IN THE SUPREME COURT OF NEW ZEALAND

I TE KŌTI MANA NUI O AOTEAROA

SC 81/2020
[2022] NZSC 113

BETWEEN	FRUCOR SUNTORY NEW ZEALAND LIMITED Appellant
AND	COMMISSIONER OF INLAND REVENUE Respondent

SC 92/2020

BETWEEN	COMMISSIONER OF INLAND REVENUE Appellant
AND	FRUCOR SUNTORY NEW ZEALAND LIMITED Respondent

Hearing:	8–10 June 2021
Court:	Winkelmann CJ, William Young, Glazebrook, O'Regan and Ellen France JJ
Counsel:	L McKay, M McKay and H C Roberts for Frucor Suntory New Zealand Ltd J B M Smith KC, E J Norris and L K Worthing for Commissioner of Inland Revenue
Judgment:	30 September 2022

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The cross-appeal is allowed with the result that the appellant's challenge to shortfall penalties is dismissed.

C **The appellant must pay the respondent costs of $45,000 plus usual disbursements.**

REASONS

Winkelmann CJ, William Young, O'Regan and Ellen France JJ	[1]
Glazebrook J	[144]

WINKELMANN CJ, WILLIAM YOUNG, O'REGAN AND ELLEN FRANCE JJ

(Given by William Young J)

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What this case is about

[1] On 17 March 2003 Deutsche Bank advanced $204 million[1] to Danone Holdings NZ Ltd (DHNZ) in exchange for a convertible note (the note) redeemable at maturity in five years' time at Deutsche Bank's election by the issue of 1,025 non-voting shares in DHNZ. Interest on the advance (often referred to in the documents as "coupons") was payable semi-annually in arrears at 6.5 per cent per annum. Over the five-year duration of the note, this amounted to $66 million and was paid by DHNZ to Deutsche Bank.

[2] DHNZ claimed deductions in respect of the interest payments, a treatment that, as will be apparent, follows the form of the transaction as between it and Deutsche Bank. That transaction, however, was a component of a broader funding arrangement under which:

(a) Deutsche Bank would, at maturity, elect to take shares in DHNZ and in this way extinguish the liability of $204 million; and

(b) Danone Asia Pte Ltd (DAP) (which owned DHNZ) paid Deutsche Bank $149 million on inception of the funding arrangement to acquire these shares at maturity (the forward purchase agreement).

[3] The position of the Commissioner of Inland Revenue is that the net economic effect of that funding arrangement was that:

(a) Deutsche Bank advanced only $55 million to DHNZ (being the difference between the $204 million advance and the $149 million paid by DAP under the forward purchase agreement); and

(b) the $66 million paid by DHNZ to Deutsche Bank amounted to repayment of that $55 million and interest on an amortising basis.

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[1] Except where otherwise stated in this judgment, amounts have been rounded for ease of expression.

[4] Section BG 1(1) of the (now repealed) Income Tax Act 2004 (the Act)[2] provides that a tax avoidance arrangement is void as against the Commissioner for income tax purposes. Tax avoidance is defined by s OB 1 to include "directly or indirectly altering the incidence of any income tax". The Commissioner maintains that the funding arrangement purported to alter the incidence of DHNZ's liability to income tax by facilitating the claim of deductions for payments which were, in substance, repayment of debt. She says that DHNZ was only entitled to deductions in respect of payments in excess of $55 million.

[5] Frucor Suntory New Zealand Ltd (Frucor Suntory) is a successor to DHNZ and is responsible for its liabilities. It is the appellant. Frucor Suntory's position throughout has been that s BG 1(1) is not engaged and that the interest deductions DHNZ claimed were legitimate.

[6] This appeal concerns only the deductions claimed by DHNZ for the 2006 ($10,827,606) and 2007 ($11,665,323) income years,[3] along with shortfall penalty assessments premised on the contention that DHNZ adopted unacceptable and abusive tax positions.[4] In issue are:

(a) whether s BG 1(1) was engaged;

(b) the Commissioner's reconstruction under s GB 1(1), under which the taxable income of DHNZ was adjusted by disallowing the deductions said to have been claimed illegitimately; and

(c) as to shortfall penalties, whether the tax positions adopted by DHNZ were "unacceptable" as not meeting the "about as likely as not to be correct" standard stipulated in s 141B(1) of the Tax Administration Act

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2 Except where otherwise stated in this judgment, all references to sections in the Income Tax Act are references to those provisions in the Income Tax Act 2004. Despite now being repealed, they are referred to in the present tense because they are operative here.

3 The Commissioner of Inland Revenue accepts that she cannot disallow deductions claimed for prior years in respect of this arrangement because of the four-year time bar in s 108 of the Tax Administration Act 1994. The dispute between the Commissioner and Frucor Suntory New Zealand Ltd in relation to the 2008 and 2009 income years remains in abeyance pending resolution of the present dispute.

4 The shortfall penalties imposed were $1,786,555 for 2006 and $1,924,779 for 2007.

1994 and, if so, whether they were "abusive" on the basis that DHNZ had acted with the "dominant purpose" of obtaining tax advantages (s 141D).

[7] In the High Court, Muir J upheld Frucor Suntory's challenge to the assessments.[5] The Commissioner's appeal to the Court of Appeal was successful as to the disallowance of the deductions but unsuccessful as to shortfall penalties.[6]

[8] Both sides now appeal to this Court.[7]

[9] We dismiss the appeal and allow the cross-appeal. This is on the grounds explained at length in these reasons and which we now summarise.

[10] As to tax avoidance our reasons are:

(a) Section BG 1(1) applies to tax arrangements (such as those associated with the note) which, but for its invocation, would have been effective in producing the desired tax advantage.

(b) Such application is justified if the tax advantage results from the use of a tax provision outside the parliamentary contemplation of that provision's purpose.

(c) Use of a tax provision intended to provide relief in relation to a particular economic burden (such as a cost, a loss or a reduction in income), where such a burden has not, in economic substance, been suffered, will usually lie outside of the relevant parliamentary contemplation. This is particularly so where such use is contrived and artificial.

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5 *Frucor Suntory New Zealand Ltd v Commissioner of Inland Revenue* [2018] NZHC 2860, (2018) 28 NZTC ¶23-078 [HC judgment].

6 *Commissioner of Inland Revenue v Frucor Suntory New Zealand Ltd* [2020] NZCA 383, (2020) 29 NZTC ¶24-075 (Kós P, Gilbert and Courtney JJ) [CA judgment].

7 Leave to appeal and cross-appeal was granted in *Frucor Suntory New Zealand Ltd v Commissioner of Inland Revenue* [2020] NZSC 150, (2020) 29 NZTC ¶24-086.

(d) In this instance the tax provisions relied on by DHNZ provide relief in relation to "interest incurred". In economic substance, however, the payments in respect of which DHNZ sought the disallowed deductions were repayments of principal. The arrangements on which DHNZ relied to categorise these principal repayments as interest were contrived and artificial. Deductibility for such repayments is not within the purpose of allowing deductibility for "interest incurred". Accordingly, DHNZ's use of the deductibility provisions lay outside of the relevant parliamentary contemplation. This means that s BG 1(1) applies to void the arrangements.

[11] Since the purpose and effect of the tax avoidance arrangements were to provide deductibility for what in economic substance were repayments of principal, the Commissioner correctly applied s GB 1(1) to adjust the taxable income of DHNZ to disallow the deductions illegitimately claimed.

[12] As to shortfall penalties:

(a) In this case at least, application of the "about as likely as not to be correct" standard must be against the background of the facts as the Court finds them to be.

(b) On the basis of the facts as we find them to be, the tax positions adopted by DHNZ did not meet that standard and were thus unacceptable.

(c) DHNZ acted with the dominant purpose of obtaining tax advantages with the result that the tax positions were abusive.

The funding arrangement

The background to the funding arrangement

[13] DAP is a Singapore-based wholly-owned subsidiary of Groupe Danone SA (Groupe Danone). DAP formed DHNZ to acquire the then New Zealand-owned Frucor Beverages Group Ltd (FBGL).

[14] The purchase by DHNZ of FBGL was completed in January 2002. The purchase price was $298 million. This was funded as to:

(a) $150 million by DAP subscribing for 1,000 ordinary shares in DHNZ at $150,000 per share; and

(b) $148 million by a loan from Danone Finance SA (Danone Finance), another Groupe Danone subsidiary, to DHNZ.

[15] As we are about to explain, prior to the January 2002 acquisition of FBGL, Groupe Danone and Deutsche Bank had considered putting in place a funding arrangement along the same lines as that eventually entered into in March 2003. It is a fair inference that the advance by Danone Finance to DHNZ was an interim measure intended to hold the position until the funding arrangement could be finalised. It is also a fair inference that the intended end result of the funding arrangement as implemented in March 2003 was to repay the advance by Danone Finance to DHNZ (of approximately $148 million), with DHNZ borrowing from Deutsche Bank some of the necessary funds and DAP contributing the balance by way of a top-up of its capital investment in DHNZ.[8]

The planning documents—prior to DHNZ acquiring FBGL

[16] What follows in this and the succeeding section of these reasons is largely derived from the judgment of the Court of Appeal.

[17] The funding arrangement put in place in March 2003 was based on a generic tax-driven convertible note funding structure developed by Deutsche Bank. Deutsche Bank had executed the structure in various different jurisdictions, including New Zealand, and claimed to have received "positive rulings" from tax advisors. Groupe Danone was familiar with the structure, having considered using it in conjunction with Deutsche Bank for an earlier proposed transaction in Argentina.

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8 It is possible that there was a shortfall in the amount required to repay Danone Finance SA and that this was met by DHNZ. The documents are not entirely consistent as to this. Whether this is so is not material and for ease of discussion we will generally proceed on the basis that the repayment of Danone Finance was entirely effected under the funding arrangement.

[18] In late 2001, Deutsche Bank discussed with Groupe Danone the possibility of using the convertible note structure as a means of financing the then proposed acquisition of FBGL. In January 2002, it presented two “Efficient Financing Alternatives for [Groupe] Danone in New Zealand”. One of these was a convertible note structure.

[19] The proposal was that:

(a) Deutsche Bank would advance money ($x) to the Danone acquisition vehicle against a convertible note carrying interest over a five-year term.

(b) This advance ($x) would be repaid by the issue of shares by the Danone acquisition vehicle to Deutsche Bank.

(c) Another Danone subsidiary would enter into a forward purchase agreement with Deutsche Bank under which it would pay ($y) to acquire the shares at termination of the funding arrangement.

(d) The effect (albeit not spelt out in the document) would be that:

  (i) Deutsche Bank’s net injection of funds was to be the difference ($z) between the advance to the Danone acquisition vehicle ($x) and the money paid by the other Danone subsidiary under the forward purchase agreement ($y).

  (ii) The Danone acquisition vehicle would pay interest on the amount of the advance ($x), with the amount paid as interest being sufficient to reimburse/repay Deutsche Bank for its net injection of funds ($z) on an amortising principal and interest basis.

To correlate this to what eventually happened, DHNZ became the Danone acquisition vehicle, DAP the other Danone subsidiary, $x became $204 million, $y became

$149 million and $z became $55 million which, as noted, the Commissioner regards as the amount actually (in economic substance) advanced by Deutsche Bank to DHNZ.

[20] Deutsche Bank explained the proposed tax consequence: the interest payable by the Danone acquisition vehicle on the convertible note would be fully deductible; there should be no capital gains tax on the acquisition of the shares purchased by the other Danone subsidiary and the funding costs in relation to setting up the funding arrangement should also be fully deductible.

[21] The advantages of the proposal were said to be that the structure was familiar to Groupe Danone and there would be no VAT or GST issues. The single constraint mentioned was that a "75% thin capitalisation rule applies in New Zealand and should be taken into account in order to determine the size of the transaction". Assuming a $300 million acquisition, the note could not exceed $225 million.

The planning documents—after DHNZ acquired FBGL

[22] Groupe Danone advised Deutsche Bank in early February 2002—the month after DHNZ acquired FBGL—that it wished to go ahead with the convertible note structure. This was confirmed in an internal Deutsche Bank email on 4 February 2002:

> Actually Yes!
>
> They've now confirmed they want to go ahead with the convertible structure. Next steps they've asked for are (i) New Zealand memorandum/opinion confirming deductibility of coupons; (ii) UK memorandum/opinion relating to forward purchase; and (iii) termsheet.
>
> The UK side of this I had prepared before when we looked at the Argentinian deal. Can you get something from an NZ lawyer for them? On the termsheet I'll start a draft and send it over to you.
>
> Concerning fees they have suggested upfront arrangement fee of [USD1 million] plus credit spread and costs (the idea would be that the credit spread is set by Corporate Bank in Paris who provide risk weighted assets and take the credit risk in return for earning the credit spread. Accordingly [Deutsche Bank Structured Capital Markets] just keeps the upfront fee but has no credit risk etc). Danone's justification for this level of fee is:
>
> 1. Fees for these transactions in Europe are generally 1% of the principal. Here the principal on the notes is only about $80mio;
>
> 2. We had agreed to execute the Argentinian transaction for this pricing (although this is because it would have been a ground-breaking transaction for

> Emerging Markets in Argentina. Also we expected to earn more by selling the notes to a tax sparing investor);
>
> 3. They have (apparently) been inundated by other banks willing to execute this structure with them in New Zealand (they have a moral commitment to us arising out of Argentina).
>
> Accordingly we should probably accept this but let me know what you think (there is also a lot of glory in this with [Deutsche Capital Management] who have been trying to develop the relationship with Danone).
>
> …

By way of explanation, we note that "the principal on the notes" of "about $80mio" is a reference to what was then thought to be the approximate amount to be advanced by Deutsche Bank to the Danone group, an amount that in the end was $55 million.

[23] The email proceeds on the basis that full deductibility of the interest payable by DHNZ was critical. It was also critical that the other Danone subsidiary (not yet identified as DAP) should not incur a tax liability in relation to the forward purchase agreement. The apparent gain under that agreement (the difference between the amount paid under the forward purchase agreement and the face value of the note) equated to the net injection of funds to be made by Deutsche Bank. If that apparent gain was taxable it would counteract the tax advantage in New Zealand of deductibility of repayment of the net injection of funds. This is presumably what was to be addressed in the "UK memorandum/opinion related to forward purchase" referred to in the email.

[24] As at 24 May 2002, it was proposed that the face value of the note be $225 million and the forward purchase payment $154 million. The $225 million equated to 75 per cent of $300 million, thus complying with the thin capitalisation rules. The calculation of the $154 million was explained in a document distributed on that date headed "Project Falcon", the project name ascribed to the transaction by Deutsche Bank. This explained that the purchase price payable by DAP:

> … on day one will be calculated as the face value of the convertible note less the present value of convertible note coupon payments discounted at the applicable zero coupon swap rate plus credit margin (0.35%).

By way of illustration, if the face value of the note was $225 million, then the purchase price payable under the forward purchase agreement would be $154 million, being $225 million less $71 million (the present value of semi-annual coupons of $8.7 million at the then applicable interest rate of 7.736 per cent per annum). Deutsche Bank would fund the "net investment" (approximately $71 million) from its normal market sources for New Zealand dollars "swapped to an amortising flow that matches the profile of the net investment".

[25] The purpose of the arrangement was set out under a heading "Summary" in the "Project Falcon" document:

> The structure provides term funding to DHNZ at an after tax cost that is significantly below the Group's normal cost of funds (ie. pre-tax equivalent of approximately minus 1.50%).

This document was used as a template and updated from time to time as the transaction progressed towards completion.

[26] By 18 September 2002, the figures had changed. The face value of the note was now expected to be $215 million and the forward purchase price $151 million, being $215 million less $64 million (the present value of semi-annual coupons of $7.69 million at an interest rate of 7.15 per cent per annum). As well, there was some additional protection for the Danone group as it was agreed that the shares to be issued by DHNZ would be non-voting.

[27] The net funding figure of $64 million had dropped to $61 million by 29 November 2002. An internal Deutsche Bank email sent on that date explained the net effect of the transaction—"Danone raises approx NZD61m for [five] years on amortising basis".

[28] An internal Deutsche Bank approval document prepared on 2 December 2002 provides further confirmation of the purpose of the five-year structured transaction—it "is designed to provide cheaper, tax efficient funding to [DHNZ]".[9] The difference between the face value of the note and the forward purchase payment "will be

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9 The document refers to "a subsidiary of Groupe Danone SA in New Zealand". For ease of discussion we will refer to this subsidiary as DHNZ.

amortised from the convertible coupons". The payments to be made by DHNZ represented repayment of principal and interest over the five-year term on an amortising basis. DHNZ would claim interest deductions for what were described as "nominal payments" of interest on the face value of the note but were, in effect, payments of principal and interest on the net funding amount.

[29] An internal Deutsche Bank email of 3 March 2003 marked a change of approach in calculating the values to be attributed to the components of the financing arrangement. Up until this time, the starting figure was the face value of the note, the upper limit on which was the maximum amount on which interest could be claimed under the thin capitalisation rules. The other components, being the forward purchase price and the net advance to DHNZ, were calculated by reference to this figure. In contradistinction, the 3 March 2003 email used as a starting point for other calculations the forward purchase amount fixed at $149 million, with the face value of the note becoming a function of that amount.

[30] The reasons for the shift to the forward purchase amount and why it was fixed at $149 million are not made explicit in the contemporaneous documents. A possible explanation for this is provided in the Court of Appeal judgment but, as we see it, nothing turns on why this figure was chosen.

[31] One of the few available Danone group documents is an internal memorandum sent on 11 March 2003 by Pierre-André Terisse, the person responsible for agreeing to the "net funding amount" and the final amount of the note. Mr Terisse explained that his memorandum was "intended to give a brief description of the transaction for signatories". His memorandum included the following summary:

> **The structure**, established by Deutsche Bank, works as follows:
>
> - issuance by DHNZ of **215 m NZD convertible bonds**, subscribed by Deutsche Bank
>
> - Deutsche Bank keeps the principal amount, which gets reimbursed over 5 years,
>
> - But sells the conversion rights to [DAP] for an amount of 149 m NZD
>
> - At the end of the 5 years, **shares issued** in repayment of the bonds are **transferred to [DAP]**, or, as a fallback, to Compagnie Gervais Danone
>
> **Benefits obtained**
>
> - Financing cost: extremely attractive for NZD financing.
>
> - NZD financing: putting a debt in the same currency as cash-flows of the company acquired provides us with a natural hedging; furthermore, interest [is] located in the same country as operating income.
>
> **Issues**
>
> - Legal / tax issues have been checked by France Hasselman, tax opinions have been obtained

[32] There are three points about this memorandum which warrant mention or explanation. The first is that the $149 million to be paid under the forward purchase agreement is referred to in the document but the other figures are not correlated to it. Second, the reference to Compagnie Gervais Danone relates to the contingency arrangement which we discuss briefly below at [38]. The third and most significant is that the attractiveness of the financing cost was a function of tax efficiency, the benefits of which, when calculated in dollar terms, were always assessed by reference to the tax position in New Zealand of DHNZ. This is illustrated by an email from Deutsche Bank to Mr Terisse soon afterwards which indicated that the "pre-tax equivalent benefit from the transaction" should be approximately:

> [Net Funding Amount]*[Tax Rate]/[1 - Tax Rate] - US$ 1mm, which is roughly **NZ$ 24mm**

[33] The rate setting and final calculation of the face value of the note did not occur until 14 March 2003. An internal Deutsche Bank email sent that day following execution of the documents confirms:

> … For your info, the rates/amounts agreed with Danone today are as follows:
>
> | | |
> |---|---|
> | Convertible Note Principal | NZD204,421,565 |
> | Interest rate | 6.50% pa payable 18 Sept/18 Mar |
> | Issue Date | 18 Mar 2003 |
> | Maturity Date | 18 Mar 2008 |
> | Forward Purchase Price | NZD149,000,000 |
>
> Therefore net funding amount is NZD55,421,565

Tax treatment in Singapore

[34] Under the funding arrangement, DAP prepaid $149 million for the purchase from Deutsche Bank of the shares to be issued by DHNZ when the note matured. These were to have a face value of $204 million. It was critical to the overall tax efficiency of the funding arrangement that DAP not be taxed in Singapore on the "profit", representing the difference between the value of shares acquired on maturity (assumed to be $204 million) and the price paid five years earlier ($149 million). If this $55 million "profit" was taxable in Singapore, it would substantially or completely negate the tax advantage DHNZ (and thus the Danone group) derived from being able to treat as deductible in New Zealand what in substance were principal repayments of $55 million.

[35] An opinion was obtained from PricewaterhouseCoopers in Singapore which was to the effect that they did not expect that DAP would be subject to tax in Singapore by reason of the steps taken on the maturity of the funding arrangement.

The components of the funding arrangement

[36] At inception of the funding arrangement:

(a) Deutsche Bank paid $204 million to DHNZ.

(b) Upon receipt of this $204 million, DHNZ returned $60 million of capital to DAP in a share buyback and the balance of $144 million was

paid in full or substantial satisfaction of the amount then owing to Danone Finance.

(c) DAP borrowed $89 million from BNP Paribas. This, along with the net $55 million provided by Deutsche Bank (which it borrowed from its internal treasury), either substantially or completely funded repayment of the amount owed to Danone Finance.[10]

(d) DAP paid $149 million to Deutsche Bank under the forward purchase agreement. This was funded as to $89 million by the advance from BNP Paribas and, as to the balance of $60 million, by the return of capital from DHNZ (which in turn had been funded by the $204 million advance from Deutsche Bank).

(e) DHNZ paid a fee of $1.8 million to Deutsche Bank.

