Preventing Tax Alchemy: The Role of New Zealand’s GST General Anti-tax Avoidance Rule
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Introduction

- GST GAAR is found in s 76 GSTA 1985
- Dearth of authority on s 76
- 15 years before the first case
- 2007 before the first Court of Appeal case
- 2008 before the first Supreme Court case
- Accordingly s BG1 ITA 207 Supreme Court jurisprudence provides the key guidance as to s 76
- Leading case is Ben Nevis Forestry Ventures Ltd v CIR (2009)
Introduction

• Dearth of authority on s 76 because of absence of avoidance opportunities?
• Broad-based, neutral GSTA 1985 does not provide the avoidance opportunities of ITA 2007?
• Glenharrow Holdings (2009) notes that there are still considerable avoidance opportunities
• Limited case law shows how an abuse of GSTA extends the tax equivalent of alchemy
• Like the ancient magical practice, taxpayers create GST credits and strike gold
• Examine how s 76 GSTA combats such arrangements
Introduction

- First, legislative history
- Second, analysis of s 76 GSTA
- Third, explanation of Ben Nevis Forestry Ventures Ltd v CIR (2009) approach to BG1
- Fourth, application of each in GST context
- Fifth, examination of key cases to show how an abuse of GSTA extends the tax equivalent of alchemy by creating GST credits and striking gold
- Examine how s 76 GSTA combats such arrangements
Legislative history:

• Original version of GST GAAR focused on an arrangement to “defeat the intent and application” of the GSTA 1985
• GST: A Review – A Government Discussion Document (1999): expressed concern as to how effective the GAAR
• Rewritten in 2000 to echo ITA 2007 GAAR (ss BG1 and GA1) (cf (Ch’elle Properties (NZ) Ltd v CIR (2007); Glenharrow Holdings Ltd v CIR (2007))
• Dearth of GST authority
• Accordingly s BG1 Supreme Court jurisprudence provides the key guidance as to s 76
• Leading case is Ben Nevis Forestry Ventures Ltd v CIR (2009)
Legislative history:

- Note: s BG1 remains substantially unaltered since s 40 Land and Income Tax Assessment Act 1891
- Mangin v CIR(1971) per Lord Wilberforce: given its source not surprising it “lacks clarity of purpose and may indeed fail of effect”
- Reform bodies have been inconsistent in their views; some critical of the uncertainty stemming from such a broadly worded GAAR, others suggesting judicial discretion has been effective
- Other aspects of ITA have been extensively amended over 30 years
- Yet ultimately GAAR remains the same
- Thus scope of s BG1 and s 76 very much judicially determined

- Note: 1974 amendment: Predication test reversed. See s YA1 ITA 2007 and s 76(2)(b) GSTA 1985
Legislative scheme:

• Section 76 revolves around the notion of “tax avoidance arrangement”
• “tax avoidance arrangement” is void: s 76 (1) and (3)
• “tax avoidance arrangement” defined: s 76(2)
• (i) “arrangement” defined: s 76(8): “a contract, agreement, plan or understanding”, “whether enforceable or unenforceable”, including “all steps and transactions” ie part of a scheme can be considered, not just whole (Peterson v CIR (2005); Russell v CIR (No 2) (2010))
• (ii) “directly or indirectly” has
• (iii) “tax avoidance” defined: s 76(8) in inclusionary terms: (a) reduction in liability to pay GST; (b) postponement in liability to pay GST; (c) increase in GST refund; (d) earlier entitlement to a GST refund; (e) reduction in consideration payable for a supply.
Legislative scheme:

• (iv) as “its” (the arrangement’s (cf Glenharrow Holdings Ltd v CIR (2009))) “purpose or effect” or “one of its purposes or effects” is tax avoidance
• as long as “not merely incidental”
• whether or not any other purpose or effect is referable to “ordinary business or family dealings”
• Note: objective test (Ch’elle Properties (NZ) Ltd v CIR (2007); Glenharrow Holdings Ltd v CIR (2007) and (2009))
• Note: the tax avoidance arrangement can be entered into by any person, it need not be the GST registered person: s 76(1)
• If that person is not GST registered, can be deemed to be registered under s 76(4)
• Note: the GST registered person caught under s 76 need to have entered into the arrangement: s 76(3)
• Note: no list of factors indicative of tax avoidance
Legislative scheme:

