in cases where a significant feature of the arrangement is the obtaining, and sometimes the sharing, of tax benefits. Where that feature is present, a court is unlikely to find persuasive the stance of a taxpayer who professes to have had no knowledge or expectation of the mechanism by which the benefit was to be delivered. In such a situation the taxpayer may well appropriately be regarded as having authorised or accepted whatever mechanism was actually used. In such circumstances a consensus could properly be found in respect of the use of that mechanism.*

7) *[55] By contrast, if the taxpayer believes on reasonable grounds*

> *that the particular and legitimate tax saving mechanism is to be used by the other party, whereas in fact the other party uses a mechanism amounting to tax avoidance, it would be difficult to conclude that the taxpayer had entered into an arrangement extending that far. In such circumstances there would ordinarily be no consensus in respect of the dimension, which constituted the tax avoidance. But as we have emphasised the extent of the arrangement entered into by the taxpayer will always depend on the facts of the particular case. That inquiry, of course, precedes consideration of its purpose or effect under s 99(2)(pp 7-8)".*

The court had decided that there was no consensus between CML (Capital Market Ltd) and the taxpayer on what proceedings CML was doing in relation to the "downstream" transactions.[242]

The only dissenting Judge was Thomas J and he gave a useful approach to the meaning of s 99 (para 118) so that:[243]

> *1) "the word "arrangement" is to be given a wide meaning;*
> *2) the scope and effect of an arrangement is to be determined objectively; and*
> *3) the "innocence" or ignorance of a participant in the arrangement does not exclude liability."*

Thomas J looked at the High Court and the majority of the judges' distinction of "upstream and downstream" as an "artificial reconstruction of the arrangement". His Honour said that it did not matter if a taxpayer had no knowledge of the tax avoidance components in a transaction (para 127-128) because

s 99(2) is aimed at an arrangement as the end result. Therefore, s 99 is applicable to the agreement or understanding that the taxpayer and CML (Capital Markets Ltd) had accomplished an arrangement.[244]

In the case of Peterson v CIR (2003) 21 NZTC 18,069, the Court of Appeal ruled that there was an arrangement to fund the production of the film based on the facts available to the Commissioner. The investment partnership had an ongoing cost that included the liability for a loan that was paid in a full settlement straight away, to take advantage of the depreciation deduction that the investors had gained a tax advantage of. However, the claimed depreciation was overstated. The Court noted from the analysis of tax avoidance the presence of "arrangement" which needed "consensus or a meeting of minds". In addition, the existence of a purpose or effect of tax avoidance must be included. All these elements must exist if there is an arrangement created because of the cost of the film. The film directors were trying to increase the depreciation of the film by the amount of the loan however technically the loan did not exist because it was settled the same day. The judgement of the Privy Council in Peterson v CIR (2005) 22 NZTC 19,098; [2005] UKPC 5, the Law Lords with the majority ruled (at pp 19,108-19,109, para 34) that their *Lordships "do not consider that the arrangement requires a consensus or meeting of minds, the taxpayer need not be a party to the arrangement and in their view, he need not be privy to its details either"*.[245]

10.7 Application of s BG 1

There are two conditions that s BG 1 will apply:[246]

a) "when the only purpose or effect of an arrangement is tax avoidance;

b) when one purpose or effect of an arrangement is tax avoidance and that purpose or effect is more than incidental".

There are three factors that must be considered in order to comprehend the scope of these two circumstances:[247]

1) "to define the definition "the purpose or effect";

2) timing of the arrangement to be involved with either a single "purpose or effect" or one "purpose or effect" (which is more than incidental) of tax avoidance;

3) the way the court is ascertaining the "purpose(s) or effect(s)" of a scheme."

10.8 Meaning of "purpose or effect"

Section OB 1 contained the meaning of "tax avoidance arrangement" as an "arrangement that must include a single "purpose or effect" or one "purpose or effect" which is more than incidental of tax avoidance". This was explained in the case of *C of IR* v *Challenge Corporation Ltd* (1986) 8 NZTC 5,219 following the approach that was taken by the Privy Council. It was proposed that the word "purpose or effect" means the object or goal of the arrangement. This explanation was taken in association with the first general anti-avoidance section, s 108 of the *Land and Income Tax Act* 1954 and the Australian s 260, the original section with similar wordings.[248]

The Privy Council in *Newton* v *FC of T* (1958) 11 ATD 442 (in connection with s 260) explained "purpose or effect" as "the effect which it is sought to achieve — the end in view" (at p 445).[249]