[37] Aspects of the documentation of the funding agreement are reasonably complex.

[38] As will be appreciated, the forward purchase agreement was to ensure that DAP retained complete ownership of DHNZ on termination of the funding arrangement. This required Deutsche Bank to transfer to DAP the shares it was expected to elect to receive. The complexity of the documentation was a function of the need to cover various risks that might prevent that transfer occurring. Since such risks were always seen as remote and did not crystallise, there is no need to review in these reasons the associated contractual arrangements. There is, however, one point we should mention. This is that although in form the note was for optional conversion of the $204 million advance into shares in DHNZ, the surrounding contractual arrangements made that conversion effectively mandatory.

10 See above at n 8.

Explanatory documents written after execution

[39] A Project Falcon summary document prepared by Deutsche Bank post-execution confirmed how the note issue price and the net funding amount were derived and how the net funding amount was to be serviced:

> The net funding requirement is therefore the difference between the convertible note issue price and the share forward purchase price. This funding will be serviced by the convertible note interest payments. … The funding for the net amount (i.e. note subscription less prepaid forward purchase price) was provided by [Deutsche Bank Treasury] to [Deutsche Bank Structured Capital Markets] by way of a 5 yr NZD amortising loan, to be fully serviced by the note interest payments.

[40] This understanding was shared by Groupe Danone. A document prepared on 15 October 2003 concerning the DHNZ funding arrangement, under a heading "Purpose and 'débouclage' of the operation", states:

> During the 5 years, DHNZ pays coupons to Deutsche Bank. Those coupons are analyzed differently according to tax/statutory and consolidated accounts:
>
> - For statutory, coupons are considered as interest expenses deductible for tax purposes. They amount to a total of some [$66 million] … The necessary cash is provided by dividends received from Frucor.
>
> - For consolidation, coupons paid are analyzed in two separate elements 1. Reimbursement of Deutsche Bank loan for [$54 million] and 2. interest expense on this loan for the difference, i.e. [$12 million]. As this is a permanent difference, no deferred tax shall be recorded in consolidated accounts.
>
> At maturity date:
>
> - DHNZ reimburses the remaining [$150 million] loan from Deutsche Bank by delivering its 40% own shares previously bought back from [DAP]
>
> - Deutsche Bank delivers those shares to [DAP], without receiving any cash, as [$150 million] were paid in advance in 2003
>
> - [DAP] holds 100% of DHNZ shares, as it was prior to the refinancing scheme.

[41] There is one other (undated) Danone group document which is material. It includes the following section:

> **What was the point of the scheme?**
>
> The scheme allowed DHNZ to finance the purchase of [FBGL] in a way that would entitle it to tax credits for the life of the scheme.
>
> Under the arrangement DHNZ made two coupon payments to [Deutsche Bank] each year. The coupon payments were approximately $7m per payment and were funded by payment of a fully imputed dividend up from FBL [Frucor Beverages Ltd, which was amalgamated with DHNZ in 2009] to FBGL and finally to DHNZ. These coupon payments were treated differently for Management and Statutory purposes.
>
> For **Stat (and Tax)** purposes, the whole payment was treated as an interest expense. The interest payment was 100% deductible. Total payments over the life of the scheme added up to $66m, which equated to $21.8m of tax credits (approx $4.4m for each year of the scheme's life).
>
> For **Management** purposes, part of the payment was treated as an interest expense, and part was treated as repayment of the principal of the convertible note loan.
>
> …
>
> An estimated … **NZD 21.6m** was saved in taxes over the 5 years as interest expense of **NZD 65.5m** arising from the convertible bond from Deutsche Bank of **NZD 204m** can be claimed as a deduction against the income of the Frucor Group as NZ practices consolidated tax filing.

The reference to the tax that was "saved" presupposes a counterfactual in which $55 million was borrowed and deductibility was confined to interest payments on that sum.

Accounting treatment

[42] During the currency of the funding arrangement, DHNZ recorded the convertible note as "borrowings" of $204 million and the coupon payments as "interest expense". On the basis of the material we have seen and the logic of the structure of the transaction, we infer that DHNZ accounted in its statutory accounts for the disbursement of the $204 million by:

(a) debiting the inter-company loan and expensing the fee of $1.8 million and crediting cash, $144 million; and

(b) debiting share capital and crediting cash, $60 million.

[43] Although we do not have the management accounts of DHNZ and DAP, internal company documents recording the way in which the funding arrangement was to be treated were in evidence (including the document referred to at [41]).

[44] Internal DHNZ documents suggest that its management accounts differed from the statutory accounts in two significant respects. In the management accounts:

(a) the transaction was treated as involving an advance of $55 million and the interest payments under the note as payments of principal and interest on that advance; and

(b) the repurchase of the shares was reversed, by debiting a receivable from DAP and crediting capital of $60 million.

The corollary of these entries (and their logic) is that DHNZ treated DAP as having contributed a further $89 million in capital. According to the documents we have, this was to be recorded in DHNZ's management accounts with an entry recognising an $89 million "share premium".

[45] In DAP's management accounts, the $60 million repayment of capital was to be reversed (matching the corresponding reversal in DHNZ's management accounts) and the $89 million borrowed from BNP Paribas to be treated as capital contributed by DAP to DHNZ; this matching what we see as the likely corresponding entry in the DHNZ management accounts.

[46] An internal DAP accounting note recorded that at the maturity of the scheme, the $89 million was to be capitalised; this because:

> a) This is pseudo capital and should be treated as part of the investment
>
> b) It can be seen as the price that we pay to hold Frucor, indirectly though through DHNZ.
>
> …

Steps at maturity and subsequent return of capital

[47] On 20 February 2008, Deutsche Bank, in accordance with the convertible note deed, gave notice to DHNZ requiring it to satisfy its obligations to repay the principal amount outstanding by issuing shares on the maturity date. At maturity on 18 March 2008, DHNZ issued 1,025 new non-voting shares to Deutsche Bank which immediately transferred those shares to DAP pursuant to the forward purchase agreement.

[48] On 22 December 2008, DHNZ repurchased from DAP 747 non-voting shares and 307 ordinary shares thereby returning $204 million of surplus capital to DAP. This was followed in February 2009 by DAP selling all shares in DHNZ to Suntory (NZ) Ltd, a subsidiary of a Japanese beverage manufacturer and distributor.

Tax avoidance—the legal framework

[49] Section BG 1(1) of the Act is in these terms:

> **BG 1 Tax avoidance**
>
> *Avoidance arrangement void*
>
> (1) A tax avoidance arrangement is void as against the Commissioner for income tax purposes.

[50] Section OB 1 defines arrangement, tax avoidance and tax avoidance arrangement as follows:

> **arrangement** means an agreement, contract, plan, or understanding (whether enforceable or unenforceable), including all steps and transactions by which it is carried into effect
>
> …
>
> **tax avoidance** includes—
>
> (a) directly or indirectly altering the incidence of any income tax:
>
> (b) directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:
>
> (c) directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax

> **tax avoidance arrangement** means an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—
>
> (a) has tax avoidance as its purpose or effect; or
>
> (b) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the purpose or effect is not merely incidental

[51] Provisions such as s BG 1(1) are often referred to as general anti-avoidance rules (GAARs). Historically, the main problem with the application of a GAAR (such as s BG 1(1), its precursors in New Zealand and its equivalents in other jurisdictions) has been the apparent awkwardness of applying a generally expressed rule in the otherwise highly prescriptive legislative context of income tax legislation. When tax avoidance is in issue, the question of whether the GAAR, or the provision(s) relied on by the taxpayer, should prevail is not susceptible to resolution on the basis of usual interpretative techniques addressed to the meaning of a single provision.

[52] The first of the modern cases, *Challenge Corporation Ltd v Commissioner of Inland Revenue*, represents an attempt to resolve this awkwardness.[11] There, the Privy Council concluded that the effect of the GAAR (at that time, s 99 of the Income Tax Act 1976) was that the entitlement to group losses under s 191 of the 1976 Act was dependent upon the companies concerned having been associated at the time the losses were incurred, a condition which was not explicit and could also hardly be said to be implicit in s 191, at least if looked at without reference to the GAAR. Instead, this conclusion was arrived at on the basis that the taxpayer had not suffered an economic burden of the kind envisaged by Parliament as warranting the tax advantage claimed.

[53] As *Challenge* illustrates, and the approach expressly and authoritatively adopted by this Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* now recognises,[12] the GAAR applies to void tax arrangements which, but for the invocation of the GAAR, would be effective, with the reconciliation of the

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11 *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 (PC) [*Challenge* PC judgment].

12 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [107] per Tipping, McGrath and Gault JJ.

GAAR and the provision relied on by the taxpayer achieved through application of a parliamentary contemplation test. This was explained in the reasons of Tipping, McGrath and Gault JJ in *Ben Nevis*:

> [107] When, as here, a case involves reliance by the taxpayer on specific provisions, the first inquiry concerns the application of those provisions. The taxpayer must satisfy the court that the use made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer's use of the specific provision viewed in the light of the arrangement as a whole. If, when viewed in that light, it is apparent that the taxpayer has used the specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement. …
>
> …
>
> [109] … The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.

[54] In these passages, the expression "specific provision" is used in contradistinction to the GAAR, rather than as indicating a tax provision which is expressed with great particularity. Indeed, it can cover general features of the tax system, such as income tax being a tax on income, as in *Penny v Commissioner of Inland Revenue* (*Penny and Hooper*),[13] or the general right to deduct expenses incurred in generating income, as in many other cases.

[55] In applying the parliamentary contemplation test, the courts have rejected claims to tax advantages where the taxpayers have not suffered the economic burden that is the usual corollary of, and purpose for, the conferral of those advantages. This is exemplified by *Penny and Hooper*. In that case the taxpayers had transferred their businesses to companies which then paid them salaries which were distinctly lower than what they had been earning. The companies were owned by trusts which they had established. The transfers to the companies occurred at a time when the marginal tax rate on income was increasing. The surplus income (that is, after payment of the

13 *Penny v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] 1 NZLR 433.

salaries) available ultimately to the trusts continued to be at the disposal of the taxpayers. Blanchard J observed that:[14]

> … Parliament has deliberately preserved, and in fact enlarged, the New Zealand general anti-avoidance provision … It continues to have work to do whenever a taxpayer uses specific provisions of the Act and otherwise legitimate structures in a manner which cannot have been within the contemplation of Parliament. … Woodhouse P said in *Challenge Corporation Ltd v Commissioner of Inland Revenue*[15] that there must be a weapon able to thwart technically correct but contrived transactions set up as a means of exploiting the Act for tax advantages. That is what the artificially low salary settings did in this case. They reduced each taxpayer's earnings but at the same time enabled the company's earnings (derived only because of the setting of the salary levels) to be made available to him through the family trusts. In reality, the taxpayers suffered no actual loss of income but obtained a reduction in liability to tax as if they had, to adapt Lord Templeman's dictum in *Challenge*.

[56] In his reasons for the majority in *Challenge*, to which Blanchard J made reference, Lord Templeman observed:[16]

> In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax.

As is at least implicit in what Lord Templeman said, and as was made explicit by Blanchard J, the "reduction in income, loss or expenditure" in the passage above is to be assessed as one of substance rather than on the form of the arrangement under challenge. In *Penny and Hooper*, while the taxpayers had undoubtedly suffered a reduction in income in a formal sense, as Blanchard J recognised, the reason why they lost the case was because under the substance of the arrangement the "lost income" remained available to them.

[57] There is one aspect of the *Ben Nevis* two-stage approach which warrants brief comment. The "first inquiry" referred to was said to be whether the taxpayer's use "of the specific provision is within its intended scope".[17] If so, the court should move to

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14 At [47] (footnotes omitted).
15 *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 (CA).
16 *Challenge* PC judgment, above n 11, at 562.
17 *Ben Nevis,* above n 12, at [107] per Tipping, McGrath and Gault JJ.

a second inquiry as to whether the taxpayer "has used the specific provision … in a way which cannot have been within the contemplation and purpose of Parliament".[18] On a literal approach to this formulation, the result arrived at in *Ben Nevis* might seem paradoxical—the taxpayers' use of the specific provisions relied on was:

(a) within their "intended scope"; but at the same time

(b) "cannot have been within the contemplation and purpose of Parliament".

[58] *Ben Nevis* cannot sensibly be applied on the basis that a conclusion that the use of the provisions relied on was within their "intended scope" for the purposes of the first inquiry precludes resort to s BG 1(1) at the second stage of the exercise. Instead, making sense of the *Ben Nevis* approach means that in the context of tax avoidance, scheme and purpose considerations of a kind that in other contexts would be applied to the construction of a statutory provision, largely come into play at the second stage of the inquiry. On this basis, the first inquiry can be dealt with on a largely textual basis. If, on the wording of the provisions relied on, an arrangement appears to warrant the tax position adopted, the court can move to the second inquiry. When tax avoidance is in issue, it is the second inquiry that is of paramount importance.

The High Court and Court of Appeal judgments as to the application of s BG 1

The High Court judgment

[59] The High Court Judge found in favour of Frucor Suntory. We outline what we see as the key elements of his reasoning.

[60] He saw the purposes of the funding arrangement as being:

(a) To put in place what was seen within the Danone group as a more appropriate debt/equity ratio for DHNZ from approximately 50:50 to approximately 63:37.[19]

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18 At [107].

19 HC judgment, above n 5, at [36(g)], [165]–[166] and [198].

(b) To do so in a way which avoided the adverse tax consequences for other Danone companies associated with the implementation of what he described as "alternative structures".[20]

[61] He summarised the alternative structures at [141(j)] as including:

> (i) [DHNZ] borrowing an additional $60 million under the Cash Management Agreement [with Danone Finance] to achieve its desired debt/equity rebalancing.
>
> (ii) DAP (or Danone Finance) lending $204 million to [DHNZ] for five years at 6.5 per cent either by way of interest-bearing debt or convertible note.
>
> (iii) [DHNZ] issuing a convertible note to [Deutsche Bank] on the same terms but without the Forward Purchase between [Deutsche Bank] and DAP and [Deutsche Bank] funding the $149 million Forward Purchase amount internally or from another bank or third party or by a loan from DAP or Danone Finance or by a sub-participation by a third party or Danone entity.

[62] He then went on to say:[21]

> … I accept that in respect of each of alternatives (i) and (ii) (and likewise (iii) with funding or sub-participation by a Danone entity) these alternative arrangements would have given rise to assessable interest in the hands of the relevant offshore Danone entity. By contrast, the distinguishing feature of the transaction entered into was that, although the same level of deduction was available in New Zealand, the Forward Purchase provisions negated foreign-assessable income.

On the basis that the avoidance of foreign tax is not tax avoidance for the purposes of s BG 1(1), the corollary of these findings was that Frucor Suntory's challenge to the assessments succeeded.

[63] As will be apparent, it follows that the High Court judgment rests in part on the factual finding that the purpose of the scheme was to adjust the debt/equity ratio of DHNZ and do so in a way which was efficient in respect of liability to foreign tax. This was in relation both to DAP not being liable to tax in Singapore for the $55 million apparent gain under the forward purchase agreement and what he saw as

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20 At [141(j)]–[141(l)], [165]–[166], [198] and [203].
21 At [141(l)].

an advantage to Danone Finance in not having to pay tax on interest receipts from DHNZ.[22]

[64] In the course of his judgment, the High Court Judge made other findings or observations, some of which we should mention:

(a) He concluded that it was not appropriate to examine the funding arrangement in terms of "overall impact at a group or consolidated level looking at the net external position of entities under common control".[23] Such an approach would be to subvert what he described as the "separate entity principle",[24] which required separate recognition of the roles of different companies within a single group.

(b) He considered that the funding arrangement involved real money flows[25] and, to the extent that there was circularity, it was not material, as real liability was affected and there was real change to DHNZ's funding structure.[26]

(c) He accepted that "the very particular sum of the [n]ote" (which as noted in [33] was $204,421,565) was unusual and was a "strong indicator that the company's medium term corporate financing requirements did not drive its face value".[27] But he did not regard this or the fact that the note lacked the usual characteristics of a note typically issued when "new 'debt'" is raised as "a significant indicator of avoidance".[28] He described as "compelling" the argument that the financial arrangement rules and the Commissioner's determinations applicable to notes did not draw distinctions between the issue of shares to a company's parent (directly or, as in this case, indirectly) or third parties.[29]

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22 At [165]–[166].
23 At [133].
24 At [122].
25 At [141(a)].
26 At [163].
27 At [141(c)].
28 At [141(f)].
29 At [183].

The Court of Appeal judgment

[65] The Court of Appeal saw the case very differently:[30]

> [82] It seems to us to be reasonably plain that the funding arrangement had New Zealand tax avoidance as one of its purposes or effects and this was not merely incidental to some other purpose. The primary purpose of the funding arrangement was the provision of tax efficient funding to [DHNZ]. That was its stated goal. The tax advantage was gained in New Zealand through the interest deductions [DHNZ] claimed. DAP (in effect) paid $149 million to [DHNZ] for the shares on day one but with the payment being structured to enable [DHNZ] to claim interest deductions on it over a five-year term. This tax beneficial outcome was achieved by calculating the amount that needed to be added to the $149 million to enable interest payments on that grossed-up sum over five years to match the amount required to repay over the same period the amount of the gross-up plus interest (the funds introduced by Deutsche Bank). [DHNZ] was thereby able to repay the $55 million advanced by Deutsche Bank plus interest over the five-year term of $11 million but claim the entire $66 million as an interest deduction.
>
> [83] DAP's subscription for equity was effectively repackaged as a loan from Deutsche Bank to achieve the intended tax benefits for [DHNZ]. DAP's equity subscription was bundled with an amortising loan from Deutsche Bank in an artificial and contrived manner to enable [DHNZ] to claim interest deductions on the loan which were, in substance, repayments of principal and interest payable to Deutsche Bank in respect of the funds it introduced to facilitate the arrangement.
>
> [84] ... We agree that avoiding offshore tax was an important consideration. The funding arrangement gave rise to the prospect of generating an unwelcome offshore taxable gain because of the notional increase in the value of the non-voting shares over the five-year period from $149 million to $204,421,565 (or whatever other figure happened to be generated by the formula at the date of closing). This potential problem needed to be managed for the funding arrangement to succeed. However, we view the need to avoid capital gains tax on the notional share value growth as a condition precedent to the intended funding arrangement rather than being its object. The condition was always understood to be readily satisfied simply by choosing a Danone entity resident for tax purposes in a jurisdiction that would not impose capital gains tax on the inferred uplift in the value of the shares represented by the difference between the forward purchase amount and the face value of the convertible note. Thus, this condition had to be ticked off before the funding arrangement could proceed but that was never going to be a problem. This consideration does not detract from our assessment that a more than incidental purpose and effect of the funding arrangement was to engineer tax deductions for interest expenses claimable by [DHNZ] in New Zealand of sufficient magnitude to repay Deut[s]che Bank. That purpose was not to come at the expense of creating tax problems elsewhere.
>
> [85] We consider the funding arrangement fits within the Supreme Court's formulation in *Ben Nevis* as one enabling the taxpayer to gain the benefit of the specific provision in an artificial and contrived way. In our view, this

[30] CA judgment, above n 6.

> transaction was in many respects artificial and it was clearly contrived for the very purpose of enabling [DHNZ] to gain the benefit of the specific provision allowing interest deductions. The artificial and contrived features of the funding arrangement are not seriously in dispute and most were accepted by the Judge. Taken together, they reveal that the purpose of the arrangement was to dress up a subscription for equity as an interest only loan to achieve a tax advantage. It is hard to discern any rational commercial explanation for the artificial and contrived features of the arrangement, other than tax avoidance.
>
> …
>
> [90] As a matter of commercial and economic reality, the payment of $149 million made by DAP did not carry any liability for [DHNZ] (or Deutsche Bank) to pay interest. The only amount that did attract interest was the $55,421,565 independently advanced by Deutsche Bank.

[66] The Court rejected the challenge by Frucor Suntory to the Commissioner's reconstruction:[31]

> [103] Section GB 1 does not require the Commissioner to consider other arrangements the taxpayer might have entered into had it not chosen to proceed with the tax avoidance arrangement under review. Further, the tax advantage with which the section is concerned is the New Zealand tax advantage achieved by the New Zealand taxpayer — [DHNZ]. While DAP is a party to the funding arrangement, its funding costs and tax position are irrelevant to the analysis that must be conducted under s GB 1.
>
> [104] We have already concluded that the principal driver of the funding arrangement was the availability of tax relief to [DHNZ] in New Zealand through deductions it would claim on the coupon payments. The benefit it obtained under the arrangement was the ability to claim payments totalling $66 million as a fully deductible expense when, as a matter of commercial and economic reality, only $11 million of this sum comprised interest and the balance of $55 million represented the repayment of principal. The tax advantage gained under the arrangement was therefore not the whole of the interest deductions, only those that were effectively principal repayments. We consider the Commissioner was entitled to reconstruct by allowing the base level deductions totalling $11 million but disallowing the balance. The tax benefit [DHNZ] obtained "from or under" the arrangement comprised the deductions claimed for interest on the balance of $149 million which, as a matter of commercial reality, represented the repayment of principal of $55 million.

[67] The Court also rejected the Commissioner's cross-appeal on shortfall penalties. It concluded that DHNZ had not taken an unacceptable tax position.[32] The Court was "not persuaded that [DHNZ's] arguments could be dismissed as lacking in substantial

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31 Footnote omitted.

32 At [107].

merit".[33] This was primarily on the basis that these arguments were accepted as correct by the High Court Judge.

