

Statutory interpretation, tax avoidance and the Supreme Court: reconciling the specific and the general

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1. Introduction

As tax avoidance provisions are contained in legislation in New Zealand, tax avoidance cases are necessarily exercises in statutory interpretation. The main issue courts have had to grapple with in such cases is the relationship between the general open-textured anti-avoidance provisions and the specific provisions in the taxation legislation.² Reconciling the

¹ Judge of the Supreme Court. Paper prepared for the New Zealand Institute of Chartered Accountants 2013 Tax Conference held in Auckland from 7–9 November 2013. I am grateful to my clerk, Claire Brighton, for her invaluable assistance with this paper. The views expressed in the paper are my own and do not represent those of the Supreme Court. For further discussion of the courts' interpretation of the general anti-avoidance provision see Susan Glazebrook "Statutory Interpretation and Tax Avoidance" available at <www.courtsofnz.govt.nz>.

² A conflict between the general open-textured anti-avoidance provision and a specific provision may not be explicit but may arise through necessary implication from what specific provisions do not cover: for example (in the taxation context) the lack of a comprehensive capital gains tax. Where a specific provision imposes tax on matters falling within its scope, it creates an implication that circumstances falling outside its scope were not intended by Parliament to be subject to that tax: see discussion in James Ruddell

general and the specific is not, however, limited to the taxation context. That is not to say that the interpretation of general open-textured provisions is easy or that the cases and methodology have always been consistent. The exercise does, however, remain one of statutory interpretation.

In this paper, I propose to examine how the Supreme Court has grappled with the interpretation of tax avoidance provisions and compare the approach in such cases with that taken to the interpretation of other open textured provisions in other legislation. That exercise will necessarily require some consideration of and comparison with the approach taken by the courts before the establishment of the Supreme Court. I concentrate on Supreme Court jurisprudence, however, because, while it draws on past jurisprudence and principles established in other jurisdictions, it is the Supreme Court that has set the current interpretation principles relating to tax avoidance provisions in New Zealand.

But first, a disclaimer. I have had to be selective in both the cases and the principles from those cases that I discuss. As a result, the paper does not purport to be a complete review of tax avoidance jurisprudence even in the Supreme Court. Still less does it purport to be an examination of the general statutory interpretation approach taken by the Supreme Court. I stress that what is set out here is my interpretation of the cases and there is no guarantee that this interpretation would be endorsed by the Supreme Court in any future cases. There is not even a guarantee that my interpretation of the cases I do discuss would survive argument in Court and collegial discussion of those arguments in any final view I might come to in the context of a future case.³ Finally, while there is no reason to think that the Supreme Court would depart from the principles espoused in the tax avoidance cases it has decided so recently, the possibility that it may do so or that it may modify them to some degree cannot be totally discounted.

“Statutory Interpretation, Parliamentary Intention and the General Anti-Avoidance Rule” [2013] 25 NZULR 497 at 514–515.

³ In this regard, I record that I was not on the leave panel for *Alesco New Zealand Limited v Commissioner of Inland Revenue* [2013] NZSC 66 and I have made a point of not reading either the High Court or the Court of Appeal decision or any of the material filed in that case before writing this paper so nothing I say here can be taken in any way as related to that case. I also record that I did not sit (at any level) on the Supreme Court tax avoidance cases I discuss in this paper and so have no inside knowledge of the facts of those cases, apart from through the judgments.

2. Interpretation of other open-textured provisions in the Supreme Court

I start with the Supreme Court's interpretation approach to other open textured provisions. In this regard, I will discuss two cases: *New Zealand Māori Council v Attorney-General*⁴ (*Water case*) and *West Coast ENT Inc v Buller Coal Limited*⁵ (*Coal case*).

3. Water case

3.1 Background

Taking the *Water case* first, it is necessary as background to discuss the seminal *Māori Council*⁶ case decided by the Court of Appeal in 1987, which considered the effect of s 9 of the State-Owned Enterprises Act 1986 (SOE Act).⁷ Section 9 provides that “nothing in this Act shall permit the Crown to act in a manner that is inconsistent with the principles of the Treaty of Waitangi.”

There was a concern that transferring assets to the new SOEs would compromise the Crown’s ability to provide redress for Treaty of Waitangi claims. This led to the case being brought by the Māori Council. Another section of the Act, s 27, had set out certain safeguards for land transferred to SOEs with regard to claims already lodged but did not provide for claims lodged after the SOE Act came into effect.⁸

⁴ *New Zealand Māori Council v Attorney-General* [2013] NZSC 6, [2013] 3 NZLR 31 [*Water case*].

⁵ *West Coast ENT Inc v Buller Coal Ltd* [2013] NZSC 87 [*Coal case*]. The case was heard by a Court comprising Elias CJ, McGrath, William Young, Chambers and Glazebrook JJ. Chambers J died before the judgment was delivered. The remaining Judges decided under s 30(1) of the Supreme Court Act 2003 to continue the proceeding to judgment.

⁶ *New Zealand Māori Council v Attorney-General* [1987] 1 NZLR 641 (CA) (often called the Lands case). The Court was comprised of Cooke P, Richardson, Somers, Casey and Bisson JJ. The Judges each gave separate judgments but were unanimous in the result.

⁷ See also the discussion of the SOE Act in the *Water case*, above n 4, at [32]–[38].

⁸ Under s 27, land that was the subject of a claim prior to the Act receiving Royal assent, was to continue to be subject to that claim and, except where findings have been made in respect of the land by the Waitangi Tribunal and the Governor General had accordingly issued an Order in Council in respect of the land, the SOE was prohibited from transferring that land or any interest therein to any person other than the Crown. This section, along with s 9 of the Act, had been added to the Bill after a report of the Waitangi Tribunal: see *New Zealand Māori Council v Attorney-General* [1987] 1 NZLR 641 at 645 per Heron J in the High Court.

The Court of Appeal, relying on s 9 of the SOE Act, held that assets could not be transferred to the new enterprises until a scheme of safeguards was put in place giving reasonable assurance that lands or waters would not be transferred in a way that might prejudice Māori claims, including future claims lodged after the SOE Act came into effect. The parties then negotiated suitable safeguards and these were later enshrined in the legislation.⁹

In reaching its conclusion, the Court of Appeal rejected a submission that there should be a narrow meaning accorded to s 9. The Court also rejected the submission that s 27 should be seen as an exclusive code for the protection of Māori claims to land.¹⁰ The Court held that s 9 was a provision expressing a broad constitutional principle and had to be interpreted accordingly. Section 27 merely provided machinery provisions for meeting Māori land claims. Where those machinery provisions did not provide sufficient protection, s 9 would apply.¹¹ Section 9 was described as a “governing consideration”¹², a “safeguard”¹³, a “paramount provision”¹⁴, as having “the impact of a constitutional guarantee”¹⁵ and an “overriding result on the rest of the Act”.¹⁶

It can be seen therefore that the Court of Appeal in 1987 was unimpressed with the argument that the broad reach of the open-textured s 9 should be read down in light of a specific provision of the Act dealing with land.

⁹ These included the insertion of new provision into the SOE Act requiring all land transferred to the State owned enterprises to have memorials on the title, with provision for resumption and return of such land should the Waitangi Tribunal recommend that course: SOE Act ss 27A–27D. Legislative protection was also afforded for claims to water which required the use rights transferred to be limited to 35 year terms, instead of being perpetual: Resource Management Act 1991 (RMA), s 386(2).

¹⁰ Per Cooke P at 658, Richardson J at 679, Somers J at 696, Casey J at 701, and Bisson J at 716.

¹¹ At 660–661 per Cooke P, at 680 per Richardson J, at 696 per Somers J, at 701 per Casey J and at 710 per Bisson J.

¹² Per Richardson J at 679.

¹³ Per Bisson J at 710.

¹⁴ Per Somers J, at 701.

¹⁵ Per Cooke P at 658.

¹⁶ Per Casey J at 701.

3.2 *Water case*

I now turn to the recent Supreme Court *Water case*.¹⁷ The background to this case was the current government's policy of partial privatisation of some SOEs, which required those companies to be taken out of the SOE regime and transferred to a mixed ownership model regime. The legislation setting up those new entities contained a provision protecting Treaty rights that was almost identical to s 9 of the State-Owned Enterprises Act:¹⁸ s 45Q of the Public Finance Act 1989.¹⁹

The case that came before the Supreme Court was brought by Māori interests claiming that the proposed transfer to the mixed ownership model was inconsistent with the Treaty because it would compromise the ability of the government to address Treaty claims in relation to water. They argued therefore that the transfer to the mixed ownership model regime and any subsequent sale of the shares of those companies could not take place until the ability to provide redress for Māori water rights was secured.

The Crown's argument was that s 45Q (the s 9 equivalent provision) did not apply to the sale of shares. This is because the power to sell shares was not derived from the mixed ownership model legislation. It was an incident of ownership. In its submission, s 45Q only applied to powers conferred explicitly in the legislation. The provisions of Part 5A of the Public Finance Act restricted the power to sell shares (for example by limiting sale to only 49 per cent). They did not confer any power of sale.

The Supreme Court rejected the Crown's contentions. It said that the Court of Appeal's approach in the original *Māori Council* case had established s 9 as stating a fundamental principle guiding the interpretation of issues involving the relationship of Māori with the Crown and that this interpretation must form the basis for all New Zealand courts when interpreting subsequent legislation containing similar clauses.²⁰ This meant that technical

¹⁷ This was a unanimous decision. The Court was comprised of Elias CJ, McGrath, William Young, Chambers and Glazebrook JJ.

¹⁸ The only difference between s 45Q and s 9 is the addition of subs (2) in s 45Q which states "For the avoidance of doubt, subsection (1) does not apply to persons other than the Crown".

¹⁹ Section 45Q is found in the new Part 5A of the Public Finance Act which deals with mixed ownership model companies. See the discussion at [40]–[45] of the *Water case*, above n 4.

²⁰ At [59].

arguments purporting to confine the operation of any provision in similar terms to s 9 and which reduced such a provision to “mere window-dressing” could not be accepted.²¹

The Court commented that giving meaningful effect to s 45Q required a realistic approach to the legislative scheme that governs the sale of shares in mixed ownership companies. Part 5A effectively permits the Crown to do something with the shares which currently is prohibited.²² This means that, as an action permitted to that extent by Part 5A, a sale of shares must be conducted in accordance with s 45Q (and the principles of the Treaty of Waitangi).²³

3.3 *Commentary*

As can be seen, the statutory interpretation process undertaken by the Supreme Court required an interpretation of both s 45Q and the provisions restricting the sale of shares in light of the overall statutory scheme and the legislative history. The Supreme Court’s approach avoided an interpretation that effectively robbed s 45Q of any effect.

4. **Coal case**

The next case I discuss is the Supreme Court *Coal case*. The issue in that case was whether, in applications for resource consents relating to the mining of coal, the effects of climate change had to be taken into account by the consent authorities. The coal from the mining activities at issue in the case was to be used in the steel manufacturing industry in India, China and other offshore locations. It was common ground that this use would result in the emission of the greenhouse gas, CO₂. Consents were required for the mining because mining is a restricted discretionary activity under the relevant District Plan. The proposals also required other ancillary consents, including for land use and roading, involving activities

²¹ At [62].

²² The sale of shares in State owned enterprises is prohibited: State-Owned Enterprises Act, s 11. Under part 5A of the Public Finance Act 1989, however, shareholding Ministers are only required to ensure that 51 per cent of the shares in a mixed ownership model company are controlled by the Crown. The rest can be sold.

²³ The Court went on to hold that the Government’s proposed sale of shares was not inconsistent with the protection in s 45Q. While the transfer to the mixed ownership regime might limit the scope to provide some forms of redress which are currently at least theoretically possible, the Court was not persuaded that it would materially impair the Crown’s ability to provide redress: at [149].

which were discretionary, controlled or non-complying under the relevant District Plan.²⁴

The argument before the Supreme Court made by the appellants was that consideration of climate change effects was necessary because of s 104(1)(a) of the Resource Management Act 1991 (RMA), which requires consent authorities to consider “any actual and potential effects on the environment of allowing the activity”. Relevant to that question was a 2004 amendment²⁵ that had been made to the RMA, which provided that consent authorities could not consider the effects on climate change of discharges into air of greenhouse gases when considering resource consent associated with such discharges.²⁶ The purpose of the 2004 Amendment Act was expressed more broadly. It said that the purpose of the Amendment was to require local authorities “not to consider the effects on climate change of discharges into air of greenhouse gases”.²⁷ That broader purpose, however, was not carried through into the principal Act.²⁸

An interesting aspect of the case was that climate change arguments were irrelevant to whether consents should be granted to allow the actual mining of the coal. This is because mining was a restricted discretionary activity²⁹ under the District Plan. A consent authority, in deciding whether to grant a resource consent for such an activity, can consider only those

²⁴ The case arose because Buller Coal and Solid Energy applied to the Environment Court under ss 310 and 311 of the RMA (which permit declarations to be applied for as to the existence of duties under the Act) for a declaration that, in considering the applications for resource consents, “the decision maker cannot have regard to the effects on climate change of discharges into the air of greenhouse gases arising from the subsequent combustion of the coal extracted in reliance on those consents”. This declaration was opposed by West Coast ENT and Royal Forest and Bird Protection Society and West Coast ENT itself applied for a declaration essentially to the opposite effect: see [10]–[11] of the *Coal case*, above n 5. The Environment Court held that consenting authorities are not permitted to consider, in granting consents, the end use of the coal to be obtained (including any probable release of greenhouse gases into the atmosphere, contributing to climate change): *Re Buller Coal Ltd* [2012] NZEnvC 80, [2012] NZRMA 401. An appeal by West Coast ENT and Royal Forest and Bird Protection Society to the High Court was dismissed by Whata J: *Royal Forest and Bird Protection Society of New Zealand Inc v Buller Coal Ltd* [2012] NZHC 2156 [2012] NZRMA 552. The Supreme Court granted leave to appeal directly from the High Court: *West Coast ENT Inc v Buller Coal Ltd* [2012] NZSC 107.

²⁵ Resource Management (Energy and Climate Change) Amendment Act 2004 [2004 Amendment Act].

