IN THE SUPREME COURT OF NEW ZEALAND

SC 59/2007
[2008] NZSC 116

BETWEEN	GLENHARROW HOLDINGS LTD Appellant
AND	COMMISSIONER OF INLAND REVENUE Respondent

Hearing:	8, 9 and 10 July 2008
Court:	Elias CJ, Blanchard, Tipping, McGrath and Anderson JJ
Counsel:	C R Carruthers QC, G J Harley and S L O'Neill for Appellant D J White QC, R J Ellis and J H Coleman for Respondent
Judgment:	19 December 2008

JUDGMENT OF THE COURT

A **The appeal is dismissed.**

B **Costs of $30,000 are to be paid by the appellant to the Commissioner together with reasonable disbursements to be fixed if necessary by the Registrar.**

REASONS

(Given by Blanchard J)

Introduction

[1] Under the Goods and Services Tax Act 1985 a registered taxpayer who purchases secondhand goods from an unregistered vendor may claim an input tax deduction for the tax fraction of the purchase price which has been paid. If in the

relevant tax period the taxpayer's input tax deductions exceed its output tax, the Commissioner of Inland Revenue must pay the credit balance to the taxpayer.

[2] In 1997 Glenharrow Holdings Ltd purchased a mining licence (which constitutes secondhand goods for the purposes of the Act) from Mr Michael Meates for $45m. The licence then had some three years of its term to run and authorised the holder to mine for serpentinite and bowenite within a defined area on Mt Griffin in Westland. Glenharrow, which had a share capital of $100, paid a deposit of $80,000 which it had obtained from its shareholder, Mr Fahey. Then, when the licence was transferred to it, it gave Mr Meates a cheque for the rest of the price ($44,920,000) drawn on its solicitor's trust account. Mr Meates gave Glenharrow a cheque for the same amount drawn on his solicitor's trust account as an advance by way of loan and Glenharrow delivered to Mr Meates a mortgage over the mining licence, a general mortgage debenture over all its assets and a mortgage over its shares executed by Mr Fahey but, it is agreed, without personal liability. (It is common ground that the supplies made by way of the cheques were financial services which are tax exempt for GST purposes.) The loan was repayable without interest by three annual instalments.

[3] Glenharrow has claimed from the Commissioner an input tax "refund" of the tax fraction (one-ninth) of $44,920,000. (It has already been paid a refund in respect of the deposit.) The Commissioner resisted Glenharrow's claim, alleging in the first place that the arrangements between Mr Meates and Glenharrow were a sham. That defence failed in the High Court and has not been further pursued. But the Commissioner also says that the arrangement constitutes tax avoidance and has treated it as void under s 76 of the Act (as that section stood in 1997). The resulting reconstruction was largely upheld by the High Court[1] and almost completely by the Court of Appeal.[2]

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1 *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,319 (HC).

2 *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2008] 1 NZLR 222 (CA) (Robertson, Ellen France and Chambers JJ).

[4] Before the licence expired Glenharrow was able to extract a limited quantity of stone and made further payments to Mr Meates totalling $210,000. The Court of Appeal has held, and the Commissioner accepts, that Glenharrow is entitled to tax credits for these payments.

[5] With that brief introduction, it is now necessary to describe in more detail the facts, the relevant portions of the GST Act and what happened in the lower Courts.

The facts

[6] The mining licence was issued on 15 November 1990 for a term of 10 years. It permitted the mining of serpentinite, bowenite and certain other rock. It was a condition of the licence that mining operations must not be carried out by any method other than hand methods. The licence area of about 80 hectares was at around 1200 metres above sea level and inaccessible by road. But the licence terms envisaged the use of helicopters to lift out boulders which, if necessary, could be sawn up using mechanical or other hand tools.

[7] There had been a quarry on the land in the early part of the 20th century and some serpentinite had been mined. Although there had been a prospectus issued by a Sydney based company, New Zealand Greenstone Ltd, in 1913, the project had evidently not prospered and the quarry closed during World War I. The trial Judge, Chisholm J, recorded that since that time only minimal quantities of rock had been extracted.[3]

[8] The licence changed hands in 1993 (for $5,000) and again in 1994 (for $100) before Mr Meates acquired it in December 1996 for $10,000. He, or companies associated with him, farm a property at the base of Mt Griffin and operate a helicopter for the purpose of recovering deer.[4] The licence area is about three minutes flying time from the farm.

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3 At para [4].
4 See *P F Sugrue Ltd v Attorney-General* [2006] 3 NZLR 464 (PC).

[9] The evidence was that early in 1997 Mr Meates was approached by Mr Gerard Fahey about selling the licence to Glenharrow. Mr Fahey knew something of the history of the old quarry and had formed the view that there was at least half a million tonnes of serpentinite and bowenite within the licence area. The values of these stones are not in dispute: $1,000 per tonne of serpentinite, $4,000 per tonne of bowenite and $10,000 per tonne of high quality bowenite. At trial there was expert evidence that these stones were likely to appear in the proportions of 85% serpentinite, 14.25% bowenite and 0.75% high quality bowenite. The quantities of stone which it was feasible to extract during the remainder of the term of the licence, the market for them and the time which it might take to achieve sales were, however, very much put in issue. So, consequentially, was the fair value of the licence. The Crown's expert assessed it at $3,207,000. Glenharrow maintained that it was worth at least $45m and the trial Judge made findings which produced a figure of $9,757,000.

[10] Where did the agreed value of $45m come from? The evidence was that after Mr Fahey indicated an interest in acquiring the licence, Mr Meates consulted his cousin, Mark Meates, who was not a valuer but had studied valuation as part of an MBA degree. In a short report dated 3 June 1997 Mark Meates referred to a range of values from $45m to $180m. Michael Meates nominated $45m as his price. Mr Fahey said that, encouraged by his view concerning the quantity of stone within the licence area and by discussions with an Asian businessmen about available markets (but with no commitment made by that person, who was not called as a witness), he would have been prepared to pay $60m and was therefore happy to accept Mr Meates's offer to sell at $45m on the basis that there would be full vendor finance except for the deposit.