The application of s BG 1(1) to the funding arrangement: our assessment

[68] For the purposes of stage one of the *Ben Nevis* framework, we accept that the funding arrangement and its various components were not shams and that, subject to the effect of s BG 1(1), DHNZ was entitled to deduct the $66 million it paid to Deutsche Bank as interest. In issue is whether such deductibility is consistent with s BG 1(1).

[69] Under s DB 7(1), a deduction is allowed for "interest incurred". "Interest" is relevantly defined in s OB 1 in this way:

> (a) for a person's income,—
>
> > (i) means a payment made to the person by another person for money lent to any person, whether or not the payment is periodical and however it is described or computed; and
> >
> > (ii) does not include a redemption payment; and
> >
> > (iii) does not include a repayment of money lent:
>
> …
>
> (d) in [section] … DB 7 …—
>
> > (i) includes expenditure incurred under the financial arrangements rules or the old financial arrangements rules …

The word "incurred" in s DB 7(1), along with the exclusion of "repayment of money lent" in s OB 1(a)(iii) and the repetition of the word "incurred" in s OB 1(d)(i), give a good indication of the kinds of interest cost for which deductibility is provided.

[70] Subpart EW of the Act (in which the financial arrangement rules are found) contemplates both repayment of debt by the issue of shares and advance subscription for shares (payment now for shares to be issued in the future) and, as well, provides for tax treatment where the payment is less than the assumed or agreed future value of the shares. The application to the note of these rules, in conjunction with

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33 At [107].

Determination G22,[34] involves no substantive complexity; this because their effect, on the arrangement as implemented, was that the amount advanced under the note was treated as debt until conversion and the coupon payments were treated as interest.

[71] In *Accent Management Ltd v Commissioner of Inland Revenue*, the decision of the Court of Appeal upheld in *Ben Nevis*, the Court commented:[35]

> Given the generality of cases to which specific tax rules necessarily apply, it would be unrealistic to confine the application of general anti-avoidance provisions to transactions which lie outside of a discernible specific legislative purpose. When construing such specific rules and looking for their scheme and purpose, it is necessary to keep general anti-avoidance provisions steadily in mind. On this basis, it will usually be safe to infer that specific tax rules as to deductibility are premised on the assumption that they should only be invoked in relation to the incurring of real economic consequences of the type contemplated by the legislature when the rules were enacted.

[72] There is nothing in the relevant deductibility provisions (just referred to at [69]) to suggest a parliamentary contemplation that deductibility should extend to what in substance are repayments of principal and which, in economic effect, are not "interest incurred" or "expenditure incurred". Nor is there any indication of legislative indifference to tax avoidance. Indeed, it would be strange to attribute to Parliament a purpose of allowing deductibility for payments that in substance are repayments of principal and able to categorised as "interest" only through the mechanism of artificial and contrived arrangements. No post-*Challeng*e case was cited to us in which a court has upheld the deductibility of a cost incurred in legal form but, in the opinion of the court, not in economic substance, where the arrangement giving rise to the cost was artificial and contrived.

[73] As we have explained, the High Court judgment in the present case was premised on two findings of fact: first, that the primary purpose of the funding arrangement was to put in place what was seen within the Danone group as a more appropriate debt/equity ratio for DHNZ from approximately 50:50 to approximately

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34 Te Tari Taake | Inland Revenue "Determination G22: Optional Conversion Convertible Notes Denominated in New Zealand Dollars Convertible at the Option of the Holder" (24 October 1990) <www.taxtechnical.ird.govt.nz>. Determination G22 has been replaced by Determination G22A: Te Tari Taake | Inland Revenue "Determination G22A: Optional Convertible Notes Denominated in New Zealand Dollars" (26 September 2006) <www.taxpolicy.ird.govt.nz>.

35 *Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230, (2007) 23 NZTC 21,323 (CA) [*Accent Management* CA judgment] at [126].

63:37; and, secondly, that there was a related purpose to do so in a way which did not attract unwelcome foreign tax in Singapore and relieved Danone Finance of a liability to tax on interest payments from DHNZ. The Judge's conclusion that s BG 1(1) was not engaged flowed from those findings of fact.

[74] In company with the Court of Appeal, we see the facts very differently.

[75] Despite the apparent complexity of the funding arrangement as a whole, its economic substance was straightforward. Netting off the transactions which occurred when the funding arrangement came into effect, in the manner in which we infer, they were separately treated by DHNZ and DAP in their management accounts. There were two primary effects:

(a) DHNZ's relevant debt was reduced from the $144 million owed to Danone Finance to the $55 million owed to Deutsche Bank; and

(b) DAP's "investment" in DHNZ increased by $89 million (corresponding to the money it borrowed from BNP Paribas).

[76] In economic substance, Deutsche Bank advanced $55 million to DHNZ which was fully repaid on an amortising principal and interest basis over the term of the note. There was never any alteration of substance in relation to the ownership by DAP of DHNZ. DAP started off owning 100 per cent. And as was always intended, it wound up owning 100 per cent. The net effect of everything that happened was that the advance of $55 million was repaid on a basis that ostensibly permitted DHNZ to deduct all payments made, including repayments of principal. This was undoubtedly the effect of the arrangement in terms of s BG 1(1). And because the arrangement had been structured so as to produce this effect, and there was no plausible commercial reason other than tax avoidance for so structuring the arrangement, this effect was distinctly more than incidental.

[77] It follows that, contrary to the finding of fact in the High Court, the purpose of the arrangement was not to alter, by increasing, the debt/equity ratio of DHNZ. In substance its effect and purpose was quite the reverse. DHNZ's relevant indebtedness

decreased from $144 million to $55 million and the capital investment of DAP in DHNZ increased by $89 million (representing the money it borrowed from BNP Paribas). As well:

(a) While it is correct, as the Court of Appeal pointed out, that it was essential to the scheme that DAP not be liable to tax in Singapore on the notional gain in the new shares which it took when the funding arrangement was unwound, it is unrealistic to treat the avoidance of tax on that gain as a purpose of the arrangement. The "gain" was itself entirely contrived; being in effect the other side of the coin to the $55 million in principal that DHNZ expensed against its New Zealand income.

(b) Income (in the form of interest payments from DHNZ) foregone by Danone Finance once the advance was repaid (and any consequential tax consequences) would presumably have been matched either by a reduction in Danone Finance's cost of funding or by income derived from the redeployment of the money represented by the repayment of the $144 million it was owed. There is no indication in any of the planning documents that the tax position of Danone Finance was a material consideration.

[78] None of the counterfactuals accepted in the High Court or advanced to us are true comparators for the actual arrangement entered into, under which DAP injected into DHNZ (through Deutsche Bank) sufficient funds (being the money it borrowed from BNP Paribas) to enable DHNZ to retire $89 million of debt owing to Danone Finance, and DHNZ borrowed $55 million to discharge the balance of the liability to Danone Finance. On any counterfactual which replicated these essential features of the funding arrangement, DHNZ would not be able to offset its repayments of the $55 million against its revenue.

[79] Contrary to the view of the High Court Judge and the arguments of Frucor Suntory, this approach does not involve inappropriately conflating DHNZ and DAP:

(a) We accept that New Zealand companies in overseas ownership are generally taxed on a standalone basis (that is, in accordance with what the High Court Judge called the "separate entity principle"). This principle is most evident in the context of the application of what can be described as the "black letter" provisions of the Act. But when it comes to avoidance and the stage-two *Ben Nevis* exercise, there can be no sensible objection to looking at a transaction, which is a component of a wider arrangement, in the round, that is, in the context of that wider arrangement.[36] Indeed, that is exactly what happened in *Ben Nevis*, in which offshore components of the overall transaction were taken into account.

(b) In any event, the conclusion we have reached reflects DHNZ's assessment of its standalone position. The management accounts of DHNZ and DAP, as described in the documents to which we have referred, show that those responsible for the management accounts of both companies recognised that the substance of what happened in respect of each of those companies, considered separately, is exactly as we have described it.

[80] The picture which emerges from the planning documents which we have reviewed is clear. The whole purpose of the arrangement was to secure tax benefits in New Zealand. References to tax efficiency in those planning documents are entirely focused on the advantage to DHNZ of being able to offset repayments of principal against its revenue. The anticipated financial benefits of this are calculated solely by reference to New Zealand tax rates. The only relevance of the absence of a capital

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[36] This is consistent with the approach taken in *Alesco New Zealand Ltd v Commissioner of Inland Revenue* [2013] NZCA 40, [2013] 2 NZLR 175 at [31]. See also Craig Elliffe "Discerning Commercial and Economic Reality: Applying the GAAR to *Frucor*" (2021) 27 NZJTLP 223 at 235–236.

gains liability in Singapore was that this tax efficiency would not be cancelled out by capital gains on the contrived "gain" of DAP under the forward purchase agreement.

[81] There were many elements of artificiality about the funding arrangement. Of these, the most significant is in relation to the note itself.

[82] Orthodox convertible notes offer the investor the opportunity to receive both interest and the benefit of any increases in the value of the shares over the term of the note. For this reason, the issuer of a convertible note can expect to receive finance at a rate lower than would be the case for an orthodox loan.

[83] The purpose of the convertible note issued by DHNZ was not to enable it to receive finance from an outside investor willing to lend at a lower rate because of the opportunity to take advantage of an increase in the value of the shares. The shares were to wind up with DAP which already had complete ownership of DHNZ. As well, Deutsche Bank had no interest in acquiring shares in DHNZ. Instead, it had structured a transaction that generated tax benefits for DHNZ in return for a fee. Leaving aside the purpose of obtaining tax advantages in New Zealand, the convertible note structure that was adopted had no point.

[84] The other elements of artificiality discussed in the High Court and Court of Appeal judgments are functions of this fundamental artificiality. The most significant of these elements is the way in which the value was attributed to various components of the funding arrangement. As we have explained at [29]–[30], as initially proposed, the starting point for attribution of value was to be the face value of the note calculated by reference to the maximum amount that DHNZ could borrow and still meet the thin capitalisation rules, with the values attributed to the other components (the amount paid under the forward purchase agreement and net contribution from Deutsche Bank) to be worked out backwards from this figure. As it happened, the eventual starting point was the amount paid under the forward purchase agreement. Again, the other figures were then worked out by reference to this different starting point and the applicable interest rate.

[85] As is often the case with tax avoidance, there were substantial elements of contrivance, circularity and cancellation. The artificial features of the funding arrangement to which we have just referred are all indications of contrivance. As between DAP, DHNZ and Deutsche Bank, there was complete circularity as to $60 million of the $149 million paid under the forward purchase agreement.[37] As well, if DHNZ and DAP are treated as a group, there was, in economic substance, complete circularity in relation to the $149 million. As to cancellation, the effect of the forward purchase was to cancel the note save as to the liability for $55 million which was to be discharged by DHNZ in the guise of interest payments on an advance of $204 million. There was also further cancellation in relation to $60 million paid by DHNZ back to DAP as a return of capital; this because it was immediately reversed in the management accounts of both companies, leaving DAP "owing" DHNZ $60 million as unpaid capital.

[86] Against this background, the effect of the arrangement was that DHNZ sought to obtain deductions in relation to $55 million in principal repayments. These are provided for in the Act to meet financing expenses and not repayments of principal. DHNZ was thus claiming deductions for expenses which, in economic substance, it had not incurred. This use of the relevant deduction provisions of the Act lay outside of parliamentary contemplation as to the use of those provisions. It was therefore tax avoidance and the Commissioner was entitled to void the arrangement under s BG 1(1).

[87] There is one final consideration we should mention. In these proceedings the onus of proof was on Frucor Suntory. In other words, it was for Frucor Suntory to show that the funding arrangement did not fall foul of s BG 1. But the only witness called by Frucor Suntory was a Danone group employee who provided linking evidence in relation to documents which he produced but who had not participated in the design and implementation of the funding arrangement. And, as the Court of Appeal noted,[38] very few documents which originated within the Danone group were produced. There was nothing from those involved in the funding

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37 This treats the payment of $149 million by DAP to Deutsche Bank as funded by the $60 million it received from DHNZ and the $89 million it borrowed from BNP Paribas, a treatment which follows the flow of money.

38 CA judgment, above n 6, at [74].

arrangement on the Danone group side and nothing apparent on the face of the contemporaneous documents which offered any explanation for the funding arrangement other than tax avoidance. This is perhaps not surprising given the tenor of the planning and post-March 2003 documents—a tenor that is not susceptible to being easily explained away. That said, an assertion that the funding arrangement was not predicated on tax avoidance could only be credible if it was based on contemporaneous Danone group documentation or evidence from someone involved in the transaction as to a commercial context or effect other than tax avoidance. In the absence of such evidence, the view taken by the Court of Appeal might be thought to have been inevitable.

Reconstruction

[88] Section BG 1(2) provides:

> *Reconstruction*
>
> (2) Under Part G (Avoidance and non-market transactions), the Commissioner may counteract a tax advantage that a person has obtained from or under a tax avoidance arrangement.

[89] Section GB 1(1) provides:

> **GB 1 Agreements purporting to alter incidence of tax to be void**
>
> (1) Where an arrangement is void in accordance with section BG 1, the amounts of assessable income, deductions, and available net losses included in calculating the taxable income of any person affected by that arrangement may be adjusted by the Commissioner in the manner the Commissioner thinks appropriate, so as to counteract any tax advantage obtained by that person from or under that arrangement, and, without limiting the generality of this subsection, the Commissioner may have regard to—
>
> (a) such amounts of assessable income, deductions, and available net losses as, in the Commissioner's opinion, that person would have, or might be expected to have, or would in all likelihood have, had if that arrangement had not been made or entered into; …
>
> …

[90] These sections confer broad powers of reconstruction. Where tax avoidance has been established a taxpayer challenging the Commissioner's reconstruction faces some hurdles, as explained in *Ben Nevis*:[39]

> [171] Furthermore, when taxpayers challenge an assessment based on a reconstruction adopted by the Commissioner, the onus is on them to demonstrate, not only that the reconstruction was wrong, but also by how much it was wrong. Unless the taxpayer can demonstrate with reasonable clarity what the correct reconstruction ought to be, the Commissioner's assessment based on his reconstruction must stand. This is settled law. …

[91] Frucor Suntory's challenge to the reconstruction is largely based on counterfactuals. The underlying argument was that DHNZ could have funded the purchase of FBGL and later the refinancing in ways that would have resulted in similar or perhaps greater deductible interest.

[92] As will be apparent, s GB 1(1) provides for, although it does not mandate, counterfactual analysis along the lines of what the tax position would have been had the arrangement not been entered into. Importantly, the generality of the power to adjust is expressly not limited by s GB 1(1)(a). This is made explicit by the phrase "without limiting the generality of this subsection" which precedes s GB 1(1)(a).

[93] We accept that in some circumstances counterfactual analysis may provide the most appropriate basis for challenging reconstruction. But, in this case:

(a) For present purposes, what is critical is that, in economic substance, DHNZ borrowed $55 million from Deutsche Bank which it repaid along with interest. The tax advantage was the deductibility of its principal repayments. The Commissioner was entitled to cancel that tax advantage, which is what she has done.

(b) In any event, none of the counterfactuals proffered by Frucor Suntory replicate the substance of what we have found to be the transaction: repayment of what was owed to Danone Finance by (a) a capital

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39 Footnote omitted.

injection by DAP into DHNZ of $89 million and (b) an advance from Deutsche Bank to DHNZ of $55 million.

Shortfall penalties

The legislative scheme

[94] Section 139 of the Tax Administration Act provides:

> **139 Purposes of this Part**
>
> The purposes of this Part are—
>
> (a) to encourage taxpayers to comply voluntarily with their tax obligations and to co-operate with the department; and
>
> (b) to ensure that penalties for breaches of tax obligations are imposed impartially and consistently; and
>
> (c) to sanction non-compliance with tax obligations effectively and at a level that is proportionate to the seriousness of the breach.

[95] Part 9 of the Tax Administration Act provides for penalties for a wide-range of conduct such as late filing of returns and late payment of tax. It addresses in particular:

(a) failure to take reasonable care in adopting a tax position (for which a penalty of 20 per cent of the tax shortfall may be imposed under s 141A);

(b) taking an unacceptable tax position (for which a penalty of 20 per cent of the tax shortfall may be imposed under s 141B);

(c) gross carelessness in taking a tax position (for which a penalty of 40 per cent of the tax shortfall may be imposed under s 141C);

(d) taking an abusive tax position (for which a penalty of 100 per cent of the tax shortfall may be imposed under s 141D); and

(e) evasion or a similar act (for which a penalty of 150 per cent of the tax shortfall may be imposed under s 141E).

[96] In issue in this case is the application of ss 141B (unacceptable tax position) and 141D (abusive tax position).

[97] Section 141B(1) of the Tax Administration Act provides that a "taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct". Whether a position meets the "about as likely as not to be correct" standard is determined at the time it was taken.[40] The matters which must be considered include:[41]

> (a) the actual or potential application to the tax position of all the tax laws that are relevant (including specific or general anti-avoidance provisions); and
>
> (b) decisions of a court or a Taxation Review Authority on the interpretation of tax laws that are relevant (unless the decision was issued up to 1 month before the taxpayer takes the taxpayer's tax position).

[98] Section 141D relevantly provides:

> (1) The purpose of this section is to penalise those taxpayers who, having taken an unacceptable tax position, have entered into or acted in respect of arrangements or interpreted or applied tax laws with a dominant purpose of taking, or of supporting the taking of, tax positions that reduce or remove tax liabilities or give tax benefits.
>
> …
>
> (4) This section applies to a taxpayer if the taxpayer has taken an unacceptable tax position.
>
> …
>
> (6) A taxpayer's tax position may be an abusive tax position if the tax position is an incorrect tax position under, or as a result of, either or both of—
>
> > (a) a general tax law; or
> >
> > (b) a specific or general anti-avoidance tax law.
>
> (7) For the purposes of this Part … an **abusive tax position** means a tax position that,—
>
> > (a) is an unacceptable tax position at the time at which the tax position is taken; and

40 Section 141B(5).
41 Section 141B(7).

(b) viewed objectively, the taxpayer takes—

(i) in respect, or as a consequence, of an arrangement that is entered into with a dominant purpose of avoiding tax, whether directly or indirectly; or

(ii) where the tax position does not relate to an arrangement described in subparagraph (i), with a dominant purpose of avoiding tax, whether directly or indirectly.

[99] There are two aspects of these provisions which warrant brief comment.

[100] In *Ben Nevis*, a majority in the Supreme Court commented on the s 141B test:[42]

> [184] On its terms this standard does not require that the appellants' tax position had a 50 per cent prospect of success but, subject to that qualification, the merits of the arguments supporting the taxpayer's interpretation must be substantial. The stipulation of an objective test means that the taxpayer's belief that the position taken was correct, or not unacceptable, is irrelevant.

This passage has sometimes been construed as substituting for the statutory language a test of substantiality.[43]

[101] We agree that a mathematical assessment is not appropriate but do not regard substituting "substantiality" for the statutory language as particularly helpful. "[A]bout as likely as not" is an ordinary, perhaps slightly colloquial, English expression with its own nuances of meaning—nuances not necessarily fully captured by the language of substantiality. Indeed, we doubt whether such a substitution was intended in the passage just cited. As we will indicate, when applying s 141B in *Ben Nevis*, this Court reverted to the statutory language.[44]

[102] Turning now to s 141D, this Court in *Ben Nevis* rejected an argument for the taxpayers "that the statute required an objective assessment of each [taxpayer's] dominant purpose in entering the arrangement".[45] In doing so the Court explained that:

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42 *Ben Nevis*, above n 12, per Tipping, McGrath and Gault JJ.

43 See, for example, *ASB Bank Ltd v Commissioner of Inland Revenue* [2014] NZHC 2184, (2014) 26 NZTC ¶21-098 at [13].

44 *Ben Nevis*, above n 12, at [203] per Tipping, McGrath and Gault JJ.

45 At [206].

> [206] … The proposition that the concept relates to the taxpayer's mind may on first impression appear arguable, but we are satisfied that there are allied provisions within the section which make it untenable. Our conclusion is that s 141D(7)(b)(i) refers to a tax position that is taken by a taxpayer by means of an *arrangement* which has a dominant purpose of avoiding tax.
>
> [207] The qualification in s 141D(7)(b), "[v]iewed objectively", substantially answers the [taxpayers'] argument. It directs attention to features of the arrangement rather than intentions of a taxpayer in taking a tax position linked to the arrangement. Subparagraph (ii) of s 141D(7)(b) reinforces this interpretation in its reference to "an *arrangement* described in subparagraph (i), *with a dominant purpose*" (emphasis added). This makes it clear that it is the purpose of the arrangement itself, not the purpose in the mind of the taxpayer, that is referred to in s 141D(7)(b)(i). This aspect of the definition of an "abusive tax position" is concerned with the means employed rather than intentions of taxpayers in taking a tax position. The section requires that the arrangement itself be examined to ascertain its dominant purpose from its terms, irrespective of what may be known or inferred concerning the motives of individual investors.

This approach was criticised by Shelley Griffiths in a 2013 article, "An 'abusive tax position'".[46] She argued that in the context of s 141D, "purpose" should be taken to refer to an objective assessment of the taxpayer's state of mind.

[103] In most situations, taxpayer purpose, objectively assessed, is likely to coincide with the purpose of the arrangement. Indeed, this is the situation in this case. However, it is possible to conceive of situations where this may not be so. For instance, it sometimes happens that the taxpayer was not privy to all the relevant features of the tax avoidance arrangement. *Peterson v Commissioner of Inland Revenue*[47] provides one example of this and *Commissioner of Inland Revenue v BNZ Finance Ltd* provides another.[48]

[104] There having been no challenge in argument to "the purpose of the arrangement" approach adopted in *Ben Nevis* and the outcome of this case not turning on the issue, there is no need for us to discuss it further.