²⁶ RMA, s 104E. The Amendment also provided that District Councils could not take into consideration the effects of climate when making policies and rules: RMA, s 70A, inserted by the 2004 Amendment Act, above n 25. This prevented Regional Councils from planning for the effects of climate change.

²⁷ 2004 Amendment Act, above n 25, s 3(b)(ii). This was because the management of air discharges and related effects on climate change was to be addressed at the national level in a national environmental standard. No national environmental standard managing the discharge of greenhouse gases has yet been promulgated. Greenhouse gas emissions are, however, dealt with under the Emissions Trading Scheme introduced in 2008 created by the Climate Change Response Act 2002: see *Coal Case*, above n 5, at [98]–[101].

²⁸ See discussion at [96]–[97].

²⁹ RMA, s 104C.

matters on which the relevant District Plan or national regulations restrict discretion. In this case, none of the relevant restrictions included climate change considerations.³⁰ So the argument as to climate change was confined to the ancillary consents.

4.1 *Majority judgment*

The majority of the Supreme Court³¹ held that a purposive interpretation of s 104(1)(a), read in the context of the statute as a whole including the 2004 amendments, meant that climate change effects were not to be taken into account by consent authorities in the ancillary consent applications.

In coming to that conclusion, the majority tested the plausibility and workability of the argument that climate change considerations should be taken into account by way of a number of examples.³² These showed that a literal interpretation of s 104(1)(a) would have the result that arguments which are off limits in relation to the issues to which they are most closely related (discharges to air) would come in by the backdoor in respect of ancillary issues (such as land use, roading and the like).³³ All of the examples showed illogicalities and anomalies that would, in the majority's view, have subverted the whole scheme and purpose of the RMA as amended in 2004.³⁴

The majority postulated that the most likely explanation for the form of the 2004 amendments was that those responsible for the drafting assumed that climate change arguments would only be relevant to rules and consents involving direct discharges. It said that such an assumption may have been reasonable in light of the state of jurisprudence before the 2004 amendments and commented that, where an amendment Act is based on a particular understanding as to

³⁰ *Coal Case*, above n 5, at [104].

³¹ The majority was comprised of McGrath, William Young and Glazebrook JJ. The Chief Justice dissented.

³² The examples given were: concurrent applications to mine and burn coal ([157]–[158]); an application to mine coal which is to be burnt subject to a separately obtained resource consent ([159]–[160]); an application to mine coal which is to be burnt in New Zealand in circumstances which will not require a discharge consent ([161]–[162]); regional rules as to activities incidental to coal mining addressed to climate change effects ([163]); making district rules about activities which may result in the emission of greenhouse gases ([164]–[165]); and an application to build and operate a coal-fired station ([166]–[167]).

³³ At [169].

³⁴ At [170].

the effect of the principal Act, it may sometimes be necessary to give effect to that understanding to avoid the overall legislative scheme being subverted.³⁵

The majority held that, when the amended RMA is looked at as a whole, the limitation to s 104(1)(a) to exclude climate change considerations is so obvious that it goes without saying. The majority commented that the limitation is consistent with the clear legislative policy that addressing effects of activities on climate change lie outside the functions of consent authorities.³⁶ In coming to its conclusion, the majority considered the wider legislative context, including the passing of the Climate Change Response Act. It also considered the legal and practical difficulties that would arise if consent authorities were required to consider climate change effects offshore.³⁷

The majority concluded that, by necessary implication, in light of the examples it gave, the scheme and purpose of the relevant provisions, the legislative policy and the legislative history, the words in s 104(1)(a) “actual or potential effects on the environment” do not (since the Amendment Act) extend to the impact on climate change of the discharge into air of greenhouse gases that result indirectly from that activity.³⁸

4.2 *Judgment of the Chief Justice*

The Chief Justice held that the meaning of s 104(1)(a) must be derived from the text, as well as the context provided by the scheme and structure of the RMA, the legislative history of the 2004 Amendment and the scheme of the Climate Change Response Act.³⁹ The Chief Justice did not agree with the majority that the context in which the provision operated justified the substantial gloss on its terms to exclude consideration of climate change effects in connection with the consents.⁴⁰

In the Chief Justice’s view, the 2004 Amendment had expressly removed climate change considerations only in respect of applications for consents to discharge greenhouse gases into

³⁵ See at [168] and [174]. The majority, at [116]–[126], discussed the earlier jurisprudence. No view was expressed as to whether that earlier jurisprudence was in fact correct.

³⁶ At [173].

³⁷ At [175].

³⁸ At [172].

³⁹ At [23].

⁴⁰ At [24].

air. The text of the legislation did not exclude the consideration of the effects of other activities on climate change, such as the land use and other consents at issue in the appeal and the scheme of the RMA pointed towards consideration of the end-use of the coal when making determinations on such consents. This is because excluding such consideration would undermine the consent authority's assessment of the consents having regard to the principles and purposes of the Act. In particular, the consent authority would be unable to assess the proposal on "sustainable management" principles in s 5, distorting consideration of "the actual and potential effects on the environment" under s 104(1)(a).⁴¹

The Chief Justice's view was that the new provisions inserted by the 2004 Amendment brought in only a limited and partial restriction to remove consideration of the effects of greenhouse gases on climate change when controlling or consenting to discharge applications for greenhouse gases alone. The legislative history indicated that this removal was required because the standards for such discharges were to be set nationally in order to facilitate a coordinated policy response to the government's commitments to reduce national emissions under the Kyoto Protocol. The Chief Justice considered that there was nothing in the scheme of the Act or the legislative history to indicate that the provisions relieved decision-makers from the obligation to take account of the effects of an activity on climate change where necessary to counter the advantages put forward for a proposal requiring a resource consent.⁴²

5. Comments on the Supreme Court approach in *Water* and *Coal* cases

In the *Water case* it was held that the general provision relating to the principles of the Treaty had an overriding effect. The *Coal case*, unlike the *Water case*, involved (for the majority) confining broad wording to give effect to the scheme and purpose of the Act as a whole.

Despite the difference in outcome, the methodology applied in the two decisions is the same. The aim is to interpret both the open-textured provision and the specific provisions of the legislation and the relationship between them in light of their purpose,⁴³ in the context of the

⁴¹ At [26]–[28] and [75]–[76].

⁴² At [84]–[85].

⁴³ Section 5(1) of the Interpretation Act 1999 provides that the meaning of an enactment must be ascertained from its text and in the light of its purpose.

legislation as a whole and, to the extent relevant, against the background of the legislative history and other related legislation.⁴⁴

The *Coal case* shows, however, that, even taking the same purposive approach to the interpretation task, views can differ. In the *Coal case* the Chief Justice considered that a broad application of the wording of s 104(1)(a) was the only interpretation possible when the terms, scheme, purpose and legislative history of the RMA and the 2004 Amendment Act were taken into account. By contrast, the majority viewed the general context of the Act (and in particular the 2004 Amendment Act) as supporting a limitation on the broad wording of s 104(1)(a) by necessary implication.

6. Group loss offset provisions and tax avoidance

I now turn to the general tax avoidance provisions⁴⁵ and their relationship with the specific provisions of taxation legislation. It is appropriate to start with the case of *Challenge*.⁴⁶ This was the first case to reach the Privy Council under the then anti-avoidance provision, s 99 of the Income Tax Act 1976. The case deals explicitly with the relationship between that general open-textured anti-avoidance provision and the relevant specific provision in the then taxation legislation. The case is interesting because of the different approaches to this issue taken by the various judges in the Court of Appeal and the Privy Council.

⁴⁴ See generally J F Burrows and R I Carter *Statute Law in New Zealand* (4th ed, LexisNexis NZ Limited, Wellington, 2009) at Part III. The Law Commission recommended including express reference to “context” in its proposed draft of the provision that was eventually enacted as s 5 of the Interpretation Act. The Commission’s draft did not define context as it did not want to restrict what might or might not be considered part of a provision’s context: Law Commission *A New Interpretation Act to Avoid “Prolivity and Tautology”* (NZLC R17, 1990) Draft Interpretation Act, cl 9, see also at [68], [71]–[72]. The express reference to context was, however, dropped by the Legislature. The explanatory note to the Interpretation Bill 1998 indicates that the words “in light of its context”, included in the Commission’s draft, had been omitted because the term is imprecise and “suggests a meaning that might well go beyond the approach of the Courts currently in interpreting legislation”: Interpretation Bill 1998 (90-2) (explanatory note) at iii.

⁴⁵ I concentrate in this paper on the general income tax anti-avoidance provision. I also concentrate on the methodology for ascertaining tax avoidance and not on other aspects of avoidance such as reconstruction powers.

⁴⁶ *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513 (report includes decisions of High Court at 513, Court of Appeal at 530 and Privy Council at 556).

6.1 *Background*

Briefly, *Challenge* concerned the purchase of a loss-making company by Challenge Corporation. Section 191 of the Income Tax Act 1976 permitted losses suffered by a company in a group of companies to be transferred to other companies in that group.⁴⁷ Challenge attempted to offset the loss of the newly acquired loss-making company against the profits of other subsidiaries in the Challenge group.

The group loss offset provision contained a specific anti-avoidance provision in s 191(1)(i). This required the Commissioner to disregard any shareholding alternations that, in his or her opinion, were of a temporary nature and which had the purpose or effect of relieving the company or any other company of liability to pay income tax.

The issue was whether s 99 could apply to a loss transfer arrangement made under s 191, or whether such an arrangement could only be addressed under the specific anti-avoidance provision in the group loss offset provision.

6.2 *Court of Appeal majority*

In the Court of Appeal, by majority (Cooke and Richardson JJ), the taxpayer was successful, as it had been in the High Court.

Cooke J (as he then was) would have been prepared to apply s 99 to the arrangement, were it not for the specific anti-avoidance provision in s 191. He said that the transactions were so artificial that one would very readily characterise them as tax avoidance.⁴⁸ However, he was not prepared to read s 191 as containing a qualification that it was subject to the provisions of s 99. He said that, where a particular section conferring tax concessions or rights has its own anti-avoidance provision, the inference is that the special provision is exhaustive. Taxpayers are entitled to assume that they have a right to order their affairs to take advantage of the

⁴⁷ The requirement for grouping under s 191 was set out in s 191(3). That provision provided that, where two thirds or more of the paid-up capital, nominal value, voting rights, or proportion of the profits of two or more companies was held by a single person or company, those companies are to be assessed for income tax under s 191.

⁴⁸ *Challenge Corporation Ltd v Commissioner of Inland Revenue*, above n 46, at 540.

benefits conferred by the section, subject to not falling foul of the terms of the specific anti-avoidance provision.⁴⁹

Richardson J considered that the Legislature could not have intended that s 99 should override all other provisions of the Act so as to deprive the taxpaying community of structural choices, economic incentives, exemptions and allowances provided for by the legislation. Equally, however, s 99 could not be subordinate to all the specific provisions of the legislation. He considered that it is inherent in s 99 that, but for its provisions, the impugned arrangements would meet all the specific requirements of the income tax legislation. The relationship between the specific and the general must therefore rely on the twin pillars which apply to the interpretation of all statutes: the scheme of the legislation and the relevant objectives of the legislation. Richardson J considered that an emphasis on trying to discern the scheme and purpose of the legislation is likely to provide the answer to the relationship between the anti-avoidance section and other provisions of the Act that best reflects the intention of Parliament as expressed in the statute.⁵⁰

In Richardson J's view, the necessary starting point is that each section has its function under the statute. If there is a specific anti-avoidance section that will be a highly relevant consideration but not necessarily determinative consideration. The question is whether there is room in the statutory scheme for the application of the general anti-avoidance provision in the particular case. It is not the function of s 99 to defeat other provisions of the Act or to achieve a result which is inconsistent with them.⁵¹

Richardson J discussed the principle articulated by the High Court of Australia in *Keighery*⁵² and commonly referred to as the "choice" principle: that the provisions in the Act are intended

⁴⁹ At 543.

⁵⁰ At 548–549.

⁵¹ At 549.

⁵² *WP Keighery Pty Ltd v Federal Commissioner of Taxation* (1957) 100 CLR 66. Richardson J saw the reasoning in that case as having been approved by the Privy Council in *Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] AC 450 (PC). He, however, preferred the way the High Court of Australia articulated the principle to the predication test in *Newton: Challenge Corporation* (CA), above n 46, at 552. For the fate of the choice principle in Australia see *Commissioner of Taxation v Gulland* [1985] HCA 83, 160 CLR 55 and the commentary in Robin Speed "The High Court and Part IVA (1986) 15 ATR 156 at 156; I C F Spry "The New Approach by the Court of Section 260" (1986) 15 ATR 1 at 3; and G T Pagone *Tax Avoidance in Australia* (Federation Press, Sydney, 2010) at 37. See also *Commissioner of Taxation v Unit Trend Services Pty Ltd* (2013) 297 ALR 190 (HCA) at [52].

to present a choice of alternative courses and the deliberate exercise of that choice is not invalidated by the anti-avoidance principle. He said that implicit in that reasoning is the proposition that to allow the anti-avoidance section to void the transaction in such circumstances would be contrary to the purposes of the specific section concerned. The High Court in *Keighery* said that the purpose of the anti-avoidance section is to protect the other provisions of the Act from frustration. It is not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them.

Richardson J commented that the concepts of grouping and the carrying forward of losses are tax concepts. They have no reality except in relation to income tax. After a detailed examination of the provisions relating to grouping, including their history, he concluded that s 191 reflected a particular tax concept and established tax norms by which the statutory liability to income tax in the specific area of its application is to be determined. In particular, s 191, as it stood at the relevant time, specified the membership of a group to be fixed as at the end of the year as the yardstick. In allowing the Commissioner to ignore temporary changes in shareholding, Parliament must have accepted that permanent changes in shareholding which resulted in compliance with the section were not susceptible to challenge. To allow s 99 to bite would be to defeat and not promote the legislative purpose.⁵³

6.3 *Dissent in the Court of Appeal*

In his dissenting judgment, Woodhouse P stated that s 99 was intended to have general application and therefore applied irrespective of s 191(1). Rather than looking to read down or reconcile s 99 with the specific provisions of the Act, he found the qualification to the apparently broad sweep of s 99 in the terms of s 99 itself and, in particular, the exclusion of arrangements where tax avoidance is a “merely incidental” purpose or effect. As a matter of construction, Woodhouse P considered that the phrase “merely incidental” in the context of s 99 points to something which is necessarily linked and without contrivance to some other purpose or effect so that it can be regarded as a natural concomitant of that other (legitimate) purpose or effect.⁵⁴ In this, he recognised that most taxpayers when considering a course of action are likely to appreciate and welcome an opportunity provided by the Act for achieving

⁵³ At 555.