Also, the Court of Appeal in *Tayles* v *C of IR* (1982) 5 NZTC 61,311 (in connection with s 108) said at p 61,318 that:[250]

> ``*The issue before the Board of Review, the High Court and this court involved an enquiry into the purpose or effect of the arrangement admittedly made. Whatever difference of meaning there may be in dictionary terms between the words 'purpose' or 'effect', posed as they seem to be as alternatives in sec 108, they usually have been looked on in the cases as a composite term. 'The word "purpose" means not motive but the effect which it is sought to achieve — the end in view. The word "effect" means accomplished or achieved. The whole set of words denotes concerted action to an end — the end of avoiding tax.' Newton v. F.C. of T. at p. 465. And 'if an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose, "Ashton v C of IR at p 61,034."*

The meaning of "tax avoidance arrangement" has the same wordings as it contained in s OB 1 and it should be construed in the same way. The Court of Appeal in *C of IR* v *Challenge Corporation Ltd* (1986) 8 NZTC 5,001, Woodhouse P has used this meaning when explaining s 99 of the *Income Tax Act 1976* that his Honour construed the purpose of an arrangement as "an end in itself" at p 5,006.[251]

10.9 Purposes within s BG 1

Sections BG 1 and GZ 1 are only applicable when the scheme contains tax avoidance as its whole

purpose, or, "if it has two or more purposes, one purpose of tax avoidance is more than incidental". The meaning of tax avoidance arrangement as in s OB 1 is contained in s BG 1.[252]

Woodhouse P in *C of IR* v *Challenge Corporation Ltd* briefly examined the construction of the law and said that:[253]

> ``*It will be seen that [s BG 1 deals] explicitly with two different situations. That contemplated by para (a) is where the tax avoidance purpose or effect of an arrangement stands by itself. The other situation, the concern of para (b), is where there are two or more purposes or effects including the tax avoidance one."*

10.10 Arrangements contain only one purpose or effect

In the meaning of tax avoidance arrangement it contains para (a) which applies to arrangements that involve only one purpose, a purpose of tax avoidance. This purpose is based on the court's determination of the arrangement's purpose which is to avoid tax and the purpose is by itself and not included with any other purposes.[254]

Example:
The Privy Council in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,219 observed that the taxpayer purchased the two loss companies, for the purpose of tax avoidance because none of the companies had any assets or debts, that para (a) is applicable. If the two companies contained an assets, the arrangement would have two purposes that para (b) is applicable instead.[255]

The case between C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,001 (CA) was about a scheme

that was associated with buying two bankrupt companies' shares with the purpose of exploiting the total losses owed. At the year ended 31 March 1978, the Challenge group expected a significant profit for the income year in discussion, and then involved in a scheme to buy the two companies with their total losses owed. Perth Property Consultants Ltd ("Perth"), a Merbank Limited's ("Merbank") subsidiary, in liquidation, had owed to Merbank the total loss of $5.8 million. The Perth share capital was raised by that amount that Merbank was given the new shares that their values were cancelled out with what was owed. Then Merbank shares in Perth were purchased in cash for the price of $10,000 by the taxpayer. In addition to this amount was half of the accumulation of tax advantages that would be gained by the Challenge group if the Challenge group's income were to successfully cancel out the Perth Company's loss.[256]

There was another case with a Merbank subsidiary that was involved with a similar transaction and was successful. Section 191 of the Income Tax Act 1976 (s IG 1) was applied by the Challenge, on another case with other members of the Challenge group's incomes, to cancel out another two companies' losses. Section 99 (s BG 1 and GB 1) was applied by the Commissioner to cancel out the conditions applicable by s 191. When a certain section is having its own anti-avoidance rule, as clarified by both the High Court and the Court of Appeal, s 99 is not applicable.[257]

Upon the overruling of the approach of the lower courts, the Privy Council supported the Commissioner's view (C of IR v Challenge

Corporation Ltd (1986) 8 NZTC 5,219). There were four various kinds of transactions pointed out by the Privy Council: "sham, evasion, mitigation and avoidance".[258]

The tax benefit sought by Challenge should be rejected under s 99, which is applicable only to transactions that involve tax avoidance. Tax mitigation is not subject to s 99 and Challenge did not apply it since the tax benefit gained was not from decreasing the income of the taxpayer or from creating extra expenses. The Privy Council introduced the notion of "tax mitigation" without any history or other support from law. Tax mitigation is mainly applicable to a single transaction, actually a single step and not included in a wider scheme.[259]

