IN THE SUPREME COURT OF NEW ZEALAND SC 24/2009

BETWEEN **GOVIND PRASAD SAHA**
Appellant

AND **COMMISSIONER OF INLAND REVENUE**
Respondent

Hearing:	27 October 2009
Court:	Elias CJ Blanchard J Tipping J McGrath J Wilson J
Appearances:	G J Harley with R P Harley for the Appellant M S R Palmer with M T Lennard for the Respondent

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CIVIL APPEAL

MR HARLEY:

Good morning Your Honours, I appear for the taxpayer with Mrs Harley.

ELIAS CJ:

Thank you Mr Harley.

MR PALMER:

Tena kotou katoa, my name is Palmer, I appear for the Commissioner of the Inland Revenue with my friend Mr Lennard.

ELIAS CJ:

Thank you Mr Palmer, Mr Lennard. Yes Mr Harley?

MR HARLEY:

Your Honours, I want to address the Court orally in five sections. The first is to take you quickly through the Court of Appeal judgment to focus on the factual and contractual matrix and then to identify the problems with paragraphs 31, 32 and 33 of the Court's reasons. Second, I want to take you through the statutory framework of the FIF regime and particularly through some worked examples of section CG 18's formula. I then want to return, particularly to paragraphs 31, 32 and 33 of the Court of Appeal judgment to make two points as to why its reasons can't be right. The fourth part of my submission will deal with briefly the Commissioner's submission. I'll identify that he too makes errors in the contractual analysis. I'll criticise the example in paragraph 12 and particularly paragraph 12.2. I'll criticise the flowchart on page 16 and explain why it is misleading and question begging. Finally fifth in that respect I will deal with the rhetoric in his paragraph 20. I expect, all things going my way, that I should finish addressing the Court before the morning adjournment.

ELIAS CJ:

Thank you. It's quite a confined point really and we have read, of course, the relatively meagre materials.

MR HARLEY:

Yes well we just about managed, both of us, to get within the page limit together. The two issues before the Court concern the application of the FIF rules, the first being whether by the forfeiture of the 2095 shares, the taxpayer's disposition to Cap Gemini France was made without consideration, that is, being in the nature of a gift so that on Justice France's approach in the High Court, section CG 23(5) would be engaged. Or if there was consideration, as the Court of Appeal accepted, then whether the taxpayer's disposition to Cap Gemini France was an exchange in kind, that is a barter transaction attracting section CG 14(2). The Court of Appeal held that there was such an exchange.

If I can take you now to the Court of Appeal's judgment. It's in the case at pages 17 to 28 but it's also been reproduced from the CCH report which is attached to what I'll call the yellow pages, which is the legislation. In paragraphs 1 through 3 the Court correctly records that the taxpayer was a partner in EY and that EY sold its consulting business to the French company Cap Gemini France but the partners of EY, including him, were paid by means of a share allocation from Cap Gemini France. He received 7566 of the shares. He was required to enter into a contract of employment with the Cap Gemini New Zealand company for a period of five years and within the sale contract there was an escrow arrangement providing for a five year release of those 7566 shares. And at 3 we're told incorrectly that Dr Saha commenced work for Cap Gemini, that is Cap Gemini New Zealand. That he subsequently became dissatisfied and left and that on leaving he lost part of his entitlement to some of the shares, that is he lost 2095 of the shares.

The Court goes on in paragraphs 5 through 11 to set out the contractual matrix correctly and at the bottom of the page sets out the escrow release dates. Just to help you with that the release dates were the closing – the closing occurred in May 2000 and he was then allocated 7566 shares. By the time he got to the dispute with Cap Gemini, we were in May 2001. There were then 4190 shares retained in the escrow and it's the 50 percent - that is the 2095 - that were forfeited by virtue of the deed of settlement. The Court correctly records in paragraph 9 that the purpose of the arrangement in terms of the escrow was so that Dr Saha and others couldn't just take the money and run, that he had to continue in employment for the five year period.

In paragraph 12 the Court quotes the forfeiture provision correctly and records there that if he were to terminate his employment within the five year period then the forfeiture sliding scale would apply to him. Then in paragraph 13 it records that he commenced employment with Cap Gemini New Zealand in April 2000. The difficulties arose and eventually they settled their differences on May 2001 with Cap Gemini and Cap Gemini New Zealand agreeing to the arrangements that are then recited. These (a), (b) and (c) in 13 are taken straight from the recitals of the deed, which is case page 80. Clause 14 of the

deed records the taxpayer would resign from Cap Gemini New Zealand, his last day of work being the 30th of June. Clause 4 of the deed provided that he was to forfeit 2095 shares from himself to Cap Gemini France.

BLANCHARD J:
Was that strictly in accordance with the original arrangement?

MR HARLEY:
No. It's half.

BLANCHARD J:
So he actually got a benefit because he didn't have to forfeit half?

MR HARLEY:
Yes.

BLANCHARD J:
Thank you.

McGRATH J:
Just while you've been interrupted Mr Harley. If you go back to clause 6, is that essentially reproducing everything in the original deed in relation to obligation to take up employment or is there – an obligation to continue in employment if perhaps I could put it that way.

MR HARLEY:
No it doesn't Your Honour. There's –

McGRATH J:
At some stage I'd like to, because it seems to me that the question of breach or potential breach is in issue here, I'd like to see what those provisions were but not now – whenever it suits you.

MR HARLEY:

I'll remind myself to come back to that but there are quite extensive terms in the deed of covenant itself in terms of its recitals and elaborate provisions in what was to be master agreement all of which were mirrored in the deed of covenant. If I could just deal with breach briefly. There was no breach. The parties had a difference between them and they settled that difference without acknowledgement of breach.

TIPPING J:

That settlement must be regarded as for consideration I would have thought?

MR HARLEY:

I agree with you Sir and so did the Court of Appeal.

McGRATH J:

I suppose it's relevant, is it not, whether the settlement was anticipating what would have been the brech if Dr Saha had chosen to – had exercised his right to leave or had chosen to leave – perhaps would be a better way of putting it?

MR HARLEY:

Because of the way the deed of settlement is written Sir, which does not refer to or acknowledge breach, my view is that the deed embodies a negotiated outcome where there is an exchange of differences between the parties and they've agreed to walk away from each other on the terms agreed.

McGRATH J:

I take it your argument includes no acknowledgement that there was a situation of breach was imminent and had to be avoided?

MR HARLEY:

Correct.

TIPPING J:

Well he wasn't threatening to break the contract, he was simply saying I want out, let's see if we can get some terms. That's what I derive from – there was no, it didn't even come as far as anticipating a breach on the material that we have anyway.

MR HARLEY:

I agree Sir but I don't think you can read the deed of settlement as being a one-way traffic because he has a complaint and a dispute with an employer which he would have asserted entitled him to certain benefits or rights and so it is the classic mutuality in terms of: "we've got a fight between ourselves, let's cut the deal and walk away", which is what they did. The terms being that he was to forfeit 2095 shares to Cap Gemini France. Cap Gemini New Zealand was to pay him $250,000 and he was to agree to bill incomplete work for his employer.

TIPPING J:

And very importantly, I would have thought, he was released from the restraint of trade?

MR HARLEY:

No he wasn't.

TIPPING J:

Wasn't he?

MR HARLEY:

No.

TIPPING J:

I thought that was, is that a misconception on my part?

MR HARLEY:

I'm sorry I've answered your question too generally. The restraint of trade is in very, very wide terms including anti-solicitation, anti-poaching –

TIPPING J:

That was varied in his favour was it?

MR HARLEY:

No, no. The only variation in respect of the restraint of trade was the termination of his employment. It was agreed that his employment was terminated but it was not agreed that he was released from the terms of the restraint of trade. Indeed the deed of settlement makes it absolutely clear that the deed of covenant is to continue in full force and effect for the rest of its term.

ELIAS CJ:

I should flag that I have difficulty in understanding how these matters of background are relevant and why one wouldn't simply start with the disposition?

MR HARLEY:

If you'll just bear with me for about two minutes Ma'am, I'll answer your question.

ELIAS CJ:

Good, thank you.

MR HARLEY:

Moving then to paragraph 26 of the Court of Appeal's judgment it correctly records that Justices France in the High Court accepted that there was no actual gain and that the forfeiture occurred by way of an adjustment to the purchase price. He then went on to conclude that section CG 23(5) applied because he found there was no consideration. At paragraph 28 of the judgment the Court of Appeal then records the argument that I made to it in

respect of section CG 23(5) being that whatever else this was, there was no gift, or nothing in the nature of a gift, going from Dr Saha to Cap Gemini France and for that reason my submission was that there was fully adequate consideration passing from Dr Saha as promisee to Cap Gemini France as promisor, the consideration being the loss that was suffered on the disposable. Then the Court goes on –

ELIAS CJ:

Why wasn't it the gain in retention of the shares?

MR HARLEY:

Well he hasn't gained anything Ma'am, he's kept them. Nothing's moved.

ELIAS CJ:

Otherwise he would have forfeited them. Absence the further agreement.

MR HARLEY:

But he didn't and he kept them and there's no gain in respect of keeping them.

BLANCHARD J:

Yes there is. Otherwise he'd have had to forfeit the lot.

MR HARLEY:

Well I disagree with Your Honour. If –

BLANCHARD J:

Well 'm sorry Mr Harley but this seems to be the nub of the case. You have to persuade that there's no advantage to him there when I would have thought clearly there was.

MR HARLEY:

We'll get to that Your Honour. In respect of paragraph 28, which I've just covered, then the Court moves on to assert that the deed of settlement

effected a new contractual arrangement between the parties and that this arises by virtue of clause 10 of the settlement deed which is the whole agreement clause. In my written submission I've criticised that my saying that's not the purpose of clause 10 at all. Clause 10 simply is a whole agreement in the sense that it takes over and prevents any reliance on earlier oral discussions but it certainly doesn't rewrite or replace the deed of covenant. The rest of the paragraph, I accept, is correct in terms of the Court's judgment, the parties must have meant that it remained in full force and effect except insofar as the deed of settlement modified it and it modified it in respect of the half.

ELIAS CJ:

Why is this error – why do you say this error is material?

MR HARLEY:

In respect of the effect of clause 10?

ELIAS CJ:

Yes.

MR HARLEY:

I don't.

ELIAS CJ:

You don't?

MR HARLEY:

No. We then get to paragraph 31 and the Court says we consider the focus must be on the settlement deed which I accept. It recorded various agreements to end the employment dispute between the parties. Dr Saha was to resign on a specified date. Yes he was. He was to resign from employment with Cap Gemini New Zealand. He was to agree to use his best endeavours to complete certain work. Yes he was with Cap Gemini New Zealand. He was required to transfer half of his unreleased transaction

shares to Cap Gemini France. Yes he was. For its part, Cap Gemini agreed to make a termination payment to Dr Saha. No it didn't. Cap Gemini New Zealand made that termination payment and it allowed him to resign from employment. Cap Gemini France allowed him to retain the half of the unreleased transaction shares. The Court goes on, Cap Gemini also agreed to release –

ELIAS CJ:

Again how is that material?

MR HARLEY:

We'll get there Ma'am in terms of the flows of consideration for the disposition of the shares.

ELIAS CJ:

So it's material to the value question?

MR HARLEY:

It is crucial to the consideration passing for the disposition of the shares to Cap Gemini France.

ELIAS CJ:

All right.

MR HARLEY:

The shares are not disposed of to the employer. The money is paid by the employer to Dr Saha. They're different contractual obligations and discharges. Cap Gemini also agreed to release Dr Saha from his employment obligations. No it didn't. Cap Gemini New Zealand did. Then the Court repeats that the deed was expressed to supersede all previous agreements and understandings in relation to the employment dispute. That's correct. But it didn't wipe the slate clean in terms of the deed of covenant. Then in 32 the Court goes on in terms of the consequence. The second line of analysis, that's section CG 14. "When the parties agreed the settlement deed each

gave consideration." I agree. Dr Saha agreed to relinquish half of his unreleased transaction shares to Cap Gemini France. He agreed to transfer them to Cap Gemini France as part of an overall settlement. And then the Court says, "In return he received certain benefits such as the freedom to undertake other employment." From whom?

TIPPING J:

That's where I think I got misled, at least on your argument.