[11] For an asset of not insignificant value, whichever of the figures is to be preferred, the documenting of the transaction between Mr Meates and Glenharrow was done in a very slapdash way. On 28 June 1997, apparently without first seeking professional advice, Mr Meates wrote and Mr Fahey countersigned a letter to a Christchurch solicitor, Mr Pengelly, recording the agreement of Mr Meates to sell the licence to Mr Fahey's company, Glenharrow, for $45m with a deposit of $80,000 and a mortgage back to Mr Meates for the rest of the price. "The mortgage is to be

over the licence and the company and the shares in the company." Capital reductions were to be made six monthly. There was to be interest at 10% per annum but not during the first two years because "it will take two years for the mining operation to get organised". There was to be no repayment of capital for three years. Despite the limited remaining term of the licence, the letter seems to envisage a long term arrangement, the parties no doubt anticipating a renewal of the licence which, in the end, despite appealing as far as the Privy Council,[5] Glenharrow was unable to achieve.

[12] After the parties received legal advice, the terms were changed somewhat. A mortgage of the licence was executed on 22 August 1997 and, seemingly overlooking the payment of the deposit, provided for three annual payments of $15m beginning on 31 March 1999 without interest (but with penalty interest for late payment). Later, on 14 November 1997, a deed of sale was completed in which the deposit payment was acknowledged and the arrangements for settlement by the exchange of cheques were set forth. Later again, on 28 November when settlement took place, Glenharrow executed a general debenture over its assets, although they seem to have consisted only of the licence, for a principal sum of $44,920,000, now said to be repayable on demand and bearing interest, if demanded, at such rates as Mr Meates might nominate but not exceeding his own bank's overdraft rate. It seems, however, that the parties or their solicitors must have afterwards realised this was inconsistent with their bargain, for the debenture was not registered and was eventually replaced by another version dated 31 July 1998 which omitted any requirement for payment of interest on the principal sum and seems to have recognised that the repayments would be in terms of the mortgage.

[13] The other document which should be mentioned is a deed of mortgage of the shares of Glenharrow which Mr Fahey executed on 31 November 1997 as further security for the $44,920,000. A reading of it gives the impression that Mr Fahey was making himself personally liable for that sum. He covenants that Glenharrow will repay it, and there is no express exclusion of personal liability. It was, however, the evidence of both Mr Fahey and Mr Meates that no such liability on the part of Mr Fahey was intended and we proceed on that basis.

5 *Glenharrow Holdings Ltd v Attorney-General* [2005] 2 NZLR 289 (PC).

[14] It was necessary for Glenharrow to obtain consents from the Ministers of Energy and Conversation before mining operations could begin. A work programme had to be approved. Glenharrow experienced considerable difficulties with officials and, in the end, very little work was able to be done during the remaining life of the licence. Only 36 tonnes of rock were extracted. Chisholm J accepted that the delays in obtaining consents and approvals provided "a plausible explanation for Glenharrow's failure to mine the site".[6]

The GST Act[7]

[15] None of what is said in this section of our reasons concerning the position of the parties under the GST Act before the question of avoidance is reached, seems to be in controversy between the parties.

[16] As is well known, the GST Act taxes supplies of goods and services[8] by registered persons in the course of their taxable activities[9] ("output tax") but permits such persons to claim deductions for the amounts they expend in connection with those activities ("input tax deductions"). The rate of tax is 12.5% and hence the "tax fraction" applicable to the deductions is one-ninth. At the end of each "taxable period" a person registered under the GST Act must make a GST return bringing to account both outputs and inputs and then either pays the debit balance or claims the credit balance (the GST refund).

[17] "Goods" means all kinds of personal or real property other than choses in action or money.[10] The mining licence was "secondhand goods".[11]

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6 At para [161].

7 Numerous amendments and structural changes were made to the GST Act by the Taxation (GST and Miscellaneous Provisions) Act 2000. Since the present proceeding is governed by the Act as it stood prior to 2000, this judgment refers to the various sections as they stood at that time.

8 A "supply" includes all forms of supply: s 5.

9 Section 6 of the GST Act defines "taxable activity" in terms of an "activity which is carried on continuously or regularly by any person". Purchases and sales by private individuals are hence kept outside the system. See also *Newman v Commissioner of Inland Revenue* (1995) 17 NZTC 12,097 (CA).

10 Section 2.

11 Section 2 does not define secondhand goods except to exclude certain limited classes, which do not include interests in land. See also *L R McLean & Co Ltd v Commissioner of Inland Revenue* [1994] 3 NZLR 33 (CA).

[18] Michael Meates was not registered under the GST Act, and he did not need to be as he was not carrying on any taxable activity. Section 51 of the Act provides that every person who carries on a taxable activity is liable to be registered. Accordingly, Glenharrow needed to become registered in order to carry on its proposed taxable activity of supplying stone to be quarried from the licence area. That would also entitle it to claim for its inputs, including amounts paid for the acquisition of the licence. Glenharrow was registered on an invoice basis.[12] It could make a deduction for input tax only when it held a tax invoice or debit note or credit note in respect of the supply in respect of which the claim was made.[13]

[19] Normally it is the person who makes a supply who must provide the person supplied with a tax invoice.[14] But an unregistered person does not make taxable supplies and is not entitled to raise a GST invoice. Section 24(7) therefore makes specific provision for a situation in which a supplier makes a supply, not being a taxable supply, of secondhand goods to a recipient which is a registered person. In that circumstance the recipient must maintain records[15] which contain essentially the same information as is required in an invoice. In this case Glenharrow created the necessary records in terms of s 24(7). Having done so, it was then entitled, under s 20(2)(c), to claim an input tax deduction in respect of the supply of the licence in an amount equal to the tax fraction of the consideration in money for that supply, provided the licence was acquired by it "for the principal purpose of making taxable supplies".[16]