10.11 Arrangements contain more than one purpose or effect

The meaning of tax avoidance arrangement consists of para (b) which is applicable to an arrangement that the courts have determined that it involved two or more purposes and one of those (which is more than incidental) is to avoid tax. Practically, the court will ascertain the purposes of the arrangement and makes a decision if one of those is to avoid tax and to make a decision if that one is more than incidental. The meaning of incidental purpose is "one that is a subsidiary or minor purpose" in comparison to other purposes in connection with the arrangement.[260]

Example:
The taxpayer in Hadlee and Sydney Bridge Nominees Ltd v C of IR (1989) 11 NZTC 6, 155

(see below for more details) has designated, to a trust, some of his shares in a partnership's capital. The transaction involved two possible purposes in accordance with the High Court's approval. The first point is the transferrence of assets to the trust to protect them from the possibility of any claim against the partnership. The second point is to minimise his partnership's income tax liability. The court decided that there was a purpose of tax avoidance under s 99(2)(b) and then made a decision "that the tax avoidance purpose was more than incidental". This decision was later affirmed by the Court of Appeal.[261]

The taxpayer in Hadlee and Sydney Bridge Nominees Ltd v C of IR (1989) 11 NZTC 6,155 was a partner in an accounting firm. The partnership was spreading nationwide and the income of the partners was splitting in accordance with the agreement of the local partnership. The local partnership's profits were divided accordingly to the partners' capital units they owned in the firm, which is the capital that each partner put into the firm when they entered into the partnership, and 32 capital units belonged to the taxpayer. The taxpayer joined an arrangement in order to minimise his partnership's income tax liability from the 32 capital units. A discretionary family trust was established in the arrangement in which the primary beneficiaries were the taxpayer's wife and children, the trustee is a company where its directors were the partners from the accounting firms nationwide and 12.8 of the capital units were allocated to the trust. The incomes obtained by the beneficiaries were paid at a lower tax rate than the tax rate the taxpayer was paid. The High Court

declared that there was an arrangement, which involved:[262]

> *1) "the creation of the trust;*
> *2) the assignment to the trust of the 12.8 capital units".*

The Court of Appeal supported the decision in Hadlee case (Hadlee and Sydney Bridge Nominees Ltd v C of IR (1991) 13 NZTC 8,116.) In Hadlee and Sydney Bridge Nominees Ltd v C of IR (1993) 15 NZTC 10,106, the taxpayer made an appeal to the Privy Council, as their Lordships' judgement concluded there was no legal assignment and the further argument under ss 10 and 99 of the Income Tax Act 1976 was irrelevant for the judgement of the Court of Appeal. The Court of Appeal's argument on further grounds stays and will be applicable on relevant cases in accordance with the Inland Revenue Department: Tax Information Bulletin Vol 4, No 10, May 1993, p 21.[263]

Woodhouse P in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,001 analysed the definition of the group of words "merely incidental" and held that the matter of concern was if there was a tax avoidance which was an incidental purpose include thinking about (at p 5,007):[264]

> ``*... the degree of economic reality associated with a given transaction in contrast to the artificiality or contrivance or what may be described as the extent to which it appears to involve exploitation of the statute while in direct pursuit of tax benefits. To put the matter in another way, there is all the difference in the world, I think, between, the prudent attention on the one hand that can always be given sensibly and quite properly to the tax implications likely to arise from a course of action when*

deciding to pursue it and its pursuit on the other hand simply to achieve a manufactured tax advantage."

10.12 Tax avoidance defined

Section OB 1 has defined the meaning of tax avoidance as:[265]

a) " directly or indirectly altering the incidence of income tax;

b) directly or indirectly relieving any person from liability to pay income tax;

c) directly or indirectly avoiding, reducing or postponing any liability to income tax."

This meaning is relevant for the functions of ss BG 1, EH 1, GB 1 and GC 12.[266]

Section 99 of the 1976 Act (now s BG 1) was only applied on a limited number of cases. It was proposed that these terms when construed in connection with s 108 of the Land and Income Tax Act 1954 and s 260 of the Australian Income Tax Assessment Act 1936 could be used by the court, under s BG 1. The first two limbs and their effectiveness are still ambiguous that the court is highly likely to apply the third limb because it affected the scheme that the result is "directly or indirectly avoiding, reducing, or postponing any liability to income tax". Justice Turner's remarks about this matter are found at p 198 in the case of Marx v C of IR [1970] NZLR 182.[267]