MR HARLEY:

He received that benefit from the termination of the employment contract with Cap Gemini New Zealand. "In our view then," the Court says, "it is not correct to say that Dr Saha obtained no gain from the transfer of the shares to Cap Gemini. Rather, he received a gain, but it was a gain in kind and not in money." And the submission I'm making is that that last sentence is crucial and wrong.

ELIAS CJ:

The employment benefit was not received in return for the disposition of the shares?

MR HARLEY:

No.

ELIAS CJ:

No.

MR HARLEY:

The shares go to a different person.

ELIAS CJ:

I understand.

MR HARLEY:

Now if I could take Your Honours to –

McGRATH J:

If you accept that, is it correct to say that he derived the freedom to undertake other employment, as long as you make sure that relates to employment from whom you say, a New Zealand company? Did he obtain freedom to obtain other employment from the deed of covenant?

MR HARLEY:

Yes but subject to the other terms of the restraint of trade. He could not go into competition with Cap Gemini. He couldn't poach either clients or staff and there were other elaborate restraint terms as well.

McGRATH J:

So he could work in the same area, general area, as he'd been working before as long as he didn't interfere with Ernst & Young's client arrangements?

MR HARLEY:

Yes.

McGRATH J:

Thank you.

MR HARLEY:

Now before I come back to these paragraphs I'd like to take Your Honours into the yellow pages and just –

BLANCHARD J:

Well just before you do can we come back to this question that I raised earlier? It's possible that you may be right in the argument you're, in the criticism you're making of paragraph 32 but it seemed to me, reading that, that

there was an element that wasn't being mentioned and that is the value that he got because he no longer had to forfeit as many shares as he otherwise would have had to forfeit.

MR HARLEY:

Your Honour, it's clearly right that he kept half the shares. Of course he did.

BLANCHARD J:

Well he's better off by that amount.

MR HARLEY:

Well I'm going to show you that he's, I can't put this in better language, he's the same off in terms of the way this formula works. Those shares are already within the tax net and are subject to the rules.

ELIAS CJ:

But he's bought all the shares within the tax net.

MR HARLEY:

Of course and now –

ELIAS CJ:

And if he disposes of them, well anyway you said you'd come on to answer it.

BLANCHARD J:

If I'm in a situation where if I do certain things, I forfeit a hundred shares, and it is proposed that I do some part of those things, but it's agreed that I only forfeit 50 shares, then I'm at least better off, I would have thought, by the 50 shares that I've been allowed to keep?

MR HARLEY:

The starting place is with the 100 shares, all of which are within the tax net and are subject to the regime. I forfeit 50. The other 50 remain within the tax net and are subject to the regime.

ELIAS CJ:

So does a disposition –

MR HARLEY:

Well that's the question –

ELIAS CJ:

– stay within the regime.

MR HARLEY:

Well that's the question.

ELIAS CJ:

Yes.

MR HARLEY:

But nothing changes within the regime for the 50 I had an already – and still maintain. I can show you this in the formula, and I will.

TIPPING J:

You don't dispute that this settlement deed involved a disposition?

MR HARLEY:

Of the 2095 shares forfeited?

TIPPING J:

Exactly.

MR HARLEY:

Correct.

TIPPING J:

So there was a disposition but you say it is outside the regime?

MR HARLEY:

Correct.

ELIAS CJ:

Well I think that is the issue. I'm not really sure why we're so exercised by what lay behind the disposition although you're going to explain why it affects the values, is that right?

MR HARLEY:

I'm also going to explain the true nature of the contract and that explains why the disposition results in a loss.

ELIAS CJ:

Well I'm not sure, I remain to be convinced and you can come back at it, but I remain to be convinced that the contract matters at all. Because he's disposed of shares and why does not the statutory regime simply attach to that disposition?

MR HARLEY:

Well the answer is –

ELIAS CJ:

He's disposed of shares he's brought within the regime.

MR HARLEY:

The answer is that the regime will provide him with a loss of those shares worth $602,938.

ELIAS CJ:

Well that's the question.

MR HARLEY:

And I'll show you on the formula how that works.

ELIAS CJ:

Yes, fine.

MR HARLEY:

In the yellow pages if we could go first to section CG 1 on page 17,001, the regime tells us that the gross income of any person includes FIF income and from –

BLANCHARD J:

I'm sorry, where are we?

MR HARLEY:

We're on the very first page of the text of the yellow pages for statutory provisions.

BLANCHARD J:

Thank you.

MR HARLEY:

Section CG 1 tells us the gross income includes FIF income. CG 15, which is on page 17,304 of the materials, defines what is a foreign investment fund in A and it's common ground that Cap Gemini France, as a French listed company, is such a company, giving rise to Dr Saha having that interest. We then get to section CG 14(1) which prescribes the rules for the cost incurred of acquiring the FIF interest. So you'll see at the top of Section CG 14(1) these were the rules for the cost of acquiring the interest and we get to paragraph C which tells us that where expenditure or cost is incurred in kind and not money the amount of the expenditure is equal to the market value of the expenditure or cost incurred in kind measured at the time incurred. In plain language what it means is that he received 7566 shares in Cap Gemini France. They had a market value. That market value is deemed to be his cost.

WILSON J:

And he gets a deduction for that cost, doesn't he?

MR HARLEY:

Yes he gets an opening stock deduction.

WILSON J:

An opening stock deduction.

MR HARLEY:

Yes. CG 14(2) deals with exchanges of FIF interests telling us that where there is an exchange in kind we use market value of the property exchanged and obtained. So it's a barter provision. CG 16 then prescribes the four methods that are to be used by a person such as Dr Saha and it's common ground that he used a comparative value method which is prescribed by section CG 1, paragraph C.

TIPPING J:

Can you just go back to CG 14(2) Mr Harley please? If the disposition of the shares is inside the regime you measure the credit by the market value of those shares, is that right? "If" the disposition is within the regime?

MR HARLEY:

If I've got 100 A FIF shares and I swap them for your 100 B FIF shares, I have to calculate the value of my shares in kind at market value. So that I recognise that there is two different transactions that occur in the barter. I've disposed of my property and I've obtained property.

TIPPING J:

But if they come in as a debit, in this opening entry that you and brother Wilson were discussing, they come in as a debit, because it's a cost –

MR HARLEY:

We're talking about two different transactions between CG 14(1)(c) and 14(2).

TIPPING J:

What I'm puzzled by is if they come in as a debit, why don't they go out as a credit?

MR HARLEY:

In –

TIPPING J:

If they're within the regime.

MR HARLEY:

In due course they will by operation of the formula.

TIPPING J:

Yes. So in concept I'm on the right lines?

MR HARLEY:

Yes.

TIPPING J:

Thank you, that's all I wanted to know.

MR HARLEY:

I'll take you now to the formula in CG 18 –

ELIAS CJ:

I'm sorry. Do you say that this was an exchange in kind?

MR HARLEY:

No I don't –

ELIAS CJ:

No.

MR HARLEY:

– there was no exchange.

ELIAS CJ:

No.

MR HARLEY:

It was a disposition from the taxpayer to Cap Gemini France.

ELIAS CJ:

Yes. Well I tend, I must say, to have some sympathy with that view, but I'm not sure that it answers the point.

MR HARLEY:

Well it does answer the point Ma'am in terms of section CG 14(2), it can't apply.

ELIAS CJ:

Yes, yes. And it disposes of some of the reasoning of the Court of Appeal but it leaves you with the reasoning of Justice France?

MR HARLEY:

Yes except that the Court of Appeal has accepted that the disposal to Cap Gemini France was for fully adequate consideration which the Judge did not accept and if that's right, and my submission is the Court of Appeal was absolutely right about that, section CG 23(5) can't apply at all. Neither section can apply.

ELIAS CJ:

I don't understand that but go on.

MR HARLEY:

If you just bear with me in terms of the formula and then I'll get to some worked examples. The formula, there's a lot of words, but to an accountant this is just intuitive and I'm not one of them.

TIPPING J:

What are we looking at now Mr Harley?

MR HARLEY:

CG 18, the formula. If we start off, in brackets, with the left-hand side, A+B. A is the market value at the end of the income year and it's perhaps best here to use some dates. The end of the income year is the 31st of March and so what's been brought to account in A is what is the market value of your FIF shares at the end of the income year, 31 March. You then add B which is the receipts from sales or dividends. That is the total value that has been received or derived or held at the end of the year. You then deduct the other two items, being C and D. C is the market value at the end of the preceding year, that's the prior year market value, and I would call that opening stock. D is then the aggregate of any expenditure that's incurred throughout the year in order to obtain the FIF interest. So D is our opening deduction for the shares that were originally allocated to us. The formula can be simplified into language being the market value of the closing stock, plus receipts and sales, minus the cost of acquisition, including the costs during the year.

Last in terms of the rules, if I could take you to CG 23(5), that simply tells us that anyone who holds a FIF and who disposes of it in a transaction that is in the nature of a gift, is required to bring the value –

ELIAS CJ:

But it doesn't say that. It doesn't say that in the nature of a gift, it's just for no consideration?

MR HARLEY:

Or for less than –

ELIAS CJ:

Or for less than, yes.

MR HARLEY:

In the nature of a gift Ma'am.

ELIAS CJ:

Well why is that not what happened here?

MR HARLEY:

Whatever else happened here, Ma'am, there was a dispute between the parties. They settled the dispute for fully adequate consideration. The disposition goes from the taxpayer to Cap Gemini as part of that settlement. He didn't gift them to Cap Gemini.

ELIAS CJ:

Well that might be so as between the parties but in terms of the tax regime he disposed of shares that he had brought into, brought to tax and he disposes of them for no consideration that he's able to bring to tax.

MR HARLEY:

He doesn't dispose of them for no consideration, which is what the section is focused on.

ELIAS CJ:

Well, do you say that? It's necessary to value the benefit he derived from the contractual adjustment?

MR HARLEY:

He derived no benefit from the forfeiture of the shares to Cap Gemini France. He's being punished.

ELIAS CJ:

He disposes of the shares and obtains the right to retain 50 percent.

MR HARLEY:

As a purchase price adjustment, yes. The price is put down.

WILSON J:

Isn't the real issue here what, if any, value is assigned to the forfeited shares for the purposes of the regime?

ELIAS CJ:

Yes.

MR HARLEY:

Yes, and the answer, in terms of the formula, is minus $602,938 being the loss. And it's the loss he suffers that is the consideration passing from him as promisee to Cap Gemini France as promisor, or, in my language, all I've done is adjusted the purchase price for the sale of the business down. And, of course, it's for fully adequate consideration.

ELIAS CJ:

But he's already bought all the shares into tax.

MR HARLEY:

Of course. Because when he received the full purchase –

ELIAS CJ:

So how he characterises it, I'm still struggling to see how that matters at all. It's just the fact of the deposition that's relevant, it seems to me.

MR HARLEY:

Let me just take you through some worked examples that shows why it is relevant, and why the formula produces the right outcome. At the top of the worked examples, I've set out the formula. I've put the formula elements of A plus B minus C plus D in at the next line, and I start the first example in year one, where my opening year is the 1st of April 2000, and my closing is the 31st of March 2002. I have a complete income year. The example poses that

we buy a hundred FIFs at $10 each. We have no sales or dividends or further purchases, and we have no change in value. As the example shows in the formula, we have closing stock at the end of March 2001, of $1000. We have no other receipts, and we have deductions which include the $1000 acquisition cost, meaning we've made neither gain nor loss. In my second example, I have the same one hundred FIFs still valued at $10 each. I have no sales dividends or other purchases, but I do have a change of value to $20. The example shows in the formula that I have closing stock of $2000. I had no receipts. I now have an opening stock deduction of $1000, which was my closing stock deduction from the previous year, telling me, under the formula, that I have a gain of $1000. In my third example, in the next year, from the 1st of April 2002 to 2003, I still hold the same hundred FIFs. I have an opening value of $20 each. I've no sales receipts or dividends, and I have a change of value from $20 down to $5. I therefore have closing stock of a hundred FIFs at $5 each. I have no receipts or dividends. I had opening stock of $2000. I have a loss of $1500. Then I get to option A in year four. I have a hundred FIFs. I have opening value of $5, which is what I had in my closing value the previous year. I have no dividends or purchases, but I forfeit 50 and I sell 50. I have no closing stock on hand at the end of the year. I have receipts from the disposition from the sale of $250. I had opening stock of 500. Therefore, I have a loss of $250, which results in the forfeiture. In option B, I have the same hundred FIFs. I have the opening value of the same $5. No sales dividends or purchases, but the FIF goes bankrupt. I therefore have no closing stock having any value at all. I have no receipts or dividends. I had closing stock, as my opening stock deduction, of 500. I've lost $500. Now, if I can take –

McGRATH J:

The option A for year four is your argument?