[105] The penalty for taking an unacceptable tax position is only 20 per cent of the tax shortfall. Where the tax position is abusive, the penalty is increased to 100 per cent. We see this as indicative of a clear legislative purpose of discouraging

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[46] Shelley Griffiths "An 'abusive tax position'" [2013] NZLJ 392.

[47] *Peterson v Commissioner of Inland Revenue* [2005] UKPC 5, [2006] 3 NZLR 433.

[48] *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 (CA).

taxpayer arrangements that have the dominant purpose of avoiding tax.[49] Taxpayers who wish to enter into such arrangements are therefore well-advised to tread carefully.

[106] The tax positions in issue were taken when the relevant returns were filed in July 2006 and December 2007. In these returns, DHNZ adopted the position that it was entitled to deduct all coupon payments made to Deutsche Bank under the convertible note. Implicit in these tax positions was the proposition that s BG 1(1) was not engaged.

[107] On the basis just outlined, the two issues that we must now deal with are:

(a) As to "unacceptable tax position" under s 141B(1), when the relevant tax returns were filed (July 2006 and December 2007), did the proposition that s BG 1(1) was not engaged meet the "about as likely as not to be correct" standard?

(b) As to whether the tax positions were abusive under s 141D, was the dominant purpose of the arrangement to avoid tax?

The approaches of the High Court and Court of Appeal

[108] Despite rejecting the Commissioner's case as to the application of s BG 1(1), the High Court Judge said that if he was "wrong in [his] principal conclusions" he "would have set aside the shortfall penalties" imposed by the Commissioner.[50]

[109] The Judge considered that the "most authoritative statement on the relationship between [the] avoidance provisions and other aspects of the Act" at the relevant time (that being between July 2006 and December 2007) was the judgment of the Privy Council in *Commissioner of Inland Revenue v Auckland Harbour Board*.[51] We

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[49] *Ben Nevis*, above n 12, at [178] per Tipping, McGrath and Gault JJ.
[50] HC judgment, above n 5, at [222].
[51] At [219], referring to *Commissioner of Inland Revenue v Auckland Harbour Board* [2001] UKPC 1, [2001] 3 NZLR 289.

will revert shortly to the passage from that judgment which he cited. He recorded that the Commissioner had argued that in the 2007 income tax year:[52]

> … the Court of Appeal in *Accent Management*[53] … confirmed deductibility provisions "should only be invoked in relation to the incurring of real economic consequences of the type contemplated by the legislature when the rules were enacted".

Recognising that similar observations had been made in earlier judgments, he finished in this way:[54]

> [221] But the inquiry is not with whether the taxpayer has *correctly* invoked the deductibility provisions. It is whether there is substantial merit in its arguments — that is whether they would be seriously considered by a court. [DHNZ] paid interest to [Deutsche Bank] and claimed a deduction for it. Focusing on the "commercial and juristic character of the transaction", there was a strong argument in the taxpayer's favour. For the reasons previously outlined, I also consider [DHNZ] was always credibly in a position to challenge the relevance of the economic analysis on which the Commissioner relied. I therefore consider that [DHNZ] did not take an unacceptable tax position. It is unnecessary in that context to consider whether the arrangement was abusive.

[110] As the Court of Appeal found that s BG 1 applied, it was required to address the shortfall penalties issue, which it did in this way:[55]

> As the Supreme Court made clear in *Ben Nevis*, the inclusion of the word "about" in the test shows that a 50 per cent prospect of success is not the standard. Rather, the question is whether the merits of the arguments supporting the taxpayer's interpretation are substantial. While we have come to a different conclusion from the High Court on the core tax avoidance issue, we are not persuaded that [Frucor Suntory's] arguments could be dismissed as lacking in substantial merit. Muir J, an experienced commercial Judge, not only regarded [Frucor Suntory's] argument as deserving of serious consideration, he explained in a careful, closely reasoned and comprehensive judgment why he was persuaded it was both factually and legally correct.

[111] As we will explain later, we see the application of the "about as likely as not to be correct" standard in this case at least as requiring a focus on the legal soundness (or otherwise) of the tax positions adopted. The starting point for our assessment must therefore be the facts as we have found them to be. If, on those facts, the tax positions adopted by DHNZ satisfy the standard of being "about as likely as not to be correct",

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52 At [220] (footnote omitted).
53 *Accent Management* CA judgment, above n 35.
54 Footnote omitted.
55 CA judgment, above n 6, at [107] (footnote omitted).

there can be no liability to shortfall penalties. If they did not, then shortfall penalties will be applied.

[112] We consider that the approaches of the High Court Judge and the Court of Appeal to shortfall penalties were erroneous. Muir J approached this aspect of the case on the basis of the factual findings that underpinned his conclusions as to the non-applicability of s BG 1(1)—factual findings that we consider to be wrong. And, the Court of Appeal did not seek to apply the "as likely as not to be correct standard" to the facts as it found them to be. Instead, it allowed its conclusion to be controlled by the result arrived at by Muir J as to s BG 1(1) despite it being based on factual findings which the Court of Appeal did not accept.

Frucor Suntory's argument on the application of the "about as likely as not to be correct" standard

[113] Frucor Suntory's argument was that on the approach taken in *Ben Nevis*, the tax positions adopted were not "unacceptable" and that, in any event, it would be inappropriate to judge tax positions adopted in 2006 and 2007 by reference to *Ben Nevis* which was decided in late 2008. The latter proposition necessitates a brief review of some of the cases referred to in the course of argument: *Challenge*,[56] *Auckland Harbour Board*,[57] *Peterson*,[58] *Accent Management*[59] and *Ben Nevis*.[60]

[114] Frucor Suntory also relied on the Commissioner having issued Frucor Suntory with assessments premised on theories that were in the alternative to the Commissioner's contention that the amount borrowed by DHNZ was in substance only $55 million—being the contention on which the Commissioner has relied in the litigation. On one of the alternative assessments, DHNZ would have been entitled to deduct all $66 million of its payments to Deutsche Bank but would have been exposed to a liability of $55 million for non-resident withholding tax. The alternative assessments were withdrawn by the Commissioner on 1 March 2017. These

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56 *Challenge*, above n 11.
57 *Auckland Harbour Board*, above n 51.
58 *Peterson*, above n 47.
59 *Accent Management* CA judgment, above n 35; and *Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC) [*Accent Management* HC judgment].
60 *Ben Nevis*, above n 12.

assessments were said by counsel for Frucor Suntory to show the strength of the case for deductibility of all $66 million paid to Deutsche Bank.

The relevant authorities

[115] We have already set out the passage in *Challenge* in which Lord Templeman explained tax avoidance in terms of seeking:[61]

> … to obtain a tax advantage without suffering that reduction in income, loss or expenditure which … Parliament intended to be suffered by any taxpayer qualifying for a reduction in … liability to tax.

We will refer to this as the "not suffering the economic burden" approach to recognising tax avoidance.

[116] The next of the relevant cases is *Auckland Harbour Board*.[62] In December 1988, the Harbour Board transferred substantial stock to two trusts which it had established. This was on the eve of its abolition and the purpose was to permit the continuation of certain activities after its abolition. The transfers were by way of gift. The application of the accrual rules in the Income Tax Act 1976 resulted in a "negative base price adjustment" of $8.6 million which, subject to the application of s 64J of that Act, the Board was entitled to deduct.[63] Section 64J(1) enabled a reconstruction by the Commissioner of a transaction if "satisfied that the parties [to it] were dealing with each other … in a manner that has the effect of defeating the intent and application of" the accrual rules.

[117] The Commissioner's argument was that the accrual rules did not contemplate a base price adjustment for transfers of financial arrangements for no consideration. Awkwardly for the Commissioner, the transaction was not an orthodox tax avoidance arrangement; this because its economic substance was entirely in accord with its legal form.

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61 See above at [56] citing *Challenge*, above n 11, at 562.
62 *Auckland Harbour Board*, above n 51.
63 At [4]–[5].

[118] In the course of its judgment in *Auckland Harbour Board*, the Privy Council compared s 64J to the then GAAR, s 99 of the 1976 Act:[64]

> In this respect [s 64J] is similar to other anti-avoidance provisions such as s 99. Their Lordships do not of course suggest that the two sections necessarily cover the same ground, but what they have in common is that they are, generally speaking, 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. Some of the work such provisions used to do has nowadays been taken over by the more realistic approach to the construction of taxing Acts exemplified by *(W T) Ramsay Ltd v Inland Revenue Commissioners*[65] … although Their Lordships should not be taken as casting any doubt upon the usefulness of such tax avoidance provisions as a long stop for The Revenue.

It then went on:

> [12] In the present case, there is no tension between the commercial and juristic character of the transaction. It is, in legal, commercial or any other terms, a transfer of financial arrangements for no consideration. Such a transaction either attracts a deduction or it does not. The Commissioner accepts that it does, but claims the right under s 64J(1) to be able to amend the law to ensure that it does not. Their Lordships do not think that the section was intended to confer such a power. It would amount to the imposition of tax by administrative discretion instead of by law.

[119] The judgment appears dismissive of the appropriateness and utility of the GAAR; this given the comparison with what was said to be "the more realistic approach" taken in *Ramsay* (based on the concept of a "fiscal nullity") and the distinctly faint nature of the praise offered ("usefulness … as a long stop"). Despite this, the summary expression of the underlying principles was in accordance with the "not suffering the economic burden approach" to the GAAR's application.

[120] At issue in *Peterson* was the tax effectiveness of a film financing scheme under which investors claimed deductions on expenditure funded in part by a non-recourse loan.[66] In the judgment, the contributions funded directly by the investors were referred to as $x with the balance, funded by the non-recourse loan, referred to as $y. The taxpayer succeeded in the Privy Council in his contention that he was entitled to deduct $x + y. On the approach of the majority:[67]

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64 At [11].

65 *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 (HL).

66 *Peterson,* above n 47.

67 At [42] per Lord Millett, Baroness Hale and Lord Brown.

> If the Commissioner had shown that the features on which he relied, singly or in combination, had the effect that the investors, while purporting to incur a liability to pay $x+y to acquire the film, had not suffered the economic burden of such expenditure before tax which Parliament intended to qualify them for a depreciation allowance, then he could invoke s 99 to disallow the deduction.

As it happened, the majority concluded:[68]

> The fact that the investment was funded by a non-recourse loan did not alter the fact that the investors had suffered the economic burden of paying the full amount of $x+y.

[121] The factual conclusion reached by the majority is not self-evidently correct. Indeed, there was a sharply worded dissent by Lord Bingham and Lord Scott. What is of far more significance for present purposes is that there was unanimity as to the applicability of the "not suffering the economic burden" approach to tax avoidance. As this Court noted in *Ben Nevis*:[69]

> The majority, in the judgment of Lord Millett, decided the appeal on the basis of a concession of fact made by the Commissioner that contractually the taxpayer had paid the full consideration to acquire the film, there being no additional purpose. …
>
> … Lord Millett went on to say that, in general, where parties stipulate a single consideration for supply of two or more goods or services, the Commissioner can go behind the allocation agreed on by the parties and reallocate the consideration on a proper basis. The effect is that taxpayers must show that the economic purpose of the entire expense incurred, rather than simply the legal benefit, relates to the income-earning process. Otherwise only the appropriate proportion will be deductible.

[122] In *Ben Nevis*, this Court upheld the judgment of the Court of Appeal (reported as *Accent Management Ltd v Commissioner of Inland Revenue* and delivered on 11 June 2007)[70] which had dismissed an appeal from a judgment of Venning J (delivered on 20 December 2004).[71] Both the Court of Appeal and the High Court judgments upheld assessments against the taxpayers for shortfall penalties. The significance of the dates of the judgments is that the judgment of Venning J preceded the date the first tax return in issue was filed (July 2006) and the judgment of the Court of Appeal was prior to the filing of the second tax return (December 2007). The

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68 At [44].
69 *Ben Nevis*, above n 12, at [199]–[200] per Tipping, McGrath and Gault JJ (footnote omitted).
70 *Accent Management* CA judgment, above n 35.
71 *Accent Management* HC judgment, above n 59.

basis upon which the taxpayers sought to resist the application of s BG 1(1) to the scheme at issue (the "Trinity scheme") was broadly the same as that relied on by the appellant in this case.

[123] In the High Court, Venning J, in concluding that tax avoidance had been established, emphasised that the limited outlays of funds by the taxpayers bore no relation to the very substantial tax advantages apparently generated.[72] This is language that at least evokes the "not suffering the economic burden" approach to tax avoidance.

[124] In the Court of Appeal judgment, the "not suffering the economic burden" approach was set out explicitly in a passage that we have already cited but it warrants repetition in this context:[73]

> Given the generality of cases to which specific tax rules necessarily apply, it would be unrealistic to confine the application of general anti-avoidance provisions to transactions which lie outside of a discernible specific legislative purpose. When construing such specific rules and looking for their scheme and purpose, it is necessary to keep general anti-avoidance provisions steadily in mind. On this basis, it will usually be safe to infer that specific tax rules as to deductibility are premised on the assumption that they should only be invoked in relation to the incurring of real economic consequences of the type contemplated by the legislature when the rules were enacted.

[125] For the sake of completeness, we note that we see the "not suffering the economic burden" approach as also consistent with a comment made by the Privy Council in *Miller v Commissioner of Inland Revenue*:[74]

> In many (though by no means all) cases, the legislation will use terms such as income, loss and gain, which refer to concepts existing in a world of commercial reality, not constrained by precise legal analysis.

[126] There is one other point worth mentioning at this stage. On appeal from the Court of Appeal judgment in *Accent Management*, the taxpayers in *Ben Nevis* argued that in 1998, when the first of the relevant tax returns were filed,[75] the Privy Council decision in *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* (usually referred

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72 At [323].
73 See above at [71] citing *Accent Management* CA judgment, above n 35, at [126].
74 *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC) at [10].
75 The first of the tax returns was filed in 1997 but the additional penalties regime was not then in effect.

to as *Europa 2*) provided apparent authority for the view that the GAAR did not overrule the operation of specific deductibility provisions relied on by the taxpayers.[76]

[127] The judgment of this Court in *Ben Nevis* noted that by the time the tax returns were lodged, the prospect of New Zealand courts applying the approach apparently adopted in *Europa 2* was "remote".[77] The judgment went on:

> [202] On general principles concerning the application of the general anti-avoidance provision, the points made earlier concerning the highly contrived nature of the whole arrangement, in conjunction with the mismatch of timing between when deductions were claimed and payments were to be made, always meant this arrangement was highly likely to be set aside.
>
> [203] Accordingly, the appellants' tax position failed to meet the standard of being about as likely as not to be correct and was an unacceptable interpretation of tax law.

To be noted, apropos of the discussion earlier at [101], is the use of the statutory language "about as likely as not to be correct".

Were the tax positions of DHNZ "about as likely as not to be correct" when they were adopted?

[128] As we have foreshadowed, we propose in this case to apply the "about as likely as not to be correct" standard on the basis of the facts as we have found them to be. We accept that in some cases, for instance, where the factual issues turn on questions of evaluation or assessment, there may be scope for taking into account a taxpayer argument along the lines that the view of the facts on which the tax position was premised was "about as likely as not to be correct". Conceivably this may sometimes be so in relation to assessments of economic substance and effect.[78] A possible example of this is *Commissioner of Inland Revenue v John Curtis Developments Ltd* which turned on the categorisation of certain receipts as capital or revenue.[79] In the present case, we consider that an argument that the economic burden contemplated by deductibility for "interest incurred" was met would not meet the "about as likely as

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76 *Ben Nevis,* above n 12, at [189] per Tipping, McGrath and Gault JJ, referring to *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1976] 1 NZLR 546 (PC).

77 *Ben Nevis*, above n 12, at [197] per Tipping, McGrath and Gault JJ.

78 We note that in *Peterson*, above n 47, there was a sharp difference of opinion between the majority and minority as to the economic substance of the burden suffered by the taxpayer.

79 *Commissioner of Inland Revenue v John Curtis Developments Ltd* [2014] NZHC 3034, (2014) 26 NZTC ¶21-113.

not to be correct" standard. We say this because all those relevantly involved were well aware of the economic substance of the funding arrangement. Indeed, they went as far as to record that substance in the management accounts of DHNZ and DAP and in other contemporaneous documentation.

[129] We accept that *Ben Nevis* (along with *Penny and Hooper*) represents something of a break from the past.[80] In part this break is one of tone, illustrated by comparing the language used in those judgments with the way the *Auckland Harbour Board* judgment was expressed. It also involves an approach to taxpayer arguments as to economic substance which is more sceptical than that of the majority in *Peterson*. As well, it provides clarification of the inter-relationship between the GAAR and specific provisions. Further, the consistency of the Supreme Court's decisions marks a change from the twists and turns which, from the 1960s, had characterised at least some of the tax avoidance jurisprudence of the Privy Council. Finally, we recognise that the language used in *Auckland Harbour Board* and at least the result in *Peterson* would have provided some encouragement for tax scheme designers (albeit perhaps enhanced by confirmation bias).

[130] All of that said, we do not see *Auckland Harbour Board* and *Peterson* as assisting Frucor Suntory. On the legal test discussed in the former and applied in the latter, the application of s BG 1(1) to the funding arrangement here is straightforward. As to the former, it is perfectly plain that there is a "tension between the commercial and juristic character" of the funding arrangement and its components.[81] As to the latter, it is also plain that DHNZ did not suffer "the economic burden of such expenditure before tax which Parliament intended to qualify" a taxpayer for an allowance.[82] So, on the law as stated or applied in those cases, s BG 1(1) is engaged in this case. As to this, we adopt the approach taken by the Court of Appeal in *Alesco New Zealand Ltd v Commissioner of Inland Revenue*:[83]

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80 Some commentators have maintained that *Ben Nevis* represents a "sea change" or a major shift: see, by way of examples, Craig Elliffe and Jess Cameron "The Test for Tax Avoidance in New Zealand: A Judicial Sea Change" (2010) 16 NZBLQ 440; Keith Kendall "Tax avoidance after *Penny*" [2010] NZLJ 245; and Michael Littlewood "The Supreme Court and tax avoidance" [2009] NZLJ 151. For a more equivocal view, see John Peterson "Tax avoidance" [2012] NZLJ 42 at 43.

81 *Auckland Harbour Board,* above n 51, at [12].

82 *Peterson,* above n 47, at [42].

83 *Alesco New Zealand Ltd*, above n 36 (footnotes omitted).

> [140] By 2003 the principles relating to construction of the anti-avoidance provisions had been settled by the Privy Council's decision in *Challenge*, affirming Woodhouse [P]'s dissent in this Court. While in *Ben Nevis* the Supreme Court expanded upon and restated the *Challenge* provisions, its approval of both relevant judgments is unequivocal. And, after surveying all the leading authorities on the application of the anti-avoidance provisions to cases of what it called "contrived deductions", the Court concluded that the principles we have applied were settled by 1998.

[131] Also relevant are the High Court and Court of Appeal judgments in respect of the Trinity scheme and the judgment of this Court in *Ben Nevis*.

[132] By way of preface to what follows, we note that in both the Trinity scheme and the tax avoidance scheme in this case, there was the same sort of mismatch between the economic substance of the transactions and their legal form. There were also substantial elements of contrivance and artificiality. The fundamental problem with both the schemes was the same: the taxpayers sought to obtain tax benefits without suffering the economic burden which those benefits were intended to mitigate. In saying this, we recognise that, in some respects, the Trinity scheme was "worse" than the arrangement here; this given the degree of artificiality and contrivance, particularly in relation to offshore features of that scheme. But that said, in both cases, the artificiality and contrivance were sufficient to result in a nominal burden that did not correlate to economic reality. This is what is critical to the application of s BG 1(1), as explained at [71]–[72]. At that level of generality, the cases are very similar.

[133] The High Court and Court of Appeal judgments in relation to the Trinity scheme are premised on understandings of the operation of s BG 1(1) which, if right, meant that s BG 1(1) also applied to the funding arrangement in this case. Those judgments were, of course, still subject to appeal when the second of the relevant returns in this case was filed (leave having been granted to appeal to the Supreme Court on 9 October 2007).[84] It would, however, have been a very bullish tax adviser who saw that appeal as being "about as likely as not" to succeed.

[134] The judgment of this Court in *Ben Nevis* is relevant for slightly different, although overlapping, reasons. As will be apparent, the application of the shortfall

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[84] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2007] NZSC 82, (2008) 23 NZTC 21,664.

penalties regime in this case involves issues that are substantially the same as those in *Ben Nevis*. The only substantial difference is that by 2006 and 2007 (when the relevant returns in this case were filed), the confirmation in *Peterson* of the "not suffering the economic burden" approach to tax avoidance, along with the High Court and Court of Appeal *Accent Management* decisions, meant that the legal environment was more discouraging from the point of view of tax avoidance than it had been in the late 1990s, when the relevant *Ben Nevis* returns had been filed. Given that the Trinity scheme did not meet the "about as likely as not to be correct" standard, as this Court held in *Ben Nevis*, it is not easy to see why we should not reach the same conclusion in relation to the tax positions which DHNZ adopted.

The significance of the alternative assessments

[135] The Commissioner's primary contention throughout the process has been the argument upon which she has succeeded in this Court. The alternative and ultimately abandoned non-resident withholding tax theory was at most a backstop to this primary contention. For this reason, the advancing of this backstop theory provides no indication of its substantiality. In any event, the application of the "about as likely as not to be correct" standard is objective and is not controlled by what the parties may have thought.

