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Public Consultation
Inland Revenue
Wellington

By email: Public.Consultation@ird.govt.nz

Re: PUB00305: Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007

1. Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on draft Interpretation Statement: *PUB00305 – Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007* (**draft statement**).

1.2 The draft statement is a carefully crafted document, based on an earlier document, and is dealing with a perpetually difficult area of tax law. The Law Society's Tax Law Committee is generally in agreement with the law as summarised in the draft statement. The Law Society does have general comments to make on timing and length, and specific comments on acceptable tax planning, relevant case law, and various terms used in the draft statement.

2. Timing

2.1 As previously expressed, the Law Society's view is that, given the potential importance and relevance of the Supreme Court's decision in *Frucor*,[1] it would be highly preferable to wait to finalise the draft statement when that decision is available. As the Commissioner is aware, the Supreme Court has given leave to both parties to appeal against the Court of Appeal decision, which we understand is set down for hearing in June 2021. Assuming the case proceeds, the Supreme Court's decision in *Frucor* will be only its fourth decision in a case on the interpretation of the general anti-avoidance rule (**GAAR**) in the Income Tax Act 2007 (section BG 1) or the GST Act 1985 (section 76), the other three being the Court's well-known decisions in *Ben Nevis*,[2] *Glenharrow*[3] and *Penny and Hooper*.[4] All of those earlier decisions are widely and correctly regarded as making important clarifications to the law relating to tax avoidance. It is highly probable that the *Frucor* decision will likewise be regarded as an important decision on the scope of section BG 1 (and perhaps also section 76), so the draft statement will likely be out of date within months.

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1 *Commissioner of Inland Revenue v Frucor* [2020] NZCA 383; *Frucor v Commissioner of Inland Revenue* [2020] NZSC 150.
2 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115.
3 *Glenharrow Ltd v Commissioner of Inland Revenue* [2008] NZSC 116.
4 *Penny and Hooper v Commissioner of Inland Revenue* [2011] NZSC 95.

2.2 Consequently, the Law Society recommends that the draft statement is not issued until after the Supreme Court decision in *Frucor* has been released (or until the appeals are abandoned, if that is what happens). This would allow the Commissioner to amend the draft statement to take into account both the decision and the reasoning in *Frucor* (at which time it would be appropriate to recirculate the draft statement for comment).

2.3 Inland Revenue have justified proceeding with this consultation exercise at this time on the basis that the draft statement is overdue to be updated, there is always a likelihood of further judicial decisions, and it has therefore decided to go ahead with this work on tax avoidance. Given this decision, the Law Society makes the comments below. The Law Society wishes to record at this time that it appears very likely it will in any event be necessary for the Commissioner to issue a further revised draft. It is not often that an avoidance case comes before the Supreme Court.

3. Length

3.1 The Law Society is concerned that, at 137 pages, the draft statement is too long to the point of being inaccessible to users. While we agree that the interpretation of section BG 1 is difficult, the lengthy treatment of the topic is problematic. The draft statement would be more helpful if it dealt directly with the aspects of section BG 1 that present the difficulty. The most important of these, as elaborated upon below, is the distinction between tax avoidance and acceptable tax planning.

3.2 One example of where the draft statement could be abbreviated is Part 10, which contains considerable repetition and includes analysis of decisions that were reversed on appeal. Another example is Appendix 2, which contains large sections of repeat material found earlier in the draft statement. Paragraphs [1.70], [1.99] and [8.21] are also repetitive.

4. Acceptable tax planning

4.1 The basic problem in interpreting section BG 1(1) lies in distinguishing between tax avoidance (which is caught by the rule) and acceptable tax planning (which is not). The draft statement, however, addresses this basic difficultly only obliquely, rather than directly, which makes it difficult to read and to interpret.

4.2 For as long as the legislation has contained a GAAR, the courts have recognised[5] that there is such a thing as acceptable tax planning, although the label attached to the concept has evolved over the years. In other words, there are things taxpayers can do that reduce their liability to tax that are not tax avoidance and so are not caught by the GAAR, even if the taxpayer's only reason for doing them is to reduce a tax liability.

4.3 The draft statement implicitly and explicitly recognises throughout that there is such a thing as acceptable tax planning. Such explicit recognition, however, is only mentioned in passing[6] in the first section of the draft statement, and subsequent mentions are not prominent enough, for instance the references to the PIE rules and the group relief rules in paragraph [7.21]. Most importantly, the draft statement deals at length with the "parliamentary contemplation" test formulated by the Supreme Court in *Ben Nevis*, without explaining that the point of that test is

[5] See, for example, *Simms v Registrar of Probates* [1900] AC 323 (PC); *Payne v The King* [1902] AC 552 (PC); *Minister of Stamps v Townend* [1909] AC 633 (PC); *Newton v Commissioner of Taxation* [1958] AC 450 (PC) and, more recently, *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115.