⁵⁴ At 532–533.

some tax benefit as an aspect of it. But this should not bring the transaction automatically within the avoidance provisions.

Woodhouse P saw the question relating to incidental purpose as being framed in terms of the degree of economic reality associated with a given transaction in contrast to artificiality or contrivance or what may be described as the extent to which the transaction appears to involve exploitation of the statute while in direct pursuit of tax benefits.⁵⁵ He saw a difference between the prudent attention that is sensibly and quite properly given to the taxation implications likely to arise from a course of action when deciding whether or not to pursue it and the pursuit of that course of action simply to achieve a manufactured tax advantage.

Putting the matter in the context of the particular case, he considered that would include an assessment as to whether details of the group loss offset disclosed by the group accounts could fairly be accepted as a record of real and relevant achievements of what, in practical terms, was the real and relevant group.⁵⁶

Woodhouse P considered it would be quite extraordinary for the draftsman to prevent a tax advantage because the shareholding was of a temporary nature and yet consciously decide that it should give its implied blessing “to a manufactured and barely tangible association of the kind under review”. In terms of “commercial animation” the tax loss company “was lifeless on arrival” and its practical association with the Challenge group had only lasted from the end of February until 1 April. He considered it likely that the draftsman had either intended all other avoidance to be dealt with under the general anti-avoidance section or that the question was not the result of any deliberate decision. In his view, there was nothing in the group loss provisions to suggest that s 99 was subordinate to the group loss offset provisions. Indeed, it was the other way round with s 99 being of general application.⁵⁷

⁵⁵ At 532.

⁵⁶ At 535.

⁵⁷ At 539–540. Woodhouse P’s views in *Challenge* were discussed by the majority of Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 (SC) [*Ben Nevis*] at [84]–[85].

6.4 *Privy Council majority*

The Privy Council allowed the Commissioner's appeal by majority (Lord Oliver dissenting).⁵⁸ The majority's decision (delivered by Lord Templeman) first disposed in short order of the argument made on behalf of Challenge that s 99 had no application if the requirements of the group loss provisions under s 191 were satisfied. It endorsed the remarks of Richardson J that s 99 would be a dead letter if it were subordinate to all the specific provisions of the legislation. Most tax avoidance arrangements involved the exploitations of exceptions and exemptions found in the Act. Section 99 would be useless if mechanical and meticulous compliance with some other section of the Act were sufficient to oust s 99.⁵⁹ It also endorsed the remarks that Woodhouse P made in rejecting the argument that the inclusion of the specific anti-avoidance provisions in s 191 ousted the application of s 99.⁶⁰

The majority rejected the notion that their interpretation would lead to ordinary and innocuous transactions being caught by s 99 by articulating a distinction between tax mitigation and tax avoidance. Mitigation occurs where a taxpayer obtains a tax advantage by reducing his or her income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability. Section 99 does not apply in such circumstances. Section 99 does, however, apply to tax avoidance which is where taxpayers reduce their liability to tax without involving themselves in the loss or expenditure which entitles them to that reduction. Taxpayers engaged in tax avoidance do not reduce their income or suffer a loss or incur expenditure but nevertheless obtain a reduction in his or her liability to tax as if they had.⁶¹

The majority said that, in a tax avoidance arrangement, 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 which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction is his or her liability to tax. In the current case, the loss

⁵⁸ The majority constituted Lord Keith, Lord Brightman, Lord Templeman and Lord Goff.

⁵⁹ At 559.

⁶⁰ At 560.

⁶¹ At 560–561.

was not sustained by any of the members of the Challenge group and therefore the arrangement was clearly tax avoidance.⁶²

6.5 *Dissent in the Privy Council*

In dissent, Lord Oliver considered that s 191 and s 99 had to be construed with a view to testing their impact upon one another. He could not see how the action of a board of directors in deciding for example to make a subvention payment would be other than tax avoidance in literal terms as defined in s 99. Thus he considered that the only possible reconciliation of ss 99 and 191 is to treat the latter as providing the code for group taxation and one which contained its own exhaustive anti-avoidance provision.⁶³

6.6 *Comments on the approach in Challenge*

In the Court of Appeal, Richardson J took a general scheme and purpose approach to the task of construing the provisions. What led Richardson J to the position he took was his view that the group loss offset provisions were a tax construct. This meant that compliance with the specific group loss offset rules in the section sufficed. The existence of the specific anti-avoidance provision in the loss offset rules was relevant but not decisive in this analysis.

Cooke J can be seen as taking a more traditional approach: that the specific must exclude the general and that therefore the specific anti-avoidance provision within the loss offset rules excluded the application of the general anti-avoidance provision.⁶⁴ Woodhouse P found the qualification confining the broad sweep of s 99 in the words of that section.

All three judges, to a greater or lesser extent, took a purposive approach to the interpretation issues faced. However, the provision that they elected to focus on arguably reflected their view regarding which of the two provisions ought to take priority. Thus Cooke and Richardson JJ concentrated on s 191, while Woodhouse P concentrated on the interpretation

⁶² At 561–562.

⁶³ At 563. The Privy Council decision in *Challenge* is discussed in *Ben Nevis*, above n 57, at [91]–[95].

⁶⁴ In accordance with the maxim *generalibus specialia derogant*. Where the literal meaning of a general enactment covers a situation for which specific provision is made elsewhere in the enactment, it is presumed that the situation was intended to be dealt with by the specific provision: Francis Bennion *Bennion on Statutory Interpretation* (5th ed, LexisNexis, London, 2008) at 1164.

of s 99. While all judges considered the purpose and scheme of the alternate provision, they arguably approached their interpretation of that alternate provision with a view to finding a meaning consistent with their earlier conclusion.

The majority of the Privy Council, however, restricted the scope of s 99 by confining the concept of tax avoidance to apply to those transactions that did not fit within the purpose of the specific taxation provisions. In this case, the majority considered that the purpose of s 191 was to enable loss sharing of losses actually incurred by an existing member of the group and not to those artificially generated by purchase. The majority can thus be seen as having attempted to interpret the purposes of both s 99 and s 191 in a manner that gave both provisions full effect.⁶⁵

Before I leave *Challenge*, I comment that the approach of Woodhouse P to the “merely incidental” qualification included in s 99 has its attractions. On his approach, the limit to the anti-avoidance provision lies in its own terms. It has been noted, however, that the purely incidental test, as expressed by Woodhouse P, is not a totally satisfactory of dividing legitimate transactions from tax avoidance arrangements. This is because there are a number of situations in which arrangements with tax as their main purpose will be perfectly acceptable uses of specific provisions under the Act. For example where a taxpayer places an investment in a Portfolio Investment Entity (PIE) scheme⁶⁶ in order to obtain a lower tax rate, the taxation consequence, far from being a merely incidental purpose, is the sole purpose of the transaction.⁶⁷

7 Film production costs and non recourse loans

Peterson v Commissioner of Inland Revenue was the last tax avoidance case to be heard by the Privy Council.⁶⁸ It is worth discussing to assess how tax avoidance jurisprudence had developed since *Challenge*.

⁶⁵ Lord Oliver, in dissent in the Privy Council, viewed the case in a manner that had elements of both Cooke and Richardson JJ's approaches.

⁶⁶ As permitted under subprt HM of the Income Tax Act 2007.

⁶⁷ Ruddell, above n 2, at 507–508. See also at 515 where he discusses tax exiles changing tax residency.

⁶⁸ *Peterson v Commissioner of Inland Revenue* [2006] 3 NZLR 433 (PC).

7.1 *The majority decision*

Mr Peterson was part of a syndicate which provided production funding for two films.⁶⁹ The films were expected to cost \$x to make but the investors were led to believe by the production company that the cost of production would be \$x + \$y. The investors paid \$x out of their own resources but paid \$y through a non-recourse loan from a third party lender connected with the production company. The production company used \$x to make the film but provided \$y to the third party lender. The investors claimed deductions of \$x + \$y, spread over two years. The Commissioner allowed the deduction in respect of \$x but not in respect of \$y, applying s 99, on the basis that \$y was expenditure not properly incurred by the investors, since it was achieved by way of a loan that inflated the cost of production and was recycled back to the investors, rather than being used for film production.⁷⁰ This view was upheld in the High Court⁷¹ and the Court of Appeal.⁷²

The majority of the Privy Council⁷³ accepted that the arrangement had the purpose or effect of reducing the investors' liability to tax. Whether or not the investors were parties to the whole arrangement, they were affected by it. The real issue was whether the tax advantage they obtained was tax avoidance.⁷⁴

As to this question, the majority held that investors in films are entitled to depreciate their full acquisition costs, however they have financed the transaction. Given that the investors had paid \$x + \$y to acquire the film, they were entitled to the deductions they claimed.⁷⁵ That conclusion held even when the wider context was concerned.⁷⁶ The majority noted that the

⁶⁹ The Privy Council decision related to both films.

⁷⁰ In one of the cases, the Taxation Review Authority (TRA) held that, applying normal income tax rules, \$y was expenditure that was never incurred. The claimed deduction could be disallowed without recourse to s 99: *Case U32* (2000) 19 NZTC 9302 (TRA). In the other decision, the TRA held that \$y was deductible expenditure and that there was no tax avoidance under s 99: *Case U6* (1999) 19 NZTC 9,038 (TRA).

⁷¹ In the High Court, the judgments on the two appeals with regard to the two films were given separately: *Peterson v Commissioner of Inland Revenue* (2005) 22 NZTC 19,482 (HC); *Peterson v Commissioner of Inland Revenue (No 2)* (2002) 20 NZTC 17,761 (HC).

⁷² In the Court of Appeal the judgments on the appeals with regard to the two films were delivered together, but in separate judgments: *Commissioner of Inland Revenue v Peterson* (2003) 21 NZTC 18,060 (CA) and *Peterson v Commissioner of Inland Revenue* (2003) 21 NZTC 18,069 (CA).

⁷³ The majority was comprised of Lord Millet, Baroness Hale and Lord Brown.

⁷⁴ At [35].

⁷⁵ At [39].

⁷⁶ With regard to the wider context the majority, at [40], quoted Richardson J's comments in the Court of Appeal in *Challenge* (above n 46, at 549) that s 99 would be a dead letter if it were subordinate to all the

wider context relied on by the Commissioner was the false inflation of production costs, the use of the non-recourse loan and the recycling of the loan to the lender.⁷⁷ The majority considered that the focus is on the party who acquires the asset and not on what happens to the funds in the hands of the vendor.⁷⁸ The Commissioner, in the majority's view, never succeeded in showing that the investors did not suffer the economic burden of \$x + \$y. The fact that the production company made a profit of \$y did not change this.⁷⁹

The majority recognised that the leverage obtained by the use of a non-recourse loan meant that the investors did not sustain an economic loss after the tax deduction was taken into account but considered that Lord Templeman in *Challenge* had in mind expenditure or loss before any tax advantage is taken into account.⁸⁰ The majority commented that tax relief often makes the difference between profit and loss after tax is taken into account and a transaction does not become tax avoidance merely because that is the case.

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. The majority noted that it was not and could not be suggested that either loan was on terms which meant that it was unlikely ever to be repaid.⁸¹

The majority considered that the circular movement of money could only be taken into account where in fact there was no underlying discharge of a genuine liability of the party making the payment.⁸² Subsequent payments, of which the investors were unaware and which they could not control or prevent, did not alter the fact that they had borrowed \$y and used it towards the discharge of their liability to pay \$x + \$y to the production company, thereby suffering the loss or incurring the relevant expenditure for which the depreciation allowance is granted. The arrangement therefore did not contravene s 99.⁸³

specific provisions of the legislation. Richardson J had gone on to say that s 99 is specific in the sense of being directed against tax avoidance.

⁷⁷ At [40].

⁷⁸ At [42].

⁷⁹ At [43].

⁸⁰ At [44].

⁸¹ At [44].

⁸² At [45].

⁸³ At [46]. I note, however, that, at [47]–[55], the majority indicated that its conclusion on the general income tax law may have been different if the Commissioner had put his case differently.

7.2 Comment on majority approach

The majority, while purporting to consider whether the investors had suffered the economic burden of \$x + \$y, in fact applied a legal form rather than economic substance approach.⁸⁴ While the *Challenge* approach focused on balancing the intended purposes of the anti-avoidance provision and the loss offset provision and finding an interpretation that reconciled the two, the majority in *Peterson* focused on the purpose of the film depreciation provisions and whether the arrangement fell within their scope. Little attention was given to the purpose or scope of s 99. This led to a narrow approach to the anti-avoidance provision that favoured the position of the taxpayer.⁸⁵

8 The Supreme Court and tax avoidance

I now turn to the approach of the Supreme Court to the relationship between specific taxation provisions and the general anti-avoidance provision.⁸⁶ The main case setting out the approach is *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*⁸⁷ and so I begin with that case. I then discuss *Glenharrow Holdings v Commissioner of Inland Revenue*.⁸⁸ Although that case concerned the GST anti-avoidance section, the Court essentially adopted the *Ben Nevis* approach.⁸⁹ I will then briefly discuss *Penny v Commissioner of Inland Revenue*.⁹⁰

⁸⁴ By contrast, the minority (Lord Bingham and Lord Scott) took a substance over form approach, looking behind the claimed deduction to the amount actually used by the film makers: at [89]–[92]. See discussion in 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 NZJTL 395 at 360–361.

⁸⁵ See Dunbar, above n 84, at 415–416, including his comments that the arrangements in *Peterson* would have likely been found to be avoidance if they were subjected to the approach set out by the majority in *Ben Nevis*.

⁸⁶ In 1994 s 99 was replaced with s BG1(1) of the Income Tax Act 1994. It is in essentially the same substantive terms as s 99.

⁸⁷ *Ben Nevis*, above n 57.

⁸⁸ *Glenharrow Holdings v Commissioner of Inland Revenue* [2009] 2 NZLR 359 (SC).

⁸⁹ The judgment in *Glenharrow* was delivered on the same date as *Ben Nevis*.

⁹⁰ *Penny v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] 1 NZLR 433.