10.13 Dividend Stripping

A specific form of tax avoidance arrangement exists under s GB 1(3). This subsection is applicable when a taxpayer is selling his or her shares for cash or other consideration that it could be a dividend

income if a tax avoidance arrangement has not been involved according to the Commissioner's opinion.[268]

Under section GB 1(3), it states:[269]

> ``*Without limiting the generality of the definitions of 'arrangement', 'liability', or 'tax avoidance' in section OB 1 or of section BG 1 or subsections (1) and (2) of this section, where, in any income year, any person sells or otherwise disposes of any shares in any company under a tax avoidance arrangement under which that person receives, or is credited with, or there is dealt with on that person's behalf, any consideration (whether in money or money's worth) for that sale or other disposal, being consideration the whole or a part of which, in the opinion of the Commissioner, represents, or is equivalent to, or is in substitution for, any amount which, if that arrangement had not been made or entered into, that person would have derived or would derive, or might be expected to have derived or to derive, or in all likelihood would have derived or would derive, as dividends in that income year, or in any subsequent income year or years, whether in one sum in any of those years or in any other way, an amount equal to the value of that consideration or, of that part of that consideration, shall be deemed to be a dividend derived by that person in that first-mentioned income year."*

The subsection does not, by itself, cancel any arrangement although it involves a tax avoidance arrangement, that arrangement is not liable to be cancelled under s BG 1. It is only applicable when "a sale or disposal of company shares is for consideration under a tax avoidance arrangement".[270]

Section GB 1(3) previously s 99(5) was first applied in New Zealand in Case P34 (1992) 14 NZTC 4,247

where two different companies were owned by the same shareholders and directors. They decided to merge the two into a new company.[271]

The shareholders from the old company sold their shares to the new company and the same shareholders held shares again, in agreed proportions, in the new company. The earnings were collected by the original companies.[272]

When finishing the transactions, tax avoidance was not the purpose of the taxpayers. If one of the effects was tax avoidance, then there was an arrangement.[273]

The difference between tax avoidance and tax mitigation was observed by the Privy Council and held to be "unhelpful". Under a dividend stripping arrangement, ss BG 1, GB 1 and GZ 1 are not applicable to the buyers of the shares, only if the buyers received no tax benefits from the arrangement, which is cancelled,.[274]

10.14 Sections BG 1 and GB 1 (post-Challenge) case laws in New Zealand

The Privy Council in O'Neil v C of IR (2001) 20 NZTC 17,051 found the tax-loss template scheme, was a case of an arrangement with a highly artificial nature that had the purpose or effect of avoiding tax within the definition of s 99 of the Income Tax Act 1976 (currently ss BG 1 and GB 1 of the Income Tax Act 1994). A deep analysis of how an arrangement is caught under s 99 is irrelevant, according to the Privy Council, but may be a comparison with those that have escaped. The Privy Council in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,219 introduced the differences

between tax avoidance and tax mitigation and described it at p 17,057 as "unhelpful". The differences between tax mitigation and tax avoidance are as follows:[275]

Contradiction between tax mitigation and tax avoidance before O'Neil.[276]

In the case of Challenge (PC), tax mitigation is the legal way of minimising a tax liability of a taxpayer. Nevertheless, Cooke P observed in the case of Hadlee and Sydney Bridge Nominees Ltd v C of IR (1991) 13 NZTC 8,116 that it did not apply globally and held at p 8,122:[277]

> ``*The distinction between tax avoidance and tax mitigation is both authoritative and convenient for some purposes, but perhaps it can be elusive on particular facts. Whether it could solve all problems in this field may be doubtful ...".*

Also, Baragwanath J in Miller v C of IR; McDougall v C of IR (1997) 18 NZTC 13,001 noted that "the distinction described a conclusion rather than providing a signpost to it (p 13,031)". The view of tax mitigation was not mentioned in the appeal to the Court of Appeal. In the O'Neil case, it contained the same result as of the judgement from this appeal.[278]

In Case M29 (1990) 12 NZTC 2,174 tax mitigation was particularly approved by the Taxation Review Authority and in other judgements there were some minor changes that occurred. Nevertheless, the authority looked at the view as stated in Challenge (1986) 8 NZTC 5,219 that it was just a summation of the earlier contradiction explained by the courts between tax evasion and tax minimisation as in case

L4 (1989) 11 NZTC 1,020 at p 1,031.[279]