MR HARLEY:

Yes.

TIPPING J:

Doesn't it depend on the terms of the forfeiture?

MR HARLEY:

Your Honour, I'm suspicious of analogies, but let me give you two to illustrate the concept of forfeiture here. The first is, let me –

ELIAS CJ:

Why are we talking about forfeiture? Why aren't we talking about disposition, for which he receives no consideration?

MR HARLEY:

Ma'am, I'm happy to talk about disposition.

ELIAS CJ:

Yes.

MR HARLEY:

But I do not accept for one moment that there is no consideration for it. So I'm happy to keep on talking.

ELIAS CJ:

Yes. I just think we should use the statutory terminology.

MR HARLEY:

Well, my next example is just going to bastardise that, but I understand the point, and I'll come back to it. And the example is, I'm in the fishing business. I breach my quota. I have my fishing boats forfeited to the Crown, dispositioned to the Crown. I have lost my boats. Now, the better example in this context is I'm the lessee, I have a long-term lease with the landlord. I breach my covenants. And I forfeit my interest in the lease to the landlord, because I have broken the terms of my agreement. Alternatively, in respect of that example, we may have a dispute, landlord to tenant, where we agree that

I can walk. And I forfeit my interest in the lease, which is undoubtedly a disposition to the landlord for consideration.

BLANCHARD J:

The consideration being that you don't have to pay any future rent?

MR HARLEY:

And I'm not suing him for not painting the building, or not keeping it watertight, or whatever it is that causes the dispute. Now, in that example, if I'm the lessee, and I have invested substantial sums in the leasehold interest, I forfeit them to the landlord by operation of the standard terms of most leases. And I suffer a loss. But there's no question that there's consideration passing in respect of that loss, any more that there's any question that there's consideration passing here in respect of the disposition of the 2095 shares to Cap Gemini France.

TIPPING J:

Mr Harley, before you go on, could I just ask you to clarify for me. We have a disposition. It could be for no consideration. I'm talking hypothetically at the moment. It could be for no consideration, it could be for partial consideration, or it could be for full consideration. I thought the scheme of this was that in either or in any of those three events, it was deemed to be disposed of at market value, unless you happened to have got more than market value, where you have to bring the law to account. I would have thought, myself, it was relatively simple along those lines.

MR HARLEY:

CG 23 can only apply to the first two options that you gave me.

TIPPING J:

But it would be perverse in the extreme if you sold for full consideration that you didn't have to bring to account the full consideration.

MR HARLEY:

Of course and if you sold that would be the case, you would bring them unknown.

TIPPING J:

So you're better off on your examples selling for full consideration than you are for partial consideration. Better off for tax purposes.

WILSON J:

As I understand it Mr Harley, under the regime when you sell for full consideration all the proceeds of sale are brought to tax aren't they?

MR HARLEY:

Yes.

WILSON J:

So you're not better off in that respect?

TIPPING J:

No, no, you're not better off in that respect, but can you ever dispose of, for tax purposes for less than market value?

MR HARLEY:

No.

TIPPING J:

Well why aren't you bringing the market value of these shares to account for tax purposes?

MR HARLEY:

I am, that's the loss.

TIPPING J:

The loss?

MR HARLEY:

Yes.

TIPPING J:

The market value can't be a loss.

MR HARLEY:

The market value of the shares is $602,938, no one's arguing about the market value of them. The taxpayer disposes of shares worth $602,938 to Cap Gemini France.

TIPPING J:

I don't think it matters to whom he disposes of them.

MR HARLEY:

Yes it does.

TIPPING J:

Well that's where we may have a fundamental difference. Is this the central plank of your argument that there is a disparity between the – the consideration doesn't move equally?

MR HARLEY:

Correct. But there is fully adequate consideration between the taxpayer and Cap Gemini France for that disposition.

TIPPING J:

So the disparity of the movement of consideration is the fundamental premise of your argument is it?

MR HARLEY:

It is for present purposes yes.

TIPPING J:

For present purposes, yes. Right I see.

McGRATH J:

How would you characterise the fully adequate consideration on the forfeiture of shares to Cap Gemini France? What's the nature of it?

MR HARLEY:

To put it in simple terms. I agreed to sell my business to Cap Gemini France with a bundle of rights and it paid me 7566 shares in consideration of that bundle of rights. Part of the price that I paid for the receipt of those shares is the obligations and burdens I assume in terms of my employment.

McGRATH J:

Such as continuing to work for a period of years for a New Zealand company?

MR HARLEY:

Yes. We part company and the rules say that in those circumstances the price that I received is reduced.

McGRATH J:

But surely it's fallacious to talk about a price being reduced when a new event has come in, namely that you're parting and certain obligations are triggered there. It seems to me that's creating a new situation which is addressed in the second deed or the deed of covenant as I think you refer to it as. It's fallacious surely to talk about a change in the purchase price?

MR HARLEY:

Not at all. The deed of covenant provides for exactly that. It contemplates exactly the position that has arisen.

McGRATH J:

Well why didn't –

MR HARLEY:

Indeed in this example, it was possible that having received the 7566 shares, if Dr Saha had gone into business in competition with the New Zealand business, he would've forfeited the lot, 100 percent. Cap Gemini would still have kept the business.

McGRATH J:

Yes.

MR HARLEY:

So what's happened here is, Cap Gemini has kept the business and they have agreed between themselves that what were the 7566 shares allocated for the total package, is reduced by the 2095 share forfeited.

McGRATH J:

There is an intervening new matter, which it seems to me has led to a variation of a contract which can't be truly characterised as saying the purchase price of the original contract is reduced. It's addressing a new situation that has been created from the desire, or if you like, mutual desire, that Dr Saha leave the employment of the New Zealand company.

MR HARLEY:

Well Your Honour is correct factually, in the sense that we get into the second year and they have a dispute as to how the terms of contract should continue to operate and they then agree, amongst other things, to invoke the remedy that they have provided for in the deed of covenant, but by half.

McGRATH J:

The remedy in the deed is however a remedy that would apply for breach of the contract?

MR HARLEY:

Yes.

McGRATH J:

And it says that a predetermined sum will be paid as damages, that being given effect to in the form of forfeiture of shares?

MR HARLEY:

Yes and that's why I accept the Court of Appeal's analysis that the deed of settlement varied the original deed of covenant to provide for that.

McGRATH J:

I would've thought what then happened was, that's the liability and damages having been incurred, two steps took place which are combined by the loose term forfeiture. One is that the shares of relinquished in return for a sum of money and that sum of money is paid to the French company in effect, which buys back the shares, so if you see it in those terms you can see whether consideration's coming for this concept of forfeiture.

MR HARLEY:

But that's not what happened.

McGRATH J:

Well it's how, if you see this as a case in which a liability to liquidated damages was being, a potential liability for liquidated damages was being addressed, that was the reality of what happened.

MR HARLEY:

No Your Honour, what happened was a share transfer was executed and handed to Cap Gemini France.

ELIAS CJ:

And what did they get for it?

MR HARLEY:

What did who get for it?

ELIAS CJ:

Well in passing over the share transfer, what was the consideration?

MR HARLEY:

The loss of $602,938, which is the consideration as the purchase price adjustment.

ELIAS CJ:

Well I find it very hard to understand why the arrangements between the parties affect the tax regime, when the taxpayer has chosen to bring all shares in to tax and has disposed of some and the statutory formula seems to treat that as deemed to have been a disposition at market value.

MR HARLEY:

If there's no consideration and there is full consideration passing from the taxpayer to Cap Gemini France in respect of the disposition of the 2095 shares. The Court of Appeal was right about that, it's embodied in the deed of settlement.

ELIAS CJ:

Well there's economic, there's economic exchange of value, but is it consideration?

MR HARLEY:

I don't understand what you mean by economic exchange of value. I do understand what contractual consideration is, and this is a –

ELIAS CJ:

Well why is it contractual consideration here?

MR HARLEY:

Because it's the detriment that's suffered by Dr Saha as promissory as part of the price he's paying to Cap Gemini France in order to bring the transaction to settlement.

ELIAS CJ:

Well I can see that that's the economic effect, but it's not identified as consideration, even in the agreement between the parties. Is it?

MR HARLEY:

Well the document's a deed, so it doesn't articulate in the terms that I put it, the consideration, but the form of the consideration that I've just described is well recognised as a classic exposition of consideration passing from promissee to promissor.

TIPPING J:

When you say that the purchase price was adjusted, in what way was it adjusted?

MR HARLEY:

Down.

TIPPING J:

Down. Well therefore you've brought in as an opening debit, too much.

MR HARLEY:

No.

TIPPING J:

And you should have that adjusted, looking at it like that.

MR HARLEY:

No, not at all. In the first year I received 7566 shares and at the end of the first year, how many were I entitled to keep? 7566 shares. The formula requires me to market value the 7566 shares as my closing stock.

TIPPING J:

Well I'm just putting it that to – it's an implied suggestion that there's a real artificiality in this if you don't do the adjustment for the opening entry.

MR HARLEY:

And everybody agrees you can't.

ELIAS CJ:

You just said that you are required to bring to market, did you mean to tax?

MR HARLEY:

Both.

ELIAS CJ:

Because you're not required to. You elect which formula you're going to adopt.

MR HARLEY:

There's nothing elective, ma'am, in terms of the tax treatment of FIF interests. You can elect your method.

ELIAS CJ:

The method is what I mean.

MR HARLEY:

But you can't elect whether you're in or out.

ELIAS CJ:

But he elected this method.

MR HARLEY:

Yes, he did. And the rules are, at the end of the first year, he is required to bring to account the entire number of shares that he held. There was no adjustment to it then, and there was no dispute then.

ELIAS CJ:

But he disposes of some shares, what's the basis on which you adjust the, there's no basis for adjusting the benefit he's received. That appears in the

documents. You can't go back and say well, retrospectively you must adjust the purchase price.

TIPPING J:

I think the reason for that is that the rules contemplate that this transactions that's now a de facto adjustment to the purchase price, according to Mr Harley, is brought in at market value. And therefore the thing will self-correct.

MR HARLEY:

That's correct. In the year that it occurs.

TIPPING J:

But I can't understand how you bring it in as a loss, because the market value, surely, can never be a loss. It seems intuitively rather peculiar.

MR HARLEY:

Well, Your Honour, let me go back to the example of the forfeiture of the lessee's interest in the lease. The lessee's interest in the lease is, let's say, $10,000,000. And by agreement, the lease is brought to an end, and the lessee forfeits the interest in the lease to the landlord. It's lost $10,000,000.

TIPPING J:

That's, you say, as a result of a breach?

MR HARLEY:

It may not be a breach. They may have a dispute between them.

TIPPING J:

It may be a consensual arrangement, which, surely, under these regulations, the person is deemed to get value equivalent through the settlement of the $10,000,000 that is being given up. Otherwise the thing completely lacks coherence.

MR HARLEY:

It's completely coherent if you've lost money. This person is $602,938 poorer the next day, isn't he?

TIPPING J:

Well, if you look at it solely from his point of view, but I'm looking at it from the point of view of the scheme of this FIF regime, and the taxation consequences.

MR HARLEY:

Yes, and they focus on the taxpayer and the taxpayer's position.

McGRATH J:

Well, he is poorer because he has had to pass shares to the same value over to the French company.

MR HARLEY:

Yes.

McGRATH J:

And what I don't understand is why you don't acknowledge that that has to be treated as a gain, which would come into account as the B figure in the year 4 option A example?

MR HARLEY:

Because it's a loss.

McGRATH J:

It's a gain, because he has, as part of his overall arrangements of some complexity, he has relinquished shares to a company, the French company, which is giving him, if you like, an advantage which is deployed or a gain that is deployed in his overall contractual arrangements reflected in the deed of covenant.

MR HARLEY:

He gets nothing back from Cap Gemini France.

BLANCHARD J:

Yes, he does. He gets the shares that he otherwise would have forfeited. He is released from that forfeiture.