[6] See paragraph [1.65] of the draft statement.

to distinguish between tax avoidance (which is caught by the GAAR) and acceptable tax planning (which is not).

4.4 It is understandable that the Commissioner might hesitate to give prominence in a statement of this kind to the concept of acceptable tax planning. It is true however that this important concept is clearly recognised by the courts. The Commissioner has also frequently recognised this important aspect of the law relating to avoidance (see, for instance, the references to the PIE rules and the group relief rules alluded to above). To downplay the centrality of the concept of acceptable tax planning will not reduce the incidence of tax avoidance, but in the Law Society's view the Commissioner's oblique treatment of it makes the draft statement unnecessarily obscure and difficult to follow.

5. The importance of the *Ben Nevis* decision

5.1 The decision of the Supreme Court in *Ben Nevis* is generally and correctly regarded as the most important case on the interpretation of section BG 1. It is likely, however, to prove less definitive than Inland Revenue seems to expect. At paragraph [1.20] the draft statement says: "The Supreme Court in *Ben Nevis* settled the approach to applying section BG 1", and similar statements can be found in a number of other paragraphs (for example paragraphs [6.1] and [10.2]). The Law Society acknowledges that the case represents a significant development in the law, but to regard the interpretation of the GAAR as "settled" would seem to be overly optimistic. The courts have been grappling with the distinction between tax avoidance (caught by the GAAR) and acceptable tax planning (not caught) for well over a century (see the *Simms, Payne* and *Townend* decisions referred to above) and it seems probable that disputes will continue to arise as to where and how the line is to be drawn.

5.2 The "parliamentary contemplation" test, as laid down by the Supreme Court in *Ben Nevis*, is obviously crucial, but it does not, on its own, constitute a definitive method of defining tax avoidance as distinct from acceptable tax planning. That that is so is confirmed by the Supreme Court's own decision in *Penny and Hooper* which, as the draft statement observes, added significantly to the law. The fact that the Supreme Court granted leave in the *Alesco*[7] and *Frucor* cases confirms that the Court itself regards the law as not yet settled, and that there are questions "of general or public importance" that remain to be answered.

6. The pre-*Ben Nevis* case law

6.1 Paragraph [1.112] states, among other matters:

> '*Except for the predication test, the judicial approaches applied before Ben Nevis (SC) are not relevant to the extent that those approaches are inconsistent with Ben Nevis (SC).*'

6.2 This is problematic in two respects. First, it assumes that determining whether the earlier case law is consistent with *Ben Nevis* will be straightforward – which it is not. On the contrary, interpreting and reconciling the cases relevant to the interpretation of section BG 1 is a matter of extraordinary difficulty. Determining what *Ben Nevis* means is a significant challenge, as is determining the significance of most of the other cases bearing on the interpretation of section BG 1, both pre- and post-*Ben Nevis*.

6.3 It seems clear that at least some of the cases decided prior to *Ben Nevis* are still authoritative, as the Supreme Court has cited various of them with approval in the *Ben Nevis* case itself, in *Glenharrow*, and in *Penny and Hooper*. The High Court and the Court of Appeal have also, in

[7] *Alesco New Zealand Ltd v Commissioner of Inland Revenue* [2013] NZSC 66.

numerous post-*Ben Nevis* cases, regarded various pre-*Ben Nevis* cases (including cases from other countries) as authoritative.

6.4 No doubt most of the cases that were decided before *Ben Nevis* that are inconsistent with it are no longer authoritative. This body of case law is large and complex, and it is unclear how the courts will go about reconciling it with *Ben Nevis*, *Penny and Hooper* and *Glenharrow* (and *Frucor*, assuming the appeal goes ahead). It is appropriate and probable that both the Commissioner and taxpayers will continue to cite pre-*Ben Nevis* cases, and therefore likely that it will take at least a number of years and a large number of cases for the courts to determine which of the earlier cases are still authoritative. For these reasons, the statement in paragraph [1.112] seems more blunt and categorical than could be justified on the basis of the current state of the case law.

6.5 The second problem with the statement in paragraph [1.112] is that it assumes that the "predication" test is inconsistent with *Ben Nevis*, but that it nonetheless remains authoritative. However, it is not clear why the Commissioner regards the predication test as inconsistent with *Ben Nevis*. If the predication test is inconsistent with *Ben Nevis* (as the draft statement seems to assume), the basis upon which it is still authoritative should be made clear.