9 Forests, licences and insurance

The arrangement at issue in *Ben Nevis* had been held to be tax avoidance both in the High Court and the Court of Appeal.⁹¹ The Supreme Court unanimously dismissed the appeal but the minority took a slightly different approach to the majority.

9.1 Background

In broad outline⁹² the scheme in *Ben Nevis* involved land owned by the subsidiary of a charitable foundation being licensed to a syndicate of single purpose investor loss attributing qualifying companies.⁹³ The licensees were obliged to plant, maintain and harvest a Douglas Fir forest on the land through a forestry management company.

The investors paid \$1,350 per plantable hectare for the establishment of the forest and \$1,946 for an option to buy the land in 50 years for half its then market value. There were other sundry payments, including a \$50 annual licence fee. These sums sufficed to cover the costs of acquiring the land and planting and maintaining the forest.

It is significant that the land had been bought for around \$580 per plantable hectare. This meant that the investor syndicate, if it wished to acquire the land after harvesting the forest, had to pay half its then value, against a background of having already paid over three times the value of the land at the inception of the scheme.⁹⁴

⁹¹ The majority comprised Tipping, McGrath and Gault JJ, with the judgment given by Tipping and McGrath JJ. The minority comprised Elias CJ and Anderson J. In both the High Court and Court of Appeal, this case was referred to as *Accent Management: Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC); and *Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230, (2007) 23 NZTC 21,323.

⁹² See the more detailed discussion of facts in the Supreme Court decision, above n 57, at [14]–[31]; the Court of Appeal decision at [3]–[15] and the High Court decision at [3]–[12] both above n 91.

⁹³ Previously, under s HG 14 Income Tax Act, a company could elect to become a loss attributing qualifying company (LAQC). Such a company could pass on losses to its shareholders who were able to offset these losses against their personal income: Gareth Harris and others *Income Tax in New Zealand* (Brookers Ltd, Wellington, 2004) at [23.9.10]. The ability to attribute losses to shareholders was removed in 2011 and LAQC's were replaced with "look-through companies": "Changes to the Qualifying Company Rules and Introduction of Look-Through Company Rules" (2011) 23(1) *Tax Information Bulletin* at 46.

⁹⁴ See at [121].

In addition to the above payments, the syndicate agreed to pay a licence premium of some \$2 million per plantable hectare, payable in 50 years time, by which time the trees would be harvested and sold. The licence premium was payable despite the fact that the investors had already paid upfront over three times the value of the land and had also paid for the planting and maintaining of the forest, which might explain why the landowner was willing to wait so long before receiving any payment for the use of its land. The syndicate purported to discharge its liability for the licence premium immediately by the issuing of a promissory note redeemable in 50 years time.⁹⁵

The evidence was that the premium had been calculated on the basis of the after tax amount that the mature forest was expected to yield.⁹⁶ The Supreme Court agreed with the courts below that the ultimate profitability of the business side of the arrangement (meaning any excess for the investor syndicate after payment of the premium) was unlikely.⁹⁷ This meant that, even though the syndicate had already paid three times the value of the land and a sum sufficient to cover the planting and maintenance costs of the forest upfront, no profit at all from the forestry venture was likely to make its way to the investor syndicate.⁹⁸

The syndicate also agreed to pay an insurance premium to a tax haven company set up by one of the promoters of the scheme to cover the risk that the harvest would not yield sufficient income to pay the licence premium. There was an upfront insurance premium of \$1,307 per plantable hectare and a further premium of \$32,000 per plantable hectare payable in 50 years time.⁹⁹ The investors purported to discharge their obligations for the deferred insurance premium immediately by the issuing of promissory note redeemable in 50 years time.

⁹⁵ This appears to have been done to avoid the application of the accrual rules: Eugen Trombitas “The Conceptual Approach to Tax Avoidance in the 21st Century: When the State Gives but the GAAR takes away” (2009) 15 NZJTL 352 at 368.

⁹⁶ See at [125] and [148].

⁹⁷ At [122].

⁹⁸ The syndicate was obliged to arrange for the cutting, extraction and sale of the forest during the four years before the expiry of the licence term in 2048. Proceeds were to be applied by the land owner first towards GST, secondly to costs of sale and thirdly to payment of the promissory notes. The balance of the net stumpage proceeds was to be paid to the syndicate: see at [21].

⁹⁹ The fact that no profit was likely from the forest meant that the single purpose syndicate companies were unlikely to have the funds to pay the deferred insurance premium: at [125]–[126].

The insurance company was a single purpose company without any independent substance controlled by one of the promoters of the scheme.¹⁰⁰ Some 90 per cent of the initial premiums paid up front were paid by the insurance company to a company under the control of one of the promoters as commission and introduction fees. Those sums then found their way back as loans to the promoters' family trusts.¹⁰¹ Further, the insurance company did not in reality carry any risk. This was as a result of arrangements with the land-owning subsidiary and because of the promissory notes from the syndicate.¹⁰² There was also a "letter of comfort" from the charitable foundation (said to be intended to create legally binding obligations) that it would make up any shortfall the insurance company was obliged to pay out.¹⁰³

Debentures over the assets and undertakings of the syndicate secured the money payable under the promissory notes for the licence premium and the insurance premium. There were no personal guarantees or security given over any other assets of the investors.¹⁰⁴

The investors claimed an immediate deduction for the whole of the insurance premium (both the upfront and deferred portions) and depreciated the deduction for the licence premium over the 50 years of the licence.¹⁰⁵ These deductions were claimed against an initial outlay for the syndicate of just under \$5000 per plantable hectare and an annual outlay of \$50 from then on.¹⁰⁶

9.2 *Majority judgment: principles*

As a general statement of principle, the majority said that, while expressed broadly, the purpose of the anti-avoidance provision is not to strike down arrangements which involve no more than the appropriate use of specific provisions. But strict compliance with the requirements of specific provisions cannot have been intended to immunise all arrangements

¹⁰⁰ The company did not reinsure the risk.

¹⁰¹ See at [144].

¹⁰² See at [25]–[27].

¹⁰³ See at [137]–[139].

¹⁰⁴ See at [127].

¹⁰⁵ The landowner was ultimately owned by a charitable trust which presumably meant that any income notionally received over the term of the licence was exempt from income tax.

¹⁰⁶ There was no issue with the tax treatment of the costs actually related to the establishment and maintenance of the forest.

involving their use against being categorised as tax avoidance. It is the purpose of the general anti-avoidance provision to avoid such immunisation.¹⁰⁷

The majority in *Ben Nevis* rejected the notion that the potential conflict between the general anti-avoidance rule and specific tax provisions requires identifying which of the provisions, in any situation, is overriding.¹⁰⁸ Rather, the majority viewed the specific provisions and the general anti-avoidance provision as working “in tandem”. Each provides a context that assists in determining the meaning and, in particular, the scope of the other. The focus of each is different.¹⁰⁹

The purpose of the general anti-avoidance provision is to address tax avoidance. Tax avoidance may be found in individual steps or in a combination of steps. The purpose of the specific provisions is more targeted and their meaning should be determined primarily by their ordinary meaning, as established through their text in the light of their specific purpose.¹¹⁰ Parliament must, however, have anticipated that at some point, the manner in which a specific provision was deployed would cross the line and turn what might otherwise have been a permissible arrangement into tax avoidance.¹¹¹

Ascertaining when the line is crossed between what is a permissible arrangement and tax avoidance should be firmly grounded in the statutory language and judicial glosses on statutory language should be kept to a minimum.¹¹² The function of the anti-avoidance provision is “to prevent uses of the specific provisions which fall outside their intended scope in the overall scheme of the Act.”¹¹³ It is the task of the courts to apply a principled approach in order to give proper overall effect to statutory language that expresses different legislative policies. The process of statutory construction should focus objectively on the features of the

¹⁰⁷ At [12].

¹⁰⁸ The tandem approach of the majority in *Ben Nevis* can be contrasted with the approach taken by the Court of Appeal in *Accent Management* (the Court of Appeal decision below) where the Court began by determining which of the two provisions (the general anti-avoidance rule or the specific provisions) took priority: above n 91, at [109] per William J. See also Ruddell who states that the conflict between the specific provisions and the general anti-avoidance rule is undeniable. He suggests the conflict might more appropriately be addressed by the application of traditional rules of interpretation. This should, it is argued, lead the court to identify the leading provision in each particular case: Ruddell, above n 2, at 516.

¹⁰⁹ At [103].

¹¹⁰ At [105].

¹¹¹ At [104].

¹¹² At [104].

¹¹³ At [106].

arrangements involved “without being distracted by intuitive subjective impressions of the morality of what taxation advisers have set up.”¹¹⁴

9.3 *Majority judgment: the test*

The majority set out a three-stage test for assessing whether an arrangement is tax avoidance for the purposes of the Act.¹¹⁵ The first step in any case is for the taxpayer to satisfy the court that the use made of any specific provision comes within the scope of that provision.¹¹⁶ Outside of the avoidance context, the court is concerned primarily with the legal structure and obligations that the parties have created and not with their economic substance or of alternative means of achieving the same result.¹¹⁷ However, it is the true legal character of the transaction rather than its label which will determine the tax treatment.¹¹⁸ Courts must construe the relevant documents as if they were resolving a dispute between the parties as to the meaning and effect of contractual arrangements.¹¹⁹ They must also respect the fact that frequently in commerce there are different means of producing the same economic outcome which have different taxation effects.¹²⁰

The second stage of the inquiry requires the court to look at the use of the specific provisions in light of arrangement as a whole. If a taxpayer has used specific provisions “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.”¹²¹

In deciding whether the use of the specific provisions is outside of Parliamentary contemplation, courts may take into account all relevant factors, including the manner in which arrangement is carried out, the role of the various parties and their relationship with the taxpayer. The economic and commercial effect of documents and transactions may be

¹¹⁴ At [102].

¹¹⁵ While the majority’s test was actually a three stage test, in light of the majority’s comment of the unlikely practical utility of the third stage, it is convenient to refer to it as the two stage test from this point onwards.

¹¹⁶ At [107].

¹¹⁷ At [47] and [147]. See also Richardson J’s comments in *Mills v Dowdall* [1983] NZLR 154 (CA) at 159–160.

¹¹⁸ At [48].

¹¹⁹ At [46].

¹²⁰ At [47].

¹²¹ At [107].

significant, as well as the duration of the arrangement and the nature and extent of the financial consequences that it will have for the taxpayer.¹²² A combination of those factors may be important. If the specific provisions of the Act are used in any artificial or contrived way that will be significant, as it cannot be “within Parliament’s purpose for specific provisions to be used in that manner.”¹²³

The courts are not limited to purely legal considerations at this second stage of the analysis. They must consider the use of the specific provisions in light of commercial reality and the economic effect of that use. The majority said that the “ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provisions in a manner that is consistent with Parliament’s purpose.”¹²⁴ If the arrangement does make use of the specific provisions in a manner consistent with Parliament’s purpose, it will not be tax avoidance.¹²⁵

The third stage is to consider whether tax avoidance is merely an incidental effect of the arrangement. If so, it will not be tax avoidance but it would be rare for this to be the case where the arrangement does not accord with the scheme and purpose of the specific provision.¹²⁶

The majority in *Ben Nevis* thus rejected the interpretation of “merely incidental” used by Woodhouse P in *Challenge Corporation*¹²⁷ but had arguably carried out an exercise similar to the one he did when they were considering what Parliament contemplated with regard to the specific provisions at the second stage of the inquiry. As the majority in *Ben Nevis* had carried out this exercise at an earlier stage, they did not need to use the “merely incidental” concept to limit the scope of the general anti-avoidance provision.

¹²² At [108]–[109].

¹²³ At [108].

¹²⁴ At [109].

¹²⁵ At [111].

¹²⁶ At [114]. It should be noted that the Inland Revenue Department views “merely incidental” as still playing a role in avoidance determinations: *Tax Avoidance and the Interpretation of Sections BG 1 & GA 1 of The Income Tax Act 2007* (Inland Revenue Department Interpretation Statement 13/01, 13 June 2013) at [96]–[92].

¹²⁷ As noted above, Woodhouse P considered that the phrase “merely incidental” in the context of s 99 pointed to something that was necessarily linked and without contrivance to some other purpose or effect so that it can be regarded as a natural concomitant of that other (legitimate) purpose or effect: *Challenge Corporation*, above n 46, at 532–533. See discussion above at section 6.3.

The majority considered that its approach did still provide taxpayers the freedom to structure transactions to their best tax advantage. The majority said that taxpayers are free to utilise “tax incentives” as permitted by the legislation. They cannot, however, do so in a manner that violates the general anti-avoidance rule.¹²⁸ In response to a submission that taxpayers need commercial certainty about their taxation affairs, the majority stated that the approach it had outlined gave as much conceptual clarity as could reasonably be achieved. Courts cannot give more certainty than Parliament has chosen to provide. The majority commented that the issue was, in any event, probably only difficult at the margins.¹²⁹

9.4 *Application of the test by the majority*

After setting out the above test, the majority turned to apply it to the facts at hand. The majority identified elements of artificiality in the scheme at issue in *Ben Nevis*, such as the promissory notes that it did not accept secured payment in any real way.¹³⁰ The unlikelihood of any profit and the extreme timing mismatch between the claimed deductions and when the licence and insurance premiums were supposedly to be paid in an economic sense added to this artificiality.¹³¹

There was also no apparent commercial reason for paying a licence premium for land where the investors had already covered the total cost of the land. In addition, the projected profits only equalled the amount of the licence premium and did not cover the insurance premium. The only benefits to the investors from the arrangement therefore were the tax deductions.¹³² Further, there was no personal liability for the investors and, given the timing mismatch, there was a real possibility that the licence premium would never be paid.¹³³

The majority said that the effect of the arrangement relating to the promissory note for the licence premium would be to “provide a tax concession in circumstances where the

¹²⁸ At [111].

¹²⁹ At [112].

¹³⁰ At [119].

¹³¹ At [120].

¹³² At [126].