MR HARLEY:

But that assumes that he was in breach. And you can't make the assumption here. There was a dispute between the parties. There is mutuality in terms of the settlement.

BLANCHARD J:

Well, even if you can't assume he was in breach, the fact that the French company has released such rights as it may have had in relation to the forfeiture of the other shares is a consideration. Maybe it's something that is very difficult to value, but you don't need to value it here, because of the deeming provision. I've always thought this was the fatal flaw in your argument, right from the leave application.

MR HARLEY:

In the leave application, I spent some time spelling out the nature of consideration with reference to flows, in the context of the meaning of the expression "derivation". In this context, the derivation that occurs is on the initial receipt of the 7566 shares which brings in within the formula. And the formula requires those shares to be treated year to year within its terms. The fact that the person keeps the 2095 shares is within the formula. And so to add it again is to double-count. That's the example 4 A.

BLANCHARD J:

It's not a consideration attaching to those shares, it's a consideration attaching to the ones that are forfeited.

MR HARLEY:

But Your Honour, the ones that are forfeited are, in the vernacular, to punish him. That's why the purchase price is adjusted down.

BLANCHARD J:

But he's managed to strike a bargain under which the punishment is not as great as it would have been.

MR HARLEY:

Correct. But he doesn't continue to own the business, and in that sense, he's at large in terms of what he may or may not be able to do as a free agent. But he doesn't derive any gain as a result of that. He suffers a loss. If you were to do his balance sheet on the day after the forfeiture, the answer is he is $602,938 poorer. Of course he is. That's the preface of the forfeiture. And Cap Gemini France continues to own the business it purchased, and has received back some of the consideration that it initially paid.

TIPPING J:

So they come in at market value as a debit, and they go out with no corresponding adjustment?

MR HARLEY:

Correct. Because of the opening stock deduction.

TIPPING J:

Well, I see that as a starkly odd outcome. If we're driven to it, we're driven to it.

MR HARLEY:

There's nothing odd about it, Your Honour, when you understand these are trading stock provisions that tell you that on day one, at the beginning of the year, you take a deduction for the market value of your trading stock.

TIPPING J:

But you yield some of your trading stock for no benefit on this analysis. And if there's no benefit, then I thought the benefit was deemed to be the market value.

MR HARLEY:

And if it were for no consideration. But, Your Honour, for reasons I'll come back to in a moment, let me give you another example that doesn't make this very surprising at all. You own a supermarket. You've got shelves full of trading stock. The rules under the trading stock provisions tell you you take a deduction on the 1st of April for the cost. And it's all gone past its use-by date. You take it to the dump.

TIPPING J:

If you take it to the dump, under this regime you're deemed to have disposed of it for market value, and the market value then becomes very difficult, doesn't it, because it's worthless.

MR HARLEY:

The market value is zero. You've taken it to the dump because it's obsolete. You get a deduction for the opening stock.

BLANCHARD J:

But here there happens to be a market value, which isn't zero.

TIPPING J:

They haven't taken it to the dump. They've used it as a trading exercise, to get benefits on the other side.

MR HARLEY:

And the detriment to the taxpayer, which is the classic expression of consideration, is the loss.

TIPPING J:

I think the benefit is being released from having to work for that company, which is deemed, under the regulations, to be the market value of the shares. And if they have a market value, then that's it.

MR HARLEY:

Your Honour, if we could go to the first diagram on page 1 of my note, you will see that the release occurs with the employer, not with Cap Gemini France.

TIPPING J:

Yes, yes, I understand all that. And this is the lack of parallel consideration point.

MR HARLEY:

Correct.

TIPPING J:

Yes, yes, I understand that.

BLANCHARD J:

But Cap Gemini France owns Cap Gemini New Zealand.

MR HARLEY:

Yes. But that doesn't, make consideration passing, these are separate entities.

BLANCHARD J:

Well, whether they're all tied into the one agreement, that must be done for a reason. And it seems to me the reason is because they're connected companies, so there's indirect consideration being measured as well as direct considerations.

MR HARLEY:

I don't understand the concept of indirect consideration to someone who is not a party to the contract.

BLANCHARD J:

Who's not a party to the contract?

MR HARLEY:

Which ones are we talking about?

BLANCHARD J:

Well, they've merged them in the deed of settlement. They're all in there, aren't they?

MR HARLEY:

Yes. And they are in the deed of covenant, too. And they are in the sale and purchase agreement too, of course they are. The correct analysis is that the sale and purchase agreement is between simply the taxpayer and Cap Gemini France. And he receives the 7566 shares in consideration for the transfer of the Cap Gemini company to Cap Gemini France. Simultaneously, he is employed by the Cap Gemini New Zealand company.

TIPPING J:

What about the quarter million going from the New Zealand company to the taxpayer on your diagram? That surely is consideration for something.

MR HARLEY:

It's employment income and taxable is employment income in the ordinary way.

TIPPING J:

It's called a termination payment. Is it something that was just going to have to be paid in any event, is that what the evidence suggests?

MR HARLEY:

It's just called a termination payment, and it's treated as employment income to the taxpayer in the ordinary way.

McGRATH J:

But there was a concession tax rate payable for termination of employment?

MR HARLEY:

No, no. Full rate.

McGRATH J:

Not 5 percent?

MR HARLEY:

No. Long gone, Sir. The point that I'm trying to make in respect of this diagram is that the termination payment of the $250,000 is fully taxable. It's not in kind.

TIPPING J:

But never mind its taxability. It seems to be part of the settlement package.

MR HARLEY:

It is part of the termination of the employment contract.

TIPPING J:

Which was, itself, part of the overall settlement, because part of what he was trying to achieve was release from having to work for the New Zealand company, wasn't it?

MR HARLEY:

Yes, but it's elementary that we keep the contractual relations and flows of consideration between what are separate people separate.

TIPPING J:

Yes, I know. That's why I'm looking at the one that does go the way between the employer and the employee.

MR HARLEY:

And my submission in respect of that is, I accept what you say in terms of taxability or otherwise. It's just irrelevant.

TIPPING J:

But what I'm saying is –

MR HARLEY:

But it does secure the termination of the employment contract.

TIPPING J:

But the market value of their shares was about $600,000, wasn't it?

MR HARLEY:

$602,938.

TIPPING J:

All right. Well, on the face of this, there was a partial, the question, I suppose, Mr Harley, is how precisely one looks at this consideration flow. In your essential point, one has to be very, very precise over this, and when you do that, somehow or other, your client doesn't have to give credit, if you like, for the value of the 2095 shares, because they've gone to a party that's not part of the consideration vis a vis the employing party. Is that it?

MR HARLEY:

And I would say that's orthodoxy.

BLANCHARD J:

You're saying that these flows all have to be separated out, but it's interesting that in the deed of settlement itself, the agreement relating to the 50 percent of the unreleased transaction shares not being forfeited is an agreement by both Cap Gemini companies?

MR HARLEY:

Correct.

BLANCHARD J:

So they've mingled them there. One would say well, what's it got to do with the New Zealand company?

MR HARLEY:

They've mingled them there but they've kept, in paragraph 5 for instance, the termination payment separate.

BLANCHARD J:

Yes, that's clearly been kept separate.

MR HARLEY:

And the way the deed is written – I'm not critical of it because it is a deed – but we are focusing here on contractual flows of consideration and the fact that the deed has parties to it does not merge the consideration. Of course it doesn't.

TIPPING J:

When you're talking about fully adequate consideration, what consideration did Cap Gemini give to the taxpayer for the forfeiture of the 2095 shares? If one's going to do this analytically and precisely, one has to do it every way and not imprecisely. Now, on the face of it, taxpayer has disposed of 2095 shares to Cap Gemini SA. On the face of the regulations that disposition is deemed to be at market value. You say it's not deemed to be at market value because it's for fully adequate consideration moving from Cap Gemini SA. Now what was that?

MR HARLEY:

We're getting a little tangled here. The focus of the section is the consideration moving from the taxpayer as promisee in respect of his disposition of the 2095 shares to Cap Gemini SA.

TIPPING J:

Yes. But presumably there would be reciprocity if you like Cap Gemini –

MR HARLEY:

There usually is in a contract –

TIPPING J:

But not here?

MR HARLEY:

Yes there is. There is a deed of settlement where Cap Gemini SA has accepted the 2095 shares to settle the dispute.

McGRATH J:

And has it not also procured its subsidiary to make a $250,000 payment and to release the taxpayer from his employment contract?

MR HARLEY:

I don't know whether it procured that or not.

McGRATH J:

I'm suggesting it's a reasonable inference to a certain extent.

MR HARLEY:

The company, Cap Gemini New Zealand, may have been absolutely delighted to have paid as little as $250,000, I don't know.

McGRATH J:

That's not the point surely. If this approach were to be if Cap Gemini did procure these two elements in the deed for the benefit of the taxpayer they then have to be valued, don't they, because they are consideration that the taxpayer is deriving in which Cap Gemini France is tied into because of its, it has effectively ensured, as party to its agreement, its subsidiary has done those two things.

MR HARLEY:

Well Your Honour I don't want to play games with you but I can turn that example literally on its head. What's wrong with the New Zealand company saying to itself, we want to get rid of this guy. He is a troublemaker. We want to give him $250,000. You parent, will you accept this, and let us get rid of him.

McGRATH J:

I think the trouble with that sort of gloss Mr Harley is that Cap Gemini France is clearly getting a benefit worth over $600,000 because it's acquiring 2095 shares and in this chart it seems to me, it's fairly readily through what it's requiring its subsidiary to do, deriving – what they've been paid for that benefit. If its subsidiary is worth less, it might have been more, it might have been less, but it's worth less by the amount of $250,000 and the employment contract which would have produced income for it.

MR HARLEY:

But Your Honour, your view is a top down view and all I'm saying to you is we're not told and we don't know what the drivers are between the parties in the bargain.

McGRATH J:

But is the scheme of these rules that if these matters are uncertain it's for the taxpayer to prove what their value is?

MR HARLEY:

There's no question of what the value of the shares is. Everybody agrees the market value of the shares is $602,938. The question here is what is the consideration passing on the disposition between the parties.

McGRATH J:

And yes that's what you have to prove, isn't it? Well it seems to me that one can readily see that what Cap Gemini did as a subsidiary, no doubt influenced

it seems to me by its parent which is deriving $600,000 worth of shares, it did two things and the value of those is very important.

MR HARLEY:

I don't dispute that the value of them is very important. The reason that Cap Gemini France accepted the forfeiture of the 2095 shares, I'm sorry Your Honour, the disposal, is that it was satisfied that that was in its interests.

BLANCHARD J:

What consideration do you say that it gave?

MR HARLEY:

The adjustment to the purchase price down.

TIPPING J:

That's a question begging answer.

MR HARLEY:

I'm sorry I didn't intend that. Can you explain that please?

TIPPING J:

Well what I mean is, that that gives the answer that your client wishes but where in real value, if you like, what did Cap Gemini SA give up in return for this 2095 shares? What detriment did it suffer? You say the adjustment of the purchase price.

MR HARLEY:

Well I'm looking at the detriment from the promisee to the promisor through the eyes of the taxpayer because that's the focus of the section here but I accept your point, Sir, of mutuality.

TIPPING J:

Yes.

MR HARLEY:

And so if we turn the whole thing on its head and ask ourselves the question looking at Cap Gemini SA's position as promisee on receipt of the shares, which is your question.

TIPPING J:

Which is my question and my brother Blanchard's question I think too.

MR HARLEY:

The question then is I don't believe question begging to say to settle a dispute.

TIPPING J:

But that must have had a value to Cap Gemini?

MR HARLEY:

Of –

TIPPING J:

It's always valuable to settle disputes –

MR HARLEY:

Of course.

TIPPING J:

– and you don't know what that value is so you take market value.

MR HARLEY:

The value to it is the receipt of the shares reducing the purchase price that they had originally agreed to pay.

BLANCHARD J:

Sorry, the value to it?

MR HARLEY:

Yes the –

BLANCHARD J:

I'm interested in the value passing the other way. What was the consideration that passed to Mr Saha from Cap Gemini?

MR HARLEY:

He suffers a loss of $602,938 in order to be released from –

BLANCHARD J:

So he got no value from Cap Gemini?

MR HARLEY:

He suffered the loss. That is his consideration –

McGRATH J:

In order to be released from an agreement and you have to look at what that was worth to him to find out the consideration.

