



Supreme Court of New Zealand

24 August 2011

MEDIA RELEASE – FOR IMMEDIATE PUBLICATION

Penny & Hooper v Commissioner of Inland Revenue
(SC 62/2010) [2011] NZSC 95

PRESS SUMMARY

This summary is provided to assist in the understanding of the Court’s judgment. It does not comprise part of the reasons for that judgment. The full judgment with reasons is the only authoritative document. The full text of the judgment and reasons can be found at Judicial Decisions of Public Interest www.courtsofnz.govt.nz

Mr Penny and Mr Hooper are orthopaedic surgeons. The Commissioner of Inland Revenue alleges that they have used certain corporate and family trust structures in a way which breaches s BG 1, the general anti-tax avoidance provision of the Income Tax Act 1994.

Each of the appellants sold his orthopaedic practice to a company of which he was the sole director. The shares in each company were owned by family trusts. Mr Penny and Mr Hooper were then employed by their respective companies to undertake exactly the same surgical work as they had performed prior to incorporation.

From the time of an increase in the top marginal tax rate in 2000, each man was paid a significantly lower salary by the company than the income he had previously received when conducting the practice in his own name. The rest of the company’s net revenue was distributed to the family trust by way of dividends. Tax was paid at the lower company or trust rate. The Commissioner alleges that the use of the structures in this way constituted a tax avoidance arrangement for the purposes of s

BG 1, and accordingly made assessments increasing the taxable incomes of both men for the 2002, 2003 and 2004 tax years.

The High Court found in favour of taxpayers, holding that there was no tax avoidance in the arrangements, and that the scheme and purpose of the Act did not require the taxpayers to derive the funds as personal income. A majority of the Court of Appeal, reversing the High Court, held that the incorporation of the practices and the payment of salaries at artificially low levels represented tax avoidance which was more than a merely incidental purpose or effect of the arrangements.

The Supreme Court has unanimously upheld the finding of the majority of the Court of Appeal. It has held that although the structures themselves were entirely lawful and unremarkable, the use of those structures by Mr Penny and Mr Hooper to pay themselves artificially low salaries constituted a tax avoidance arrangement in each of the relevant years. Accordingly the Commissioner is entitled to treat the arrangements made by the taxpayers as void against him for income tax purposes under s BG 1.

Contact person: Gordon Thatcher, Supreme Court Registrar (04) 914 3545