10.15 Cases on ss BG 1, GB 1 and GZ 1

Since 1986, s 99 (currently ss BG 1, GB 1, and GZ 1) has been used in a few cases. The Taxation Review Authority had made most of the later decisions. "Any transactions with contrived or artificial aspects obviously aimed at tax avoidance and with no real business or commercial purpose" are the regular characteristics of most cases and they have been caught under s 99. In Case M72 (1990) 12 NZTC 2,419 at p 2,426 this concept was identified by Barbara DJ when she declared that ... "the inquiry in many cases involving sec 108 or sec 99 has been as to the reality or otherwise of the transactions in question". In C of IR v Dandelion Investments Ltd (2001) 20 NZTC 17,293 (confirmed on appeal in Dandelion Investments Ltd v C of IR (2003) 21 NZTC 18,010, contained the evidence of "an arrangement with no business or commercial purpose" besides collecting consideration without tax. The case included a chain of transactions during 1986 involving money deposited into companies in the Cook Islands. The High Court noted that the different steps were arranged into one transaction. The purpose of the arrangement was that the taxpayer would receive a dividend with the amount of tax worth less than the loan's interest because the loan was paid in full on the same day the loan was made. In C of IR v BNZ Investments Ltd (2001) 20 NZTC 17,103, the Court of Appeal's judgement did not support the taxpayer's case because his lawyer had written a letter outlining specifically the way the whole transaction would be. The court had decided that with that understanding

"there must have been the consensus, the meeting of minds, necessary to constitute an arrangement under s 99".[280]

Case K52 (1988) 10 NZTC 426

A family trust that belonged to an insurance agent had collected insurance commissions that were earned from selling his previous policies. He, then, had new policies and still worked and earned commissions from the same insurer. Subsequently, the tax to pay on the income from the policy going to the trust was entitled to a lower rate than it would have been if it was still the taxpayer's income. Section 99 was applied and the transaction was found to be void because it was a tax avoidance arrangement. The conditions of the transactions were completely administered by the taxpayer. He had the legitimate power over the rights to the insurance, according to the trust deed, and even after the transfer to the trust was completed. The moving of the assets to the trust was only a minor component of the transaction.[281]

11 PART 8: Choice Principle

11.1 The Choice Principle Considered

The choice principle belongs to specific provisions of the Income Tax Act where it has a choice of other paths to generate a tax benefit that cannot be disqualified by a general provision like s BG 1. The explanation for the principle is that under the rules of the specific provision, s BG 1 could frustrate the rules if it tries to eliminate the rules. A general provision cannot overrule a specific provision like the choice principle.[282]

The Australian courts started the choice principle. New Zealand courts used the concept before BG 1, that other provisions in the Act could be overruled. The Privy Council confirmed this concept that it is of general application and overrules other provisions in the Act except there is a specific provision that is applicable to the rules.[283]

11.2 Australian decisions

The choice principle is well established in Australia where it is illustrated in court cases. In WP Keighery Pty Ltd v FC of T (1957) 100 CLR 66 the full High Court of Australia included choice principle in their decisions; the case is famous with the first device of the principle. The principle was confirmed in Casuarina Pty Ltd v FC of T 70 ATC 4069 and the court acknowledged that the principle allows a taxpayer to increase the tax benefits allowed by the provisions of the Act as in Cridland v FC of T 77 ATC 4538.[284]

The choice principle, on the other hand, has its boundaries as was taken in FC of T v Gulland 85 ATC 4765. It demonstrated that choice principle is not available in all provisions of the Act and to give the taxpayer a choice that is outside the scope of s 260 of the Australian Income Tax Assessment Act 1936. The support for this principle is not very strong as shown in the latest Australian judgement where it demonstrated an unwillingness to approve false choices as in FC of T v Spotless Services Ltd 96 ATC 5201.[285]

11.3 New Zealand approach to the choice principle

The choice principle is favoured in the New Zealand courts for the fact that its application is not restricted by the ambit of s 108 of the Land and Income Tax Act 1954 (the predecessor to s 99 of the Income Tax Act 1976, s BG 1 of the Income Tax Act 1994, and now s BG 1 of the Income Tax Act 2004). The Privy Council in Europa Oil (NZ) Ltd (No 2) v C of IR (1976) 2 NZTC 61,066 had specific comments about choice principle as being good legislation in New Zealand ((Newton v FC of T (1958) 98 CLR 1 and was cited with acceptance in Hadlee's case.). Their Lordships accepted the High Court of Australia's earlier decision in Cecil Bros Pty Ltd v FC of T (1964) 111 CLR 430, while sitting in the case of Europa Oil. In Cecil Bros Pty Ltd, the Australian Chief Justice held that "the Australian equivalent to s 108 of the 1954 Act could not apply to reduce or defeat any deduction otherwise truly allowable under the general deduction provision (s DA 1 of the New Zealand 2004 Act)". The Privy Council held that "allowance of a deduction under s 104 (s DA 1) would be "incompatible" with the deduction being liable to avoidance under s 99 (s BG 1)".[286]