MR HARLEY:

Well it was $602,000 poorer off –

BLANCHARD J:

Well that's only one part of it.

MR HARLEY:

Well –

TIPPING J:

No one gives away 2095 shares if they don't have to without getting something in return.

MR HARLEY:

Your Honour I'm with you 100 percent which is why we have fully adequate consideration here. The Court of Appeal was right about that. The deed of settlement embodies the consideration. That must be so.

BLANCHARD J:

And what was that consideration?

MR HARLEY:

From the taxpayer to Cap Gemini France –

BLANCHARD J:

From Cap Gemini to the taxpayer?

MR HARLEY:

It's an agreement between the parties to adjust the original purchase price of 7566 shares down by 2095 shares.

McGRATH J:

Which parties are those?

MR HARLEY:

Cap Gemini France and the taxpayer.

BLANCHARD J:

It's an agreement by Cap Gemini to adjust the price down, is that what you're saying?

MR HARLEY:

Yes.

BLANCHARD J:

Well that has to have a value.

McGRATH J:

It's a payment.

MR HARLEY:

A value to whom?

BLANCHARD J:

To Mr Saha. There has to be a consideration flowing both ways in the settlement arrangement. I'm trying to get from you what that value is passing from Cap Gemini.

MR HARLEY:

And my answer, which I've been struggling to make clear, is in general contractual terms. If one party is in a dispute with another, in this case focusing on the taxpayer, and he agrees to suffer the detriment of losing his shares, worth $602,938, that is his consideration, the price he is paying to achieve the settlement.

BLANCHARD J:

Yes but I'm not asking you about that, I'm asking you about what was flowing the other way?

TIPPING J:

If they were giving up, in effect, part of the purchase price, that has a value and the obvious value is the amount of the value of the shares.

MR HARLEY:

No, they are accepting that their business – let me put this more precisely. They are accepting, Cap Gemini France is accepting that the value of the business that it paid for is less.

BLANCHARD J:

Well isn't that making an allowance to Mr Saha of the amount of that adjustment?

MR HARLEY:

Which is his loss.

BLANCHARD J:

But it's part of a package and there are other things flowing in his favour as well.

MR HARLEY:

Your Honour I'm not trying to argue with you about whether it is or it isn't part of a package, of course it is, but I am focusing on the nature of the contractual relationship between the taxpayer and Cap Gemini France because that's where the disposition occurs. And I'm entitled to take the point in respect of that contractual relationship, what the nature of that consideration is, and I am asserting that the nature of that consideration from the taxpayer is the detriment.

ELIAS CJ:

Was that market value of the shares at the time?

MR HARLEY:

The detriment?

ELIAS CJ:

Yes?

MR HARLEY:

Yes, the loss.

ELIAS CJ:

It was the mark –

MR HARLEY:

Yes.

ELIAS CJ:

– because you have to, you have to demonstrate, don't you, that it, that he received the market value of the shares at the time of disposition if you're not to run foul –

MR HARLEY:

No Ma'am he gave up –

ELIAS CJ:

– of CG 23(5).

BLANCHARD J:

He gave up the shares but he did receive something in exchange and that was the release from the forfeiture of the shares he didn't give up.

MR HARLEY:

But he's still got them. There's no movement in respect of the shares that he still got and it's within the formula.

BLANCHARD J:

It's still part of the consideration for the shares that he forfeited.

TIPPING J:

That consideration was multi-faceted. It's counterintuitive to simply look at it from the point of view of him making a loss. He gained something equivalent to that loss.

BLANCHARD J:

Well it may not have been equivalent to that loss but it had a value –

TIPPING J:

It had a value, all right. It was deemed to be equivalent to that loss.

ELIAS CJ:

If it was less than market value.

MR HARLEY:

No one is arguing, so far as I know, that these shares were not worth $602,938. That's not the issue.

BLANCHARD J:

That's accepted.

MR HARLEY:

Indeed. The issue is the nature of the consideration passing from the taxpayer to Cap Gemini and, section CG 23(5) operates if there is no consideration or inadequate consideration. As I understand it, it's common ground there's consideration.

BLANCHARD J:

It's consideration passing from Cap Gemini to the taxpayer.

TIPPING J:

If it was equivalent to or more than the market value of the shares it would seem extraordinary if that didn't have to be brought to account in the same way as the deeming provision makes a deemed figure to be brought to account.

BLANCHARD J:

What he got was perhaps, if you can split it into this, he got nothing for the shares that were forfeited directly but he got the release from the forfeiture of the remaining shares and that's part of the consideration that flowed to him from Cap Gemini.

MR HARLEY:

And where I'm parting company with you in respect of that expression of reasoning Sir is it starts with the supposition that he was not entitled to keep the lot.

BLANCHARD J:

There was an argument about it. They settled that argument. There was consideration given by Cap Gemini in that it compromised its position. In other words it compromised the position it was arguably open to it.

MR HARLEY:

Indeed and –

BLANCHARD J:

So it may be that the value is relatively small but it is still a consideration.

MR HARLEY:

And he compromised his position in terms of asserting that he was entitled to the lot.

BLANCHARD J:

Yes. There was a flow of consideration both ways.

MR HARLEY:

What I would call mutuality.

BLANCHARD J:

Yes but section CG 23(5) is focused on one flow of consideration. And how do we value the flows either way anyway?

MR HARLEY:

Well it might be slightly cheeky to say by recognising that he has made a loss for $602,938 and is poorer because of it and on the other side Cap Gemini has received those shares worth that value –

BLANCHARD J:

Well he must have thought it was worth doing.

TIPPING J:

If you do the precise contractual analysis, allowing him to keep the other shares flows from Cap Gemini France and the money and the release from employment flows from Cap Gemini New Zealand. But the former must have a value in any commercial sense. It's deemed therefore to have a value under, of market value.

MR HARLEY:

And –

TIPPING J:

Equivalent to what has transferred the other way.

MR HARLEY:

And my answer to you is precisely the same as I've just given to Justice Blanchard. You are assuming that from the taxpayer's perspective he would otherwise have had to abandon his rights in respect of the total balance whereas he's asserting he's entitled to all of them. So what he has agreed to do is to lose half, the half that he keeps is within the formula and the formula operates in respect of the half that he keeps.

McGRATH J:

Are you saying that relative to his stated position he was incurring a loss?

MR HARLEY:

Yes and as I put earlier, if you look at his balance sheet the day after obviously he is poorer by $602,938, of course he is. That's the purpose of the forfeiture.

ELIAS CJ:

Doesn't that simply, isn't that simply to acknowledge that he did not, he received less than the market value of the property at the time of the disposition?

MR HARLEY:

I don't understand that Ma'am. I don't understand how the shares can't have the market value.

ELIAS CJ:

Did he, but he didn't receive that market value.

MR HARLEY:

If I go back to my lessee/lessor example, where the lessee forfeits its interest in the leasehold, it is giving up its value in the leasehold as a loss to the landlord.

McGRATH J:

I think the better example actually is your first example, the fishing quota, where let's say the boat's worth 10,000, it's forfeit to the Crown, the reality of that is that in order to discharge a penal's liability of say $10,000, if that's what the boat's worth, the taxpayer releases the boat and the consideration is he's satisfied the liability and that's worth $10,000 to him.

MR HARLEY:

Well Your Honour I don't like that example.

McGRATH J:

It was your first example.

MR HARLEY:

Yes it was and the reason I don't is that first there's no contractual relationship in terms of the punishment that's being inflicted there and second it begs what

would be a serious question in respect of the depreciation regime where this does occur, these examples, because –

BLANCHARD J:

Well it's a bit remote from a foreign investment fund.

MR HARLEY:

Absolutely yes.

BLANCHARD J:

Analogies as you said were dangerous.

MR HARLEY:

Yes.

McGRATH J:

Can I just ask you this. I want to just put aside for the moment the 2095 retained shares issue and just focus on the release from the employment contract and the $250,000 payment. Is it essential to your argument that these are by a subsidiary, not by Cap Gemini France? Because otherwise it seems to me you couldn't possibly argue there wasn't a direct flow of consideration to the taxpayer if everything had been, if it wasn't doing these things through a subsidiary, was doing them itself, the principal company.

MR HARLEY:

I'm not sure that this is going to answer the question but it makes the argument that I am attempting to put forward clearer and easier to understand, particularly because the relationship between the Cap Gemini New Zealand company and the taxpayer is one of employment. There is a termination of the employment contract and there is a cash payment. On those terms section CG 14(2) can't apply to that relationship. So my submission is, in respect of that, the Court of Appeal can't be right. Because that's what they've hung their hat on.

McGRATH J:

I think would you agree though that in doing that you're looking at the transaction in isolation from the role of Cap Gemini's principal? Which is deriving a substantial benefit.

MR HARLEY:

I am treating the Cap Gemini companies as being separate contracting parties with their own rights and benefits and I am treating the employment contract and the termination payment from the Cap Gemini New Zealand company for the purposes of section CG 14(2) as saying on its face it cannot apply because it's a payment in cash not in kind.

McGRATH J:

I think you really are answering me by saying, what you're really saying is the Cap Gemini role in this is focused exclusively on employment and we have to treat it in that way and we can't see it as involved in any sense in deriving a benefit from the forfeiture of the shares which is the benefit that goes to the principal company in France.

MR HARLEY:

My answer to that is yes, if I can interpolate into that sentence when we're talking about Cap Gemini New Zealand.

COURT ADJOURNS: 11.33 PM

COURT RESUMES: 11.50 AM

ELIAS CJ:

Yes, thank you.

MR HARLEY:

If I could bring this part of the submission to a rapid end, I would say that the focus of section CG 23(5) is whether the disposition is for consideration between Cap Gemini France and the taxpayer? If the answer to that question

is yes, clearly because there's mutuality in the deed of settlement, the section simply does not inquire into the elements of that consideration. It simply doesn't apply, because there is consideration between the parties. In this case, if I can take you back to section CG18 the section contemplates that the result of the formula can be either income or loss.

ELIAS CJ:

Can be, sorry?

MR HARLEY:

Contemplates that the result of the application of the formula is that there can be either income or loss and item B explicitly refers to whether there's a gain. My submission is that there is no gain here, there is a loss, but that's not what section CG 23(5) focuses on, it simply focuses on the existence and contract law of consideration between the parties.

ELIAS CJ:

There's no definition I take it, of consideration in the Income Tax Act?

MR HARLEY:

This version of the Income Tax Act ma'am is about three volumes and no one wants another one. The other point that I wanted to make in respect of the shares that the taxpayer kept, is that they're not counted again because they're already within the section CG18 formula as my examples show and they are brought to account because he does continue to own them within the FIF rules. The last point and to repeat myself the $250,000 cash is also already within the Tax Act separately accounted for and we don't account for that again either. That would bring me then to the end of the note that I've put into paragraph 3. I don't need to go through that with you because I've covered all those points and it would bring me to paragraph 4 which is to deal briefly with the Commissioner's submission in reply.

The first point in respect of the Commissioner's submission in reply, if I could take you to his paragraph 10.3 on page 11 and as I've set out in the note, it's

the last two sentences that I'm focussing on page 12, "in economic terms this is similar to a sale of shares in return for a monetary gain", my submission in reply to that is that it's nothing similar at all. The way that is expressed mis-characterises the true legal nature of the contract. The forfeiture as I have submitted is an adjustment to the purchase price, it's an adjustment down, a price reduction that's not remotely similar to a sale which has already occurred. Then if I can take you to the Commissioner's paragraph 21.2 on page 20, the Commissioner submits that it's "too simplistic to say that a loss cannot be a gain and that the appellant lost the forfeit shares" to which my response is, "There's nothing simplistic about a loss being a loss and it is the antithesis of a gain". Then the Commissioner submits that he (Dr Saha) entered the settlement agreement where he gave up the shares in return for a bundle of monetary and non-monetary gains and for the reasons I have already gone through, that conflates the relationships between the two Cap Gemini companies.