Conclusion as to unacceptable position

[136] For the reasons we have given, we are satisfied that shortfall penalties are payable.

Was the dominant purpose of the arrangement to avoid tax?

[137] We accept that it was an essential part of the tax scheme that DAP not incur tax liabilities in Singapore. Such tax liabilities would have had the tendency to cancel out the tax advantages of the advance from Deutsche Bank. But, absent the purpose of obtaining that funding on a basis designed to achieve tax advantages for DHNZ in New Zealand, there would have been no occasion for DAP to enter into reasonably complex transactions in relation to the share capital of DHNZ that had the potential to generate a tax liability in Singapore. In any tax scheme aimed at producing tax

advantages, there must always be an associated purpose of not generating counteracting tax disadvantages.

[138] The most favourable way of looking at this aspect of the case from the point of view of Frucor Suntory is that the dominant purpose of the arrangement was to reduce the tax liabilities of DHNZ in New Zealand without the Danone group incurring counter-balancing liabilities elsewhere (and in particular in Singapore). We see such a compound purpose as engaging s 141D.

A brief response to the dissent of Glazebrook J

[139] The dissent of Glazebrook J is based on views of the facts and law sufficiently different from those expressed in these reasons as to make detailed response not particularly practicable. There are, however, two points that we wish to make.

[140] The first relates to her comment at [190] that this Court's judgment in *Ben Nevis* introduced two changes, the need to consider the economic substance of the transaction and the contemplation of Parliament test.

[141] In the cases cited between [115] and [127] there are numerous mentions of the "not suffering the economic burden" approach to identifying tax avoidance. As well, although the phrase "parliamentary contemplation" was used for the first time in the Supreme Court judgment in *Ben Nevis*, a very similar phrase was used in the *Accent Management* Court of Appeal judgment which referred to "the incurring of real economic consequences of the type contemplated by the legislature when the rules were enacted".[85] The passages cited from *Challenge*, *Auckland Harbour Board* and *Peterson* also use language that is broadly similar (by reference to what "Parliament intended", "defeating the intention and application of the statute" and "the economic consequences which Parliament intended").[86]

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[85] *Accent Management* CA judgment, above n 35, at [126].

[86] See, for example, *Challenge* PC judgment, above n 11, at 562 per Lord Keith, Lord Brightman, Lord Templeman and Lord Goff; *Auckland Harbour Board,* above n 51, at [11]; and *Peterson,* above n 47, at [32].

[142] The second point by way of response is more general. We accept that the approaches to facts and law proposed by Glazebrook J are based on arguments that are sophisticated and are (and were) capable of being credibly advanced. This, however, is not controlling. This is because the result we arrive at in relation to penalties reflects our assessment that as at 2006 and 2007 when the returns were filed, such arguments nonetheless were not "about as likely as not" to be accepted by New Zealand courts.

Disposition

[143] The appeal is dismissed and the cross-appeal is allowed. The appellant is liable for shortfall penalties under s 141D. The appellant must pay costs of $45,000 plus usual disbursements.

REASONS

GLAZEBROOK J

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Introduction

[144] The issue in this case is whether a financing arrangement involving Frucor Suntory New Zealand Ltd (Frucor) is tax avoidance.[87] The High Court held that it was not.[88] The Commissioner's appeal was allowed by the Court of Appeal which found the arrangement to be tax avoidance but did not impose shortfall penalties.[89]

[145] Frucor appeals against the finding of tax avoidance by the Court of Appeal. Alternatively, it argues that, even if there was a tax avoidance arrangement, the Commissioner's tax reassessments are not an appropriate exercise of the Commissioner's reconstruction powers. The Commissioner cross appeals against the Court of Appeal finding that shortfall penalties do not apply.

[146] The majority of this Court dismiss Frucor's appeal and allow the Commissioner's cross appeal on penalties. I take a different view. I would have allowed the appeal and, as a result, dismissed the Commissioner's cross appeal on penalties.[90]

Background

[147] Frucor is a wholly-owned subsidiary of the Danone group of companies. It is the successor company of Danone Holdings NZ Ltd, which was incorporated in January 2002 to acquire all of the shares in Frucor Beverages Group Ltd (Frucor Beverages Group) for around $298 million. The financing structure for the

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87 Frucor Suntory New Zealand Ltd is the successor to Danone Holdings NZ Ltd which was the original party at issue: see majority above at [5]. I use Frucor's current name for ease of reading given that Frucor is the appellant.

88 *Frucor Suntory New Zealand Ltd v Commissioner of Inland Revenue* [2018] NZHC 2860, (2018) 28 NZTC ¶23-078 (Muir J) [HC judgment].

89 *Commissioner of Inland Revenue v Frucor Suntory New Zealand Ltd* [2020] NZCA 383, (2020) 29 NZTC ¶24-075 (Kós P, Gilbert and Courtney JJ) [CA judgment].

90 As it does not arise, I do not need to comment on the issue of reconstruction: discussed above at [88]–[93] of the majority's reasons.

purchase is set out in Appendix One. Basically, the funding came from two of the Danone group companies: a Singapore company, Danone Asia Pte Ltd (Danone Asia) provided $150 million in equity funding; and Danone Finance SA provided $148 million of debt funding.

[148] In March 2003, the funding was restructured (shown diagrammatically in Appendix Two). Frucor issued a convertible note to Deutsche Bank (Deutsche) for $204 million.[91] The note was for a five-year term at 6.5 per cent interest with a $1.8 million upfront fee. Frucor used the $204 million to repay the Danone Finance debt of $144 million and to redeem part of the Danone Asia equity (400 shares) for $60 million. Of the $204 million provided by Deutsche, $55 million came from its internal treasury. The remainder ($149 million) came through a forward purchase by Danone Asia of the shares in Frucor after the exercise of the option under the convertible note at the end of the five-year period.

[149] The tax advantage for the group of this structure was that, unlike interest payments on a loan, the difference between the $204 million agreed value of the shares and the $149 million paid by Danone Asia is not taxable in Singapore (except possibly if the shares are sold). From the perspective of Frucor, the position before and after the restructuring was expected to be the same: deductibility of the interest paid on the loan before the restructuring and; after the restructuring, deductibility of the interest paid under the convertible note before its conversion to shares.

[150] In February 2009, Danone sold the shares in Frucor to a third party for some $1.45 billion.

Law on tax avoidance

[151] In accordance with the majority view in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (*Ben Nevis*), the relevant questions are:[92]

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[91] This was an optional convertible note but it is agreed that, absent extraordinary circumstances, it would be converted to non-voting shares in Frucor at the end of the five year period.

[92] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 [*Ben Nevis*] at [107]–[109] per Tipping, McGrath and Gault JJ.

(a) Is the use made of any specific provisions within the intended scope of those provisions?[93] This is essentially based on an analysis of the legal effect of the arrangement, leaving aside the general anti-avoidance provision (the GAAR).[94]

(b) Has the taxpayer made use of the provision in a way that was not within the contemplation and purpose of Parliament when it enacted the provision? At this stage courts are not limited to "purely legal considerations" and should consider the use made of the provisions "in light of the commercial reality and the economic effect of that use".[95]

[152] The majority in *Ben Nevis* gave some guidance on the factors that might be relevant in deciding whether a tax avoidance arrangement exists. It said:

> [108] The general anti-avoidance provision does not confine the court as to the matters which may be taken into account when considering whether a tax avoidance arrangement exists. Hence the Commissioner and the courts may address a number of relevant factors, the significance of which will depend on the particular facts. The manner in which the arrangement is carried out will often be an important consideration. So will the role of all relevant parties and any relationship they may have with the taxpayer. The economic and commercial effect of documents and transactions may also be significant. Other features that may be relevant include the duration of the arrangement and the nature and extent of the financial consequences that it will have for the taxpayer. As indicated, it will often be the combination of various elements in the arrangement which is significant. A classic indicator of a use that is outside parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for specific provisions to be used in that manner.

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93 I do not agree with the majority (above at [58]) that the first step of *Ben Nevis* is largely textual. The inquiry at the first stage should be whether the arrangement meets the specific provisions of the Act, interpreted in accordance with normal statutory interpretation principles. The difference at this first stage is that the economic substance of the arrangement is not in play. That only comes at the second stage, as does the inquiry about whether the impugned arrangement viewed as a whole falls within parliamentary contemplation in relation to the specific provisions involved. This first stage of the *Ben Nevis* test is effectively a survival from the old "legal substance" approach discussed below at [190]–[192]. As an aside, I note that Thomas J, writing extrajudicially, has commented that *Ben Nevis* should have moved directly to the question of tax avoidance (the *Ben Nevis* second step) "without making a finding as to the legitimacy of the arrangement under the specific provisions" (the *Ben Nevis* first step): EW Thomas "The Evolution from Form to Substance in Tax Law: The Demise of the Dysfunctional 'Metwand'" (2011) 19 Wai L Rev 17 at 52.

94 I use this commonly used abbreviation (GAAR) to avoid confusion because there are different general anti-avoidance provisions referred to in this judgment.

95 *Ben Nevis*, above n 92, at [109] per Tipping, McGrath and Gault JJ.

[153] The majority made it clear, however, that the ultimate question is whether the use of the provisions in question is consistent with Parliament's purpose or whether they are used in a way that is beyond Parliament's contemplation:[96]

> The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.

Submissions

[154] It was agreed by both parties that, in terms of the first stage of the *Ben Nevis* analysis, Frucor was, under the provisions relevant to interest deductions, entitled to claim a deduction for the $66 million interest paid to Deutsche.[97] The parties disagree on the second stage of the analysis.

Frucor's submissions

[155] Frucor submits that the Court of Appeal did not conduct its inquiry into the arrangement under the second stage of *Ben Nevis* in the manner directed by that case. In particular, it did not conduct a proper inquiry to ascertain Parliament's purpose and contemplation with regard to the interest deductibility provisions relevant to a taxpayer carrying on business in New Zealand.

[156] For that inquiry, the starting point should be that a New Zealand resident taxpayer is entitled to an interest deduction where it borrows for purposes which qualify interest for deduction. This applies whether the borrowing is from a lender which is non-resident or resident and whether the lender is related or unrelated. In the case of borrowing from a non-resident related party, the transfer pricing rules must be complied with (in other words, no more than a market rate of interest). And, if the borrower is owned by a non-resident, the resulting debt/equity ratio much be within the thin capitalisation requirements. In Frucor's submission, it is within Parliament's

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[96] At [109] per Tipping, McGrath and Gault JJ.

[97] The majority also agree that the arrangement meets this stage of the analysis: see majority above at [68].

purpose and contemplation for taxpayers to make a choice between debt and equity funding, even in the case of a wholly-owned group and non-resident lender, subject to transfer pricing and thin capitalisation rules and to non-resident withholding tax being paid on interest payments to a non-resident lender. Debt can be discharged through the issuing of shares without affecting a borrower's entitlement to an interest deduction during the term of the arrangement. A convertible note is debt funding until it is converted. In addition, the New Zealand taxation position of a New Zealand resident taxpayer is determined on a stand-alone basis – in other words, a taxpayer is treated as operating independently, and at arm's length from other members of its group.

[157] Applying these principles, Frucor submits that it was within Parliament's purpose and contemplation that the whole of the $204 million under the convertible note is debt funding and that Frucor is entitled to a full deduction for the interest it paid. Frucor argues that the $149 million provided by Danone Asia could be treated as the economic equivalent of a loan (albeit a related-party hybrid loan). There is no requirement for interest deductibility purposes for funding to be provided by unrelated parties. While the ratio of debt to equity rose, this was only from some 50 per cent debt funding to some 63 per cent. This was still within the thin capitalisation limits. Further, the 6.5 per cent interest on the convertible note does not fall foul of the transfer pricing rules. Indeed, the interest deduction amounts before and after the 2003 refinancing were similar. The advantage from the refinancing was offshore and from a whole group perspective in that the difference between the price paid for the shares by Danone Asia was a non-taxable capital receipt in Singapore. This is not relevant for New Zealand taxation purposes.

[158] Finally, Frucor also says that it is significant that there are a large number of alternative refinancing arrangements by which a full interest deduction for the $66 million would have arisen.

Commissioner's submissions

[159] The Commissioner supports the decision of the Court of Appeal on tax avoidance. The Commissioner's position is that in economic substance the $66 million (6.5 per cent interest on $204 million over five years) in fact comprised

both principal and interest payments on the $55 million provided by Deutsche. Therefore, despite its legal form as interest, Parliament would not have contemplated the interest deductibility provisions being used in this manner. Thus $55 million of the $66 million claimed by Frucor as deductions were actually non-deductible, and s GB 1 of the Income Tax Act 2004 (the Act) was rightly used to counteract the tax advantage.

[160] It is submitted that a key focus in tax avoidance cases is whether the taxpayer has suffered the economic burden which Parliament had contemplated to qualify for the deduction. In the Commissioner's submission, there is no economic gain or loss resulting from the receipt and repayment of principal amounts. Parliament's contemplation is that only the amounts over and above the principal amount borrowed should be deductible as interest.

[161] The Commissioner submits that the manner in which the arrangement is carried out is also relevant. Here the principal amount of the convertible note was derived by a formula which ensured the coupon payments Frucor made under the note exactly matched the principal amount advanced by Deutsche plus market rate interest. Further, the process by which the lowest price for the shares was derived was contrived and had nothing to do with the value of the shares. In terms of the relationship between the parties, the arrangement was designed to ensure Frucor's relationship with its parent did not change. Deutsche's role was as a conduit for the passing of the $149 million to Frucor and thereby to facilitate the tax effects.

[162] In the Commissioner's submission, there were also artificial and contrived features of the arrangement, including that the note was not priced as a normal convertible note, there was no intention of Deutsche benefiting from the note converting to shares, and the transaction was structured so there was no realistic possibility of the note not being converted to shares. The commercial and economic effect was that the note was a convertible bond in name only and not issued to enable a growing company to offer shares to outside investors who were prepared to lend money at a lower rate for the benefit of a volatility play. The Court of Appeal was correct, in the Commissioner's submission, to hold that there was no rational commercial explanation for the artificial and contrived features of the arrangement.

Second step in the *Ben Nevis* analysis

[163] It is important to remember that the aim of the second step in *Ben Nevis* is to assess whether specific provisions are being used in a manner that is not within the contemplation and purpose of Parliament. It is true that the economic substance of an arrangement is considered at this second stage but it is not legitimate to jump to the conclusion that the economic substance of the transaction should be taxed without carefully analysing whether the provisions are being used in a way not contemplated by Parliament.[98]

[164] As the majority in *Ben Nevis* say, ascertaining when an arrangement crosses the line "should be firmly grounded in the statutory language of the provisions themselves."[99] Taxpayers still have a choice to structure their affairs to gain a tax advantage as long as they do so in a manner that is not outside the contemplation and purpose of Parliament.[100]

[165] Similar comments have recently been made by the Supreme Court of Canada in *Canada v Alta Energy Luxembourg SARL* (*Alta Energy*).[101] The majority of the Supreme Court in that case said that taxpayers are free to minimise their tax liability and even to engage in "creative" tax planning as long as this is not abusive within the meaning of the GAAR.[102]

[166] In Canada, the test for applying the GAAR is a three-part process,[103] as set out in *Canada Trustco Mortgage Co v Canada* (*Canada Trustco*):[104]

(a) whether there is a tax benefit arising from a transaction;

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98 I accept Frucor's submission that the Court of Appeal in this case did not perform the proper analysis at step two. It follows that I consider that the majority fall into the same error.

99 *Ben Nevis*, above n 92, at [104] per Tipping, McGrath and Gault JJ.

100 At [111] and [114] per Tipping, McGrath and Gault JJ.

101 *Canada v Alta Energy Luxembourg SARL* 2021 SCC 49 [*Alta Energy*].

102 At [48] per Côté J (Abella, Moldaver, Karakatsanis, Brown and Kasirer JJ concurring).

103 Compared to the two-stage process in New Zealand.

104 *Canada Trustco Mortgage Co v Canada* 2005 SCC 54, [2005] 2 SCR 601 [*Canada Trustco*] at [17] and [66], affirmed in *Alta Energy*, above n 101, at [31] per Côté J (Abella, Moldaver, Karakatsanis, Brown and Kasirer JJ concurring) and [113] per Rowe and Martin JJ (Wagner CJ concurring).

(b) whether the transaction is an avoidance transaction (in the sense that it cannot be said to have been reasonably undertaken primarily for a bona fide purpose other than to obtain a tax benefit); and

(c) whether there was abusive tax avoidance.

[167] The first two stages of the Canadian analysis do not have a New Zealand counterpart. The third stage, however, is similar to the second part of the test in *Ben Nevis.* The majority in *Alta Energy* explain the third stage as follows:[105]

> To determine whether a transaction is abusive, this Court has set out a two-step inquiry. Under the first step, the provisions relied on for the tax benefit are interpreted to determine their object, spirit, and purpose. The second step is to undertake a factual analysis to determine whether the avoidance transaction at issue is consistent with or frustrates the object, spirit, and purpose of the provisions.

[168] Abusive tax avoidance includes a transaction that "defeats the underlying rationale of the provisions that are relied upon".[106] The majority in *Alta Energy*, in a similar manner to the majority in *Ben Nevis*, warned that:[107]

> … the abuse analysis is not meant to be a "search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue". The focus of the interpretation is on the object, spirit, and purpose of the *specific provisions* and not on the broader policy objective of the *Act* or of a particular tax treaty.

[169] In *Alta Energy* the relevant provisions were contained in a tax treaty between Canada and Luxembourg. After considering the object, spirit and purpose of the treaty, the majority held that the arrangement in question did not constitute tax avoidance. Although taking a different view, the minority applied the same test as the majority (and in *Ben Nevis*). They said that the task was to ascertain whether the transactions in question "frustrate the underlying rationale" of the provisions.[108]

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105 *Alta Energy*, above n 101, at [31] per Côté J (Abella, Moldaver, Karakatsanis, Brown and Kasirer JJ concurring) (citation omitted).

106 At [32] per Côté J (Abella, Moldaver, Karakatsanis, Brown and Kasirer JJ concurring) citing *Canada Trustco*, above n 104, at [45].

107 At [49] per Côté J (Abella, Moldaver, Karakatsanis, Brown and Kasirer JJ concurring) (citation omitted).

108 At [100] per Rowe and Martin JJ (Wagner CJ concurring). To the extent that the minority rely on the underlying rationale of the Treaty as a whole, this might not match the approach of New Zealand, which is, like the majority, to concentrate on the particular provisions. I say "might", however, because provisions need to be seen in context.

[170] The Canadian terminology of "frustrate the underlying rationale of the provisions" may be useful to give more analytical structure to the test of "contemplation of Parliament". A requirement to consider the underlying rationale of a particular provision would encourage a focus on the particular provisions and reduce the risk that judges might take a purely subjective view of what is within the contemplation of Parliament.[109]

My assessment of the arrangement in this case

[171] The issue is whether the use of the relevant provisions by Frucor is outside the purpose and contemplation of Parliament. At this stage regard can be had to the economic substance of the arrangement. I accept, in terms of economic substance, that Deutsche only provided $55 million, with the remainder of the $204 million being provided through the forward purchase arrangement with Danone Asia. In economic substance, this is in effect debt funding provided in part by Deutsche ($55 million) and in part by Danone Asia ($149 million).[110] My analysis below proceeds on the basis of this view of economic substance.[111]

[172] I make eight interrelated points. The first is that debt and equity are treated differently under the Act. Parties are, however, free to choose between debt and equity funding, whether from unrelated or related parties (subject to limited restrictions discussed below). Thus the fact that part of the money provided to Frucor can be traced to Danone Asia does not take the transaction outside the contemplation of Parliament. Nor can it turn a debt of $204 million into a debt of only $55 million.

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109 There has been academic concern that judges may effectively substitute their own views under the guise of considering what was within Parliament's contemplation: see Craig Elliffe and Jess Cameron "The Test for Tax Avoidance in New Zealand: A Judicial Sea Change" (2010) 16 NZBLQ 440 at 459; and David Dunbar "Tax Avoidance: The Court of Appeal Judgment in *Penny and Hooper*, the Application of the Parliamentary Contemplation Test, and the Demise of Scheme and Purpose" (2011) 17 NZJTLP 395 at 407.

110 It follows that I do not accept the analysis of the economic substance of the transaction by the Commissioner (summarised above at [159]) or that of the majority (above at [75]–[77]). In particular, I am at a loss to understand how the refinancing can somehow have the effect of turning debt into equity (see the majority above at [77]) before the actual conversion into shares.

111 Most of the points would equally apply had I taken the majority's view of economic substance. There should not be an automatic leap from economic substance to tax avoidance; parliamentary contemplation must be considered: see above at [163]. The fact is that Parliament contemplated that there be interest deductibility in a business context with only limited exceptions. Frucor was entitled to structure its affairs accordingly. That taxpayers can structure their affairs as long as they do so in a manner that is not outside the contemplation of Parliament was accepted by this Court in *Ben Nevis*, above n 92, at [111] per Tipping, McGrath and Gault JJ: see above at [164].