Richardson P in C of IR v BNZ Investments Ltd (2001) 20 NZTC 17,103 scrutinised the restrictions of the general anti-avoidance provisions and cited the choice principle during the case. His Honour's decision suggested that the anti-avoidance provisions only applied when the taxpayer's transaction was associated with lies and set up and the transaction involved the exact conditions

outlined in the income tax law. Subsequent to the explanation of s BG 1 "as a yardstick for drawing the line between legitimate tax planning and improper tax avoidance", Richardson P at p 17,115 held that:[287]

1) *"[40] Line drawing and the setting of limits recognise the reality that commerce is legitimately carried out through a range of entities and in a variety of ways; that tax is an important and proper factor in business decision making and family property planning; that something more than the existence of a tax benefit in one hypothetical situation compared with another is required to justify attributing a greater tax liability; that what should reasonably be struck at are artifices and other arrangements which have tax induced features outside the range of acceptable practice — as Lord Templeman put it in Challenge at NZLR p 562; (1986) 8 NZTC 5,219 at pp 5,226-5,227, most tax avoidance involves a pretence; and that certainty and predictability are important but not absolute values.*
2) *[41] The function of s 99 is to protect the liability for income tax established under other provisions of the legislation. The fundamental difficulty lies in the balancing of different and conflicting objectives. Clearly, the legislature could not have intended that s 99 should over-ride all other provisions of the Act so as to deprive the taxpaying community of structural choices, economic incentives, exemptions and allowances provided by the Act itself. Equally, the general anti-avoidance provision cannot be subordinated to all the specific provisions of the tax*

> *legislation. It, too, is specific in the sense of being specifically directed against tax avoidance; and it is inherent in the section that, but for its provisions, the impugned arrangements would meet all the specific requirements of the income tax legislation. The general anti-avoidance section thus represents an uneasy compromise in the income tax legislation."*

12 PART 9: The Commissioner's power

12.1 The Commissioner's Policy on s BG 1

In February 1990, the Commissioner made it available to the public (Tax Information Bulletin Vol 1, No 8) a fundamental report which contained the guidelines, for the use of the Department, on how to construe s 99 of the Income Tax Act 1976, currently ss BG 1, GB 1 and GZ 1 of the Income Tax Act 1994. The report was the first inclusive consideration of the topic by the Department for numerous years and it changed the Commissioner's scrutiny of s 99, which is after the Privy Council's judgement in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,219. The Commissioner declared that the report was required because of the ambiguity contained in the wide definitions where the section is embedded.[288]

The new policy was applicable at the time that was made available to the public and that would be applicable to cases that were under discussion at the same time.[289]

This approach is based on a research of:[290]

> a) *the underlying scheme and purpose of the Act as a whole and of the specific provision under review;*

b) the arrangement, to ascertain its purpose or effect;

c) whether a fair and reasonable inference can be drawn that tax avoidance is a purpose of the arrangement (other than a merely incidental purpose); and

d) whether following this analysis it can be inferred that the arrangement frustrated the underlying scheme and purpose of the legislation".

The third component includes an assessment of the scheme with "a view to concluding whether one can predicate whether the arrangement was implemented in a particular way so as to achieve an income tax advantage".[291]

If tax benefit was gained, it is crucial to find out if the benefit "is merely incidental to other purposes or effects of the agreement". The incidental purpose tests of Woodhouse P, who read the dissenting decision of the Court of Appeal judgement in C of IR v Challenge Corporation Ltd (1986) 8 NZTC 5,001, was adopted by the Commissioner.[292]

The determination of whether s 99 (currently ss BG 1, GB 1 and GZ 1) is applicable, according to the Commissioner, is to be done without transactions associated with particular sections in the Act.[293]

On 1 April 1995, the system of binding rulings were enforced in the Inland Revenue Department where it gives taxpayers choices when they are not sure about particular concepts when anti-avoidance provisions are applicable. Further discussion about the binding rulings will be in Part 10.[294]

When specific circumstances contradict s BG 1, a non-binding ruling will be provided by the Department. This is an illegitimate binding ruling.