¹³³ At [127]. This was because, after the 50 year time gap, the syndicate members may not still be in existence. Further, their shareholders had no personal liability and, in any event, may not still be alive in 2048.

commitment to make the payment is dependent on stumpage proceeds and is otherwise illusory”.¹³⁴ The result of this kind of use of a specific provision was to take the arrangement outside the scope of what Parliament contemplated the proper use of the specific provision to be and into tax avoidance.¹³⁵ In addition, the insurance arrangements were not arms length and the tax haven company was in no real sense at risk. There were also elements of circularity in the insurance arrangements.¹³⁶

9.5 *Comments on majority approach*

Concern has been expressed that the Parliamentary contemplation test may simply allow a judge to substitute his or her own view on the arrangement under the guise of answering the question of what would be within Parliamentary contemplation.¹³⁷ Concerns have also been raised about the impact that such an approach would have on the rule of law and whether it falls within the proper role of courts.¹³⁸

The majority in *Ben Nevis* did make it clear that the exercise was one of statutory interpretation and that judges should not be distracted by “intuitive subjective impressions of the morality” of certain arrangements.¹³⁹ The relationship between the first two stages of *Ben Nevis* does pose some conceptual issues, however, which may have contributed to the above concerns.

¹³⁴ At [130].

¹³⁵ At [130].

¹³⁶ At [146]. The insurance arrangements with the land owning company and the letter of comfort given by the ultimate owner of the land owning company to the tax haven insurer for the scheme demonstrated that any risk was at least in part an indemnified risk. These arrangements also led to circularity in the insurance aspect of the scheme.

¹³⁷ 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 NZJLTP 395. It has also been argued that the generality of the anti-avoidance provision should not be allowed to compromise certainty and fairness. The need for certainty is also connected to the principle that there must not be taxation without representation. This is set out in the Bill of Rights 1688 (UK) which is incorporated into New Zealand law by the Imperial Laws Application Act 1988: see Trombitas, above n 95, at 387. See also Julie Cassidy “The Duke of Westminster Should Be Very Careful When He Crosses The Road in New Zealand: The Role of The New Zealand Anti-Avoidance Rule” [2012] NZ Law Review 1 at 32.

¹³⁸ See generally Michael Littlewood “Tax Avoidance, the Rule of Law and the New Zealand Supreme Court” [2011] New Zealand Law Review 35; Craig Elliffée and Jess Cameron “The Test for Tax Avoidance in New Zealand: A Judicial Sea Change” (2010) 16 NZBLQ 440, at 447; Cassidy, above n 137, at 32; and Dunbar, above n 84, at 406–407. For a discussion of morality and the general anti-avoidance rule see: Dunbar, above n 84, at 407; Zoe Prebble and John Prebble “The Morality of Tax Avoidance” (2010) 43 Creighton Law Review 693; and E W Thomas “The Evolution from Form to Substance in Tax Law: The Demise of the Dysfunctional “Metwand”” [2011] 19 Waikato L Rev 17 at 22–23.

¹³⁹ *Ben Nevis*, above n 57, at [102].

At the first stage, the specific provisions are applied to the legal substance of the transaction. At the second stage, the whole arrangement and its economic substance are examined to consider if the use of the specific provisions is outside Parliamentary contemplation and purpose.¹⁴⁰ This arguably requires a broader examination of the purpose of a specific provision than at the first stage.

The majority make it clear that, at the first stage, the specific provisions are interpreted in a purposive fashion, as they must be in terms of s 5(1) of the Interpretation Act.¹⁴¹ The specific provisions are applied to the legal substance of the arrangement. At the second stage the economic substance of the arrangement is considered. The issue is whether a different exercise is undertaken at the second stage when considering Parliamentary purpose and contemplation as it applies to the specific provision. Arguably it is, but I do not see this as allowing the personal views of the particular judge to reign.

I would suggest that, just as the economic substance of the whole arrangement is considered at the second stage, so it is the underlying economic rationale or economic substance for the specific provisions that is at issue at the second stage. I use the terms economic rationale or economic substance in the sense of ascertaining the intended economic effect of the particular provision. Given that the provisions concern taxation, all taxation provisions will have an economic effect, even in cases where, to achieve the intended economic effect, mere technical compliance with the provisions may suffice.¹⁴²

Any view of Parliamentary contemplation (even at the second stage of the *Ben Nevis* inquiry) must, however, be grounded in the words of the statute, interpreted in the context of the Act as a whole and any relevant wider context, which may include extra parliamentary material.¹⁴³

¹⁴⁰ James Coleman *Tax Avoidance Law In New Zealand* (2nd ed CCH New Zealand Ltd, New Zealand, 2013) at 77–78. Coleman explains the difference between the first and second stages by contrasting the “input data” that is included at each stage. At the first stage only the legal rights and obligations created by the arrangement are considered. When, at the second stage the economic substance is also considered, a different outcome may be reached.

¹⁴¹ Section 5(1) of the Interpretation Act, set out above n 43.

¹⁴² This addresses the criticisms that have been made from time to time that some specific provisions under the Act are merely technical and therefore technical compliance suffices. See discussion at 12.

¹⁴³ The development of tax law in New Zealand is done in accordance with the 16 stage Generic Tax Policy Process (GTPP). As a result there is normally a considerable amount of extrinsic materials that can

If it is not, then the courts would be overstepping their role. It is true, that where the policy behind a particular provision is obscure, this may make the test of the majority in *Ben Nevis* difficult to apply.¹⁴⁴ In such cases, the courts will have to fall back just on the text.¹⁴⁵ The courts in such cases are not there to fill the policy gaps left by Parliament with what the judge or judges think should have been the policy.¹⁴⁶

A number of articles have queried whether the “Parliament” referred to in the Parliamentary contemplation test is the Parliament that actually enacted the provision or a hypothetical Parliament faced with a factual situation which may have not been contemplated at the time that the legislation was passed.¹⁴⁷ This is not the place to resolve the debate about the nature of statutory interpretation and whether a concept of Parliamentary intention ever makes sense, especially in an MMP context.¹⁴⁸ But the debate does highlight the point that ascertaining Parliamentary purpose or intent will always to a degree be a hypothetical exercise. For present purposes, it is sufficient to say that, while original intent or purpose (as shown by pre-legislative material such as consultation documents and Parliamentary material on introduction) will be important, legislation cannot stand still and must be applied to circumstances as they arise.¹⁴⁹ What is important, however, is that the task remains an exercise in statutory interpretation and not one of rewriting the legislation.¹⁵⁰

legitimately be used to ascertain the purpose of tax provisions: Dunbar, above n 84, at 407; Ruddell, above n 2, at 520.

¹⁴⁴ Judith Freedman “Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament” (2007) 123 LQR 53 at 85.

¹⁴⁵ This is not to suggest that the courts can depart from the text in any statutory interpretation exercise. The task in all cases is to interpret text but to do so in light of purpose. The actual words are “the most important single factor in statutory interpretation”: JF Burrows and RI Carter *Statute Law in New Zealand* (4th ed, LexisNexis, Wellington, 2009) at 202.

¹⁴⁶ See Susan Glazebrook “Filling the Gaps” in Rick Bigwood (ed) *The Statute: Making and Meaning* (LexisNexis NZ Limited, Wellington, 2004) at 153.

¹⁴⁷ Dunbar, above n 84, at 407; Elliffe and Cameron, above n 138, at 458–459.

¹⁴⁸ Ekins’ support for the concept of Parliamentary intention can be compared with Sir Kenneth’s approach which prefers to limit consideration to the purpose underlying a provision: Richard Ekins *The Nature of Legislative Intent* (Oxford University Press, Oxford, 2012); and K J Keith *Interpreting Treaties, Statutes and Contracts* (Occasional paper No 19, May 2009) at 34–35. See also J Waldron, *Law and Disagreement* (Oxford University Press, New York, 1999) at 142.

¹⁴⁹ Under s 6 of the Interpretation Act “An enactment applies to circumstances as they arise”.

¹⁵⁰ This point was made by Lord Hoffman in *Norglen Ltd. v Reeds Rains Prudential Ltd* [1999] 2 AC 1. He said that, by the true construction of an anti-avoidance provision, an arrangement will either be caught by it or not. In his words “it is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes. There is no need for such spooky jurisprudence”: at 13–14.

9.6 *Minority judgment*

The minority agreed with the result reached by the majority but differed from the majority's reasoning in one significant respect relating to the interpretation of specific provisions of the Act.¹⁵¹ The minority said that it would be wrong to interpret taxation statutes in terms of concepts such as "legal meaning" or "ordinary meaning" as words in a taxation statute can, depending on the context, be used in a business or accounting sense.¹⁵² When interpreting taxation statutes, the context may therefore require consideration of economic substance even when interpreting specific provisions of the legislation.¹⁵³

The real question is whether the relevant provisions of the statute were intended to apply to the facts viewed realistically. If the use of a specific provision falls outside its intended scope in the scheme of the Act, the use is not authorised within the meaning of the specific provision. This, the minority considered, would avoid distortion and overuse of the general anti-avoidance provision.¹⁵⁴ In the minority's view, care should be taken not to resurrect two myths: first, that in tax cases, more than any other field, form prevails over substance. The second is that the substance of a transaction is its legal rather than economic substance.¹⁵⁵

The minority went on to say that tax avoidance occurs when "the object or end in view or design of an arrangement is alteration to the incidence of tax and that object is not incidental to a business purpose."¹⁵⁶ This requires a realistic assessment of their purpose or effect.

¹⁵¹ The minority and majority in *Ben Nevis* also differed in their view of the usefulness of English authorities. The minority did not consider that there were any stark differences between the general approach to statutory interpretation of taxation provisions in the United Kingdom and New Zealand and thus considered the English decisions would be of assistance: at [2]. The majority considered English authorities to provide only limited direct assistance as the English cases were not concerned with the reconciliation of potentially conflicting provisions: at [110]. Any analysis of the approach to tax avoidance in the United Kingdom is beyond the scope of this paper. For a discussion of the English approach to the interpretation of tax statutes and in particular the "fiscal nullity" line of cases see Freedman, above n 144. I note, however, that the United Kingdom recently enacted a general anti-avoidance rule, which came into force on 17 July 2013. It is found under Part 5 and Schedule 43 of Finance Act 2013. See Ashley Greenbank "Finance Act Notes: Sections 206-215 and Schedule 43: the General Anti-Abuse Rule" (2013) 4 BTR 505. It is likely that the English courts will concentrate on these new provisions rather than developing further the existing jurisprudence.

¹⁵² At [4].

¹⁵³ At [5]. See Thomas above n 138.

¹⁵⁴ At [2].

¹⁵⁵ At [4].

¹⁵⁶ At [9].

Purpose is not to be equated with motive, although it may be evidence which sheds light on the purpose and so is not wholly irrelevant.¹⁵⁷

As to where to draw the line between tax avoidance and legitimate transactions, the minority said that the fact that an arrangement achieves some business effect does not mean that the overall effect is not tax avoidance. An arrangement will cross the line into tax avoidance if the fiscal effect intended is more than “merely incidental” to the business or family purpose. They added, however, that fiscal implications of an arrangement that are “merely incidental” to a business purpose “may in some cases be substantial and still within the statutory scheme and purpose.”¹⁵⁸

In this case, the minority considered it doubtful that the arrangements fell within the specific statutory provisions properly construed but agreed with the majority’s conclusion that they clearly constituted tax avoidance.

9.7 *Comments on minority approach*

The minority’s approach to “merely incidental” is comparable to that of Woodhouse P in *Challenge*.¹⁵⁹ Like Woodhouse P, the minority suggests that what is or is not merely incidental can be determined by reference to the significance of a fiscal purpose as against an arrangement’s legitimate business or family purposes. This will determine whether the fiscal purpose has crossed the line from merely incidental to avoidance.

The view of the minority that the arrangements might, in economic substance, contravene the specific provisions of the Act properly construed has been seen as radical. However, the judgment does not suggest that there should be a wholesale move to an economic substance analysis for the interpretation of taxation statutes in general. Their judgment only says that in

¹⁵⁷ At [8], citing Lord Denning in *Newton v Commissioner of Taxation of the Commonwealth of Australia*, above n 52, at 465. Elliffe and Cameron point out that there will be times when the taxpayer’s subjective purpose is a critical part of a court’s assessment of non-commerciality, consistent with a purpose of tax avoidance. For example, in *Ben Nevis*, the majority considered a comment made by one of the parties involved in constructing the *Ben Nevis* forestry scheme indicating that “[t]he real benefits of the deal are tax concessions that can be obtained now by the investors and the foundation” to be “highly significant”: Elliffe and Cameron, above n 138, at 445, citing *Ben Nevis*, above n 57, at [136].

¹⁵⁸ See at [9]. I assume this is a reference to the more general scheme and purpose of the Act rather than the scheme and purpose of the specific provisions.

¹⁵⁹ See discussion above at section 6.3.

some cases specific provisions properly construed may call for an economic, as against, a legal substance interpretation.¹⁶⁰ Further, the facts of the *Ben Nevis* case were extreme and therefore the conclusion that the arrangement potentially did not come within the specific provisions of the Act properly construed is not as radical as it may seem.¹⁶¹

10 Mining licences, secondhand goods and GST

*Glenharrow Holdings Ltd v Commissioner of Inland Revenue*¹⁶² concerned a mining licence which permitted the extraction of serpentinite, bowenite and certain other rock. Mr Meates had acquired the licence in 1996 for \$10,000. In 1997, Mr Meates sold the licence to Glenharrow Ltd, for \$45 million.¹⁶³ Glenharrow, through its major shareholder, Mr Fahey, had formed the view that \$45 million was a fair reflection of what the licence was worth.¹⁶⁴

Glenharrow had a share capital of \$100 and no assets.¹⁶⁵ The purchase of the licence was completed on the basis that Glenharrow would pay \$80,000 initially and the vendor, Mr Meates, would lend it the remaining \$44,920,000, repayable within three years. The initial \$80,000 was advanced to Glenharrow by Mr Fahey. When the licence was transferred, Glenharrow gave Mr Meates a cheque for \$44,920,000, drawn on its solicitors trust account. Mr Meates gave Glenharrow a cheque for the same amount (also drawn on his solicitor's trust

¹⁶⁰ In England, the courts have never considered themselves to have the power to consider economic over legal substance. Such an approach is considered to be outside the role of the judiciary and could only be introduced through legislation: Freedman, above n 144, at 73. See also Lord Hoffmann's comments in *Commissioner of Inland Revenue v Auckland Harbour Board*, [2001] 3 NZLR 289 (PC) at 299. This can be compared with the approach taken in the United States, where the courts have been more ready to look behind a transaction to its economic substance. See for example the comments of Hand J in *Gregory v Helvering* 69 F 2d 809 (2nd Cir. 1934) at 810–811. See also Joshua D Blank and Nancy Staudt "Sham Transactions in the United States" in Edwin Simpson and Miranda Stewart (eds) *Sham Transactions* (Oxford University Press, Oxford, 2013).