7. The first *Europa* case

7.1 One of the draft statement's key concerns is to explain the necessity of a two-stage analysis in avoidance cases, as explained in *Ben Nevis*. This emphasis is entirely appropriate. That is, in cases in which the Commissioner has invoked the GAAR, it is generally necessary to determine, first, whether the particular rules relied upon by the taxpayer produce the result that they claim; and, second, if the taxpayer succeeds on that first point, whether what they have done constitutes a tax avoidance arrangement. In other words, it is necessary to determine, first, whether, but for the GAAR, the arrangement in question would have produced the outcome claimed by the taxpayer; and, second, whether, if it would otherwise have produced that outcome, it is caught by the GAAR. As the draft statement explains, the "parliamentary contemplation" test is the method laid down in *Ben Nevis* for addressing the second question.

7.2 It appears there is still widespread misunderstanding among taxpayers (and their advisers) as to the first stage, and as to the relationship between the two stages. It would be helpful if the draft statement referred to the first of the two *Europa* cases: *Inland Revenue Commissioner v Europa Oil (NZ) Ltd*.[8] In that case, the taxpayer sought to deduct payments which it had made to an associated company, and the Commissioner disallowed the claims in part, on the basis that: (a) some of the expenditure did not satisfy the rules allowing deductions (now sections DA 1 and DA 2); and (b) if the expenditure satisfied the rules relating to deductions, the contracts pursuant to which they were made were nonetheless a tax avoidance arrangement and therefore caught by the GAAR. The Privy Council held that the Commissioner succeeded on the first point and that it was therefore unnecessary to consider the second. That is, the rules relied on by the taxpayer (the rules relating to deductions) did not produce the result claimed by the taxpayer; rather, they allowed the deductions only to the extent acknowledged by the Commissioner. The Commissioner had therefore acted correctly in disallowing the deductions in part; and it was consequently unnecessary for the Board to consider whether what the taxpayer had done constituted tax avoidance. The case is a helpful illustration of the first stage of the two-stage analysis required by, among other cases, *Ben Nevis*, and is

8 *Inland Revenue Commissioner v Europa Oil (NZ) Ltd* [1971] AC 760 (PC).

authority for the Commissioner's position on alternative arguments as outlined in paragraphs [3.41] – [3.45].

8. "Using" and "circumventing" specific provisions

8.1 The draft statement refers repeatedly to two different kinds of arrangement that might be entered into by a taxpayer. First, the arrangement might "use" a specific provision. This reflects the language used by the Supreme Court in *Ben Nevis*, where the taxpayers "used" the provisions relating to deductions. Secondly, an arrangement might "circumvent" a specific provision. The word "circumvent" seems to have been adopted by the Commissioner in light of *Penny and Hooper*, where the "use" of the relevant statutory provisions yielded the result the taxpayers contended for. The terminology used in the draft statement ("using" and "circumventing" specific provisions) is helpful, but it would be better if officials could more clearly explain the distinction and why it has been adopted, where it is first mentioned. There is a brief explanation at paragraphs [2.26] – [2.29] that could be expanded upon and shifted to where the first mention of the distinction is made.

9. The relevance of English cases

9.1 At paragraphs [3.31] – [3.33] the draft statement notes that, as explained by the majority of the Supreme Court in *Ben Nevis*, the English line of authority beginning with *WT Ramsay Ltd v IRC*[9] is of "limited" relevance in New Zealand. That is correct, however it would be helpful if the draft statement expanded on the nature of the limited relevance.

9.2 If the English cases are taken as laying down a judge-made anti-avoidance doctrine in lieu of a statutory GAAR, then they are not relevant to New Zealand's income tax and GST legislation at all (because both statutes contain a GAAR). The more recent English cases seem to treat the earlier ones not as establishing a rule of that sort, but merely as instances of the broader point that all legislation, including tax legislation, is to be interpreted purposively. That would seem to be the law of New Zealand also. For this reason, the relevance (albeit limited) of the English cases should be regarded as being that, at the first stage of the two-stage inquiry, the specific rules that the taxpayer has "used" (or "circumvented") should be interpreted purposively (in the same way as any other statutory provision).

10. Facts, features and attributes

10.1 The draft statement refers at several points to "facts, features or attributes". The reference is presumably to the facts of the case or to the features or attributes of the arrangement in question. It would be helpful if the draft statement included an explanation of the legal authorities upon which it is based.

11. "Merely incidental"

11.1 The Act provides that an arrangement is not caught by section BG 1 if its "tax avoidance purpose" is "merely incidental". The draft statement deals with this aspect of the legislation repeatedly, and so gives it a prominence which the case law appears not to support. It would improve readability if the Commissioner confined discussion of this aspect to a discrete section, somewhere near the end.

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[9] *WT Ramsay Ltd v IRC* [1982] AC 300 (HL).

Next steps

If you have any questions or would like to discuss these comments, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the Law Society's Law Reform and Advocacy Advisor, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

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Vice President