The Commissioner usually follows a ruling except when the taxpayer has ignored one of the terms, for instance, responsibility to declare the whole details of the transaction.[295]

Before section 99 is applied, these four steps are cumulative, where each step must be present in a case.[296]

Step (1) and step (4) are outlined below:

12.2 Scheme and Purpose

Mr. Justice Richardson gave a short and clear explanation of "scheme and purpose" in his paper 'Appellate Court Responsibilities and Tax Avoidance' that was delivered at Monash University in 1984. This explanation is stated below:[297]

> *"'The twin pillars on which our approach to statutes rests are the scheme of the legislation and purpose of the legislation. Consideration of the scheme of the legislation requires a careful reading in its historical context of the whole Act including the long title analysing its structure and examining the relationship between the various provisions, and recognising any discernible themes and patterns and underlying policy considerations. It presupposes that in that way the study of the statute or of a group of sections may assist in the interpretation of a particular provision in its statutory context. It may provide a detailed guide to the intentions of the framers of the legislation and in so doing may cast light on the meaning of the provision in question.'*

This scheme and purpose approach may not provide the solution to the whole array of interpretation problems that may emerge according to his Honour. Nevertheless, he was pleased that stress on the

attempt to determine the scheme and purpose of the legislation, seemed in many situations to head in the direction of solving the interpretation problems in the tax arena, which matched well Parliament's purpose as stated in the legislation. The Commissioner agrees with this issue.[298]

The language of the statute is the most important issue to observe in attempting to determine the scheme and purpose of the statute. What is important is the purpose of Parliament that is stated in the legislation. Determination of the real intention of Parliament is hard because of many interrelated parts of tax statutes that cause doubts about the meaning of specific sections. The statute that is under discussion can be translated with the help of the committee reports, debates and discussions from Parliament and the guidelines for interpretation by the department.[299]

12.3 Frustration

The combination of the other parts of the process is required. The rest of the Act is used to back up by section 99. Its purpose is to save the liability for income tax that is existed under other parts of the Act. Therefore, section 99 will be used to cancel those schemes "where an evaluation of the arrangement results in the inference that a non-incidental purpose or effect is tax avoidance and the resulting tax advantage "frustrates" the intent of the Act."[300]

This new four-step approach is viewed by the Commissioner as an appropriate position of s 99 inside the Act, allowing it to function impartially and efficiently.[301]

13 PART 10: Binding Ruling

13.1 Rulings as a whole

Before the ratification of s 91A to 91I of the Tax Administration Act 1994, any rulings by the Commissioner of Inland Revenue (either private or public) about how the legislations of taxation were applied in association with any specific taxpayer, was not bound by his rulings. Justice McCarthy noted in *Reckitt & Colman (New Zealand) Ltd* v *Taxation Board of Review* [1966] NZLR 1032 at p 1,045 that:[302]

> ``*... the general scheme of the Acts is as follows. Liability for tax is imposed by the charging sections, ss. 77 to 79 of the Land and Income Tax Act 1954. The Commissioner acts in the quantification of the amount due, but it is the Act itself which imposes, independently, the obligation to pay."*

The main reason that the Commissioner could not use the legislation in a different way to separate taxpayers is located in the same case by the decision of Justice Turner at p 1,042:[303]

> ``*I have come to the firm conclusion that the public has an interest in the due compliance with every requirement of a revenue statute — and if there can be any distinction between revenue statutes I would think that this conclusion is peculiarly applicable to income tax provisions. It is of the highest public importance that in the administration of such statutes every taxpayer shall be treated exactly alike, no concession being made to one to which another is not equally entitled. This is not to say that in cases where the statute has so expressly provided the Commissioner a discretion to differentiate between cases — but this is in my opinion only to be done when provision for it is expressly,*

> *or it may be impliedly, made in the legislation. Where there is no express provision for discretion, however, and none can be properly implied from the tenor of the statute, the Commissioner can have none; he must with Olympian impartiality hold the scales between taxpayer and Crown giving to no-one any latitude not given to others."*

Normally, publication about how the legislation is applied is usually published in Public Information Bulletins ("PIB") by the Commissioner. Lately, it is published in Tax Information Bulletins ("TÌB") and the Inland Revenue Department has created many different pamphlets and booklets. The department usually follows these statements and will always stick to them.[304]

A particular ruling about a specialised matter or on how the legislation is applied to a particular taxpayer's circumstances, when it is required, was also wanted by the Commissioner. In the Public Information Bulletin No 117, June 1982, p12, the established practice by the department about this issue was published.[305]