[20] Where the consideration for a supply is a consideration in money the value of a supply is the amount of the money.[17] Where the consideration is not a consideration in money or the parties are associated persons, the value is the "open market value"[18] of the consideration.[19] "Money" is defined in s 2 to include bills of

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12 See ss 19 and 19A.
13 Section 20(2).
14 Section 24.
15 Section 75.
16 Definition of "input tax" in s 2.
17 Section 10.
18 The open market value of any supply of goods and services at any date is the consideration in money which the supply of those goods and services, or a similar supply, would generally fetch if supplied in similar circumstances at that date in New Zealand, being a supply freely offered and made between persons who are not associated persons: s 4.
19 Section 10.

exchange, so that consideration in money includes a payment made by cheque. Michael Meates and Glenharrow were not associated persons, as defined in s 2. Therefore, subject to the question of tax avoidance, the price paid ($45m) must be taken to be the value of the supply of the licence.

[21] The only other provision of the Act which needs to be mentioned is, of course, the general anti-avoidance provision, s 76, which in 1997 and until 2000 was in the following form:

> **76 Agreement to defeat the intention and application of Act to be void—**
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> (1) Notwithstanding anything in this Act, where the Commissioner is satisfied that an arrangement has been entered into between persons to defeat the intent and application of this Act, or of any provision of this Act, the Commissioner shall treat the arrangement as void for the purposes of this Act and shall adjust the amount of tax payable by any registered person (or refundable to that person by the Commissioner) who is affected by the arrangement, whether or not that registered person is a party to it, in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that registered person from or under that arrangement.
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> (2) The Commissioner may, for the purposes of this section, deem—
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> (a) Any person (not being, apart from this subsection, a registered person) who is a party to or has participated in any way in any arrangement, to be a registered person:
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> (b) Any supply of goods and services, whether or not a taxable supply, that is affected by or is part of any arrangement, to be both made to and made by any registered person:
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> (c) Any supply of goods and services to occur in any taxable period that, but for any arrangement affected by this section, would have been the taxable period in which the supply was made:
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> (d) Any supply of goods and services to have been made, or consideration for such supply to be given, at open market value.
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> (3) Where—
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> (a) Any person (in this subsection hereafter referred to as the original person) enters into any arrangement on or after the 22nd day of August 1985 whereby any taxable activity formerly carried on by the original person is carried on, in whole or in part, by any other person or other persons; and
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> (b) The original person and the other person or other persons are associated persons,—

> for the purposes of sections 15(3), 15(4), 19A(1), and 51(1) of this Act, the value of the supplies made in the course of carrying on all taxable activities in any period of 12 months commencing on the first day of any month by the original person and by the other person or, as the case may be, by the other persons shall, so far as the value relates to those supplies arising from the taxable activity formerly carried on by the original person, each be deemed to be equal to the aggregate of the value of the taxable supplies made by all of them for that period:
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> Provided that the Commissioner may, having regard to the circumstances of the case and if the Commissioner thinks it equitable to do so, determine in any particular case that this subsection shall not apply to all or any of the original person and that other person or, as the case may be, those other persons.
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> (4) For the purposes of this section—
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> "Arrangement" means any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect:
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> "Tax advantage" includes—
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> (a) Any reduction in the liability of any registered person to pay tax:
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> (b) Any increase in the entitlement of any registered person to a refund of tax:
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> (c) Any reduction in the total consideration payable by any person in respect of any supply of goods and services.

The High Court judgment

[22] In concluding that the arrangements between Mr Meates, Glenharrow and Mr Fahey were not a sham Chisholm J found that there was a rational explanation for the price of $45m and that Mr Meates sold the licence with the intention that the price would be paid in full. For his part, the Judge found, Mr Fahey intended that the licence be mined and that the payments due to Mr Meates should be met from the revenue. The agreement, i.e the deed of sale, was intended to be implemented according to its terms. The Judge also accepted that Glenharrow's primary or fundamental purpose was to work the licence and extract stone. He said that was, at

28 June 1997, a genuine and potentially achievable purpose.[20] By this he seems to have meant that the extraction of *some* quantity of stone was potentially achievable.

[23] On this footing, Chisholm J turned to s 76,[21] expressing his agreement with the opinion of Rodney Hansen J in *Ch'elle Properties (NZ) Ltd v Commissioner of Inland Revenue*[22] that s 76 did not require proof of a subjective intention and was directed at the effect or purpose of the arrangement. The question was whether the arrangement was one which, objectively, defeated the intent and application of the Act. Rodney Hansen J had accepted that two fundamental objectives of the Act were defeated: first, that an overall balance be achieved between the outputs and inputs of a registered person and, second, that there should be some reasonable relationship between the time that outputs and inputs in relation to a particular supply were accounted for. Like Rodney Hansen J, Chisholm J had difficulty in accepting that the legislature intended s 76 to be governed by the personal motives of the taxpayer when entering into the arrangement.[23]

[24] In broad terms, the Judge said, a deduction was available under s 20(3)(a) to the extent that a payment had been made during the taxable period. He was satisfied that there had been a payment and "economic sacrifice". The value of the mining licence was represented by the consideration passing for it. But:

> Although market forces will generally set the value of the supply, it is scarcely debatable that the intent and application of the provisions relating to input tax would be defeated if input tax could be claimed on the grossly inflated consideration.[24]

The definition of a "tax advantage" in s 76(4) included an increase in the entitlement of any registered person to a refund of tax. If the consideration was grossly inflated, the input tax would also be grossly inflated.

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20 At para [166].
21 At paras [167] – [214].
22 [2004] NZLR 274 (HC) at para [45].
23 At para [183].
24 At para [186].