[173] The second point is that companies are allowed a deduction for interest incurred under s DB 7 of the Act with only limited exceptions, none of which are relevant in this case. In this case the funds originally provided to Frucor by the Danone group (through a mixture of debt and equity) funded the purchase of the Frucor Beverages Group for some $298 million. The current arrangement through Deutsche refinanced part of that funding. The underlying investment was very successful, shown by the sale in 2009 for $1.45 billion. There is nothing in the use of the funds that is outside the contemplation and purpose of Parliament. Borrowing for investment in business assets, including shares, fits squarely within the underlying rationale for the interest deductibility provisions.[112] There is also no doubt that the $66 million was paid to Deutsche by Frucor and therefore constituted a real outlay of funds on the part of Frucor. As such, Frucor did in fact bear the economic burden of the outlay of the $66 million interest in terms of s DB 7.[113]

[174] The third point is that hybrid debt is treated as debt before conversion and as equity afterwards.[114] There is no policy reason why this should not apply equally to related or unrelated-party debt, and nothing in the Act suggests that hybrid instruments are not available between related parties.[115] The Act after all contemplates a choice between debt and equity even for related parties. Therefore, until conversion, the

[112] Indeed, there used to be a specific provision making that clear (see s DD 1(2) of the Income Tax Act 1994), which is no longer needed given the general permission for interest deductibility for companies in s DB 7.

[113] Contrary to the Commissioner's submission (summarised above at [160]) and the majority view (above at [86]).

[114] This applies both to optional conversion and mandatory conversion convertible notes: see Te Tari Taake | Inland Revenue "Determination G22A: Optional Convertible Notes Denominated in New Zealand Dollars" (26 September 2006) <www.taxpolicy.ird.govt.nz>; and Te Tari Taake | Inland Revenue "Determination G5C: Mandatory Conversion Convertible Notes" (18 February 1994) <www.taxtechnical.ird.govt.nz>. This means that the fact that there was no realistic prospect of the note not being converted to shares is irrelevant, contrary to the Commissioner's submission (above at [162]). The same conclusion was reached at first instance: HC judgment, above n 88, at [172]. That hybrid debt is treated as debt before conversion is accepted by the majority above at [70].

[115] I acknowledge the Court of Appeal decision in *Alesco New Zealand Ltd v Commissioner of Inland Revenue* [2013] NZCA 40, [2013] 2 NZLR 175. However, that was a case where no interest was in fact payable. It is not therefore necessary to comment on whether or not that case was correctly decided. If the majority (above at [82]–[83]) are suggesting that hybrid instruments are not allowable for tax purposes within wholly-owned groups then I disagree.

$204 million provided to Frucor was rightly treated as debt and the interest is deductible.[116]

[175] The fourth point is that each taxpayer is treated separately for taxation purposes, even if they are in a wholly-owned group.[117] The consequences for this are twofold. First, it does not matter for interest deductibility purposes whether the funds are borrowed from a related or an unrelated party.[118] There is no requirement that funds lent to a New Zealand subsidiary are sourced from third parties. The fact that part of the $204 million was provided to Deutsche through the forward purchase agreement with Danone Asia therefore does not affect the above analysis. The loan to Frucor was $204 million and not $55 million.[119] The $66 million was interest on the $204 million. Second, what the lender does with the interest received or the characterisation of the funds in the hands of the lender (even one in a wholly-owned group) is irrelevant in terms of the deductibility of interest for the borrower.[120]

[176] The fifth point is that the New Zealand taxation system is generally not concerned with the taxation consequences for offshore lenders. In particular, the New Zealand anti-avoidance provision is not concerned with offshore tax advantages

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116 The treatment in the management accounts (discussed by the majority above at [42]–[46]) is unsurprising as the payment was for the purchase of the shares once converted. It follows that I disagree with the majority's view expressed above at [128].

117 Frucor submits, and I accept, that the stand-alone approach is clear from: (1) the adoption of the non-resident withholding tax regime premised on the separate tax treatment of group entities to withhold tax from cross-border payments of interest, dividends and royalties; (2) the transfer pricing regime within s GD 13 of the Income Tax Act 2004 (the Act) which requires the substitution of arm's-length consideration to transactions between group members; and (3) the thin capitalisation regime which assumes individual recognition in a multi-national group context. The stand-alone approach is embedded in New Zealand and other Organisation for Economic Co-operation and Development (OECD) countries' tax frameworks: see Craig Elliffe *International and Cross-Border Taxation in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2018) at [44.1]. This means that it is not legitimate to then take a group-based approach to stage two of *Ben Nevis* since the focus is on what Parliament contemplated with respect to the specific provisions: contrast with the view of the majority above at [79](a).

118 Subject to certain restrictions discussed below at [177].

119 The fact some of the $204 million was provided by Danone Asia cannot turn a $204 million loan into a loan for $55 million contrary to the Commissioner's contention (summarised above at [159]–[160]). It will be clear too that I disagree with the majority that the relevant debt was reduced to $55 million: see majority above at [75](a). It was not. The relevant debt was $204 million which comprised of $55 million provided by an unrelated party (Deutsche) and the remaining $149 million provided by Danone Asia through the forward purchase agreement.

120 It is therefore irrelevant for New Zealand tax purposes that, because of the forward purchase arrangement, Deutsche was able to use the $66 million interest received from Frucor to cover the $55 million it provided plus interest. It is also irrelevant that Danone Asia was able to convert what would have been interest received into a capital receipt, the purpose of the forward purchase agreement.

to non-New Zealand tax residents even if they are part of the same group as a New Zealand corporate taxpayer. The fact that the arrangement was designed to receive a possible favourable Singapore taxation consequence for Danone Asia is therefore irrelevant.[121]

[177] The sixth point is that the choice between debt and equity funding extends to corporate groups, even where the lender is an offshore related party. Because there is scope for non-market transactions between corporate groups, however, there are some specific rules that are designed to limit non-market transactions. Thin capitalisation rules place a limit on the amount of interest that can be deducted to counter cross-border shifting of profit through excessive debt. In New Zealand, where the borrower is owned by a non-resident, the maximum amount of debt is established by a pre-determined debt/equity ratio. In addition, if the lender to a New Zealand resident company is a non-resident related party, the rate of interest must be a market rate under New Zealand's transfer pricing rules. In this case, the level of Frucor's borrowings fell well within the then allowable levels under the thin capitalisation regime,[122] and the rate of interest payable was arm's length.[123]

[178] The existence of specific anti-avoidance rules does not necessarily mean that the GAAR is inapplicable.[124] But in this case these rules serve as another illustration of the proposition that it is within the contemplation of Parliament that interest deductions on related party debt are available as long as the thin capitalisation and transfer pricing rules are met.

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[121] Several elements of artificiality and contrivance relied on by the Commissioner (summarised above at [161]–[162]) and by the majority (above at [84]–[85]) are related to the forward purchase agreement and do not therefore have any bearing on the tax avoidance analysis for New Zealand.

[122] The ratio prescribed in the relevant time period was 75 per cent: Income Tax Act 2004, s FG 3 (now repealed). Frucor's debt/equity ratio rose from some 50 per cent to 63 per cent after refinancing, although the actual interest deduction amounts remained the same: see above at [157].

[123] One of the elements of artificiality suggested by the Commissioner (above at [162]) and endorsed by the majority (above at [83]) is that interest on convertible notes is usually at a lower rate. It was not, however, the basis of the Commissioner's assessment that the transfer pricing rules were breached – this was accepted in the High Court (HC judgment, above n 88, at [141](e)) and not questioned in the Court of Appeal.

[124] *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 (PC) [*Challenge (PC)*] at 559 per Lord Keith, Lord Brightman, Lord Templeman and Lord Goff.

[179] The seventh point is that there is nothing to suggest that refinancing is treated any differently from original financing or that, where there is a refinancing, taxpayers are required to maintain the same debt/equity ratio as in the original financing.[125]

[180] Finally, it would be odd indeed if the current refinancing arrangement is held to be outside the contemplation of the provisions when exactly the same tax effect would have been achieved had the refinancing involved Danone Asia lending $204 million directly to Frucor at 6.5 per cent interest. The choice of debt funding would have been for the purpose of securing the interest deductions and therefore a New Zealand "tax advantage" but it would have been totally within the contemplation of Parliament.[126] There would therefore be no suggestion of there being a tax avoidance arrangement.

[181] I accept, of course, that it is the tax effect of the current arrangement that is in issue and it is not necessarily an answer to say that another similar arrangement would not constitute tax avoidance. However, what is required is a consideration of whether the use of the specific provisions is outside the contemplation of Parliament. I consider the fact that direct lending, whether by way of interest-bearing debt or convertible note, would have yielded exactly the same tax effect as the indirect lending by Danone Asia through Deutsche shows conclusively that the use of the provisions in this case was well within the contemplation of Parliament.[127] In other words, it does not frustrate the underlying rationale of the interest deductibility provisions.[128]

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[125] The majority point out elements of circularity (above at [85]), but this will always be the case with refinancing arrangements. As the High Court says, the payment by Danone Asia to Deutsche also discharged a genuine contractual liability, and the element of circularity did not fall into the "offensive" category: HC judgment, above n 88, at [163].

[126] See HC judgment, above n 88, at [141](j)(ii) and [141](k). The majority make much of the fact that the aim of the current arrangement was to ensure interest deductions in New Zealand (see for example above at [80]), but that is not the test for tax avoidance. Instead, the tax advantage must be outside the contemplation of Parliament, which deductions for interest paid on related party funding is not, provided the thin capitalisation and transfer pricing rules are complied with.

[127] The fact that Frucor's relationship with its parent did not change is actually supportive of this approach, contrary to the Commissioner's submission (above at [161]) and the view of the majority (above at [76]). It is true that Danone Asia owned 100 per cent of the shares both before and after the arrangement but, if the economic substance of the loan from Deutsche is taken into account as being partially provided by Danone Asia and partially by Deutsche, Danone Asia would also have provided debt funding to Frucor, with Deutsche acting as a conduit. Debt funding by related parties and the associated interest deductions are, however, not outside the contemplation of Parliament.

[128] For the underlying rationale of the interest deductibility provisions, see in particular above at [173] where I note that there are few restrictions on interest deductibility, all of which were met in this case. And it is also a question of refinancing a particularly successful business acquisition.

Conclusion

[182] For all of the above reasons, the use of the specific provisions in this case is within the contemplation of Parliament or, to put it in another way, the use of the interest deductibility provisions does not frustrate the underlying rationale of the provisions. It follows that the arrangement is not a tax avoidance arrangement. I would have allowed the appeal and dismissed the Commissioner's cross appeal.

Postscript: penalties

[183] Even had I been of the same view as the majority on the question of tax avoidance, I would still have dismissed the Commissioner's cross appeal on penalties for the reasons I now set out.[129]

Majority's approach: one view of the facts

[184] The majority's reasoning has the result that, once an arrangement is held to be tax avoidance, it will almost certainly follow that it is abusive. This is because the majority hold that whether an arrangement is abusive is generally judged on the findings of fact made by the court.[130]

[185] This is wrong in principle and inconsistent with the scheme of the penalty provisions. The provisions mandate a separate inquiry into whether shortfall penalties should be imposed with a sliding scale of sanctions increasing in severity according to the gravity of the circumstances and the culpability of the taxpayer.[131]

[186] The majority's approach of approaching the issue of penalties "on the basis of the facts as we have found them to be" leaves room for only one interpretation of the

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129 The High Court did not accept that there was tax avoidance, but said that, even if it was wrong in its principal conclusions, it would not impose shortfall penalties: HC judgment, above n 88, at [222]. Although the Court of Appeal disagreed with the High Court on tax avoidance, it also would not have imposed shortfall penalties: CA judgment, above n 89, at [108]. Both the High Court and the Court of Appeal accepted that there could be alternative plausible views of the current transaction and that there was substantial merit in Frucor's arguments: see below at [186].

130 See the majority above at [111] and [128].

131 See generally Tax Administration Act 1994, ss 141A–141E; and *Ben Nevis*, above n 92, at [174] and [178] per Tipping, McGrath and Gault JJ. See also the comments of the Minister of Revenue: (28 September 1995) 550 NZPD 9339–9340; and Taxpayer Compliance, Penalties, and Disputes Resolution Bill 1995 (119–2) (select committee report) at ii–iii.

facts. Both the High Court and Court of Appeal accepted that there could be alternative plausible views of the current transaction, taking the view that Frucor's arguments had "substantial merit".[132] Even assuming that my characterisation of the economic substance of the current arrangement is not correct, it must be at least a credible view on an objective view of the facts.[133] That there are other possible and credible views is also supported by the fact that the Commissioner had previously issued an alternative assessment in respect of the impugned arrangement which was based on a different view of the economic substance of the arrangement.[134]

State of the law at the time Frucor took its tax position

[187] An unacceptable tax position must be assessed at the time at which the tax position is taken.[135] Frucor's tax positions for its 2006 and 2007 income years were adopted when *Commissioner of Inland Revenue v Auckland Harbour Board* and *Peterson v Commissioner of Inland Revenue* had been relatively recently decided by the Privy Council,[136] and while *Ben Nevis* was making its way through the courts but had not yet reached this Court.

[188] The majority says that this Court's decision in *Ben Nevis* represented "something of a break from the past".[137] Frucor submits that, after this Court's decision in *Ben Nevis*, s BG 1 went from a mere "long stop" to a provision of equal status with tandem operation where s BG 1 was intended as "the principal vehicle" to

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[132] HC judgment, above n 88, at [221]; and CA judgment, above n 89, at [107].

[133] The test for an "unacceptable tax position" under s 141B of the Tax Administration Act, as set out in *Ben Nevis*, above n 92, at [184] per Tipping, McGrath and Gault JJ, is whether "the merits of the arguments supporting the taxpayer's interpretation [were] substantial". Unlike the majority above at [101], I see no reason to depart from the *Ben Nevis* test as it is merely a means of making the point that a mathematical assessment is not envisaged, a point the majority accept.

[134] The alternative assessment (now withdrawn) treated the arrangement as Frucor issuing a deeply discounted zero-interest bond to Danone Asia with a face value of $204 million and an issue price of $149 million. This would have given rise to a non-resident withholding tax liability on $55 million of interest paid by Frucor to Danone Asia upon maturity of the convertible note, while preserving the tax deductibility of the $66 million in interest paid by Frucor under the convertible note.

[135] Tax Administration Act, ss 141B(5) and 141D(7)(a).

[136] *Commissioner of Inland Revenue v Auckland Harbour Board* [2001] UKPC 1, [2001] 3 NZLR 289 [*Auckland Harbour Board (PC)*]; and *Peterson v Commissioner of Inland Revenue* [2005] UKPC 5, [2006] 3 NZLR 433.

[137] See the majority above at [129] as well as the academic commentary cited at n 80.

address tax avoidance.[138] While Frucor overstates the position somewhat, the majority seriously understates the changes brought about by *Ben Nevis*.

[189] I say Frucor somewhat overstates the position because, from at least the decision of the Privy Council in *Challenge Corporation Ltd v Commissioner of Inland Revenue* (*Challenge (PC)*),[139] it was clear that meeting the specific provisions of the relevant tax legislation, including any specific anti-avoidance provisions, did not mean that the GAAR could not be engaged.[140] *Challenge (PC)* introduced the notion of tax mitigation (allowable) and tax avoidance (caught by the GAAR). The latter was where taxpayers reduce their liability to taxation without involving themselves in the loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer.[141]

[190] I say that the majority seriously understates the effect of this Court's decision in *Ben Nevis* because there were two significant changes brought by that decision, both contained in the second stage of the analysis and which are not referred to by the majority. These are the requirements to consider both the economic substance of an arrangement and also what was within the contemplation of Parliament.[142] Before then, the courts took what I term a "legal substance" approach.

[191] Under the legal substance approach, the inquiry was not an assessment of the contemplation of Parliament but rather involved a consideration of the words of the statute interpreted in light of their "scheme and purpose" (essentially the first stage of

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138 See *Auckland Harbour Board (PC)*, above n 136, at [11]; and contrast *Ben Nevis*, above n 92, at [103] per Tipping, McGrath and Gault JJ.

139 *Challenge (PC)*, above n 124.

140 This means (as pointed out in *Ben Nevis*, above n 92, at [197] per Tipping, McGrath and Gault JJ) that there was only a remote prospect of the New Zealand courts reverting back to the approach applied in *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1976] 1 NZLR 546 (PC) [*Europa 2*]. See also the majority discussion above at [126]–[127]. I also say Frucor overstates the position in light of the criticism that the "long stop" characterisation by the Privy Council received: see below at [219].

141 *Challenge (PC)*, above n 124, at 561–562 per Lord Keith, Lord Brightman, Lord Templeman and Lord Goff. I discuss *Challenge (PC)* in relation to later cases below at [213], [215], [222]–[224], [232]–[233] and [246]. I note that the majority, above at [115], dubs this the "not suffering the economic burden" approach.

142 The majority, above at [141], refer to the numerous cases where there is a mention of "not suffering the economic burden". This is quite different from the economic substance approach in *Ben Nevis*, as explained in detail below.

the *Ben Nevis* analysis).[143] This approach is shown by the comments of the majority of the Privy Council set out below.[144] Richardson J in the Court of Appeal's decision in *Challenge* made similar comments:[145]

> … emphasis on trying to discern the scheme and purpose of the legislation is likely to provide the legal answer to the relation between [the GAAR] and other provisions of the Act that best reflects the intention of Parliament as expressed in the statute.

[192] Further, it was the legal form of an arrangement, rather than the economic substance, that was examined.[146] As Richardson J said in *NZI Bank Ltd v Euro-National Corporation Ltd*:[147]

> … the true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. It is not to be determined by an assessment of the broad substance of the transaction measured by the overall economic consequences to the participants. The forms adopted cannot be dismissed as mere machinery for effecting other purposes. At common law there is no half-way house between sham and characterisation of the transaction according to the true nature of the legal arrangements actually entered into and carried out.

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143 As noted above at n 142, and contrary to the view of the majority above at [141], the legal substance and the "not suffering the economic burden" approaches are different from the *Ben Nevis* economic substance approach. It follows therefore that the language "what Parliament intended" is also different from "Parliamentary contemplation", at least insofar as what those tests are applied to: ie the legal substance or the economic substance. I note too that the approach to ascertaining Parliamentary intention in the pre-*Ben Nevis* cases was largely grounded in the language of the statute: see, for example, below at [197] and [200]. As noted at n 93, this effectively equates to the first stage of *Ben Nevis.* I refer also to the comments of Professor Elliffe and Jess Cameron, above n 109, quoted below at [193], on the much less formalistic approach under the Parliamentary contemplation test.

144 *Auckland Harbour Board (PC)*, above n 136, set out below at [197] and [200]. .

145 *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 (CA) [*Challenge (CA)*] at 549. Although the Court of Appeal's actual decision in that case was overturned by the Privy Council, Richardson J's approach remained current at the time Frucor filed its tax returns, as was accepted by the Court of Appeal in the decision upheld in *Ben Nevis*: *Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230, (2007) 23 NZTC 21,323 [*Accent Management (CA)*] at [112]–[113]. *Accent Management (CA)* and *Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC) [*Accent Management (HC)*] are the lower Court decisions relating to the same matter as in *Ben Nevis*, above n 92.

146 For a discussion of the history and a criticism of the "legal substance" approach, see generally Thomas, above n 93.

147 *NZI Bank Ltd v Euro-National Corporation Ltd* [1992] 3 NZLR 528 (CA) at 539, discussed in Thomas, above n 93, at 26–27.

[193] Professor Craig Elliffe and Jess Cameron have labelled *Ben Nevis* a "sea change", both with regard to the concentration on economic substance and the modification of the scheme and purpose approach:[148]

> Although the "scheme and purpose" approach remains, it is modified by two factors. First, there is an explicit acknowledgement that, in a "tandem approach" to interpretation of the black letter law and the GAAR, the GAAR is to be given equal weight and purposively interpreted. Secondly, the test is modified by the addition, or some might say substitution, of a "Parliamentary contemplation" test.
>
> The result of both of these significant changes is an empowering of the judiciary to pursue a form of interpretation that is much less formalistic, and that necessarily involves even more of an enquiry into the commercial and business motivations of the taxpayer. A natural consequence of this may be a greater reliance on the attitude of the judges applying the test and definitely a significant loss of certainty …
>
> …
>
> [I]t is the writers' view that there has been a sea change in the judicial approach to tax avoidance cases. The scheme and purpose approach is modified with a more purposive interpretation of the GAAR, backed by a judiciary hostile to tax avoidance and prepared more than ever to focus on the economic consequences of a transaction, rather than its legalistic form.

[194] The legal substance approach, which was current at the time Frucor took its tax position, is illustrated by *BNZ Investments Ltd v Commissioner of Inland Revenue,*[149] *Peterson* and the High Court and Court of Appeal decisions in *Ben Nevis* but, most relevantly for this case, by *Auckland Harbour Board.* I deal with these cases in the chronological order in which they were decided. Appendix Three sets out the timing of the relevant decisions by comparison to when Frucor took its relevant tax positions.

Commissioner of Inland Revenue v Auckland Harbour Board

[195] The Auckland Harbour Board, which was about to be abolished, transferred a substantial amount of government and local authority stock for no consideration to two charitable trusts it had created.[150] The absence of consideration created a negative

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[148] Elliffe and Cameron, above n 109, at 442 and 461 (footnotes omitted).

[149] *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 (CA) [*BNZ Investments (CA)*].

[150] The transfers were done to avoid the effects of impending local government reform which would have required the Harbour Board to transfer the stock to Auckland Regional Council, the successor to the Board. A fuller background is set out in *Auckland Harbour Board v Commissioner of Inland Revenue* (1998) 18 NZTC 13,826 [*Auckland Harbour Board (HC)*] at 13,854.

base price adjustment, under the formula then contained in s 64F(2) of the Income Tax Act 1976, that it claimed as a deduction.[151] The Commissioner took the view that such a deduction was not available because of what it described as the general anti-avoidance section contained in s 64J(1) of the then Act. That provided:

> **64J Non-market dispositions**
>
> (1) Where the Commissioner, having regard to any connection between the parties to the issue or transfer of a financial arrangement and to any other relevant circumstances is satisfied that the parties were dealing with each other in relation to the issue or transfer in a manner that has the effect of defeating the intent and application of sections 64B to 64M of this Act, the Commissioner may, for the purposes of calculating the assessable income or expenditure of the parties under section 64C or section 64D or section 64F or section 64I of this Act, deem the consideration for the issue or transfer to be equal to the consideration that might reasonably be expected for the issue or transfer if the parties to the issue or transfer were independent parties dealing at arm's length with each other in relation to the issue or transfer.