¹⁶¹ Dr Littlewood suggests that the Commissioner should not have conceded in *Ben Nevis* that the requirements of the specific provision had been met. The licence premium and the insurance premiums were arguably not expenses that had been incurred for the purposes of s DA 1 of the Income Tax Act because they were expenses that, as the majority recognised, were very unlikely actually to be paid: Littlewood, above 138, at 57–58. The majority in the Privy Council in *Peterson* noted on the conclusion of their judgment that if the CIR had presented his case in a different way, he might have been successful. The Commissioner could have argued that the inflated fee was paid for the services of the production company in procuring the limited recourse loan. If this was the case then the inflated amount would not represent deductible expenditure: per Lord Millet at [47]–[53]. Also see Dunbar, above n 84, at 366.

¹⁶² *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88.

¹⁶³ At [2]. Details of how this price was reached set out at [9].

¹⁶⁴ At [15].

¹⁶⁵ At [2].

account) by way of a loan.¹⁶⁶ Glenharrow then delivered to Mr Meates a mortgage over the licence, a general mortgage debenture over all its assets and a mortgage over its shares executed by Mr Fahey but, it was agreed, without personal liability.¹⁶⁷

Under the Goods and Services Tax Act 1985 (GST Act), a person registered for GST who purchases secondhand goods from an unregistered person is entitled to an input tax credit for the “tax fraction” of the price.¹⁶⁸ Mr Meates was not registered for GST, but Glenharrow was.¹⁶⁹ The mining licence was a “secondhand good” and accordingly Glenharrow claimed an input tax credit for one-ninth of the initial \$80,000 (\$8,888). The Inland Revenue Department (IRD) paid the amount. Glenharrow then claimed a further refund of one-ninth of the outstanding \$44,920,000 (that is, \$4,991,111). The IRD declined to pay, maintaining that the arrangements amounted to tax avoidance under s 76 of the GST Act.¹⁷⁰

In the High Court,¹⁷¹ Chisholm J concluded that the \$45m purchase price was inflated and accordingly so was the refund claimed. He considered that, taking into account his view of the correct value of the licence, and accounting for the input credit already paid on the \$80,000 sum, Glenharrow was entitled to an input tax credit on only \$9,757,000. The Judge therefore ordered the Commissioner to credit Glenharrow with a GST credit of the tax fraction of that amount.¹⁷²

The majority in the Court of Appeal held that the arrangement was tax avoidance but went further than the High Court. It held that the arrangement constituted tax avoidance “because in economic terms [there] was only a conditional obligation to repay the loan and there was no definitive commitment to repay irrespective of the success or failure of the venture”.¹⁷³ The only way in which that advantage could be counteracted was to assess the entitlement to

¹⁶⁶ At [2].

¹⁶⁷ At [2].

¹⁶⁸ At the time the rate of GST tax was 12.5 per cent and hence the “tax fraction” applicable to the deductions was one-ninth: at [16].

¹⁶⁹ At [18].

¹⁷⁰ See the description of the facts in the Court of Appeal decision: *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2007] NZCA 346, [2008] 1 NZLR 222 per the majority of Robertson and Ellen France JJ at [26]–[27].

¹⁷¹ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* HC Christchurch CIV 2002 409 772, 23 August 2005 [*Glenharrow* HC].

¹⁷² At [212]–[215].

¹⁷³ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2007] NZCA 346, [2008] 1 NZLR 222 At [82].

input tax credits with regard to the price actually paid to date to Mr Meates, some \$210,000.¹⁷⁴ Glenharrow appealed to the Supreme Court, which dismissed its appeal.¹⁷⁵

I mention this case largely because of the approach the Supreme Court undertook at the second stage of the analysis in assessing the wider purpose of the specific provisions at issue. It was said that the whole premise of the GST Act generally, and of the secondhand goods provisions in particular, is that transactions will be driven by market forces. This means that their commercial and fiscal effects will be produced by those forces and will not contain distortions which affect (ie defeat) the contemplated application of the GST Act. It is when market forces do not prevail that s 76, the GST Act anti-avoidance provision, is available to the Commissioner.¹⁷⁶

The Court went on to say (in answer to a submission that this approach means that the bargain struck by the parties is not respected) that uncertainty is inherent where “transactions have artificial features combined with advantageous tax consequences not contemplated by the scheme and purpose of the Act.”¹⁷⁷ It said that transactions which are driven only by commercial imperatives are unlikely to produce tax consequences outside the purpose of the legislation. If commercial transactions have unusual features, then a binding ruling can always be sought.¹⁷⁸

In the instant case, the Court held that, on an objective view of the arrangement, the effect of the structure was to produce a GST refund totally disproportionate to the economic burden undertaken by Glenharrow or the economic benefit obtained by Mr Meates. This conclusion was based on the gross disparity between the price and the size of the purchaser and, particularly, the shrinking value of the asset with its very limited practical life. Mining could not have begun until the final (third) year of the licence. This means that, even if the price could be justified on the basis of the stone available within the licence, an objective observer

¹⁷⁴ *Glenharrow HC*, above n 171, at [116].

¹⁷⁵ At [56].

¹⁷⁶ At [47].

¹⁷⁷ At [48].

¹⁷⁸ At [49]. Binding rulings are provided for in prt 5A of the Tax Administration Act 1994. Rulings can be public, private or in relation to a particular product. Taxpayers can apply for a private ruling under s 91EC of the Taxation Administration Act.

in 1997 would have realised that payment in full would not occur as enough stone could not be extracted within the remaining term to enable payment in full.¹⁷⁹

Relevant to the Courts assessment was that Glenharrow was a shell company, meaning that it had no other assets, there were no guarantees and the company's payment of the price was entirely dependent on the success of the mining operation. In the Court's view, the transaction had no reality as a "cash" transaction, despite being structured as if it were.¹⁸⁰ It was also relevant that Mr Meates was not registered for GST. This created a distortion which defeated the intent and application of the Act.^{181 182}

11 Doctors, salaries and trusts

In *Penny v Commissioner of Inland Revenue*,¹⁸³ the taxpayers were surgeons who had transferred their practices to companies owned by their family trusts.¹⁸⁴ One of the taxpayers (Mr Penny) had established the company and trust structure several years before the increase in the maximum individual tax rate to 39 cents in the dollar, at a time when he would have obtained no tax advantage from the use of the structure.¹⁸⁵ However, he limited his salary after the tax rate change and arranged for his family trust to lend back to him (interest free) a large part of the dividends received by the trust.¹⁸⁶ The dividends to the trust were taxable at 33 cents in the dollar for trustee income or at the rate for individual beneficiaries.¹⁸⁷ By contrast, Mr Hooper restructured his practice in 2000 at the time of tax rate changes.

¹⁷⁹ It was not explained why the credit should not be applied to the part of the purchase price that in 1997 may have been anticipated could be extracted. Presumably the answer is that this was not available because of what the Court held to be the lack of reality in the financing arrangements and the mismatch created through Mr Meates being unregistered.

¹⁸⁰ At [52]–[53].

¹⁸¹ See summary at [54].

¹⁸² At [50].

¹⁸³ *Penny v Commissioner of Inland Revenue*, above n 90.

¹⁸⁴ Both gave evidence that they had restructured their practices because of a concern about exposure to medical negligence claims that may not be covered by the Accident Compensation Scheme: see at [16]. This had been accepted by Mackenzie J in the High Court as reflecting a genuine concern: *Penny v Commissioner of Inland Revenue* [2009] 3 NZLR 523 (HC) [*Penny v Commissioner of Inland Revenue* (HC)] at [46].

¹⁸⁵ The top tax rate increased from 33 to 39 cents in the dollar from 1 April 2000. The company tax rate remained at 33 cents in the dollar.

¹⁸⁶ See at [3].

¹⁸⁷ See at [2].

The Supreme Court unanimously held the arrangements to be tax avoidance.¹⁸⁸ The Court noted that merely transferring a business to a company owned by a family trust is lawful and unremarkable and could not constitute tax avoidance in itself. It was a choice the taxpayers were entitled to make. There was also no suggestion that the arrangements fell outside any of the specific provisions of the Act on their ordinary meaning.

The Court was therefore able to go directly to the second stage of the *Ben Nevis* test. In that regard, the Court held that the purpose of the regular salary setting, when viewed in light of its effect within the wider context of the arrangement as a whole, was tax avoidance. The salaries were not set with regard to any market benchmark and the taxpayers admitted in cross-examination that they would not have entered into those arrangements with an unrelated party.¹⁸⁹ Nor were the salaries set having regard to any business requirements of the company, such as the need for capital expenditure or contingencies.¹⁹⁰ The taxpayers had also retained the use of the income of their practices through loans in one case (Mr Penny) or, in the other, through the use of the funds of the family trust for household purposes (Mr Hooper).¹⁹¹

The artificially low salary settings had therefore reduced the taxable earnings of each taxpayer but allowed the company's earnings to be made available to the taxpayers through the family trusts. The Court said that, in reality, the taxpayers suffered no actual loss of income but obtained a reduction in liability for tax as if they had.¹⁹²

¹⁸⁸ The High Court had held the arrangements did not constitute tax avoidance: *Penny v Commissioner of Inland Revenue* (HC), above n 184. The Court of Appeal by majority had allowed the Commissioner's appeal: *Commissioner of Inland Revenue v Penny* [2010] NZCA 231, [2010] 3 NZLR 360 per Hammond and Randerson JJ. Ellen France J dissenting.

¹⁸⁹ See at [16].

¹⁹⁰ At [16] and [34]–[35].

¹⁹¹ The Court cited the Australian High Court and Privy Council decisions in the case of *Peate*, a similar case involving incorporation and the use of family trusts by medical practitioners. There the respective courts had found the arrangements to be tax avoidance: *Peate v Commissioner of Taxation of Commonwealth of Australia* (1962–1964) 111 CLR 443, aff'd *Peate v Commissioner of Taxation of Commonwealth of Australia* [1967] 1 AC 308 (PC). *Peate* was also applied in the early New Zealand avoidance case of *Elmiger v Commissioner of Inland Revenue* [1967] NZLR 161 (CA) at [165].

¹⁹² See at [47].

12 Summary of Supreme Court approach

In summary, *Ben Nevis* set down a staged test.¹⁹³ At the first stage, the legal form of the transaction is tested against the ordinary meaning of any relevant specific provisions. At the second stage, the economic substance of the arrangement is considered, both in its constituent parts and as a whole. That arrangement is then tested against a wider view of the purpose of the specific provisions, viewed in the context of the Act as a whole. Effectively, I have suggested that this means looking at the economic substance of the particular provisions. So the second stage consists of testing the economic substance of an arrangement against the economic substance of the specific provisions used.

The intended economic substance of provisions may of course depend on legal form. For example, company taxation provisions depend on the corporate form of the taxpayer. Further, the economic substance of some provisions may be to provide a tax concession if the technical requirements of the provisions are met, provided these specific provisions are not used in an artificial or contrived manner.¹⁹⁴ However, given that we are dealing with taxation, all specific provisions will have an economic effect, even where, to achieve the intended economic effect, mere technical compliance with the provisions may in some circumstances suffice.¹⁹⁵

If the arrangement (or any constituent part of that arrangement) does not fit within the particular provisions (considered in the wider sense) at the second stage, then, viewed objectively, the purpose or effect of the arrangement will be tax avoidance. In this way, effect is given to both the general avoidance provision and the specific provisions, both viewed purposively.

In *Ben Nevis*, the majority noted a number of factors that would be relevant to the second stage Parliamentary contemplation enquiry, including the manner in which the arrangement is carried out, the duration of the arrangement and the financial consequences for the taxpayer,

¹⁹³ As noted earlier, there is a third stage (merely incidental) but the majority considered it would rarely apply. For these purposes therefore I only consider the first two stages.

¹⁹⁴ See for example the discussion of the PIE rules in Michael Littlewood “Amending New Zealand’s Anti-Avoidance Rule” (2013) 25 NZULR 522 at 527–528.

¹⁹⁵ See earlier comments at section 9.4.

as well as artificiality.¹⁹⁶ Apart from artificiality, where the majority said that it would not be within Parliament’s purpose for provision to be used in an artificial manner, no real guidance was given as to when the factors identified will signal that an arrangement is outside Parliamentary contemplation.¹⁹⁷

In the cases considered in this paper, however, various matters were identified as significant when assessing whether an arrangement falls outside the contemplation of the specific provisions. These include artificiality,¹⁹⁸ circularity,¹⁹⁹ non-market transactions,²⁰⁰ whether expenditure will in fact be incurred²⁰¹ and the (lack of) effect on a taxpayers’ financial position.²⁰² The factors set out above and identified by the majority in *Ben Nevis* will need to be considered when deciding whether these hallmarks of avoidance are present.²⁰³

13 What is new?

For a long time, courts have tried to tackle the conceptual problem posed by the breadth of the general anti-avoidance provision which, if taken literally, would cover numerous common transactions. As pointed out by Woodhouse J in the early case of *Elmiger v Commissioner of Inland Revenue*, the section “would extend to every transaction whether voluntary or for value

¹⁹⁶ See at section 9.2 above.

¹⁹⁷ See Littlewood, above n 138, at 65. Mike Lennard argues that *Ben Nevis* essentially establishes two tests for avoidance: one for those who prefer the conceptual rigour of the scheme and purpose/Parliamentary contemplation tests and one for the “sniff testers” who like to be able to point to concrete factors that contribute to the overall “foul smell” of a transaction. He argues that, in practice, it is the sniff test which is more commonly applied. Lennard “Two Tribes and an Elephant Called *Ben Nevis*” (2009) 22 Taxation Today, cited in Elliffe and Cameron, above n 138, at 451.

¹⁹⁸ See for example: *Ben Nevis*, above n 57, per the majority at [108], [147]–[148], [190]–[191]; *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [51]–[53]; *Penny v Commissioner of Inland Revenue*, above n 90, at [33], [46].