I then want to take Your Honours to the Commissioner's examples at paragraphs 12.1 and 12.2 of his materials on pages 12 and 13. Just before I do, can I just take Your Honours to page 13, the second line of paragraph 12, the Commissioner has got a number in there, $602,941, that's just a rounding difference, this is common ground between us, it's just a rounding difference. The actual number we're talking about is $602,938, but it doesn't change the example, it just – the three dollars difference is a rounding. In paragraph 11, the Commissioner uses the hypothetical of the shares, no dividends, no receipts and then in 12.2, sorry in 12.1 we're dealing with the year being the 31st of March 2001 and if I could just correct the third and fourth boxes of the Commissioner's example, the item C should be "nil" and item D should be the "$602,941", it's simply an incorrect application of the formula, but it doesn't change the result. The difference between the two is a confusion between using the paragraph D purchase cost and the opening stock and in the example of course there will be no opening stock, because the taxpayer has acquired the shares in the course of the year. This is also common ground between us. The point is and the essential point in the example is the Commissioner's right in his submission resulting in A plus B, minus the

C plus D equals zero and then goes on and says, “There would be no net gain or loss” in this example, it would be the same, which is my example 1. I agree with the Commissioner in respect of that result. Where I part company with him then, is in paragraph 12.2, where he sets out the next example and comes to correctly identify the result of minus $602,941. That is the correct application of the formula and it is what is in dispute here. The Commissioner then goes on and says, “According to the appellant’s approach, the taxpayer would enjoy a large loss in 2002 and accordingly across both years”. No he wouldn’t. There is no “across both years”. As his example in 12.1 shows there is no loss in respect of the first year. The opening stock is equal to the closing stock. I’ve set out the correct position in respect of the application of the formula between the two years, on page 4 of my note. I don’t need to take you through that because we’ve already effectively gone through it and simply to reiterate the point that the actual number that’s in dispute here, is the $602,938. That then gets me to the Commissioner’s flowchart analysis on page 16 and which in my submission is substantially, if not totally, question-begging. Your Honours will have the benefit of another shot at this chart. My friend’s going to take you through it with an elaborate, and in colour, presentation. I regret that my skills don’t rate to that level.

BLANCHARD J:

My skills don’t even go to reading flowcharts.

MR HARLEY:

Well I’m going to try Your Honour and hopefully mine do, and you can make of what I say as you wish. My submission in terms of the third box is that the question actually should be “Not whether is it for a gain?” but “Whether pursuant to what agreement did the disposal of the 2,095 share to Cap Gemini France occur, what was the true legal nature of that disposition?” Was it in the nature of a gift, or was there an exchange in kind between the parties? And as I submit on page 5 of my note, the true position is that it was for fully adequate consideration for the reasons the Court of Appeal gave at 32, it is therefore wrong to focus on the right hand of the flowchart being the

approach of Justice France, he can't be right in respect of relying on section CG 23(5).

The alternative then is, given that the disposition executed the contractual rights and obligations between the parties for consideration within the deed of settlement, let's go to CG 14(2), which is the left hand of the flowchart. I say that the correct question then is, "Did the disposition by way of the forfeiture, having the agreed value of the $602,938, result in any gain in kind?" The concept here for section CG 14(2) purposes, being an exchange of items of property. If yes, what was the nature of anything in kind received by the taxpayer and from whom. My criticism of the left hand flowchart is that it misstates the question posed by section CG 14(2). Section CG 14 (2) can only apply if the disposition to Cap Gemini France resulted in an exchange in kind received from the taxpayer as consideration. There was no such exchange. I submit that the forfeiture was a loss like the lessee's interest in the lease and therefore the item in B is nil. I say that the Court of Appeal at 32, recognised that the transfer to Cap Gemini France occurred as the disposition. It then says the taxpayer made a gain being the certain benefits, such as the freedom to undertake the employment. My submission in reply is those benefits, if they're relevant, and I say they're not, but if they are, didn't come to him from Cap Gemini France. The gain he received from Cap Gemini New Zealand was the $250,000 dollars in cash which is not in kind.

Last in respect of Court of Appeal's paragraph 33, where the Court of Appeal adopts section CG 14(2), there is no gain in kind and then it uses section CG 23(5) to apply market value in circumstances where the Court itself is accepted that the disposition was for fully adequate consideration. The problem here is, the Court and the Commissioner and then it uses section CG 23(5) to apply market value in circumstances where the Court itself is accepted that the disposition was for fully adequate consideration. The problem here is, the Court and the Commissioner have misused CG 23(5) to equate gain the giving of consideration, which are different concepts.

WILSON J:

Well in essence this is your argument isn't it, that the disposition of the shares was for fully adequate consideration, but nevertheless resulted in a loss?

MR HARLEY:

Yes, that is it. I don't then, on that basis need to go any more into paragraph 12, but I do want to address some of the rhetoric in paragraph 20 of the Commissioner's submission which is on page 18. And I have an example coming, Your Honour the Chief Justice, which maybe familiar to you. In respect of the Commissioner's submission in paragraph 20 he talks about one-way deductions and symmetry and gross mis-matches and opportunities for avoidance and all this stuff. If I could take you to paragraph 24.2, which is on page 19, the Commissioner says that if the appellant is correct then we would be in asymmetry, which any taxpayer could easily exploit by selling a capital asset and receiving FIF shares as consideration, as happened here. Yes it did. Cancelling the contract so that the taxpayer retains the capital asset and the shares have to be handed back, as happened here. My submission in reply is nothing of the sort has happened here. There is no capital asset retained. The taxpayer sold his interest in the consulting business of EY. The balance of the shares were not forfeited but were on revenue account and they were retained because the sale contract was not cancelled. "As happened here", did not happen here. My submission and criticism of this sort of language is that they just do not respond to the statutory concepts. For the reasons that I've set out in 14, the trading stock provisions of the FIF rules, simply transfer the amount that he received as a capital amount to income amount as trading stock. I give examples in paragraph 13 then, of where this is common within the Income Tax Act. For instance where land is taken by a taxpayer from capital account, subject to subdivision and development on revenue account, or where the person takes the share portfolio from capital to trading account, or where the thoroughbreeder takes the racehorse from racing to breeding account.

ELIAS CJ:

Thank you.

MR HARLEY:

It gets painful ma'am. In each instance the taxpayer obtains in opening stock, cost deduction equal to the capital value. If the subdivision fails, losses arise, the taxpayer obtains a deduction for the loss. Same with the share trader making a loss, the revenue account gives rise to the deduction. If the horse dies, the breeder's business obtains a deduction for the loss. Any trading stock loss on revenue account is deductible, it's unremarkable. There's no "magic". "Symmetry" is irrelevant. Any deduction is "one way" as the Commissioner puts it so colourfully, but the expression simply fails to recognise, that's the nature of any such loss, there's no such thing as a two-way loss. This taxpayer's contention is that he did suffer a loss by the forfeiture. The loss is the antithesis of being a gain, which is what section CG 14(2) and section CG 18 contemplate.

This isn't a "narrow argument" about the words if the Commissioner characterises it, my submission is, that's what the words mean. The asserted "magic result of a tax deduction for nothing" misses the point. My submission is that he lost $602,938 by his forfeiture. No one regards that sensibly as a magic result, let alone being enjoyable, even if the loss is deductible. The taxpayer is poorer by the amount that's lost. That takes me through the Commissioner's submission, including paragraph 3.1 of his response and I can come back to the summary of contentions which are in the written submission, but unless there are any questions, that would be an appropriate place for me to finish.

ELIAS CJ:

Yes, thank you Mr Harley.

MR PALMER:

Your Honours I have a handout which outlines the Commissioner's submissions, the Crown submissions in one page, which may be of assistance just in following the argument. If you could hand that out. I do acknowledge that the error that my learned friend corrected in the paragraph that he referred to in the formula where two values were transposed, and I

also note that last week the Commissioner filed a request for leave to use PowerPoint in the presentation. In the course of argument today I wasn't sure whether the Court had granted that or not.

ELIAS CJ:

I don't think you really need leave for that. We'll – my screen's not working but I'll come and look at yours if that's all right.

MR PALMER:

We'll see if they work or not. Your Honours the issues in this case, the differences between the Commissioner and the taxpayer do seem to come down to an essentially how you characterise some of the facts involved and on the one page outline that I've just had handed out, point 1, which I think Your Honours have already referred to, is that in 2001 the appellant acquired the shares and brought them all to tax at their market value under the FIF regime, using the comparative value method. The appellant paid no money for the shares in that acquisition, but they were brought to tax at their market value and when one considers how that might have occurred and this is not a matter of dispute between the parties in terms of fact that it did occur, but if you consider how it might have occurred that it was proper to bring them to account to tax at market value, you do get into these deeming provisions. And I will take Your Honours to those provisions slightly later, when we're talking about the law.

In essence, my point at this point is simply that in this first half, if you like, of the transaction, the acquisition of shares was brought to tax at the market value of the shares. I think it is worth spending some time on the deed of settlement, which has already been the subject of some discussion. And this is the point, too. The way that the Commissioner characterises what happened here is that the appellant forfeited, and I use that term while acknowledging that you could use disposed or, as the Court of Appeal suggested, transferred, the appellant forfeited some of the shares as part of the settlement agreement, and there were other elements to that settlement agreement. He clearly obtained a gain from the overall agreement, otherwise

he would not have entered into it. And some of the points that my learned friend made this morning in relation to the precise identities of the parties to the settlement agreement are new to us, and we have taken the opportunity, during the course of the morning, of sketching out in diagrammatic form in another diagram that my friend is about to hand up, this was done quickly, you'll understand, Your Honours, an outline of how the settlement agreement worked. Your Honours, the way that the commissioner would characterise this agreement is that there is no differentiation or assignment within the agreement of the various items of consideration. It's a global tripartite agreement.

The agreement itself is contained on page 80 of the case on appeal, and it might be worth turning to that now. The parties to the agreement are listed. There are three of them. Cap Gemini, for ease of reference we'll call that Cap Gemini France. Then Cap Gemini, or Ernst & Young in New Zealand, and then Dr Saha. So there are three tripartite parties to the agreement. The background rehearses the existence of the dispute about employment. It notes that Dr Saha and Cap Gemini are parties to the deed of covenant, but this settlement, as was indicated in some of the questioning this morning, the commissioner would suggest is a separate legal event. There was a dispute in the course of employment. That dispute has been settled by way of this agreement, involving several terms, and the terms are listed numerically. Firstly, Dr Saha will resign, with the last day of employment being the 30th of June, some six weeks after the date of this agreement, which you'll see down the bottom as 18 May. Secondly, in full and final settlement, Cap Gemini and Ernst & Young New Zealand agrees to these terms and full and final settlement of all claims. So Dr Saha clearly had claims arising from his employment, and you'll see that we have represented that on the diagram that we've handed up. So Dr Saha has been released from the claims that he may have had. At point number four, there's one term of the agreement here which encapsulates both that 50 percent of the shares will not be forfeited, and that the remaining shares will be transferred to Cap Gemini. We've also represented those on the diagram. Over the page, at point 5, there is a termination payment of $250,000, which is also represented on the diagram.

Also, at point 7, Dr Saha agrees that until the 30th of June, he will use his best endeavours to complete existing engagements and bill them. And I note at point 10 that this deed constitutes, it's the entire agreement between the parties, with respect to the subject matter of this deed, and supersedes all prior agreements and understandings. So the Commissioner would characterise this agreement as a tripartite agreement. It is difficult to separate exactly what flowed to whom, but we have attempted to do so there. And I suppose the overall point about that is that if Dr Saha had not considered that there was a gain to be derived from this agreement, it was his choice as to whether he entered into it. And the fact that it is difficult to identify what the monetary value of that gain is goes to some of the way in which that's treated under the tax legislation. But it does not obviate the point that there was a gain. As the Commission's contentions that who exactly receives what money doesn't matter particularly for the construction of the legislative scheme and the terms of the legislation. The question, and this is also a difference that my learned friend has pointed out to Your Honours, the question in the Commissioner's contention is that there was a gain. And that gain is, perhaps, difficult to value in monetary terms because there is the release from employment, as well as the release from whatever claims Dr Saha made. All of these different elements were brought to the transactions by the different parties, and they arrived at a mutually satisfactory agreement, it must be surmised. As a result of which, there must have been some gain to each of them. The purpose of the legislative regime, in the Commission's contention, is that this is a disposition that is intended to be brought to tax, just as the appellant brought to tax the acquisition that was similarly not for a specific monetary value.