[196] Counsel for the Commissioner argued that a transfer of a financial arrangement to a related party for nil consideration had the effect of defeating the intent and application of the accrual regime.[152]

[197] The Privy Council accepted that the Harbour Board was connected to the trusts, the trusts having been established by the Harbour Board.[153] It said that, in light of those circumstances and the fact that the transfer was for nil consideration, the question was whether the transaction had the effect of defeating the "intent and application" of the accruals regime in terms of s 64J.[154] It described the appropriate approach as follows:[155]

> … the only way to test [the Commissioner's] submission is to inquire into what Parliament's intention in the matter actually was. And for this purpose, *the only available material is the language in which Parliament has expressed itself,* properly construed according to currently accepted notions of how a taxing Act should be interpreted and with due regard to s 5(j) of the Acts Interpretation Act 1924 as amended.

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151 *Auckland Harbour Board (PC)*, above n 136, at [3]–[4]. It is worth noting the obvious: the trusts, being charitable, would not be paying tax on any returns from the stock.

152 At [8].

153 At [6].

154 At [6]–[7]. That the transfers may have been to defeat the objects of the local government reform was held by the Privy Council to be irrelevant for the purposes of the legal issues before the Court: at [1]. Today the accruals regime is often called the financial arrangements regime. I use the terms interchangeably in this judgment.

155 At [8] (emphasis added).

[198] The Privy Council noted the Commissioner's concession that it was not possible to read s 64F:[156]

> … as requiring anything other than the actual consideration to be used as part of the formula for calculating the base price adjustment. If the consideration is nil, that is the figure to be inserted. If this is what s 64F means, [t]heir Lordships find it difficult to understand on what basis it can be said that it was not its intention.

[199] The view of the Privy Council was that in that particular case there was "no tension between the commercial and juristic character of the transaction."[157] It was:[158]

> … in legal, commercial or any other terms, a transfer of financial arrangements for no consideration. Such a transaction either attracts a deduction or it does not. The Commissioner accepts that it does, but claims the right under s 64J(1) to be able to amend the law to ensure that it does not. Their Lordships do not think that the section was intended to confer such a power. It would amount to the imposition of tax by administrative discretion instead of by law.

[200] The Privy Council considered that the Commissioner's argument was in effect that an exception or qualification should be added to s 64F(1) but this was "*contrary to several of the provisions of the Act, which is the appropriate place in which to discover what the legislature contemplated*".[159] In particular, the Privy Council noted two provisions: s 64J(3) which dealt with persons holding financial arrangements as trading stock who transfer financial arrangements for no consideration; and s 64F which dealt with the forgiveness of consideration due under a financial arrangement – the Privy Council considered the latter in commercial terms to be no different from a transfer for no consideration.[160] The Privy Council characterised s 64J(1) as "a long stop".[161]

[201] The Court of Appeal, by majority, had concluded that Auckland Harbour Board was entitled to a deduction by virtue of the base price adjustment under s 64F(2), and

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156 At [9].
157 At [12].
158 At [12].
159 At [14] (emphasis added).
160 At [14]–[15].
161 At [11]. This comment was not, however, vital to its decision. See the majority's discussion of this point above at [119].

that s 64J(1) did not apply to disallow the deduction.[162] The majority took a narrow view of the "scheme and purpose" of the accrual rules as being "primarily concerned with the timing and recognition of income and expenditure for tax purposes."[163] It considered that nothing had been done by Auckland Harbour Board to shift or change that timing.[164]

[202] Gault J, in applying a legal substance approach, also relied heavily on the statutory wording of s 64J which emphasised the requirement that there be a "transfer".[165] Nevertheless, he reached a different outcome from the majority on the basis that the connection between the parties and the circumstances of the transfer were such that intent and application of the rules were defeated.[166]

[203] In his dissent Thomas J emphasised an approach towards GAAR that would have required the courts to examine the economic substance of the transaction, as opposed to the more formalistic approach of the majority which stressed the statutory language of the specific provisions under which the deductions were sought.[167]

[204] Thomas J placed emphasis on the fact that transferring the stock for no consideration meant that receipt of income had been "deferred in toto" and "effectively eliminated".[168] He commented that the accrual rules were "not designed to provide a base price adjustment in circumstances where the donor has chosen to give a financial instrument to a third party".[169] This was particularly the case in his view where the Harbour Board did not in fact suffer a loss on the stock and it had been

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162 *Auckland Harbour Board v Commissioner of Inland Revenue* (1999) 19 NZTC 15,433 (CA) [*Auckland Harbour Board (CA)*].

163 At [60]–[61] per Richardson P and Keith J. See also the concurring judgment of Blanchard J at [150].

164 At [62] per Richardson P and Keith J.

165 At [79], [83] and [85] per Gault J. The then s 64J(2) stated that "where in relation to any persons, a financial arrangement matures or is remitted ..., sold, or otherwise transferred ... that financial arrangement shall be an amount calculated in accordance" with the provided formula.

166 At [84] per Gault J. The High Court had considered that, but for the Harbour Board's channelling of the stock through the trusts it would not have been entitled to the base price adjustment deduction: *Auckland Harbour Board (HC)*, above n 150 at 13,857. The Privy Council did not see these circumstances as relevant: see above at [197], in particular, n 154.

167 At [94]–[95] per Thomas J.

168 At [110] per Thomas J.

169 At [109] per Thomas J.

transferred for reasons that were not associated with the instrument.[170] Finally, he considered that to allow a deduction in these circumstances would be to allow a deduction for a gift, effectively avoiding gift duty and creating an unwarranted difference between a gift of cash and the gift of a financial arrangement, albeit equivalent in economic terms.[171]

Discussion of *Auckland Harbour Board*

[205] *Auckland Harbour Board* is the most analogous to the facts of the present case. In the present case, on the majority's view of the economic substance of the arrangement, Frucor was claiming a deduction for capital payments.[172] In *Auckland Harbour Board* the Privy Council, taking the then "legal substance" approach, allowed the Harbour Board what were essentially deductions for gifts of capital.

[206] In Frucor's case, the refinancing involved the issuing of a convertible note to replace a loan associated with a real business acquisition which (as shown by the eventual sale price) had significantly gained in value.[173] This in fact puts the Frucor arrangement in a more favourable light than in *Auckland Harbour Board*, where the transfer had no association with the Board's business but rather was to avoid the consequences of the local government restructuring.[174]

[207] Had the Privy Council applied this Court's approach in *Ben Nevis* to the facts of *Auckland Harbour Board* a different outcome would likely have been reached. To apply the *Ben Nevis* approach, it is first necessary to understand the underlying rationale of the financial arrangements regime. The regime was designed:[175]

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170 At [111] per Thomas J. The allegation was that the transfer to the trusts had been to avoid a transfer to the Auckland Regional Council: see above at n 150.

171 At [112] per Thomas J.

172 See the majority above at [72]. But note the test was legal and not economic substance at the time Frucor took its tax positions and the legal form was a convertible note which is treated as debt until converted: discussed further below at [246].

173 See above at [147]–[148] and [150].

174 See above at n 150. The Privy Council considered that the fact that the transfer was to avoid the consequences of restructuring was not a relevant consideration: see above at [197], in particular, n 154.

175 Winston Peters and Bill Birch *The Taxation of Financial Arrangements: A discussion document on proposed changes to the accrual rules* (Inland Revenue Department, December 1997) at [1.2]. For the policy and legislative history of the accrual regime, see generally Susan Glazebrook, Andra Glyn-Jones, Jan James and Greg Cole *The New Zealand Accrual Regime – a practical guide* (2nd ed, CCH, Auckland, 1999) at ch 1.

- to bring to tax all returns on financial arrangements on an accrual basis over the term of the arrangement, including the returns on instruments that can alter the incidence of those returns, such as derivatives;

- to overcome deferral of tax by spreading income and expenditure over the term of the arrangement; and

- to set out the methods by which expected income and expenditure are calculated and allocated to an income year.

[208] In other words, the purpose of the regime was to bring to tax, on an accrual basis, all returns from financial arrangements whatever their form. In the case of *Auckland Harbour Board*, the decision of the Privy Council gave a deduction for what was, in economic terms, a gift of capital, and in circumstances where the related recipient trusts would pay no tax on any returns from the bonds. If the *Ben Nevis* parliamentary contemplation and economic substance test had been applied to the *Auckland Harbour Board* transaction, it is difficult to see how it could not have been seen as defeating the underlying rationale of the accrual rules (in other words outside the contemplation of Parliament) and thus as tax avoidance. However, at the time it was the legal and not the economic substance of an arrangement that was at issue. Hence the decision of the Privy Council that it did not constitute tax avoidance.

[209] The majority in this case place little weight on *Auckland Harbour Board*.[176] This seems to be on the basis that in Frucor's case, unlike for the Harbour Board, there was "tension between the commercial and juristic character of the transaction."[177] As already noted, however, the Privy Council, in making the comment that there was no such tension in *Auckland Harbour Board*, was not applying an economic substance approach. It was applying the then current legal substance approach. In economic terms, the Harbour Board's loss was not a negative return on a financial arrangement (the way it was treated by the Privy Council and by the majority of the Court of Appeal). It was a gift of capital to a related entity. There was therefore, contrary to the view of the Privy Council majority, clearly a difference between the transaction's legal form and its economic substance in *Auckland Harbour Board*. This is therefore not a legitimate basis to distinguish the *Auckland Harbour Board* case from this one.

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[176] See the majority above at [130].

[177] *Auckland Harbour Board (PC)*, above n 136, at [12]. I discuss the Privy Council and Court of Appeal majority approaches above at [197]–[201].

Commissioner of Inland Revenue v BNZ Investments

[210] The legal substance approach is also clearly discernible in the High Court decision in *BNZ Investments Ltd v Commissioner of Inland Revenue* and the Court of Appeal majority decision upholding it.[178]

[211] In that case, BNZ Investments (a subsidiary of the BNZ) made nine redeemable preference share (RPS) investments in entities provided by Capital Markets Ltd, a member of the Fay Richwhite Group. The RPS provided a return in the form of dividends.

[212] Capital Markets utilised the proceeds from the RPS in complex offshore transactions, which avoided New Zealand tax on the investment earnings. The High Court characterised these as "downstream" transactions and the transactions related to the subscription for the RPS as "upstream" transactions.[179] The Court held that BNZ Investments was not party to an "arrangement" within the meaning of the GAAR involving the "downstream" transactions.[180] Although that finding was sufficient to dispose of the matter, the High Court went on to consider whether the "downstream" transactions meant that the whole arrangement was a tax avoidance arrangement.[181] The Judge applied a legal substance approach, focusing on the individual transactions:

> [108] … the purpose of the intermediate transactions was to avoid tax, required by the economics of the overall scheme, but each came within a concessional specific provisions of the Act, and each involved real transactions with actual financial effects. … These were real transactions, with real alterations of position in their terms.

[213] The Judge declined the Commissioner's invitation to take a more holistic economic substance approach, considering himself bound to take the legal substance approach:[182]

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178 *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732 (HC) [*BNZ Investments (HC)*]; and *BNZ Investments (CA)*, above n 149. For a discussion of the case, see Thomas, above n 93, at 40–42.

179 *BNZ Investments (HC)*, above n 178, at [5].

180 At [70].

181 At [71].

182 Referring to *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 (HL).

> [110] The Commissioner seeks to overcome these individual realities by *Ramsay* and economic substance approaches. On that more Olympian view, the downstream transactions are put as a preordained and interdependent whole, the effect being [the taxpayer] lending at interest. That perspective is not permissible under *Challenge* doctrine. The individual steps have tax consequences under the Act and carry individually and collectively the necessary alterations and financial position. …

[214] The Court of Appeal, by majority, agreed that there was a natural divide between the upstream and downstream transactions.[183] The majority held that an "arrangement" under the GAAR required a meeting of minds between the parties.[184] On the High Court's findings of fact, there was no such meeting of the minds between BNZ Investments and Capital Markets as to the activities Capital Markets would undertake downstream.[185] This finding meant that the majority did not need to consider the downstream transactions.

[215] The majority reasons, delivered by Richardson P, did, however, make some comments on the proper approach to the GAAR:

> [39] For the reasons discussed in the cases (eg *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 at 545), [the GAAR] is perceived legislatively as an essential pillar of the tax system designed to protect the tax base and the general body of taxpayers from what are considered to be unacceptable tax avoidance devices. By contrast with specific anti-avoidance provisions which are directed to particular defined situations, the legislature through [the GAAR] has raised a general anti-avoidance yardstick by which the line between legitimate tax planning and improper tax avoidance is to be drawn.
>
> [40] Line drawing and the setting of limits recognise the reality that commerce is legitimately carried out through a range of entities and in a variety of ways; that tax is an important and proper factor in business decision making and family property planning; that something more than the existence of a tax benefit in one hypothetical situation compared with another is required to justify attributing a greater tax liability; that what should reasonably be struck at are artifices and other arrangements which have tax induced features outside the range of acceptable practice – as Lord Templeman put it in *Challenge* at 562, most tax avoidance involves a pretence; and that certainty and predictability are important but not absolute values.
>
> [41] The function of [the GAAR] is to protect the liability for income tax established under other provisions of the legislation. The fundamental difficulty lies in the balancing of different and conflicting objectives. Clearly

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183 *BNZ Investments (CA)*, above n 149, at [56] per Richardson P, Keith and Tipping JJ. See also at [168]–[169] and [171] per Blanchard J.

184 At [50] per Richardson P, Keith and Tipping JJ. Blanchard J held that "the taxpayer must at least have a broad appreciation of the character of what is occurring": at [172].

185 At [56] per Richardson P, Keith and Tipping JJ and [170]–[171] per Blanchard J.

> the legislature could not have intended that [the GAAR] should override all other provisions of the Act so as to deprive the taxpaying community of structural choices, economic incentives, exemptions and allowances provided by the Act itself. Equally the general anti-avoidance provision cannot be subordinated to all the specific provisions of the tax legislation. It, too, is specific in the sense of being specifically directed against tax avoidance; and it is inherent in the section that, but for its provisions, the impugned arrangements would meet all the specific requirements of the income tax legislation. The general anti-avoidance section thus represents an uneasy compromise in the income tax legislation.
>
> [42] Line drawing represents the legislature's balancing of the relevant public interest considerations. …

[216] Thomas J, in dissent, would have applied an economic substance approach:[186]

> [113] I therefore hold firm to the view that … a general anti-avoidance provision requires the Courts to examine the substance of a transaction. Semantics aside, this question can only be answered by reference to the true nature of the transaction. … such an examination is necessary to determine whether certain steps or transactions in an arrangement are fiscally ineffective and to be disregarded in terms of the *Ramsay* principle or approach. Other perceptions or tests fare no better without regard to the substance of the arrangement. …

[217] Thomas J considered the upstream/downstream analysis adopted by the majority as "an artificial reconstruction of the arrangement" ignoring:

> [146] … the overall basic agreement or understanding whereby [BNZ Investments] subscribed for RPS with [Capital Markets], provided a put option, had the right to redeem at a fixed dividend rate, such rate being calculated at a discount from the prevailing interest rate of half the amount of tax saved. Following the use of the tax shelter by [Capital Markets] the funds were returned to [BNZ Investments] as dividends and therefore exempt income.

[218] The majority's exclusion of the downstream transaction because there was no meetings of the minds was criticised by Thomas J as "clearly an arbitrary restriction on the scope of the arrangement for the purposes of [the GAAR]."[187] On the Judge's view, the effect of the arrangement in substance was undeniably the avoidance of tax.[188]

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186 Referring to *Ramsay*, above n 182.
187 At [150] per Thomas J.
188 At [166]–[167] per Thomas J.

[219] As an aside, the description by the Privy Council in *Auckland Harbour Board* of the GAAR at issue in that case as a "long stop" was criticised by Thomas J. He noted Blanchard J's comment that it seemed contrary to decisions of the High Court of Australia and the Supreme Court of Canada in relation to the anti-avoidance provisions in those jurisdictions.[189] He also said that it was contrary to indigenous perceptions of the GAAR, noting that Richardson P, writing for the majority, described the GAAR as "as an essential pillar of the tax system".[190]

Discussion of *BNZ Investments*

[220] The Court of Appeal majority's approach (and that of the High Court) in *BNZ Investments* is a further example of the legal substance approach. This is evident from the division drawn between upstream and downstream transactions, the narrow reading of "arrangement" and the emphasis on the lack of knowledge by the taxpayer as to the detail of the so-called downstream transactions. In the High Court the legal substance approach is also illustrated by the focus on the individual transactions and the specific provisions when considering the downstream transactions. Thomas J, as in *Auckland Harbour Board*, remained a lone voice advocating for the economic substance approach, later introduced by this Court in *Ben Nevis.*

Peterson v Commissioner of Inland Revenue

[221] Mr Peterson was part of two syndicates each of which provided production funding for a film.[191] That funding was provided by the syndicate members in part out of their own resources and in part by way of a non-recourse loan from a party associated with and funded by the production company. The Commissioner allowed a deduction in respect of the amount provided out of Mr Peterson's own resources but not for the amount provided by way of non-recourse loan.

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[189] At [75] per Thomas J referring to Blanchard J's comments at [182] citing *John v Federal Commissioner of Taxation* (1989) 166 CLR 417 and *Stubart Investments Ltd v Canada* [1984] 1 SCR 536.

[190] At [76] per Thomas J citing [39] per Richardson P, Keith and Tipping JJ. The quote from Richardson P is set out in full above at [215]. This is another reason I say Frucor overstated the position somewhat: see above at [188]–[189].

[191] *Peterson,* above n 136. The films were "Utu" and "Lie of the Land".

[222] The Privy Council, by majority, held that Mr Peterson was entitled to the full deduction.[192] The majority held that the fact that the investment was funded by a non-recourse loan, which was unlikely ever to be repaid, did not alter the fact that the investors had suffered the economic burden of paying the full amount.[193] Even taking the wider context into account, including the inflated production costs and the recycling of the loan to the lender, the majority considered that the focus is on the party who acquires the assets and not what happens to the funds in the hands of the vendor.[194]

[223] The minority disagreed. They considered that the non-recourse loan was in fact a device to produce a higher sum to be depreciated; these sums were never received or recorded by the respective production companies as premiums that had to be paid as part of the investors' acquisition costs.[195] In the minority's view, it was not possible to ignore what happened to the money once it had left the investors' hands.[196] In addition, the findings in the Taxation Review Authority meant that in fact the loans had never been made (although the investors were not aware of this and were also not aware of the inflated production costs).[197] The Privy Council minority said that:[198]

> The source of the $y the investors allegedly paid was the non-recourse loans. But the loans were never made. … a clearer case can hardly be imagined of an arrangement that has not in fact involved the taxpayer "in the loss or expenditure which entitles him to that reduction" (per Lord Templeman in the *Challenge* case cited at [37] of Lord Millett's opinion).

Discussion of *Peterson*

[224] Although the majority of the Privy Council in *Peterson* purported to consider whether Mr Peterson had suffered the economic burden of the whole payment, they in fact applied an (arguably extreme) legal form over substance approach. Because of the circumstances of the non-recourse loan, the Commissioner's view of the

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192 At [54] per Lord Millett, Baroness Hale and Lord Brown.
193 At [44] per Lord Millett, Baroness Hale and Lord Brown. The majority set out the test under *Challenge (PC)* (see above at [189]) at [37].
194 At [40]–[42] Lord Millett, Baroness Hale and Lord Brown.
195 At [91] per Lord Bingham and Lord Scott.
196 At [101] Lord Bingham and Lord Scott.
197 At [95]–[98] per Lord Bingham and Lord Scott.
198 At [96] per Lord Bingham and Lord Scott. The minority made this comment in relation to the Utu loans, although it also concluded that the loans had not been made in the case of the Lie of the Land either: at [98].

transaction was well available on the then-current approach to tax avoidance, as is shown by the minority judgment.

[225] The Privy Council majority's view of the particular transaction can arguably be seen as somewhat of an outlier, even on the then-current approach to tax avoidance.[199] Nevertheless, when Frucor took its tax position and filed its 2006 and 2007 returns, no judicial retreat could have been discernible from the legal substance approach. If anything, it would appear from the Privy Council *Peterson* majority decision that the pendulum had swung further in the direction of an even more formalistic approach than had been applied up to that point.

Trinity scheme

[226] The majority in the present case also rely on the High Court and Court of Appeal judgments in *Accent Management* which relate to the Trinity scheme.[200]

[227] The Trinity scheme involved land owned by the subsidiary of a charitable foundation being licensed to a syndicate of investors. The licensees were obliged to plant, maintain and harvest a forestry plantation through a forestry management company. The investors paid $1,350 per plantable hectare for the establishment of the forest and $1,946 per plantable hectare for options over the land, namely, an option to buy the land in 50 years for half of its then market value. This and sundry other payments, including a $50 annual licence fee, sufficed to cover the costs both of acquiring the land and planting and maintaining the forest. The land had been bought for around $580 per plantable hectare.