[25] Chisholm J then spent some time assessing evidence bearing on the value of the licence, reaching the view that the consideration of $45m was grossly inflated. The figure he eventually arrived at as an appropriate valuation of the licence was $9,757,000. He ordered the Commissioner to credit Glenharrow with a GST deduction of the tax fraction of that amount.

The Court of Appeal judgment

[26] Both sides appealed but the Commissioner did not pursue his argument that the arrangement had been a sham. In the Court of Appeal the majority (Robertson and Ellen France JJ) were of the view that the Judge had not been wrong in finding tax avoidance on the basis of a grossly inflated price. The majority said that transactions at non-market value can in some circumstances defeat the intent and application of the Act.[25] The special rule for non-market value transactions[26] implied that such transactions can frustrate the scheme of the Act. The majority was satisfied that the old version of s 76 did not incorporate a subjective test, which would have rendered it virtually inoperative.[27] The Judge had plainly been entitled to conclude that, although Mark Meates had not been involved in any sham, his valuation was grossly inflated. The arrangement constituted tax avoidance "because in economic terms [it] was only a conditional obligation to repay the loan and there was no definitive commitment to repay irrespective of the success or failure of the venture". The mere completion of loan documents and the swapping of cheques was "insufficient to constitute the economic sacrifice Parliament intended in limiting the secondhand goods refund to the extent that payment is made in the period in question".[28] The expressed legal obligation was artificial.[29]

[27] The majority pointed out that the very first letter created by the parties (without legal advice) contemplated that there was to be no interest at all on what the majority called "this extraordinarily large advance" for two years to allow, as the

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25 At para [77].
26 At para [78].
27 At para [79].
28 At para [81].
29 At para [82].

letter said, for the mining operation to get organised. There was no repayment of capital for three years. Although there were undoubted expectations that there might be renewals or extensions of the licence, the hard legal reality was that the licence expired on 15 November 2000. The majority also observed that no stamp duty had ever been paid on the transactional documents.[30] It was satisfied that there had been a significant temporal mismatch and that the line had been crossed into tax avoidance "because the obligation to pay the purchase price was replaced, in commercial terms, by only a conditional commitment to repay the loan".[31]

[28] In this case, the majority said, the tax advantage had been Glenharrow's increased entitlement to a tax refund. The only way in which that advantage could be counteracted was to assess the entitlement to input tax credits at the further $210,000 (the instalments of price actually paid to Mr Meates).

[29] Chambers J (dissenting) was influenced by the Commissioner's concession that the arrangement was not a sham and that the consideration for the mining licence was $45m. After explaining why he thought the second concession was wrong – essentially that what Mr Meates got by way of payments and promises from Glenharrow did not have a value of $45m – Chambers J proceeded on the basis of the concession as made. On this basis, he considered that Chisholm J's findings of fact precluded a finding that the arrangement had been entered into to defeat the intent and application of the Act. The Judge had found the agreement to be genuine and that the parties intended to implement it according to its terms. Accepting that it was genuine, there was a rational business explanation for the structure and the price.[32] The conclusion that the price was grossly inflated[33] sat uneasily with those other findings. It was not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income.[34] The majority's conclusion, that

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30 At para [87] and High Court judgment at para [151].
31 At para [92].
32 At para [167].
33 High Court judgment at para [213].
34 *Cecil Bros Pty Ltd v Commissioner of Taxation of the Commonwealth of Australia* (1964) 111 CLR 430 and *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1976] 1 NZLR 546 (PC).

the legal obligation falling on Glenharrow was artificial, could not stand with the findings of the trial Judge, not challenged on appeal.

[30] It also seemed to Chambers J to be wrong to evaluate the transaction by what subsequently happened. That the business enterprise proved to be unsuccessful, despite the best efforts and intentions of the parties, could not justify a later characterisation of the GST claim. With obvious reluctance, Chambers J would have allowed Glenharrow's appeal.

The position before the avoidance issue is reached

[31] Before any consideration is given to the effect on the transaction of the pre-2000 version of s 76, the position was said by counsel for Glenharrow to be as follows:

(a) Michael Meates was not a registered person; Glenharrow was a registered person on the invoice GST accounting system.

(b) The parties were unrelated and at arm's length – they were not associated persons.

(c) The licence was secondhand goods, acquired by Glenharrow for the principal purpose of conducting its taxable activity of mining.

(d) The deed of sale for the $45m price provided for consideration in money. The open market value provisions of the Act did not apply to that agreement.

(e) Glenharrow made two payments, the first of $80,000 and the second of $44,920,000, on 28 November 1997, to acquire the licence.

(f) Glenharrow complied with the secondhand goods records rule in s 24(7).

(g) Glenharrow was entitled to claim its second GST input amount, being one-ninth of $44,920,000 when it paid the balance of the purchase price by cheque on 28 November 1997.

(h) The provision by Michael Meates of vendor finance on 28 November 1997 of $44,920,000 to Glenharrow was the supply of an exempt financial service. Any repayment by Glenharrow of principal and interest was also the supply of an exempt financial service.

(i) In the relevant return period, being the period February/March 1998, Glenharrow's input tax deductions exceeded its output tax, entitling it to seek a refund of that excess under s 45 of the Act.

[32] As will appear, we accept that analysis, on the basis of the findings of fact made in the Courts below. But that, of course, is before looking at the operation of s 76.

The operation of s 76

[33] Section 76 assumes that the arrangement under scrutiny is not a sham. The concern under s 76 is whether, notwithstanding juristic compliance with the other provisions of the Act, the Commissioner may set a particular arrangement aside and make a reconstruction because the arrangement constitutes tax avoidance.