If Your Honours don't have any questions about that diagram, I would just like to move on to the legislative regime itself. And my learned friend was, perhaps understandably, keen to go straight to the specific sections that were at issue. The Commissioner suggests that it is worth just noting the purpose of the regime, and this is our point three on the outline. The purpose of the regime includes ensuring that the world-wide income of New Zealand tax residents that is accumulated in foreign companies is brought to tax.

TIPPING J:

Does this purpose have a statutory formulation, or is this the submission of what the purpose is?

MR PALMER:

This is our submission. There is, Your Honour, supplementary materials that were filed, which consists of, I am informed by my learned friend that this is all common ground as to purpose but if I can just direct Your Honours to the Commissioner's supplement to the case on appeal which is the affidavit of Mr Frawley.

TIPPING J:

It's just useful to be able to attribute if it comes from somewhere else.

MR PALMER:

I understand Your Honour. In fact I do also note that the purpose that was of the legislation that was characterised by Mr Frawley in this affidavit was referred to by both the High Court and the Court of Appeal and it is common ground. I don't think there is a dispute about it.

McGRATH J:

But we must take it presumably as a submission –

MR PALMER:

Yes Your Honour.

McGRATH J:

– from him as to purpose, coming through you. But you can't point to anything specific in the statute? Normally there would be a purpose clause to look at?

MR PALMER:

There is not a specific purpose clause, no.

ELIAS CJ:

Well he says that the policy appeared in the 1994 Income Tax Act at sections AA 2 and BD 1?

MR PALMER:

Yes, Your Honour, the AA 2 section is one which simply records that New Zealand residents are subject to tax and BD 1 is a reference to gross income and the notion that gross income under various parts of the Income Tax Act is the relevant standard.

TIPPING J:

I don't want to make more out of this, Mr Palmer, than is necessary, thank you.

MR PALMER:

The simple point on behalf of the Commissioner is that if the accumulated funds in foreign companies were left to be accumulated in those companies and not distributed then, and if that were not to be taxed, then tax on that, what is effectively income, would either be deferred, would be able to be deferred by the taxpayer or avoided entirely if it was taken as a matter of capital gain. So the purpose of this regime is to bring to tax the accumulation of funds in FIF.

TIPPING J:

It's a kind of foreign accruals regime in a sense?

MR PALMER:

In a way, yes.

McGRATH J:

It disregards divisions such as capital income and the gains they're taxed, is that it?

MR PALMER:

It tends to skate over that. But there are various different methods, as Your Honours know, of how to measure the income that should be taxed. There were four at the time that Dr Saha made his choice. He elected the comparative value technique and at point 4 of the outline I have attempted to reduce to English the numerical or algebraic formula. Simply you take the market value at the year end and the gains during the year. You subtract from that the market value at the year start and the expenditure during the year.

WILSON J:

Just in terms of the wording of the formula Mr Palmer. If you look please at the concluding words of CG 18(b), namely with respect to the interest. What do those words mean?

MR PALMER:

I would suggest, Your Honour, that that refers to – so if you were to take out the extraneous wording, that definition would be, "B is the aggregate of all the gains derive by the person with respect to the interest." So that's the interest in the FIF.

WILSON J:

Yes I just wonder how wide an import are those words having regard to what seems to me to be the essential issue that arises on this appeal.

MR PALMER:

Your Honour the Commissioner hasn't taken the view that there's anything of particular relevance to those words.

TIPPING J:

But if the gain is linked in some sensible way to the interest –

MR PALMER:

That's right.

TIPPING J:

– that's what it must be seeking to do, mustn't it?

MR PALMER:

Yes.

TIPPING J:

There's got to be some sort of nexus between the gain and the interest.

MR PALMER:

Because that is what –

TIPPING J:

But I would have thought relatively wide –

MR PALMER:

Yes. That would be consistent with the purpose of this regime. The aggregate of all gains and it might just be worth referring back to earlier in that legislation on I think it's page 17, 001, section OB 1 defines gain. Just earlier in the handout in the yellow materials. So section OB 1 defines gain in the FIF rules to include all forms of gross gain whether distributions in the nature of dividends, proceeds from disposition or otherwise. So as Your Honour says a relatively wide definition of gain.

ELIAS CJ:

Sorry which provision was that?

MR PALMER:

This is –

ELIAS CJ:

Oh at the beginning.

MR PALMER:

It's difficult to be numbered.

ELIAS CJ:

Thank you.

MR PALMER:

And it also stands to reason, Your Honour, given that the purpose of this whole part that for the purpose of calculating gains and losses they need not be monetary or even actually received but rather what we're doing here is looking at the economic gain or loss attributed to the taxpayer and for that purpose there are a number of deeming provisions that are associated with a comparative value method and we've talked about some of them. So there's a deeming provision with respect to expenditure in kind, so this is CG 14 1(c), so that's on page 17,303, where there's expenditure or cost incurred in kind the amount shall be equal to the market value of the expenditure or cost incurred in kind. And then analogously we have CG 14(2) further down that page which is where any gain is derived in kind. The amount of the gain shall be equal to the market value of the gain derived. So these in essence are deeming provisions and then there's another set in section CG 23, page 17,552. In fact section CG 23(4) provides that where a person dies and holds property the person shall be deemed to have disposed of the property immediately before death. Then the ones that we're interested in, CG 23(5) and 23(6) deems disposition so disposal of property for no consideration or for consideration which is less than market value is deemed to have been derived at consideration or consideration equal to market value. Then in CG 23(6) is the analogous section dealing with acquisition.

Your Honours have already commented on what the Commissioner terms symmetry between the tax treatment of acquisition and the tax treatment of disposition. It is the Commissioner's suggestion that if it was the case that the value of the shares were brought to tax at market value when they were acquired, that would presumably have been under sections 14(1)(c) and 23(6)

and accordingly the analogous sections, their analogies, ought to be used for the disposition when the shares are disposed of. Your Honours you spent some time this morning about – on the question on what gain was acquired by the appellant and the Commissioner's simple point is that there were a variety of different elements of the transaction, that the appellant derived gain from all of those elements together. It is therefore difficult potentially to assign a monetary value to the gain that the appellant derived from a settlement agreement and as the Court of Appeal notes there was no evidence available as to that value. But whatever it was, if the gain to the appellant was less than the market value, then section CG 23(5) applies to deem the amount to be at market value and in addition because you could characterise this as a gain in kind, then CG 14(2) applies to deem that to be at the market value of the gain in kind. So it is the Commissioner's assertion that both sections do come into play just as the Court of Appeal found.

ELIAS CJ:

Was that what was argued in the High Court by the Commissioner? I got the impression that it wasn't.

MR PALMER:

Your Honour I'm informed that the Commissioner relied primarily only on section CG 23(5) in the High Court.

ELIAS CJ:

Yes, it seemed that the Court, in the Court of Appeal identified CG 14 –

MR PALMER:

Yes Your Honour, but it does in the Commissioner's argument now, that having been pointed out, it does make sense –

ELIAS CJ:

Yes.

MR PALMER:

Because the two sections do make two different points. Section CG 14(2) deals with the question of the fact that it was in kind, therefore it should be at the market value of the gain in kind and because you can't actually measure what the market value is, then that leads you to section CG 23(5).

ELIAS CJ:

Yes, yes I understand that.

MR PALMER:

And both Courts of course did find that through either of those roots, that the value of the shares should be brought to tax.

TIPPING J:

I don't think it's an either/or is it, really they both brought, they work in tandem, to borrow a phrase, from Trinity.

MR PALMER:

I would hesitate to do that Your Honour, but I agree with that.

TIPPING J:

No I don't wish to sound provocative.

MR PALMER:

Your Honours the way in which this works in this case can be illustrated using the numerical example, which is at, in the Commissioner's submissions at paragraph 12 and if you would indulge me, I would like to present this by way of a PowerPoint set of slides, which is on your – is that on your screens now?

ELIAS CJ:

Oh yes, it has come on this one. It's just my note-taking one that's not working.

MR PALMER:

So this is a hypothetical situation that the Commissioner is supposing exists, because the actual numerical examples, with respect to the actual transactions, are complicated by the fact that there were various disposals of some shares at different times and that shares also depreciated in value during both years. So the objective of this hypothetical example is to strip away those complications and focus only on the acquisition and then the disposition, and to see how that would be taxed. From my learned colleague's comments earlier, I take it that he agrees with the first year, the way in which the Commissioner presents this, doesn't like the outcome of the Commissioner's argument, but that of course is where we differ. So this is the situation at the beginning of the 2001 tax year where the market value of the shares at the end of the preceding year is zero, that is value C, that's all we know at that point, because there are no shares. This is the year in which the shares are acquired. You then have the acquisition of share occurring. This is value D, and the amount of the shares is again the hypothetical amount, $602,941, that is the expenditure in acquiring the shares in a year, is value D, and at the end of the year, the market value is assumed to be the same, so there has been no change to the market value, so A is the same amount, and when you put those values into the formula, you have the market value at the end of the year A, cancelling out the expenditure in acquiring the shares in the year D, the other values are zero, so the total value is zero. So there is no income to be taxed. Well there's no tax loss either. That is the hypothetical example that focuses just on what's at issue.

In the second year, you start the year with the shares and again we're assuming no change in value, so market – sorry, element variable C, the market value at the end of the preceding year is that same amount. And then we have the difference between the Commissioner's argument and the appellant's argument. Now the Commissioner's argument is that there was a gain to the appellant during the year, this is from the disposition, or the forfeiture if you wish and we say that that gain should be brought to tax by entering value B with that same amount. The appellant argues that it wasn't a

gain, that it was somehow a loss and says that that value should be zero and so at the end of the year, because all the shares are assumed to have been disposed of, there is no market value of them held at the end of the year, so A is zero and there's been no expenditure, so D is zero and so the outcome, according to the Commissioner, all other things being equal, focussing just on this question of acquisition of forfeiture, is that there would be no tax, no taxable income, and no loss. Whereas according to the appellant, there is, what I won't call a magical result of a tax loss existing, of minus $602,938 or 41 thousand. Your Honours I would suggest that the Commissioner's interpretation of how this works is the intended result according to the purpose of the legislation. That if on this point only, if the Commissioner's interpretation were to hold, then there would be no tax gain or loss. The appellant is arguing in favour of a position which would deliver the appellant understandably, with a tax loss of some significance and that does not accord with the purpose of the legislation or in the Commissioner's argument the terms of the legislation. Your Honour –

TIPPING J:

Is the question then really reduced in your submission to two short steps, was there a gain on the disposition of these shares? If so, it must be market value unless demonstrated by the taxpayer to be demonstrably otherwise.

MR PALMER:

Ah yes Your Honour.

TIPPING J:

Or maybe even without that. Without that last –

MR PALMER:

Even if it weren't at market value, it must be deemed to be at market value unless it's higher.

TIPPING J:

Unless it's higher.

MR PALMER:

In which case it must be at the, whatever the higher value is, if that can be calculated. But if it can't and if it was only in kind, then section CG 14(2) suggests that it would be at market value. So there was a gain, we would say. The consideration, if you wish, the gain that the taxpayer obtained was the mixture of intangible and tangible benefits that derived from the settlement agreement. It does not matter, in the Commissioner's submission, exactly who received what in terms of the two Cap Gemini companies. The point was that the –

ELIAS CJ:

Who provided what presumably?

MR PALMER:

Who provided what, I'm sorry, yes. The point was that the taxpayer disposed of the shares and received a gain for it which must be brought to tax. And the suggestion, if I might just characterise it, and it is somewhat complicated, that in some way that what was happening with this settlement agreement was a purchase price adjustment retrospectively to an original agreement, simply is misconceived.

TIPPING J:

Mr Palmer could I just add to what I put to you a moment ago? Even if there wasn't a gain, say this was a demonstrable case of gift, as I recall somewhere in there, you have to bring it to account at market value, even if it's for no consideration?

MR PALMER:

At no consideration, this is CG 23(5) Your Honour, yes.

TIPPING J:

So it's only got, it would only escape from that regime if the taxpayer showed that on a correct analysis, for present purposes, not only was there no gain or lack of consideration, but there was a demonstrable real loss.

MR PALMER:

Yes I just struggle to understand how that could be demonstrated, yes.

TIPPING J:

I'm not necessarily forecasting that's the view I take of it but I would have thought theoretically that would be an open proposition. It would be, as you say, difficult to see how that might occur.