¹⁹⁹ See for example: *Ben Nevis*, above n 57, per the majority at [146]; *Penny v Commissioner of Inland Revenue*, above n 90, at [19] (referencing [70] of the High Court judgment). Compare with *Peterson v Commissioner of Inland Revenue*, above n 68, per Lord Millet for the majority at [19] and [45].

²⁰⁰ See for example: *Penny v Commissioner of Inland Revenue*, above n 90, at [49]; *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [44]; *Ben Nevis*, above n 57, per the majority at [23], [25]–[26].

²⁰¹ See for example: *Ben Nevis*, above n 57, per the majority at [122] and *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [51]; compare *Peterson v Commissioner of Inland Revenue*, above n 68, at [41]–[42].

²⁰² *Ben Nevis*, above n 57, per the majority at [202]; *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [51]; *Penny v Commissioner of Inland Revenue*, above n 90, at [47]. See also *Challenge Corporation Ltd v Commissioner of Inland Revenue* (PC), above n 46, at 561–562.

²⁰³ There may of course be factors identified in future cases as pointing towards avoidance, in addition to the hallmarks I have identified.

which had the effect of reducing the income of any taxpayer".²⁰⁴ An ordinary and literal reading of the provision could for example include the selling of an income producing asset or, at the more extreme end of the spectrum, a couple choosing to have only one working parent instead of two.²⁰⁵ It has fallen to the courts to delimit the scope of the general anti-avoidance provision through a process of statutory interpretation.

There has been debate about how different the Supreme Court approach to tax avoidance actually is. Some suggest the Parliamentary contemplation test is merely the old scheme and purpose approach in fancy dress.²⁰⁶ Others say it is a totally new approach.²⁰⁷ I propose to discuss this issue under a number of headings. I first assess the extent to which the test itself is new and then assess whether the various hallmarks of avoidance that can be discerned from the Supreme Court cases so far depart from the approach taken by the courts in the past. Finally, I will assess what remains of the choice principle.

13.1 *Staged approach*

Under the scheme and purpose approach, espoused in particular by Richardson J in *Challenge*, both the anti-avoidance provision and the specific provisions were analysed in terms of their purpose and in their context but this was not done explicitly in a two stage approach. Richardson J in the Court of Appeal in *Challenge* made it clear, however, that merely coming within the terms of the specific provisions did not mean there was no room for the operation of the general anti-avoidance provision. So, although he did not articulate a two

²⁰⁴ *Elmiger v Commissioner of Inland Revenue* [1966] NZLR 683 (SC) at 688 citing Knox J in *Federal Commissioner of Taxation v Purcell* (1921) 29 CLR 464 at 466. This point was also made by Richardson J in *Challenge Corporation (CA)*, above n 46, at 550. See also *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591 (PC) at 602 per Lord Wilberforce and *Ben Nevis*, above n 57, per the majority at [12].

²⁰⁵ Michael Littlewood "Tax Avoidance, the Rule of Law and the New Zealand Supreme Court" [2011] NZ L Rev 35 at 41; Cassidy, above n 137, at 10; Ruddell, above n 2, at 500–502.

²⁰⁶ Eugen Trombitas "The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives but the GAAR Can Take Away" (2009) 15 NZJTL 352 at 352, 357, 360 and 361; Littlewood, above n 205, at 53.

²⁰⁷ See Elliffe and Cameron, above n 138, at 458; Julie Harrison and Mark Keating "New Zealand's General Anti-Avoidance Provisions: A Domestic Transfer Pricing Regime by Proxy?" (2011) 17 NZLTJP 419 at 418; Thomas, above n 138, at 45–49; Cassidy, above n 137, at 21 and Harry Ebersohn "Tax Avoidance and the Rule of Law" [2012] New Zealand Law Review 243 at 260. Other commentators are unsure of the extent of the departure: Dunbar, above n 84, at 404–406.

stage approach, Richardson J clearly recognised complying with specific provisions did not immunise the taxpayer from a tax avoidance finding.²⁰⁸

The staged approach, articulated by the majority in *Ben Nevis*, does arguably lead to a wider view of the purpose of the specific provision being considered at the second stage and thus a wider role for the anti-avoidance provision.²⁰⁹ This wider role may not be new, however. It is reminiscent of the view taken by the majority of the Privy Council in *Challenge* of the specific provisions when tax avoidance was being considered.²¹⁰ The majority in the Privy Council in *Challenge* also took a staged approach to tax avoidance similar to that taken by the majority in *Ben Nevis*.²¹¹

13.2 *Tandem interpretation*

The majority in *Ben Nevis* viewed the specific provisions and the general anti-avoidance provision as working “in tandem.” They considered that Richardson J in *Challenge* had dealt with the conflict between the specific provisions and the general anti-avoidance provision by reading the latter down.²¹²

I interpolate that this is one way of interpreting Richardson J’s judgment in *Challenge*.²¹³ Another interpretation is that the result Richardson J reached in *Challenge* stemmed from his view of the purpose of the loss offset rules, rather than necessarily a “reading down” of s 99. Richardson J considered that, because the group loss rules were a tax construct, then adherence to the artificial rules in those provisions sufficed.²¹⁴

²⁰⁸ *Challenge* (CA), above n 46, at 549. On appeal, the majority in the Privy Council cited this view with approval: at 559 per Lord Templeman. Cooke J in the Court of Appeal took a narrower more traditional approach than Richardson J: see above at section 6.2.

²⁰⁹ See discussion above at section 9.2.

²¹⁰ See discussion above at section 6.4.

²¹¹ See also *Peterson v Commissioner of Inland Revenue*, above n 68, per Lord Millet for the majority at [42].

²¹² *Ben Nevis*, above n 57, at [88]–[89]. Essentially, Randerson J said the same in *Penny*, above n 90, at [62]. See also Dunbar, above n 85, at 405.

²¹³ This observation has also been made by commentators: see Dunbar, above n 84, at 405; and Ebersohn, above n 207, at 260.

²¹⁴ Referring to Richardson J’s judgment in *Challenge*, Dunbar has identified three main categories of legislation. First, that which relates to business concepts for example deductibility provisions. Second, that which relates to pure tax concepts for example the loss carried forward and offset provisions. Third, that which relates to tax incentives for example provisions granting tax credits and tax deductions for exporters, and standard values for farms: Dunbar, above n 84, at 367–368.

It cannot be said, however, that the majority in the Privy Council in *Challenge* failed to give full scope to s 99. Indeed, the majority’s approach in *Ben Nevis* does not differ greatly from the approach of the majority in the Privy Council in *Challenge*. In *Challenge* the majority rejected the view that the inclusion of the specific provision ousted the application of s 99 and emphasised the Court’s role in identifying the line between tax mitigation and avoidance.²¹⁵ This gave effect both to the specific provisions and the general anti-avoidance rule.

There is no doubt, however, that the tax avoidance jurisprudence since *Challenge* has not been totally consistent with the *Challenge* approach.²¹⁶ One case even described the general anti-avoidance provision as a “longstop,”²¹⁷ a comment firmly rejected by the majority in *Ben Nevis*.²¹⁸ Therefore, while the tandem approach is not necessarily new, it has been emphatically re-asserted by the Supreme Court.

13.3 *Economic as against legal substance*

The majority in *Ben Nevis* held that the economic substance of an arrangement is relevant in the second stage Parliamentary contemplation enquiry. Consideration of economic as against legal substance is not, however, new within the tax avoidance context. The Privy Council in *Challenge*, for example, took economic substance into account in allowing the appeal, and, while Richardson J’s result in the Court of Appeal differed, this was because of the view he took of the specific provisions at issue being a tax construct. Richardson J had in earlier cases recognised that economic substance could be taken into account under the general anti-avoidance provision. In *Mills v Dowdall*, for example, he stated:²¹⁹

The true nature of [a] transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. Not on an assessment of the broad substance of the transaction measured by the results intended and achieved; or of the overall economic consequences to the parties ... The only exceptions to the principle that the legal consequences of a transaction turn on the terms of the legal arrangements

²¹⁵ *Challenge* (PC), above n 46, at 559–561. Discussed above at section 6.4.

²¹⁶ See for example the discussion of *Peterson* above.

²¹⁷ That the anti-avoidance provision was a longstop: *Commissioner of Inland Revenue v Auckland Harbour Board*, above n 160, at [11] per Lord Hoffmann. See: Elliffe and Cameron, above n 138, at 447.

²¹⁸ The majority cited the characterisation of the general anti-avoidance rule as a “longstop” provision as indicating that clarification as to the relationship between the general anti-avoidance and specific provisions was needed: at [100]. The majority’s tandem approach, discussed above at section 9.2, demonstrates the majority’s rejection of this view of the general anti-avoidance rule.

²¹⁹ *Mills v Dowdall*, above n 117, at 159–160.

actually entered into and carried out are ... where there is a statutory provision, such as s 99 of the Income Tax Act 1976, mandating a broader or different approach which applies in the circumstances of the particular case.

In *Peterson*,²²⁰ however, while purporting to apply *Challenge*, the majority in the Privy Council in fact took a legal substance rather than an economic substance approach.²²¹ To this extent, the approach of the majority in *Ben Nevis* again heralds a clear and unambiguous endorsement of the necessity to take into account the economic substance of an arrangement in an avoidance context.²²²

13.4 Artificiality

All three Supreme Court cases I have discussed highlight the artificiality present in the particular arrangements at issue. In *Penny* it was the lowering of the surgeon's salaries at "artificially low levels whereby the incidence of tax at the highest personal rate was avoided".²²³ In *Glenharrow*, it was the fact that the purchase price of the licence was not paid in economic terms but rather through the exchange of matching trust fund cheques in circumstances where it was unlikely ever to be paid in full.²²⁴

The arrangement in *Ben Nevis* was of course almost wholly artificial.²²⁵ From the syndicate's point of view:

- (a) Why, having already paid three times the value of the land, would the syndicate agree to pay such a substantial licence fee for the use of the land, particularly when no additional profit from the forestry venture was likely?
- (b) Why would the syndicate pay half of the value of the land in 50 years to acquire land it had already paid for three times over?
- (c) Why would the syndicate agree to pay what was likely to be the total forestry proceeds for the use of land it had already paid for three times over, when it

²²⁰ *Peterson v Commissioner of Inland Revenue*, above n 68.

²²¹ See above at Section 7.

²²² See also *Dunbar*, above n 84, at 406.

²²³ At [33].

²²⁴ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [51]–[53].

²²⁵ *Penny v Commissioner of Inland Revenue* above n 90, at [33] and [46].

had already also paid the full cost of the planting and maintenance of the forest?

The answer given by the Supreme Court was that, apart from the obvious hoped for tax advantages from the arrangement, the investors knew that the licence premium was unlikely in fact ever to be paid.²²⁶

From the land-owner's point of view:

- (a) Why would the landowner wait 50 years to be paid for the use of its land?
- (b) Why would it be indifferent to the likely tax consequences during the term in relation to the deferred licence fee?

The obvious answer is that the landowner had already been paid three times the value of the land and for the planting of the forest. Further, the landowning company was owned by a charitable foundation.

From the point of view of the insurance company:

- (a) Why would an insurance company pay out virtually the whole of the initial premium for the privilege of being introduced to an insurance arrangement that had the bulk of the premium paid in 50 years, at the very time the insured risk would materialize if it was going to?
- (b) In addition, why would an insurance company agree to take on a risk of such magnitude with no ability to invest the premium and no assets from which to cover the risk, particularly when one of those involved was "a bit too technical"²²⁷ about risk issues?

²²⁶ *Ben Nevis*, above n 57, at [122], [127].

²²⁷ See at [134] of *Ben Nevis*, above n 57. When Mr Muir was arranging the scheme, he was alerted that one of those involved at the tax haven level could be "a bit too technical," and that he needed to be "made to understand" that there was "no real risk in the whole thing."

The obvious answer for the insurance company is that, because of the letter of comfort and the other arrangements, there was actually no risk.²²⁸

It has been said of *Ben Nevis* that the Supreme Court did not attempt a detailed analysis of the scheme and purpose of the specific provisions relied on by the taxpayers but essentially reduced the question of tax avoidance to a question of fact.²²⁹ This may have been the case in *Ben Nevis* but that was based on the proposition that contrived or artificial arrangements are not within the contemplation of Parliament. The proposition that artificial arrangements do not come within the contemplation of Parliament seems wholly justified. As Elliffe and Cameron say:²³⁰

As Parliament's purpose in enacting specific provisions is axiomatically targeted at the most commonplace and conventional issues which arise, anything that indicates an unusual or contrived application of a provision is also likely to indicate that the provision was not used in the way Parliament thought it would be. If enough of these abnormalities are present, and are also accompanied by tax advantages, then it is a fair conclusion that the use is outside Parliamentary contemplation and the [general anti-avoidance provision] applies.

Given the almost wholly artificial nature of the arrangements in *Ben Nevis*, it is difficult to see what further analysis of the particular specific provisions could have accomplished in that case. That does not mean, however, that in all cases the issue will be so straightforward.

The concentration on artificiality in tax avoidance cases is not a recent development. In *Miller v Commission of Inland Revenue*,²³¹ for example, the Privy Council noted the “highly artificial nature of the scheme” and found the case to be such a clear cut decision that it was unnecessary to examine in any depth the criteria by which arrangements caught by the general anti-avoidance rule were to be distinguished from those which were not.²³²

²²⁸ *Ben Nevis*, above n 57, at [146].

²²⁹ Mark Keating “In the Beginning was *Trinity*: A Review of Recent Tax Avoidance Jurisprudence” in Andrew Maples, Adrian Sawyer (eds) *Taxation Issues: Existing and Emerging* (Centre for Commercial and Corporate Law Incorporated, Christchurch, 2011) 135 at 138; Eugen Trombitas “The Conceptual Approach to Tax Avoidance in the 21st Century: When the Statute Gives but the GAAR Can Take Away” (2009) 15 NZJTL 352 at 369.

²³⁰ Elliffe and Cameron, above n 138, at 452.

²³¹ *Miller v Commission of Inland Revenue* [2001] 3 NZLR 316 (PC).

²³² At [9]. See also [11].