The Inland Revenue Department did not stop supplying non-binding rulings when required if even though the binding rulings legislation was in force. The department's guide to "Binding Rulings" (IR 115G), issued in May 1995, at p 9 contained these passages.[306]

13.2 The taxation laws were binding rulings may be carried out

The following Acts and their provisions have allowed the Commissioner to carry out his or her judgment and to make binding rulings [307]

a) "the Estate and Gift Duties Act 1968;

b) the Gaming Duties Act 1971;

c) the Goods and Service Tax Act 1985 (apart from ss 12 and 13);

d) the Stamp and Cheque Duties Act 1971; and

e) the Income Tax Act 1994."

The Commissioner may not be able to make a binding ruling upon Income Tax Act 1994 to a point "that the matter in question is or could be the subject of a determination":[308]

a) "in relation to a financial arrangement, where a determination may be made under s 90 or s 90AC of the Tax Administration Act 1994;

b) in relation to the extent to which a financial arrangement provides funds to a party under the arrangement for the purposes of the capitalisation rules (under s 90A of the Tax Administration Act);

c) in relation to petroleum mining operations (under s 91 of the Tax Administration Act);

d) in relation to "accrual expenditure" under subs EF 1(3) of the Income Tax Act 1994;

e) in relation to depreciable property (under any of ss EG 4, EG 10, EG 11 and EG 12 of the Income Tax Act 1994), or

f) in relation to the valuation of specified livestock and non-specified livestock (under s EL 4 and subs EL 9(3) respectively of the Income Tax Act 1994)."

The Commissioner may have discretion to rule under the Income Tax Act 1976 but not to the taxpayers from 1994/95. This change was caused by the changes to subsection 1(3) of the Taxation Administration Act 1994 and s YB7 of the Income

Tax Act 1994. Furthermore, there were other issues such as the tax system administrations and the power to issue exemption certificates for non-resident contractors by the Inland Revenue Department. The Commissioner has no power to issue binding tax rulings on these matters. Binding rulings are prohibited on the balance date specifically and all other provisions of the Tax Administration Act 1994.[309]

The Commissioner has a restricted category for the type of ruling that he may make. For instance, the Commissioner may not make a binding ruling on questions of fact for private and product rulings.[310]

The power of the Commissioner to make a binding ruling may include any rule that is subject to Tax Administration Act 1994, s 225 "(the general income tax regulation-making power)" or Order in Council or subject to any of the Acts outlined above apart from the related section that:[311]

> *a) is or could be the subject of one of the determinations listed above; or*
>
> *b) relates to exemption certificates for non-resident contractors under reg 5(1A) of the Income Tax (Withholding Payments) Regulations 1979 (or any successor to that regulation).*

The authority of the Commissioner to make a binding ruling does not include the following:[312]

> *a) impose or remit any penalty;*
>
> *b) undertake a tax investigation or otherwise inquire into the correctness of any return or other information supplied to the Department;*

c) commence or withdraw any prosecution; or

d) *recover any debt owing to the Commissioner.*

14 Conclusion

Although there are many other cases mentioned in this Dissertation with different interpretations for their win or loss under s 99, now s BG 1, the writer's attention is caught by the interpretations of the cases of BNZ Investment (BNZI) and Peterson. The writer concludes that the decision in the case of BNZ Investment should be reversed and applied the decision of the dissenting Judge, (Dissenting judgment of Thomas J in C of IR v BNZ Investments Ltd (2001) 20 NZTC 17,103; [2002] 1 NZLR 450 cited.). His decision was supported by their Lordships in the case of Peterson -- that they ruled that arrangement "**does not require a consensus or meeting of minds, the taxpayer need not be a party to the arrangement and in their view, he need not be privy to its details either":** (Peterson v Commissioner of Inland Revenue (2005) 22 NZTC 19,098.)

The true meaning of "tax avoidance arrangement" rest on the discretion of the interpretation of the gurus in taxation and the judges of the cases involved. The Commissioner's role is to apply s BG 1 if the arrangement has the purpose or intention of tax avoidance and if the taxpayer has gained a tax advantage from the arrangement, independent of a merely incidental purpose.

15 Areas identified for further research

There are many cases that this Dissertation has yet to address to find out why or why not s 99, now s BG 1, was applicable or not applicable. The writer recommends further research into the old cases such as from the 18th and 19th centuries and recent cases such as from the 20th century.

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