Supreme Court of New Zealand | Te Kōti Mana Nui o Aotearoa

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MEDIA RELEASE

FRUCOR SUNTORY NEW ZEALAND LIMITED v COMMISSIONER OF INLAND REVENUE (SC 81/2020)

COMMISSIONER OF INLAND REVENUE v FRUCOR SUNTORY NEW ZEALAND LIMITED (SC 92/2020)

[2022] NZSC 113

PRESS SUMMARY

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

Background

On 17 January 2002, Danone Holdings NZ Ltd (DHNZ) bought Frucor Beverages Group Ltd for $298 million. DHNZ funded the purchase with $150 million received from Danone Asia Pte Ltd for the issue of 1,000 ordinary shares, and a loan from Danone Finance SA for the balance.

On 17 March 2003, the funding was restructured. Deutsche Bank advanced $204 million to DHNZ in exchange for a convertible 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 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. DHNZ claimed deductions in respect of these interest payments.

The convertible note transaction 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 (which owned DHNZ) paid Deutsche Bank $149 million on inception of the funding arrangement to acquire these shares at maturity (the forward purchase agreement).

Issues

There are three matters in issue:

1. **Tax avoidance**: Whether s BG 1(1) of the (now repealed) Income Tax Act 2004 was engaged. Section BG 1(1) provides that a tax avoidance arrangement is void as against the Commissioner of Inland Revenue for income tax purposes.
2. **Reconstruction**: Whether the Commissioner's reconstruction under s GB 1(1) of the 2004 Act, under which the taxable income of DHNZ was adjusted by disallowing the deductions said to have been claimed illegitimately, was correct.
3. **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 141(B) of the Tax Administration Act 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).

Lower Court judgments

In the High Court, Muir J upheld Frucor Suntory's challenge to the assessments. The Commissioner's appeal to the Court of Appeal was successful as to the disallowance of the deductions but unsuccessful as to shortfall penalties. Both sides appealed to this Court. The approved grounds of appeal were whether the Court of Appeal was correct to allow the appeal and whether it was correct to hold that shortfall penalties do not apply.

Result

The Supreme Court has, by a 4-1 majority, dismissed Frucor's appeal on the tax avoidance and reconstruction issues, and allowed the Commissioner's cross-appeal on shortfall penalties.

Tax avoidance

The Supreme Court unanimously confirmed that *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 contains the authoritative test on whether there was tax avoidance under s BG 1(1). *Ben Nevis* sets out a two-step test: first, whether the use made of the specific provision was within its intended scope; and second, whether, viewed in light of the arrangement as a whole, the taxpayer's use of the specific provision was outside the contemplation of Parliament when it enacted the provision. The Judges unanimously agreed that Frucor met the first step.

Applying the second step of *Ben Nevis*, Winkelmann CJ, William Young, O'Regan and Ellen France JJ (the majority) found that the tax provisions relied on by DHNZ provide relief in relation to "interest incurred". However, in economic substance 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 and therefore the funding arrangement was a tax avoidance arrangement. Section BG 1(1) applied to void the arrangement.

Glazebrook J dissented. She considered that the majority erred in jumping to the conclusion that the economic substance of the transaction should be taxed without carefully analysing parliamentary contemplation. Among other things, that Frucor could have achieved the exact same tax effect through other similar arrangements showed conclusively that the use of the provision in this case was well within the contemplation of Parliament.

Reconstruction

The majority held that the Commissioner correctly applied s GB 1 to adjust the taxable income of DHNZ to disallow the deductions illegitimately claimed. The reconstruction issue did not arise under Glazebrook J's approach.

Shortfall penalties

The "about as likely as not to be correct" standard under s 141B of the Tax Administration Act is judged by the law at the time the taxpayer took its tax position. The majority was satisfied that on the basis of the facts as they found them to be, the tax positions adopted by DHNZ did not meet that standard, with reference to the law prior to *Ben Nevis*, and were therefore unacceptable. DHNZ acted with the dominant purpose of obtaining tax advantages with the result that the tax positions were abusive per s 141D of the Tax Administration Act.

Glazebrook J, dissenting, considered the majority approach of "taking the facts as they have found them to be" wrong in principle and inconsistent with the scheme of the penalty provisions, leaving room for only one interpretation of the facts. Further, at the time DHNZ had taken its tax positions which was prior to *Ben Nevis*, the courts took a "legal substance" approach. Judged by the legal substance approach, the tax position DHNZ took was at least about as likely as not to be correct and DHNZ therefore did not take an unacceptable tax position. Nor did DHNZ act with the dominant purpose of achieving an illegitimate tax advantage in New Zealand in terms of s 141D.

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