13.5 *Circularity*

There were aspects of circularity found to exist by the Supreme Court in *Penny*, specifically that the income from the taxpayer surgeons' practice made its way back to the taxpayers. This was seen as important in the Court's conclusion that the arrangements constituted tax avoidance.²³³ This was also the case in *Ben Nevis* (particularly in the case of the insurance arrangements).²³⁴ There was also circularity in the financing arrangements in *Glenharrow*.²³⁵

Circularity, along with artificiality, has also long been a hallmark of tax avoidance for the courts. In *Dandelion Investments Ltd v Commissioner of Inland Revenue*,²³⁶ for example, the Court of Appeal stated that:²³⁷

The transaction was circular in its inception and unwinding. ... No element of business dealing other than tax avoidance can be identified as a purpose of the arrangement. It is an artifice involving a pretence and not a real group investment transaction at all ... It is the type of arrangement which s 99 was enacted to counteract.

Circularity alone, however, will not render an arrangement tax avoidance. "Circularity" of funding is common in commercial transactions. Where a purchase is funded by a vendor, a circular cash flow takes place from the vendor in its capacity as lender to a borrower and from the purchaser to the vendor by way of application of the borrowed funds in discharge of the purchase price obligation.²³⁸

What is important is whether, as in *Dandelion*, this is coupled with enforceable obligations on the part of the borrower.²³⁹ In that case, the Court noted that the taxpayer faced no risk and assumed no financial obligation through entering into the transaction.²⁴⁰ What was important

²³³ *Penny v Commissioner of Inland Revenue*, above n 90, at [19] (referencing [70] of the High Court judgment).

²³⁴ *Ben Nevis*, above n 57, per the majority at [146].

²³⁵ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [52]

²³⁶ *Dandelion Investments Ltd v Commissioner of Inland Revenue* [2003] 1 NZLR 600 (CA).

²³⁷ At 623.

²³⁸ As pointed out in *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [53].

²³⁹ See Dunbar, above n 84, at 415. This point is also made by Blanchard J writing for the whole Court in *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [53].

²⁴⁰ At 623.

in *Glenharrow* was the fact that it was obvious from inception that the full purchase price was not going to be paid.²⁴¹

13.6 *Effect on taxpayers' financial position*

The effect, or rather lack of effect, on the taxpayers' financial position has also been an important factor in the Supreme Court jurisprudence. For example, in *Ben Nevis*, because of the timing mismatch and the lack of security, it was very unlikely that the licence premium would ever be paid. It was also unlikely that any excess profit from the arrangement would accrue to the taxpayers. Indeed, profits were even unlikely to cover the insurance premium.²⁴² The same conclusion was reached in *Glenharrow* with regard to the purchase price of the licence.²⁴³ In *Penny*, the fact that the taxpayer's financial position effectively remained the same was a significant factor in the overall conclusion on tax avoidance.²⁴⁴

Consideration of an arrangement's lack of effect on a taxpayer's financial position was also considered in the early tax avoidance decisions. The 1967 case of *Elmiger v Commissioner of Inland Revenue* was the basis of many of the tax avoidance decisions that followed it.²⁴⁵ In that case North P considered that the fact that the arrangement created the impression of reducing the appellant's income by almost half, while retaining for the taxpayers the use of substantially all the moneys involved in the transaction, supported his conclusion that the arrangement bore "ex facie the stamp of tax avoidance."²⁴⁶

Economic reality and the financial position of the taxpayer was also the key factor in the majority decision in the Privy Council in *Challenge* and that of Woodhouse P in the Court of Appeal. In the majority judgment in the Privy Council in *Challenge*, Lord Templeman had stated that the distinction between mitigation and avoidance is that an arrangement will be

²⁴¹ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [51]

²⁴² *Ben Nevis*, above n 57, per the majority at [202].

²⁴³ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [51].

²⁴⁴ *Penny v Commissioner of Inland Revenue*, above n 90, at [47].

²⁴⁵ For example, *Marx v Commissioner of Inland Revenue* [1970] NZLR 182 (CA) at 189, 191–192 and *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591 at 596.

²⁴⁶ *Elmiger and another v Commissioner of Inland Revenue*, above n 191, per North P at 179. Turner J was influenced by the fact that the taxpayer's continued to derive the same income as before: at 184–185.

avoidance “where the taxpayer obtains a tax advantage by reducing his liability to tax without involving him in the loss or expenditure which entitles him to that reduction”.²⁴⁷

In *Ben Nevis* the majority stated that the distinction between tax mitigation and tax avoidance is now seen as “conclusory and unhelpful”.²⁴⁸ While the majority in *Ben Nevis* distanced themselves from the tax mitigation avoidance distinction, the identification of an arrangement’s lack of effect on a taxpayer’s financial situation as a factor signaling avoidance contains echoes of the Lord Templeman’s mitigation test. The Supreme Court’s approach can therefore be seen as a return to the tax mitigation versus tax avoidance approach, though expressed in different terms.

13.7 *Non-market pricing*

Where transactions occur at a value that cannot be justified by market forces, this was seen as a powerful indicator of tax avoidance in the Supreme Court cases: the non-market salaries in *Penny*,²⁴⁹ the high price paid in *Glenharrow* for a shrinking asset²⁵⁰ and the various non-market sums paid in *Ben Nevis*.²⁵¹

This rests on a similar assumption to the artificiality consideration: that Parliament can only have intended the specific provisions in the Act to apply to real transactions. Where therefore a transaction makes no commercial sense without taking into consideration the taxation benefits afforded to the parties (as in *Ben Nevis*) or where the tax benefits are such that there is no incentive for the parties to scrutinise the transaction from a commercial standpoint,²⁵² then this may indicate that the transaction had a tax avoidance purpose.

Dr Littlewood goes so far as to suggest that this means that transactions that are “pre-tax negative but post-tax positive” will generally, and perhaps necessarily, constitute tax

²⁴⁷ *Challenge* (PC), above n 46, per Lord Templeman for the majority at 562.

²⁴⁸ At [94]. This comment was made by the Privy Council in *Miller v Commissioner of Inland Revenue*, above n 231, at [9] endorsing Baragwanath J’s comments in the High Court below: *Miller v Commissioner of Inland Revenue* (1997) 18 NZTC 13,001 (HC) at 13,031.

²⁴⁹ *Penny v Commissioner of Inland Revenue*, above n 90, at [49].

²⁵⁰ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 88, at [44].

²⁵¹ *Ben Nevis*, above n 57, per the majority at [23], [25]–[26].

²⁵² As the Supreme Court appeared to think was the case in *Glenharrow* and it seems to me was certainly the case in *Peterson*.

avoidance.²⁵³ It has even been suggested that the emphasis on market value transactions in the Supreme Court jurisprudence has introduced a domestic transfer pricing regime.²⁵⁴

In each of the cases mentioned above, however, the lack of market value in the transaction was coupled with other factors. For example, in *Penny*, the Court noted that the arrangement had aspects of artificiality, circularity and a lack of effect on the taxpayer's financial position.²⁵⁵ The non-market pricing was coupled with almost total artificiality in *Ben Nevis*. In *Glenharrow*, it was said not to be the price but the "payment" that created the distorting effect.²⁵⁶ Thus it remains to be seen whether (and in what circumstances) non-market pricing on its own could cause a transaction to be classified as tax avoidance.

13.8 *Choice principle*

So what is left of the so-called "choice" principle on the majority's approach in *Ben Nevis*? The majority indicated that, if the economic and commercial effect of the arrangement is within the economic and commercial effect of the particular provision, then it is not tax avoidance and there remains room for legitimate tax planning.²⁵⁷ The majority view in *Ben Nevis* therefore still leaves scope for the "choice" principle to apply.²⁵⁸

The test in *Ben Nevis* has regard to economic substance but does not require economic equivalence. Taxpayers are not required to elect the form of a transaction that would require them to pay the largest amount of tax. They are, however, required to utilise specific

²⁵³ Littlewood, above n 138, at 56. Whether this is in fact the case remains to be seen: see for example the view expressed by the minority in *Ben Nevis*, above n 57, at [9], that the tax benefits from a legitimate transaction may be considerable and the comments of Woodhouse P in the Court of Appeal decision in *Challenge* (CA), above n 46, at 535 and the discussion in section 6.3 above. These comments would suggest that taking tax considerations into account in assessing the commercial value of a transaction will not always mean that a transaction is tax avoidance.

²⁵⁴ Harrison and Keating, above n 207. The authors characterise the non-market transaction factor identified in *Ben Nevis* as consideration of the "commerciality" of a transaction: at 427. They also note that the majority's approach in *Ben Nevis* relies heavily on an economic analysis of the transactions to determine whether they meet the Parliamentary contemplation test. This, they argue, bears a striking resemblance to the functional analysis necessary under New Zealand's transfer pricing regime: 428.

²⁵⁵ *Penny v Commissioner of Inland Revenue*, above n 90, at [49] (non-market) [19] (circularity), [33] and [46] (artificiality) and [47] (lack of effect on taxpayer's financial situation).

²⁵⁶ At [51].

²⁵⁷ *Ben Nevis*, above n 57, per the majority at [111]. See discussion above at section 9.2. In the Court of Appeal decision in *Challenge*, Woodhouse P also recognised that commercial parties will normally consider the taxation implication of a transaction and that this, alone, will not render it tax avoidance: *Challenge* (CA), above n 46, at 535.

²⁵⁸ See discussion above at section 9.2.

provisions as Parliament intended them to be used. If the economic substance of an arrangement means that the arrangement falls outside of Parliamentary contemplation, with regard to the specific provisions utilised, then it will be tax avoidance.²⁵⁹

Of course, the choice principle has always been subject to limitations. While the majority in *Ben Nevis* characterised this by reference to Parliamentary contemplation, previous cases have also viewed the principle as being limited by the general anti-avoidance rule.²⁶⁰ In the case of *Commissioner of Inland Revenue v Mangin*,²⁶¹ for example, a farmer leased parts of his farm property on a rotating basis to his family trust in a so called paddock trust. Mr Mangin was employed by the trustees to sow, harvest and sell the wheat produced in the relevant paddock. This was held to be tax avoidance.²⁶²

13.9 *So what is different?*

The Supreme Court's three stage approach, and particularly the introduction of the Parliamentary contemplation test, is a departure from some of the previous cases. That said, the majority in *Ben Nevis* was not the first court to utilise a staged approach or to acknowledge that compliance with a specific provision would not prevent the general anti-avoidance rule applying. The wider view of purpose taken in the second stage of the *Ben Nevis* test is reminiscent of the Privy Council's approach in *Challenge*.²⁶³

The Supreme Court's tandem approach does herald a subtle change in how the courts will deal with the relationship between specific provisions and the general anti-avoidance rule, although, once again, comparisons can be drawn with the approach of the majority in the Privy Council in *Challenge*.²⁶⁴

²⁵⁹ See for example the comments in: *Tax Avoidance and the Interpretation of sections BG1 and GA 1 of the Income Tax Act 2007* (Inland Revenue Department, Interpretation Statement 13/01, 13 June 2013) at [390].

²⁶⁰ See generally Cassidy, above n 137.

²⁶¹ *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591 (PC)

²⁶² See also *Elmiger v Commissioner of Inland Revenue*, above n 191, at 184; *Marx v Commissioner of Inland Revenue* [1970] NZLR 182, per Turner J (dissenting) at 209; and *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591 per Lord Donovan at 598.

²⁶³ See above at section 13.1.

²⁶⁴ See above at section 13.2.

The emphasis put on the economic substance of a transaction by the majority in *Ben Nevis* is a departure from the legal form approach taken in cases such as the Privy Council majority in *Peterson* but earlier cases such as *Challenge* and *Mills v Dowdall* had considered economic substance to be relevant in the tax avoidance context.²⁶⁵ As to artificiality, courts have also long considered this to signal tax avoidance.²⁶⁶

The Supreme Court's decision in *Ben Nevis* did not therefore signal a complete shift in how the courts approach tax avoidance. However, as the majority said in *Ben Nevis*, tax avoidance jurisprudence had become somewhat confused.²⁶⁷

The majority in *Ben Nevis*, stressed the important role of the general anti-avoidance rule within the Act and rejected past suggestions that reduced its scope or which labelled it simply a “long-stop” provision.²⁶⁸

The majority also identified aspects of previous tax avoidance jurisprudence that were to be preserved and those that were no longer valid law. In particular the Supreme Court has firmly endorsed an economic substance approach to avoidance. As Cameron and Elliffe say:²⁶⁹

Highlighting some of these factors is nothing new. Artificiality, contrivance, pretence, circularity of funds, timing mismatches, unnecessary insertion of steps into a transaction, lack of a business purpose, a divergence between the economic and legal effects of a transaction and dealings between non-arm's length parties have often been cited as hallmarks of tax avoidance arrangements. Therefore, the Supreme Court's reference to these factors does not necessarily represent a departure from the orthodox, but the emphasis on the examination into the background economic and commercial considerations seems to be a focus on the substance of the transaction and the purpose behind it, and a move away from a focus on the legal form that it takes. In particular, in expenditure related tax avoidance cases, the test of whether the economic burden is actually shouldered by the taxpayer is fundamental to the tax avoidance test, regardless of the legal form.

²⁶⁵ See above at section 13.3.

²⁶⁶ See above at section 13.4.

²⁶⁷ *Ben Nevis*, above n 57, at [100].

²⁶⁸ *Commissioner of Inland Revenue v Auckland Harbour Board*, above n 160, at [11] per Lord Hoffmann.

²⁶⁹ Elliffe and Cameron, above n 138, at 451.

14 It is all just statutory interpretation

In conclusion, there is nothing revolutionary in the principles expressed by the majority in *Ben Nevis*. The majority applied established statutory interpretation techniques to establish the proper scope of the anti-avoidance provision, as the courts are required to do whenever Parliament chooses to legislate in general terms. The same approach was taken in the *Water* and *Coal* cases discussed at the start of this paper.

The courts' role is to interpret the broad wording of general provisions to give effect to that provision in light of the scheme and purpose of the Act as a whole. As demonstrated by the *Coal case*, this is not an exact science.²⁷⁰ The differing views reached by the majority and the Chief Justice in the *Coal case* demonstrate how views can diverge, even where proper emphasis on the statute and legitimate statutory interpretation techniques are used to interpret the text of a provision in light of its purpose.²⁷¹

²⁷⁰ See above at section 5. See also, Littlewood, above n 138, at 45–46.

²⁷¹ See discussion above at 4.3.