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[199] It may be the case that the Privy Council majority was influenced by the fact that the investors had not been aware of the way in which the scheme as a whole operated. The High Court and the Court of Appeal majority in *BNZ Investments* were clearly influenced by BNZ Investments' apparent lack of knowledge as to the so-called downstream transactions: see above at [212] and [214]. However, both the *Peterson*, above n 136, Privy Council majority (at [34]) and the minority (at [93]) said, contrary to the view of the majority in *BNZ Investments (CA)*, above n 149, that an "arrangement" did not require a meeting of the minds, that the taxpayer need not be party to the arrangement and need not know the details of the arrangement.

[200] *Accent Management (CA)*, above n 145, was decided before Frucor filed its 2007 tax return but after it had filed its 2006 tax return. *Accent Management (HC)*, above n 145, was decided before Frucor filed its 2006 and 2007 tax returns: see Appendix Three.

[228] Despite the upfront payments already covering the cost of the land and planting and maintenance of the forest, the syndicate investors agreed to pay a licence premium of some $2 million per plantable hectare payable in 50 years' time after the trees were harvested and sold. The syndicate purported to discharge its liability for the licence premium immediately by the issuing of a promissory note redeemable in 50 years' time. It was unlikely that ultimately the venture would be profitable given the amounts paid already by the investors.[201]

[229] There was also a purported insurance arrangement to cover the risk that the harvest would not yield sufficient income to pay the licence premium. There was an upfront and a deferred insurance premium payable, at $1,307 per plantable hectare and $32,791 per plantable hectare respectively. The insurance provider was controlled by one of the promoters of the scheme and, because of an arrangement with the landowner, did not in fact carry any risk.[202] Some 90 per cent of the upfront premiums paid found their way back to the promoters' family trusts.[203]

[230] The investors claimed an immediate deduction for the insurance premium (both the current and deferred portions) and claimed a depreciation deduction of the $2 million licence premium amortised over the 50 years of the arrangement.

[231] All three Courts in the judicial hierarchy held that the Trinity scheme was tax avoidance.[204] All three Courts considered that the taxpayers had taken an abusive tax position in terms of s 141D and imposed 100 per cent shortfall penalties.[205]

High Court decision in *Accent Management*

[232] The High Court, noting the uncertainty of the profitability of the forest venture contrasted with the certainty and extent of the deductions as well as the degree of relationship and circularity between payments, concluded that the Trinity scheme was

201 *Ben Nevis*, above n 92, at [122].
202 At [148].
203 At [144].
204 *Accent Management (HC)*, above n 145, at [401]; *Accent Management (CA)*, above n 145, at [146]; and *Ben Nevis*, above n 92, at [1] per Elias CJ and Anderson J and [156] per Tipping, McGrath and Gault JJ.
205 *Accent Management (HC)*, above n 145, at [402]; *Accent Management (CA)*, above n 145, at [170]; and *Ben Nevis*, above n 92, at [1] per Elias CJ and Anderson J and [209] per Tipping, McGrath and Gault JJ.

established and structured to achieve the mismatch of the deductibility of the license and insurance premiums.[206] Applying *Challenge (PC)* and the majority approach in *BNZ Investments*,[207] it held the arrangement to be tax avoidance.[208]

Court of Appeal decision in *Accent Management*

[233] The Court of Appeal conducted a review of the caselaw to date on the GAAR. It identified the "scheme and purpose" approach of Richardson J in the *Challenge* Court of Appeal decision as "current" and of "particular significance".[209] The Court identified several indicators of tax avoidance such as where transactions are "technically correct but contrived" or where there are "elements of pretence".[210] The Court said that, although there is no taxation on the basis of "economic equivalence", issues relating to economic reality are nevertheless important,[211] referencing the approach in *Challenge (PC)* and quoting the comment of Lord Nolan that:[212]

> The hallmark of tax avoidance is that the taxpayer reduces [their] liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in [their] tax liability.

[234] The Court of Appeal referred with approval to the comments on the proper approach to tax avoidance by Richardson P in *BNZ Investments* and, in particular, the comments on line drawing.[213] It then examined in some depth the Privy Council decision in *Peterson*,[214] concluding both the minority and the majority used a similar test and commenting that:

> [123] … the difference between the two approaches seems to have come down to a difference of opinion as to whether the investors had, in truth,

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206 *Accent Management (HC)*, above n 145, at [308], [312], and [322].
207 At [282]–[286] and [305].
208 At [146], [304] and [306].
209 *Accent Management (CA)*, above n 145, at [112]. I also discuss this above at n 145.
210 At [118](a)–(b) citing *Challenge (CA)*, above n 145, at 532 per Woodhouse P; and *Challenge PC*, above n 124, at 562 per Lord Templeman.
211 At [118](c).
212 *Inland Revenue Commissioners v Willoughby* [1997] 1 WLR 1071 (HL) at 1079. The Court of Appeal in *Accent Management* commented (at [118]) that the remarks in *Willoughby* had been cited by the majority in *Peterson*, above n 136, at [38], as applicable in the New Zealand context.
213 *Accent Management (CA)*, above n 145, at [119]. The relevant quotes from *BNZ Investments (CA)*, above n 149, are set out above at [215].
214 At [120]–[123]. *Peterson*, above n 136, was decided after the High Court decision in *Accent Management* and before the Court of Appeal decision: see Appendix Three below.

> suffered the pretax economic consequences which were intended by the legislature to be the prerequisite of deductibility.

[235] The Court of Appeal thus accepted the test of whether the requisite economic consequences had been suffered was the correct one. It said that in some cases the legislature must have intended to encourage certain types of behaviour.[215] The anti-avoidance provisions could not be taken to apply in such cases. Likewise, it may be "obvious that the specific tax rules relied on were not intended to confer the tax benefit in issue".[216] Such cases would probably fail on a proper interpretation of the specific provisions without need to have recourse to the GAAR. The Court went on to say:

> [126] Cases which lie in between the two extremes just identified still raise a question of statutory interpretation but one which, in our view, cannot be addressed solely by reference to the specific tax rules relied on by the taxpayer. The relevant general anti-avoidance provisions are also relevant. Given the generality of cases to which specific tax rules necessarily apply, it would be unrealistic to confine the application of general anti-avoidance provisions to transactions which lie outside of a discernible specific legislative purpose. When construing such specific rules and looking for their scheme and purpose, it is necessary to keep general anti-avoidance provisions steadily in mind. On this basis, it will usually be safe to infer that specific tax rules as to deductibility are premised on the assumption that they should only be invoked in relation to the incurring of real economic consequences of the type contemplated by the legislature when the rules were enacted. Further, it also seems reasonable to assume that deductibility rules are premised on a legislative assumption that they will only be invoked by those who engage in business activities for the purpose of making a profit. Further, schemes which come within the letter of specific tax deductibility rules by means of contrivance or pretence are candidates for avoidance. The result in any given case comes down to a question of evaluation, or as Richardson P put it in *BNZ Investments*, an exercise in "line drawing".

[236] Applying the analysis required by the past caselaw, the Court of Appeal held that, because the license fee payable by the taxpayers was "essentially voluntary", the taxpayers had "not suffered the pre-tax economic burden (as opposed to a technical legal liability) which Parliament intended as the pre-condition of deductibility".[217] Although there was a business in the "real and tangible sense":[218]

> … the real purpose of the arrangement is not the conduct of a forestry business for profit, but rather generation of spectacular tax benefits. The end result (ie

215 At [125].
216 At [125].
217 At [144].
218 At [140]–[141].

> the profitability or otherwise of the venture) was never seen as being material. The corollary of this statement is that there never was a "real" purpose of making a profit from the harvesting of trees.

[237] The Court of Appeal concluded that there was thus no economic burden borne and no business purpose. The arrangement was "technically correct but contrived" and "an artifice".[219] In the light of those conclusions, the Court of Appeal was of the view that the scheme was "well and truly across the 'line' referred to by Richardson P in *BNZ Investments*."[220]

Discussion of *Accent Management*

[238] Both the High Court and the Court of Appeal in *Accent Management* applied the then-current legal substance test to the Trinity scheme, as they were of course obliged to do in terms of the then-current Privy Council authority. There is nothing in the *Accent Management* judgments therefore that suggests a different approach from the previous authorities, including *Auckland Harbour Board*.[221] Frucor's liability for penalties must therefore be judged on the basis of the legal substance approach. Under this approach, it is true taxpayers must incur the economic burden envisaged by the relevant provision in terms of *Challenge PC*, but this is judged on the basis of legal form and not economic substance.[222]

[239] The "sea change" of moving to economic substance and contemplation of Parliament[223] occurred at the time of this Court's decision in *Ben Nevis* which post-dated the tax positions taken by Frucor.

[240] While the majority acknowledges that the Trinity scheme was "worse" than the arrangement in the case before us, they still suggest that the Court of Appeal decision

219 At [144](d).
220 At [146].
221 There were arguably indications in the Court of Appeal judgment that, absent current authority, the Court may have preferred a different approach (see for example at [114]–[115]). But that cannot change the fact the Court was applying the then-current caselaw, including *Challenge PC*, above n 124, in its analysis and therefore there could have been nothing to alert to any change in the test to be applied.
222 The majority's comments at [139]–[142] misunderstand the previous caselaw in this regard and therefore, as noted earlier, the majority seriously understates the fundamental changes brought about by *Ben Nevis*, above n 92.
223 Elliffe and Cameron, above n 109.

on the Trinity scheme is important in assessing whether Frucor was taking an unacceptable or abusive tax position.[224]

[241] I disagree. The Frucor convertible note involved deductions for actual payments made that, on the majority's view of economic substance, were partly capital in the guise of interest. But, note that legal and not economic substance was the test at the time Frucor took its tax positions. *Auckland Harbour Board*, the most analogous case, involved a gift of capital.[225]

[242] Neither *Auckland Harbour Board* nor the present case bear any relationship to the elaborate and artificial Trinity scheme which involved large deferred sums that would never in fact be paid and that had absolutely no business justification. The licence premium purportedly related to forests and land which had in fact already been paid for by the investor,[226] while the deferred insurance premium related to what was in effect an illusory insurance scheme.[227]

[243] In Frucor's case, the refinancing was of a debt incurred for the acquisition of a very successful investment by way of the issuing of a convertible note on which interest was actually paid and thus the economic burden suffered.[228] This provides a very stark contrast to the Trinity scheme where, as the Court of Appeal held, there was no economic burden borne (because the deferred payments would never be paid), no commerciality of any kind and effectively no business.[229]

[244] As Professor Elliffe and Jess Cameron say:[230]

> The Ben Nevis scheme in particular was an especially egregious arrangement in many respects. There was a large disparity between the magnitude of the tax advantages claimed, as compared to the economic burden borne. It was also clear from both the statements made by the architect of the scheme,

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224 See the majority above at [131]–[132].
225 See above at [205]–[209].
226 See above at [227]–[228].
227 See above at [229]–[230].
228 There may have been some contrivance and artificiality involved in the offshore elements of the scheme but under the legal substance test it would have been the economic burden of the interest under the convertible note that was at issue.
229 See above at [236]–[237].
230 Elliffe and Cameron, above n 109, at 443. See also Susan Glazebrook "Statutory Interpretation, Tax Avoidance and the Supreme Court: Reconciling the Specific and the General" (2014) 20 NZJTLP 9 at 24–25.

> Dr Muir, and the insertion of various artificial steps into the arrangement that this scheme had been very carefully engineered to maximise tax benefits, with little regard for the purported business purpose of the transactions.

[245] For all of the above reasons, the majority's reliance on the fact that penalties were imposed in *Ben Nevis* is misplaced.[231]

Frucor under the legal substance test

[246] Applying the legal substance approach, at issue would be the correct treatment of the interest under the convertible note pursuant to the interest deductibility provisions, interpreted purposively. The legal form of the convertible note was a debt instrument until converted.[232] The interest paid on the debt was in fact paid. Under *Challenge (PC)*, the taxpayer (Frucor) therefore had the economic burden of paying the interest and thus suffered the expenditure other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction of tax liability.[233] There are few restrictions on interest deductibility and Frucor met all of them.[234] Further, the convertible note was issued to refinance a very successful business acquisition.[235] In these circumstances and, judged by the state of the law at the time, the tax position Frucor took was (at least) about as likely as not to be correct.[236] It follows that Frucor did not take an unacceptable tax position.

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231 See the majority above at [134].

232 The need to consider the legal form of arrangements is discussed above at [192].

233 *Challenge (PC)*, above n 124, at 562 per Lord Keith, Lord Brightman, Lord Templeman and Lord Goff. The majority say above at [130] that it is clear that Frucor (DHNZ in their judgment) did not suffer the economic burden of the amounts paid in interest on the convertible note. On the legal substance approach that is just not correct. The interest was actually paid to Deutsche. Indeed, this is true even on the majority's economic substance approach. The interest was paid and the economic burden of payment suffered by Frucor. That economic burden actually suffered has just been recharacterised by the majority (and the Commissioner) as partly a payment of capital.

234 See above at [173]. Frucor's debt/equity ratio (63 per cent) was well within the allowable levels under the thin capitalisation regime – it could have further increased the convertible note amount up to thin capitalisation limits (75 per cent) to increase its interest deductions. But it did not do so.

235 See above at [150] and [206].

236 Tax Administration Act, s 141B(1). Given the state of the law as at the time Frucor filed its returns and, in particular, the legal substance as against the economic substance approach, the result in *Auckland Harbour Board* and the majority approach in *Peterson*, I cannot understand the general response of the majority above at [142]. I reiterate that the matter is not viewed through a post-*Ben Nevis* lens but in terms of the position at the time the tax returns were filed.

Dominant purpose

[247] The majority say that the dominant purpose of the arrangement in this case was to reduce the tax liabilities of Frucor.[237] This despite the fact that the whole reason for the restructuring was to ensure that Danone Asia did not incur tax liabilities in Singapore, unlike the position before the refinancing where direct debt funding was provided by Danone Finance.[238] Given that, before the refinancing, Frucor was deducting interest payments roughly equivalent to the amounts it claimed deductions for under the current arrangement, it is difficult to see how its purpose could have been to achieve a result it was already receiving (deductibility of interest) and thus difficult to see its dominant purpose as being to reduce its tax liabilities or to achieve an illegitimate tax advantage in New Zealand.

Credible view of the law

[248] As discussed above, I take a different view of the economic substance of the arrangement from the majority.[239] Even on the majority's view of economic substance, however, most of the points I make still apply.[240] There is therefore not only a credible view of the facts that would lead to a finding there had not been tax avoidance but also a credible view of the law, even based on the majority's view of economic substance, that the arrangement was not tax avoidance. In other words, there was a credible view that Frucor was not using the interest deductibility provisions in a manner that was outside the contemplation of Parliament.

Conclusion

[249] For the above reasons, I do not consider penalties should have been imposed. I would have dismissed the Commissioner's cross appeal, even if I had taken the same view as the majority on the question of tax avoidance.

Solicitors:
Bell Gully, Auckland for Frucor Suntory New Zealand Ltd
Crown Law Office, Wellington for Commissioner of Inland Revenue

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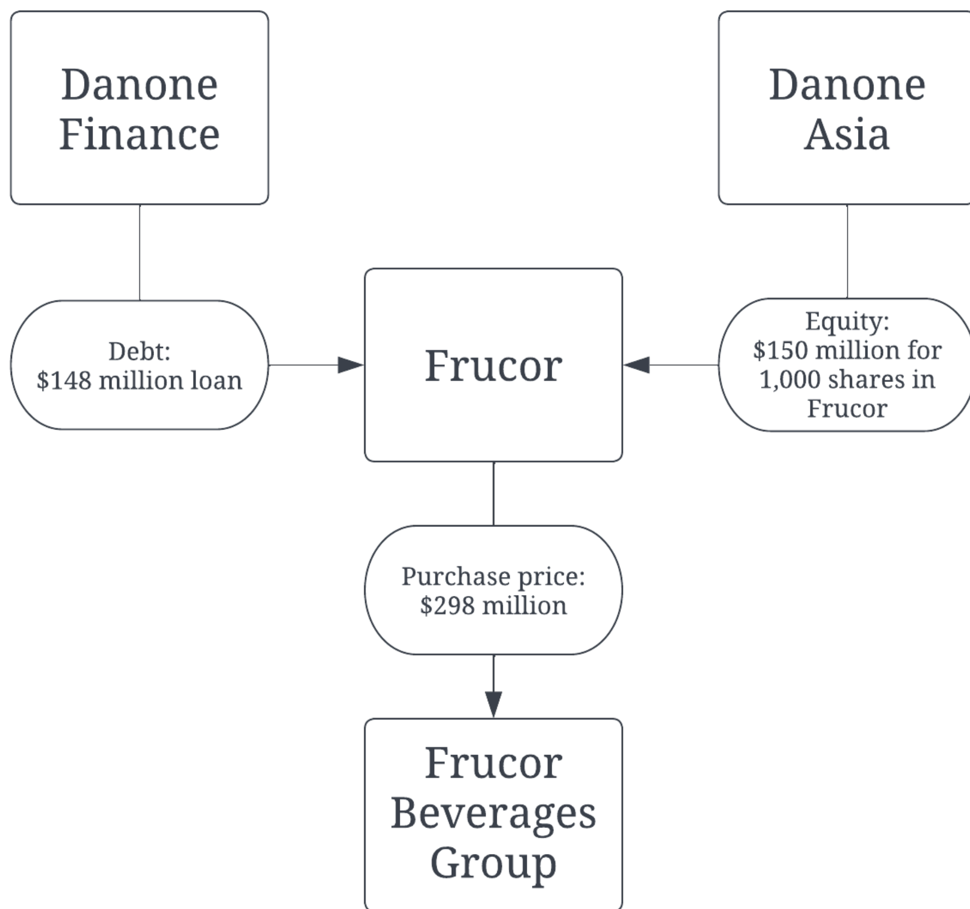
[237] See the majority above at [138].

[238] The majority accept that it was an essential part of the scheme that Danone Asia (called DAP in the majority judgment) not incur tax liabilities in Singapore: see above at [137].

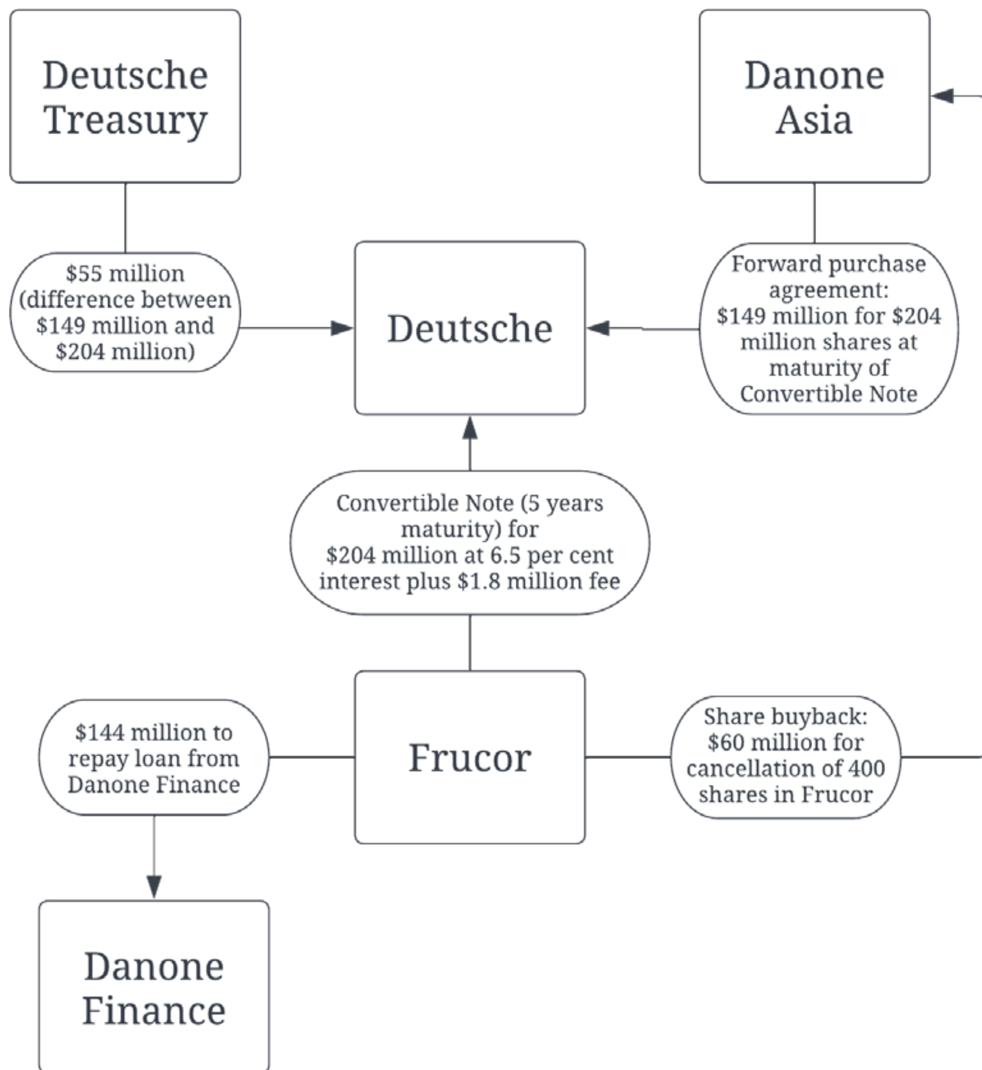
[239] See above at [171], in particular, n 110.

[240] See above at n 111 and n 233.

Appendix One: Pre-refinancing diagram



Appendix Two: Post-refinancing diagram



Appendix Three: Timeline of Frucor's tax returns and relevant judgments