[34] In order for the Commissioner to be able to invoke s 76 he must be satisfied that the arrangement which he wishes to treat as void has been "entered into between persons to defeat the intent and application" of the GST Act or of any provision of the Act. Consistent with the approach to interpretation of General Anti-Avoidance Rules (GAARs) in the income tax context, and as foreshadowed in the preceding paragraph, this determination requires an assessment that goes beyond the technical legality of the constituent parts of the arrangement. The onus is on the taxpayer to show that the Commissioner could not properly have been satisfied in terms of the section.[35]

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35 Tax Administration Act 1994, s 149A(2)(b).

[35] There is a two-stage process before the Commissioner can carry out a reconstruction under s 76. First, the Commissioner must have been justified in coming to the view that there was an "arrangement"[36] entered into between at least two persons. In the present case this has never been an issue. There was certainly an arrangement between Mr Michael Meates, Glenharrow and Mr Fahey. Secondly, the Commissioner must have been properly satisfied that the arrangement was entered into between the parties to it to defeat the intent and application of the Act or any provision of the Act. This does not mean that the Commissioner must have been satisfied that the parties subjectively had that defeating purpose, i.e that they were consciously trying to achieve the end of defeating the intent and application of the Act. Mr Carruthers accepted, correctly in our view, that this was not the appropriate test even though it might have appeared to be open on the wording of s 76 as it stood at the time. That is, however, an unlikely legislative approach because, as Rodney Hansen J pointed out in *Ch'elle*[37] and the Court of Appeal in the present case confirmed, whether or not a particular arrangement constitutes tax avoidance should not depend on difficult judgments about what the taxpayer had in mind. If it did, a scheme which was void if devised and implemented by one taxpayer could be immune from s 76 if developed by another in different circumstances. That cannot be so, for such an approach would produce different results for identical arrangements depending on whether the parties were or were not driven wholly or in part by a desire to produce a particular tax consequence. It would also require the courts to assess the veracity of the parties, who are always likely to say that tax consequences were not in the forefront of their minds. The courts are on much firmer ground disregarding subjective purpose, as they have always done in applying general anti-avoidance provisions in income tax statutes, as will be seen.

[36] A natural and sensible reading of s 76, as it stood prior to 2000, is to read it as requiring the Commissioner to be satisfied that an arrangement has been entered into between persons "so as to" defeat the intent and application of the Act or any provision of the Act. That requires the Commissioner and the Court to ask what objectively was the purpose of the arrangement, which in turn requires examination of the effect of the arrangement. Section 76, even in its pre-2000 version, therefore

36 Section 76(4).
37 At para [45].

requires an examination of the purpose or effect of the arrangement, and in this respect the current version of the section has merely stated expressly what was implicit in the former version.

[37] In *Newton v Commissioner of Taxation of the Commonwealth of Australia*,[38] in giving the advice of the Judicial Committee, Lord Denning said that in the phrase "purpose or effect" in the Australian general anti-avoidance provision of that time the word "purpose" meant not motive but the effect which it was sought to achieve – the end in view. The word "effect" meant the end accomplished or achieved. It was necessary, his Lordship said, to look at the arrangement itself and see its effect irrespective of the motives of the person who made it.

[38] What Lord Denning was emphasising was that the general anti-avoidance provision was concerned not with the purpose *of the parties* but with the purpose *of the arrangement*. That is a crucial distinction. Once you put the purpose of the parties to one side and seek by objective examination to find the purpose of the arrangement, you must necessarily do that by considering the effect which the arrangement has had – what it has achieved – and then, by working backwards as it were from the effect, you are able to determine what objectively the arrangement must be taken to have had as its purpose. That approach is inevitable once any subjective purpose or motive is ruled out of contention, as the authorities say it must be. The position is summed up in a passage from the advice of the Privy Council in *Ashton v Commissioner of Inland Revenue*,[39] where Viscount Dilhorne said:

> If an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose and oral evidence to show that it has a different purpose or different effect to that which is shown by the arrangement itself is irrelevant to the determination of the question whether the arrangement has or purports to have the purpose or effect of in any way altering the incidence of income tax or relieving any person from his liability pay income tax.

This passage may at first sight appear somewhat circular but must be read as a whole. Viscount Dilhorne was clearly ruling out evidence of subjective purpose or motive and requiring the objective purpose to be determined from the effect of the

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38 [1958] AC 450 at p 465.
39 [1975] 2 NZLR 717 at p 722 (PC).

arrangement.[40] He went on immediately to approve what Lord Denning had also said in *Newton*:[41]

> In order to bring the arrangement within the section you must be able to predicate – by looking at the overt acts by which it was implemented – that it was implemented in that particular way so as to avoid tax.

It is because the objective purpose is deduced from the effect that the phrase "purpose or effect" in general anti-avoidance provisions has been said to be a composite term.[42]

[39] The present case is unusual because evidence was given that the taxpayer did not consider GST.[43] Whether or not evidence of that character is accepted, any such finding is not determinative. Just as the taxpayer's state of mind concerning taxation is not determinative of purpose when the taxpayer is known to have been aware of taxation considerations, so it cannot be determinative if he or she was unaware of them. The purpose of the arrangement may be deduced entirely from the arrangement and its effect.

The intent and application of the Act

[40] The application to an arrangement of tax legislation such as s 76 of the GST Act is concerned with the "aim or end in view" of the arrangement.[44] It is to be objectively assessed. And the assessment will principally be a matter of inference from the arrangement and its effect. The purpose of an arrangement will be deduced from the arrangement itself and its effect. The intention of the Act will be defeated if an arrangement has been structured to enable the avoidance of output tax, or the obtaining of an input deduction in circumstances where that consequence is outside the purpose and contemplation of the relevant statutory provisions. Lord Hoffmann

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40 See also *Commissioner of Taxation of the Commonwealth of Australia v Hart* (2004) 217 CLR 216 at para [65] and *Calder v Commissioner of Taxation* (2005) 226 ALR 643 at para [96] (FCA).