MR PALMER:

Yes Your Honour. And the reading of these sections, of 23(5) and 14(2), needs to be undertaken in the context of the overall purpose of this part of the Act.

ELIAS CJ:

Just thinking about the horse analogy. It doesn't really fit within the wording of CG 23(5). If the horse dies it's hardly a disposition of property which is an interest of the person in a fund with respect to which the person uses a comparative value method.

TIPPING J:

Is this an overseas horse?

ELIAS CJ:

Never mind, don't take any time on it Mr Palmer.

BLANCHARD J:

Well the same would apply if the company in which the investment is made has simply gone broke –

ELIAS CJ:

Yes, yes.

BLANCHARD J:

– then there's no value.

ELIAS CJ:

Yes.

BLANCHARD J:

But that's a different situation.

MR PALMER:

Yes it is. Your Honours, the appellant's argument in essence ignores the fact that there does, the appellant does receive a gain in return for what is called forfeiture. In a way it seems to be similar to arguing that if he had simply sold them, that the fact that the shares had moved away from him and to someone else, represents a loss. It ignores the fact that there is a purchase price coming either way or in this case the fact that there was a gain by reason of these mixture of intangible and tangible benefits. And that Your Honours, that sort of symmetry between – not between taxpayers but between a taxpayer's tax treatment of income and expenditure is an important principle in the Act. If it were not then it could be exploited in various ways which would be undesirable.

McGRATH J:

When you refer, use the phrase tangible and intangible benefits, can I just clarify what you're covering from that are the employment related matters of the $250,000, the release from the employment contract. How do you deal with the 2095 shares kept? Do you also see those as part of that?

MR PALMER:

That was an element of the agreement, yes Your Honour.

McGRATH J:

Was the ability to keep them, would you say that was an intangible benefit?

MR PALMER:

Possibly that is more tangible.

McGRATH J:

Okay. Anything else apart from those three that we should bear in mind?

MR PALMER:

Well the appellant was released from employment so he had the opportunity of seeking employment elsewhere whether – and that freedom itself could be defined to be, said to be an intangible benefit, difficult to value unless there was another job opportunity immediately presenting itself at a higher income. We have no evidence about that.

McGRATH J:

That presupposes an obligation to work for the company that no longer applies as a result of the deed?

MR PALMER:

Yes.

McGRATH J:

Thank you.

MR PALMER:

So Your Honours in summary the case for the Commissioner is reasonably straightforward and that concludes it.

ELIAS CJ:

Thank you Mr Palmer. Yes Mr Harley?

MR HARLEY:

Your Honour if I could take, I'm addressing Chief Justice here, if I could you back to my worked example.

ELIAS CJ:

I probably didn't read it properly or was it an oral one?

MR HARLEY:

You asked me a question and I just wanted to take you back through examples year 3 and option A which is in my submission the nub of the difference between us. In fact if I could start in year 2. I used in year 2 the FIF opening stock value of $10 and then in year 3 I got to – sorry in the same year 2 I went from opening stock value of $10 to closing stock of $20 in the example set out again. The purpose of raising this with you is simply to make sure that we understand that on the first day of the next year I've paid tax on the $20 gain and my opening stock cost reflects the $20 and so when I sell for $5 I get a deduction equal to the $20 less the $5 brought in. Now my point in raising this with you again is in respect of either option A or B, when I forfeit on ordinary language I get nothing in. They're gone, taken away, and my submission is that is the same as the bankruptcy to me.

Now I wanted to take you then back to probably what was a terrible example using the horse, but it doesn't matter, and just respond to the exchange between you and Justice Blanchard where His Honour put the proposition that the horse and the FIF going bankrupt is a different situation. No it's not. It's the same but it affects a different item in the formula. The item that it affects in the formula is item A because if the horse is dead or the FIF has gone bankrupt you've got no closing stock value. So the formula adjusts for the bankruptcy the market value up or down. I hope I haven't muddied the water but that' –

ELIAS CJ:

My question was more directed to the literal wording of CG 23(5) which deals only with disposition of property which is an interest of the person in a fund and it's only in relation to a disposition of property of that sort that there's a statutory deeming.

MR HARLEY:

And my response to you would be if the FIF interest is dead, as in bankrupt, then the interest in the fund –

ELIAS CJ:

But is that a disposition?

MR HARLEY:

No, no this, I'm going to agree with you it's not a disposition and Justice Blanchard and you are right in terms of that provision. What I'm saying to you is that the formula adjusts for the result in another way …

ELIAS CJ:

Oh yes, yes I understand that. Yes.

MR HARLEY:

That's the only point if there is a point.

ELIAS CJ:

Yes, but that still leaves you with the difficulty that you do, it seems to me, have a disposition -

MR HARLEY:

Unquestionably.

ELIAS CJ:

Of property which is an interest of a person in a fund.

MR HARLEY:

Correct.

ELIAS CJ:

And unless you are able to demonstrate that the disposition was for market value or more, why doesn't CG 23(5) blow you out of the water?

MR HARLEY:

Because there's fully adequate consideration between the parties and that's all CG 23(5) focuses on. All I have to do is show that there's fully adequate consideration between the parties.

ELIAS CJ:

But why is it fully adequate consideration between the parties, which is a different concept than consideration for less than market value?

MR HARLEY:

I mean the section poses the question, whether there is consideration between the parties. It doesn't ask the nature of it. It simply questions the existence of it and the obvious example is, if I gift my FIF interest to you, there is no consideration, there is a disposition the section applies at market value.

ELIAS CJ:

Yes, yes.

MR HARLEY:

But here we have a disposition between the parties for fully adequate consideration. The section doesn't apply on its face.

TIPPING J:

Fully adequate must mean equivalent or better than market, therefore why on earth don't you bring in market?

BLANCHARD J:

Where does the expression, "Fully adequate" come?

MR HARLEY:

I made it up.

ELIAS CJ:

Made it up. Yes and that –

MR HARLEY:

What I mean is, that's what the section means.

BLANCHARD J:

Does it?

ELIAS CJ:

It's the market value of the property at the time.

MR HARLEY:

Well it's the proxy for the adequacy of the consideration.

BLANCHARD J:

This is not about adequacy of consideration. It's about comparison with market value.

MR HARLEY:

The question posed by the section is whether the disposition is for no consideration for the reasons that I submitted this morning. The answer to that question is no. There is consideration for the disposition.

ELIAS CJ:

But is it consideration which is more than the market value of the property at the time?

MR HARLEY:

And for the reasons that I submitted this morning, the market value of the property at the time was $602,938 dollars and in this instance by the disposition affecting the purchase price adjustment as I explained, he suffered a loss, but it is the loss that is the consideration. We don't get in then, to the salami slice of what elements might have been good or bad to him, we simply

have answered the question in terms of what the section itself poses, and it can't apply.

Now my friend in his address, asserted that the taxpayer clearly obtained a gain, otherwise he wouldn't have entered deed of settlement, that doesn't follow at all. He may well have viewed the settlement as stopping him from getting into deeper trouble, and so he's limited his damage as a result. But that doesn't make it a gain for reasons that I'll come to in a moment. When he took you through the so-called tri-partite deed of settlement, he said there was no division of consideration where, with all due respect to him, there plainly is in terms of the clauses, in terms of clauses 1, 4 and 5, there are discrete elements between the parties deliberately reflecting the contractual relationship between them. Relatedly he then said that there were flows of value or items of exchange of property and with Justice McGrath then we went to the ideas of tangible and intangible benefits. I think we need to be careful here as to what the statutory focus is. This is not about whether the taxpayer felt personally satisfied or happy with what he had achieved. We don't tax people on the basis of whether they feel good as a result of the transactions. Of course we don't. We tax them on receipts of cash or benefits in kind that we bring to charge. Now in this case, what has to be identified and is not in the Commissioner's submission to you, is what it is that he focuses on, that is the gain in kind and where does it come from. For the reasons I've submitted the cancellation of the employment contract cannot be relevant. It confers no interest in property to the taxpayer. He receives nothing. Just as it occurs when any contract comes to an end. There is no flow and yet the architecture of the Act depends on the recognition of a flow of value in the context of derivation.

Just for clarity in terms of what was argued in the Courts below. Both provisions were argued before the Court of Appeal. The primary focus before the High Court Judge was CG 23(5) and we did not get to CG14 because it was obvious in the course of argument that he was highly attracted to that analysis and so he focussed on it. But both provisions were before the Court in a jurisdictional sense and both were argued in written submissions.

McGRATH J:

Just coming back to tangible and intangible for a moment. Are you saying that release from an onerous contract can never be equated to gain, because there doesn't – you have to show that there was an income flow thereby created, which will be the gain.

MR HARLEY:

The answer for income tax purposes is yes. I am saying that. When a contract is terminated without more there is no flow receipt or benefit derived, subject to income tax. Very different if the releasor, pays the releasee for the release. In which case there is a receipt, which may or may not income, depending on its characteristic. But they are quite different in concept.

ELIAS CJ:

Mr Harley, can you just remind me, where, I can't remember where it is best set out, the comparative contentions of the parties, is it in one of the judgments or is it in the submissions? Can you just – I just want to have a look.

MR HARLEY:

In terms of the detail ma'am, I would say that's the difference that is exemplified with the Commissioner's slides. If I can just check with Mr Palmer.

ELIAS CJ:

I just thought that we had in hard copy, somewhere, a table which set out the different intentions.

MR HARLEY:

I did in my note, which is on page 4. And I'm sure this is common ground between us in terms of showing what the difference is. So the first year

results in a deduction for the cost, the recognition of income for the closing stock, the result is zero. We then get to the year in contention. We have an opening stock deduction equal to the closing stock value of the $602,941. We then have the forfeiture, and we have no closing stock on hand. My contention is that the result, correctly applied of the formula, is you have a deduction of the $602,941 resulting in the deduction of the opening stock cost, and you've got nothing left. The Commissioner says you bring back – the correct amount is $602,938 – but that's the difference between us.

The last point I wanted to deal with just goes back to Justice Tipping, and the exchange with my friend wherein a series of propositions. His Honour asserted, the first question was, was there a gain, and, if so, that it must be at the market value, unless the taxpayer shows that there's something different. Therefore, the propositions were that the taxpayer has to show that there's no gain, no lack of consideration, and that there's a demonstrable real loss. I think I got the sequence right, sir.

TIPPING J:

Something like that, Mr Harley, yes.

MR HARLEY:

It was quick. For the purposes of CG 23(5), the question is not whether or not there's a gain. The section doesn't ask that question. It asks whether there is fully adequate consideration for the purposes of the disposition. If the answer to that question is yes, there is, CG 23(5) does not apply.

Then we get to CG 14(2), and it poses a question of gain in respect of an exchange in kind in relation to the disposition. And my answer to that, as I've already submitted, is there is no property received by the taxpayer that constitutes a gain from Cap Gemini France. And for the reasons that I submitted earlier, it is misconceived and irrelevant to treat the relationship between the taxpayer and Cap Gemini New Zealand, which is brought to an end by termination of the employment, is giving rise to any kind of property exchange at all. There isn't any. The only item that's relevant there is the

$250,000 in cash that was received, that is not property in kind, and to which section CG 14 doesn't apply.

In final response to Your Honour Justice Tipping in respect of that elemental analysis, I'd ask you to focus again on the day after this taxpayer has forfeited these shares. Is he poorer or richer?

TIPPING J:
For better or worse?

BLANCHARD J:
It would have been interesting to ask him, given the flows.

MR HARLEY:
Well, I'm not going to give you evidence, but he has a very, very clear view about that.

BLANCHARD J:
I'm sure he does.

TIPPING J:
Well, as you've rightly said, that's got nothing to do with it, what his perceptions of the matter are, as to whether he's better or worse off.

MR HARLEY:
Yes it does, in this sense, Sir.

TIPPING J:
Well, you're sort of having some of it when it suits you.

MR HARLEY:
Sorry, we don't care what he thinks. That's not the point.

TIPPING J:

That's my only point.

MR HARLEY:

And my point in reply is the words in the section. Section CG 18(1) asks the question, gain or loss? And that's why I put to you the question, richer or poorer?

TIPPING J:

Yes, I do understand the point.

MR HARLEY:

And he's poorer.

ELIAS CJ:

Thank you counsel, we will reserve our decision in this matter. Thank you for your argument.

COURT ADJOURNS: 1.06 PM