IN THE SUPREME COURT OF NEW ZEALAND

I TE KŌTI MANA NUI

SC 23/2018
[2018] NZSC 54

BETWEEN	PATTY TZU CHOU LIN Applicant
AND	COMMISSIONER OF INLAND REVENUE Respondent

Court:	Elias CJ, O'Regan and Ellen France JJ
Counsel:	G D Clews and S J Davies for Applicant D J Goddard QC and J B Y Cheng for Respondent
Judgment:	20 June 2018

JUDGMENT OF THE COURT

A The application for leave to appeal is dismissed.

B The applicant must pay the respondent costs of $2,500.

REASONS

[1] The applicant seeks leave to appeal against a decision of the Court of Appeal[1] dealing with an issue of interpretation of the double tax agreement between New Zealand and the People's Republic of China (the NZ/China DTA).[2]

[2] The applicant had a 30 per cent interest in five companies that were resident in China for tax purposes and trading in that country. They were Controlled Foreign Companies (CFCs) for the purposes of New Zealand tax law, which meant that the

1 *Commissioner of Inland Revenue v Lin* [2018] NZCA 38 (Harrison, Cooper and Asher JJ) [*Lin* (CA)].
2 Double Taxation Relief (China) Order 1986.

income of the companies in China was attributed to the applicant for New Zealand tax purposes under the CFC regime.

[3] China provided tax concessions to the companies, which meant that they were exempt from paying tax that would otherwise have been payable in China. The provision of such a concession was referred to in the lower Courts as "tax sparing", and we will adopt the same terminology.

[4] Article 23(2)(a) of the NZ/China DTA provides that, in general terms, Chinese tax paid in respect of income derived by a resident in New Zealand from sources in China (with some exceptions) is allowed as a credit against New Zealand tax payable in respect of that income by the New Zealand tax resident.

[5] Article 23(3) deals with the situation of tax sparing. In essence, it provides that tax payable in China by a resident of New Zealand is deemed to include any amount that would have been payable as Chinese tax but for an exemption or reduction of tax granted under Chinese law. Thus, tax spared by the Chinese authorities is also allowed as a credit against New Zealand tax payable by the New Zealand resident.

[6] The five Chinese companies in which the applicant had a 30 per cent interest benefited from tax sparing arrangements in China. The applicant's New Zealand tax liability for income earned by the companies in China under the CFC regime was calculated by the Commissioner on the basis that a credit was provided for tax actually paid in China, but no credit was given for tax spared in China.

[7] The applicant's challenge to this assessment was upheld in the High Court.[3] The High Court Judge considered that the applicant was entitled to a credit in New Zealand for tax spared in China to the CFC, interpreting art 23(3) on the basis that it had to be read in the light of the wording of art 23(2)(a) so that the two provisions could be read consistently.[4] She said that this interpretation was underscored by evidence about the way in which double tax agreements are negotiated, the research done by each country into the other's tax systems and policy and the

3 *Lin v Commissioner of Inland Revenue* [2017] NZHC 969 (Thomas J).
4 At [97].

irresistible inference that both parties would have known at the time of entering into the NZ/China DTA that New Zealand intended to implement a CFC regime. She considered that the interpretation of art 23(3) respected the purpose of the tax sparing provision in the NZ/China DTA to encourage investment in China by ensuring that the benefit of the Chinese tax concessions remained with investors, rather than accruing to the benefit of the New Zealand tax system.[5]

[8] The Court of Appeal differed from the High Court, focusing closely on the wording of art 23 itself. It considered that art 23's meaning was clear, and thus there was no necessity to resort to extrinsic materials for assistance in its interpretation.[6] It considered that art 23(3) dealt with tax that would have been payable in China by a resident in New Zealand. It did not deal with tax that would have been payable in China by a CFC, in which a New Zealand resident has an interest, thus causing the income of the CFC to be attributed to the New Zealand resident under the CFC regime.

[9] The applicant wishes to challenge the Court of Appeal on the basis that the Court of Appeal did not apply the principles of interpretation of treaties and was too strongly influenced by the plain meaning interpretation of art 23(3). She argues that interpretation of treaties, particularly double tax agreements, is a matter of public importance, noting that New Zealand has 40 double tax agreements with its main trading and investment partners. She also argues that the interpretation of the NZ/China DTA itself is a matter of public importance and a matter of commercial significance, given the fact that double tax agreements are effectively part of New Zealand tax law through the operation of s BH 1(1)(c) of the Income Tax Act 2007.

[10] As the applicant acknowledges, however, the significance of the present case is substantially affected by two important developments.

[11] The first of these is the change made by Parliament to the CFC regime in 2009. The effect of this was that, from that time, the CFC regime required the attribution to a New Zealand shareholder of a CFC of the passive income of the CFC, but not the

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5 At [101]–[102].
6 *Lin* (CA), above n 1, at [23].

active income. (The applicant's tax liability in the present case predates 2009.) As tax sparing incentives are designed to promote active business, this means that it is unlikely that a CFC will ever benefit from a tax sparing provision in relation to income attributed to it in New Zealand.

[12] The second is that a new double tax agreement is currently being negotiated between New Zealand and China. The respondent referred to New Zealand's long-standing policy of not agreeing to tax sparing provisions and to recent double tax agreements signed by China, the majority of which have not included tax sparing provisions. It is anticipated that even if the new double tax agreement allows for tax sparing provisions, it will make clear one way or the other what credit should be available to a New Zealand tax resident.

[13] We see these two developments as strong indications that the arguments that the applicant wishes to pursue if leave is granted are not points of sufficient importance to justify the grant of leave for a further appeal to this Court. Also, we do not see any appearance of a miscarriage of justice if leave is not granted in this case.

[14] In those circumstances we decline leave to appeal.

[15] We award costs of $2,500 to the respondent.

Solicitors:
Simpson Western, Auckland for Applicant
Crown Law Office, Wellington for Respondent