41 *Ashton*, at p 722, citing *Newton*, at p 466.

42 *Tayles v Commissioner of Inland Revenue* [1982] 2 NZLR 726 at p 734 per McMullin J (CA).

43 See High Court judgment at paras [39], [51], [110] and [144].

44 *Shiu Wing Ltd v Commissioner of Estate Duty* (2000) 3 HKCFAR 215 at p 238.

in *Commissioner of Inland Revenue v Auckland Harbour Board*[45] commented that, generally speaking, GAARs were:

> aimed at transactions which in commercial terms fall within the charge to tax but have been, intentionally or otherwise, structured in such a way that on a purely juristic analysis they do not. This is what is meant by defeating the intention and application of the statute.[46]

An arrangement of this kind is not in accordance with the overall purpose of the Act because it produces a "tax advantage"[47] not within the contemplation of the statute.

[41] Broadly speaking, GST is a type of value-added tax. It is fundamentally an indirect tax levied on transactions with consumers. The legislation envisages that, for a business, over time the net impact will be an impost of GST on the value which the business adds to the goods and services it supplies. GST has been likened to a turnover tax (the outputs are the turnover) but with provision for offsetting deductions (or credits) for the GST content of input costs (the expenses incurred in producing the outputs).[48]

[42] GST replaced New Zealand's wholesale sales tax system and was introduced as part of the 1980s general programme of economic liberalisation. Reflecting policy work[49] undertaken to ensure that the new regime was as non-distortionary as possible in its attempt to lower average and marginal tax rates, and reduce fiscal deficits, inequities between taxpayers, and opportunities for avoidance and evasion,[50]

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45 [2001] 3 NZLR 289 at para [11] (PC).

46 See also *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115 at paras [108] – [109].

47 Section 76(4). It includes (a) any reduction in the liability to pay tax, (b) any increase in the entitlement to a refund of tax and (c) any reduction in the total consideration payable in respect of any supply of goods or services. The new s 76 now refers to the term "tax advantage" as "tax avoidance": s 76(8), as substituted by s 116(1) of the Taxation (GST and Miscellaneous Provisions) Act 2000.

48 Cooper and Vann, "Implementing the Goods and Services Tax" (1999) 21 Sydney Law Review 337, pp 345 – 347. Of course it is not simply a tax on receipts or turnover: *Commissioner of Inland Revenue v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 at p 13,193 (CA).

49 For example that done by Scott and Davis, *The Gist of GST: A briefing on the goods and services tax* (1985).

50 Bollard, "New Zealand's Experience with Consumption Tax" (1992) 9 Australian Tax Forum 473, pp 473 – 479 and Stephens, "New Zealand's Tax Reforms, 1984 – 1992" in Head (ed) *Fightback! An Economic Assessment* (1993) 193, pp 193 – 194, 197 – 202 and 231.

GST was intended to be broad-based, efficient and neutral.[51] Nevertheless, as the review done in 1999[52] highlighted, compliance and administration costs preclude perfect neutrality ever being achieved.[53] Tax avoidance opportunities notably remain at the boundaries between taxable and non-taxable transactions and between registered and unregistered persons. Accordingly, a general anti-avoidance provision was considered necessary.[54]

[43] GST utilises the invoice or credit-offset system. Consequently, and differing from other forms of consumption tax, GST is a multi-stage tax imposed on the value added at every stage of the business activity by which goods or services reach the ultimate consumer.[55] It is a tax on final consumption because it is the sum of the value added by firms at each stage of the supply chain that consumers ultimately purchase and consume. Registered persons producing taxable supplies effectively operate as tax collectors on behalf of the Government and as such are not themselves subject to GST's economic incidence.[56] That is of course consistent with the neutrality and efficiency of the revenue collection rationales that underlie the Act. The corollary is that registered persons should, by the same token, not obtain unacceptable windfall gains from the regime.

[44] From a reading of the Act as a whole it is clear that the legislature anticipated that, for a trader in goods and services, there will over time usually be some balancing out or netting off of the GST components of sales and purchases. There

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51 A tax is described as neutral if its application does not distort the relative prices of goods and/or services, work and leisure, so as to alter the behaviour of consumers and/or producers: Evans, "The Value Added Tax Treatment of Real Property – An Antipodean Context" in Krever and White (eds) *GST in Retrospect and Prospect* (2007) 243, p 246. Tax studies frequently equate neutrality with efficiency.

52 Policy Advice Division of the Inland Revenue Department, *GST – A Review* (1999).

53 Clough, *A Study of New Zealand's Experience with the Goods and Services Tax* (1988) Working Paper 1988/27 (Wellington: NZIER), p 2.

54 *GST – A Review* (1999), paras [6.1], [6.2] and [6.5]. For comparable reasons, Australia has also included a similarly worded general anti-avoidance rule, specifically Div 165, in its GST legislation.

55 Tait, *Value Added Tax: International Practice and Problems* (1988), pp 9 – 17 and Cooper and Vann, p 345.

56 Bollard, p 9; *King v Bennetts* (1994) 16 NZTC 11,370 at para [23] (CA) and *Nicholls v Commissioner of Inland Revenue* (1999) 19 NZTC 15,233 at p 15,240 (CA). Market competition may sometimes require the supplier to absorb some, or even all, of the tax: Hill, "GST – An Income Tax to be Interpreted by Reference to Income Tax Principles or Just Another Consumption Tax" (2002) 17 Australian Tax Forum 229.

will obviously be timing differences. Goods and services will frequently not be both bought and sold in the same GST period but the Act appears to have been drafted with an anticipation that in the long run, and broadly speaking, appropriate offsetting will occur. In fairness, however, where a cost of acquisition precedes the return from a sale, a deduction is made available in advance of the arrival of that return. Where this occurs there is always the risk that the return which eventuates will not be as great as the cost of acquisition, or there will be a nil return. That is a risk which the Act requires the Revenue to accept as within a normal range of trading results, in the same way as it is able to take a greater benefit where a return from a business transaction is unusually large. The intent and the application of the Act accommodates such variables. Where transactions are between traders the Act is effectively self-policing because both must account for GST.[57] There is limited opportunity for manipulation if the parties are at arm's length. The consideration they agree upon can be expected to be an open market value as defined in s 4. But if they are associated persons and hence are not at arm's length, there is obvious potential for adoption of an unrealistic value which could create distortion, and the Act therefore requires an accounting on the basis of an open market value, which is either the value the goods or services would normally fetch or as determined by the Commissioner in accordance with a method which provides, as s 4(4) puts it, "a sufficiently objective approximation".

[45] As we have said, the Act applies to persons who engage in the "taxable activity"[58] of buying and selling goods and services. They must register in order to be able to claim input tax credits, but have a discretion whether to register where their turnover is, under the current threshold, less than $40,000.[59] The Act does not have direct application to those who transact as consumers, i.e without themselves

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57 Schenk, "Policy Issues in the Design of a Value-Added Tax: Some Recent Developments in OECD Countries" (1989) 1 Tax Notes International 111, pp 118 – 119. Because GST involves two cash-flows (namely the refund of input tax credits and the charging of tax on sales), the regime is vulnerable to the claiming of GST on fictitious acquisitions and creates temptation for registered persons to "cheat" by overstating their deductions and understating their sales income: Cooper and Vann, p 356.

58 See footnote 9.

59 Section 51.

proposing to make taxable supplies. Consumers pay indirectly through the GST component of the supplies made to them by registered persons. They have no obligation to account to the Revenue for GST when selling an asset and accordingly they are neither required nor permitted to issue invoices claiming or recording the charging of GST.

[46] Because of the credit-offset mechanism for inputs, sales between registered persons are tax neutral. So are sales between unregistered persons because the regime does not apply to them.[60] There is, however, potential for registered taxpayers knowingly or otherwise to create distortions at the boundary between themselves and unregistered persons. The same can occur where transactions are between those registered on a payments basis and those registered on an invoice basis (as in *Ch'elle* and *Nicholls v Commissioner of Inland Revenue*[61]). The general anti-avoidance provision is available to stop or counteract both these distortions. The possibility of distortion exists in the former situation because, in order to preserve neutrality where a registered person is acquiring goods from an unregistered person, it is necessary to allow the registered person to claim an input tax credit which reflects the GST already included in the acquisition price. Otherwise there would not be neutrality because secondhand goods would be taxed twice over and would thus bear a higher tax burden than new goods. Neutrality is achieved by means of the special regime for secondhand goods,[62] which permits an input deduction for a notional tax element in the price paid by the registered purchaser notwithstanding that the unregistered vendor will not have to account for any corresponding amount of GST. There is still likely to be the controlling influence of market forces where the parties are not associated persons but the absence of a GST accounting at both ends gives rise to the possibility of a transaction being structured so as to have the effect of producing an artificially enhanced consideration or an artificial advancement of the point at which a deduction is claimable.[63]

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60 *L R McLean and Co Ltd*, at p 35.
61 (1999) 19 NZTC 15,233 (CA).
62 See para [19].
63 As in *Ben Nevis* – see paras [108] – [109] and [137] – [138] of the judgment in that case.

[47] Does it follow from the provision made concerning sales of secondhand goods between associated persons that if parties who are not associated, one being registered and the other not, enter into a transaction which is not a sham and in which the latter buys secondhand goods from the former, the Commissioner is bound to accept the terms they agree upon as regards price and payment? Can it be suggested that those terms (that part of their arrangement) nonetheless defeat the intent and application of the Act so as to allow the use of s 76? In our view it can. The whole premise of the Act generally and of the secondhand goods provisions in particular is that transactions will be driven by market forces: that their commercial and fiscal effects will be produced by those forces and will not contain distortions which affect (ie defeat) the contemplated application of the GST Act. It is when market forces do not prevail that s 76 is available to the Commissioner. Take an obvious example (which on the High Court's finding of fact is not the present case). An unregistered vendor and a registered purchaser, not being associated persons, inflate the price of goods in return for a non-recourse loan to the purchaser by the vendor. The purchaser obtains the advantage of a higher input tax deduction/refund. This would plainly defeat the intent and application of the Act, namely that the purchaser's deduction would be no more than the tax fraction of the market value of the goods. If the price were influenced by the tax advantage, the purchaser would be achieving something not contemplated by the Act – an artificially enhanced deduction. It is the same if the structure of the transaction enables the purchaser to obtain an artificially early deduction, that is, one which is unrelated to the market realities of the transaction.

[48] It may be said, and indeed the appellant does say, that to approach the question of the intent and application of the Act in this way is not to respect the bargain struck by the parties and would allow the Commissioner to restructure their bargain for them, with different GST consequences, and would thus be productive of uncertainty. But that uncertainty is inherent where transactions have artificial features combined with advantageous tax consequences not contemplated by the scheme and purpose of the Act. There will also inevitably be uncertainty whenever a taxing statute contains a general anti-avoidance provision intended to deal with and counteract such artificially favourable transactions. It is simply not possible to meet the objectives of a general anti-avoidance provision by the use, for example, of

precise definitions, as may be able to be done where an anti-avoidance provision is directed at a specified type of transaction.

[49] Transactions which are driven only by commercial imperatives are unlikely to produce tax consequences outside the purpose of the legislation and, in any isolated case in which the commercial drivers do have unusual consequences, the existence of those consequences will surely alert the parties to the possibility that the Commissioner may consider invoking the general anti-avoidance provision and may have to be persuaded that the intent of the legislation is not actually being offended. An advance ruling can be sought.[64]

The application of s 76 in this case

[50] In the present case, it must be accepted that, whether or not the price agreed on by Mr Meates and Glenharrow reflected a market value – a matter on which we heard argument but on which we need not form a view – it was the subject of a genuine bargain. The trial Judge has so found. Glenharrow agreed to pay $45m. That was not, on the Judge's finding, a price which the parties had artificially inflated. There was stone within the licence which justified the price if the stone could be extracted while the licence still ran.

[51] But, even on that basis, the arrangement still had a very artificial element: the price was not paid in economic terms, even though as between the parties a debt was discharged. In this case it is not the price but the "payment" that created the distorting effect. Glenharrow accepted the legal obligation to pay the full price but at the outset the parties were well aware, and any objective observer in 1997 would have seen, that payment in full would certainly not occur. The licence had only a little over three years to run. Whatever the parties may have thought, no renewal was available as a matter of law.[65] The parties themselves believed[66] and the objective observer would have concluded, that it would take two years to get started

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64 Tax Administration Act 1994, s 91C(1)(c).
65 See para [11].
66 See letter quoted in Court of Appeal judgment at para [17].

on mining because of the need first to obtain various consents and approvals. The parties to the arrangement may have had an intention to implement their agreement according to its terms but that was plainly an impossible task. No one has ever suggested that the remainder of the term would suffice for the success of the project to a point where it would produce enough extraction of stone to pay the $45m. There was no prospect of the payment being made by any other means. The only person who made any legal commitment to the $45m was Glenharrow which had a capital of $100 only. Mr Fahey had found the $80,000 deposit but, according to the evidence, was not to be looked to as a guarantor, nor did he ever undertake to introduce further capital into his company. It should be emphasised that this analysis does not depend upon hindsight. It looks at the matter as it would have appeared to an objective observer at the time when the arrangement was entered into. The arrangement is not being judged, impermissibly, on the basis of what actually happened afterwards.[67]

[52] In reality the only part of the price which in economic terms would ever be paid – disregarding the possible use of any GST refund for this purpose – was such as could be funded from sales during the third year. An objective observer, when the arrangement was made, would have said that Glenharrow would never be able to mine enough stone during the term of the licence in order to generate sufficient sales. It certainly would not be able to pay the first two annual instalments of the price because it would not have begun mining. Yet the structure adopted was for a "payment" and a "re-advance". This achieved no economic effect and nothing significant in commercial terms. The licence passed across to Glenharrow (which, we were told from the bar, did not need legal title in order to begin mining) but only subject to a security in favour of Mr Meates who could, upon default, resort to it to restore his ownership of the licence. Theoretically he could sell the licence, under power of sale, to a third party but only after, at the earliest, a year had passed (when there was a default on the first instalment) by which time inevitably any realisation would be nowhere near $45m and no stone would have been extracted.

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[67] *Ashton*, at p 722.

[53] This is not to say that an exchange of cheques accompanied by a transfer of property and a mortgage back to the vendor can ordinarily be regarded as an artificial procedure. The contrary is true. Ordinarily an exchange of cheques, with accompanying conveyancing documentation, is a routine commercial procedure which does not give rise to an impermissible tax advantage.[68] However, in this case that procedure was inserted into a "pay as you go" transaction so as to produce an artificial effect with consequent tax advantage, contrary to all economic reality. In economic terms there was no consideration in money given by Glenharrow because of the commercial impossibility of payment by it in circumstances where it was virtually uncapitalised and its obligation was not supported by its shareholder. The terms of the arrangement may well have made business sense from the perspective of each party as a transaction which enabled Glenharrow to exploit the licence and pay the price as and when stone was extracted and sales eventuated. It safeguarded Mr Fahey and Mr Meates to some extent against the risks of the venture. But it had no such reality as a "cash" transaction, despite being structured as if it were.

[54] In contrast to the position in the United Kingdom,[69] the New Zealand GST Act does have a general anti-avoidance provision and on an objective view of the present case, the effect of the structure, given the gross disparity between the price and the size of the purchaser and given, particularly, the shrinking value of the asset, with its very limited practical life, was to produce a GST refund totally disproportionate to the economic burden undertaken by Glenharrow or the economic benefit obtained by Mr Meates. Indeed, there can be no issue that Glenharrow undertook liability for the $44,920,000 funded by vendor finance. But Glenharrow was a shell company with a share capital of just $100. And as Mr Meates was unregistered, there was no GST impost on the other side of the transaction. The end in view was a distortion which very plainly defeated the intent and application of the Act. It cannot be said that, looked at objectively, the tax advantage was merely incidental to the commercial decisions of the parties to the arrangement.

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[68] *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311 at para [16].

[69] See *Customs and Excise Commissioners v Faith Construction Ltd* [1990] 1 QB 905 (CA).

The Commissioner's reconstruction

[55] Since, as we have concluded, the Commissioner could properly be satisfied that the arrangement was entered into between the parties to defeat the intent and application of the Act, s 76 requires him to treat it as void for the purposes of the Act. The Commissioner must then adjust the amount of the tax which is refundable "in such a manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained … from or under that arrangement".[70] The Commissioner has a discretion in this respect. He chose to exercise it by treating the deposit as the only payment made by Glenharrow in the taxable period in respect of which the refund was claimed and allowed a refund of the tax fraction of that payment. That, it seems to us, was an entirely proper exercise of the discretion. It was in accordance with the reality of what had occurred during that period. The Court of Appeal decided that the Commissioner should also treat the instalments made during later periods as payments and should allow further refunds. That too reflects the reality of what occurred in the periods in question. The Commissioner has not challenged the Court of Appeal's decision. We can see no basis upon which either the Commissioner's original decision or the adjustment ordered by the Court of Appeal can be impugned by the taxpayer.

Result

[56] The appeal should be dismissed with costs of $30,000 to be paid by the appellant to the Commissioner.

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Crown Law Office, Wellington for Respondent

70 Section 76(1).