Commissioner’s powers re a void tax avoidance arrangement: s 76
• “tax avoidance arrangement” is void: s 76(1) and (3)
• “counteract any tax advantage” that the GST registered person has obtained from or under a tax avoidance arrangement: s 76(3)
• Adjust the tax payable/refundable re the GST registered person affected by an arrangement in the manner the “Commissioner considers appropriate” to counteract any tax advantage from or under the arrangement: s 76(3);
• Additional powers in s 76(4): (a) treat a party to the arrangement as being a GST registered person; (b) treat a supply as being a taxable supply made by/to a GST registered person; (c) adopt the taxable period that would have occurred but for the arrangement; (d) adopt open market value of supply.
Legislative scheme:

Specific Anti-avoidance provision: s 76(5)-(7)
• If a person enters into an arrangement that involves the transfer of the whole or part of a taxable activity to another person(s), the total turn-over can be attributed to both the transferor and transferee for the purposes of, inter alia, the threshold for registration under s 51 GSTA 1985
Judicial approach to ITA 2007 GAAR

• Despite the GAAR the Duke of Westminster principle had been reiterated by the NZ courts (and Privy Council) eg CIR v Challenge (1986), Auckland Harbour (2001), BNZ Investments (2001), Peterson v CIR (2005)
• Courts had also adopted the interrelated broad choice principle: CIR v Challenge (1986)
• Combined with the formal legal rights approach
• GAAR had been ineffective to deal with avoidance schemes that have been purposely structured to fall within the formal parameters of a provision.

• Impact of Ben Nevis re:
  • First, the interplay between the GAAR and specific statutory provisions
  • Second, the interpretation of tax provisions, including more specifically the GAAR
Judicial approach to GAAR

• Ben Nevis: Very complicated facts involving:
  • A partnership of LAQs
  • A charitable trust incorporated in the Cayman Islands (tax haven)
  • An insurance company incorporated in the British Virgin Islands (tax haven)
  • Essence was the tax deductions arising from deferred inflated licence and insurance premiums to use farmland to grow Douglas fir trees
  • Fee payable at the time of the subject forest was harvested in 50 years time (growing cycle of the trees)
  • Mismatch of when fees incurred and paid (if ever)
  • CIR assessed under s BG1
  • Supreme Court agreed, applying its new parliamentary contemplation test
Judicial approach to GAAR

Interplay between the GAAR and specific statutory provisions: Impact of Ben Nevis

• Ben Nevis at [100]: “continuing uncertainty about the inter-relationship of the general anti-avoidance provision with specific provisions. That makes it desirable for this Court to settle the approach which should be applied in New Zealand.”
• Rejected choice principle
• Mere compliance with the technical requirements of a section does not suffice where tax avoidance is more than merely incidental purpose or effect
• “Parliament must have envisaged that the way a specific provision was deployed would, in some circumstances, cross the line and turn what might otherwise have been a permissible arrangement into a tax avoidance arrangement”
Judicial approach to GAAR

Interplay between the GAAR and specific statutory provisions: Impact of Ben Nevis

• “Taxpayers have the freedom to structure transactions to their best tax advantage. They may utilise available tax incentives in whatever way the applicable legislative text, read in light of its context and purpose permits...”
• Tempered by (i) giving s BG1 an ‘equal voice’ (ii) parliamentary contemplation test
• Specific tax benefits only permissible if (i) use is within parliamentary contemplation or (ii) tax avoidance purpose or effect is merely incidental
Judicial approach to GAAR

Interplay between the GAAR and specific statutory provisions: Impact of Ben Nevis

• “Ben Nevis at [103]: “tandem approach”
• Specific section providing the tax benefit and the GAAR are given equal weight
• Each is purposively interpreted
• The specific provision is interpreted on the basis of its “ordinary meaning, as established through [its] text in light of [its] specific purpose”
• The GAAR is interpreted in light of its purpose of combating tax avoidance
Judicial approach to GAAR

Interplay between the GAAR and specific statutory provisions in the GST Context

• The tension between s BG1 and specific incentives not as great in GSTA?
• GSTA is intended to be broad-based, efficient and neutral: Glenharrow Holdings Ltd v CIR (2009)
• Absence of exemptions etc means the tension between s 76 and specific incentives is not as great as under ITA 2007?
• Still tax avoidance opportunities under GSTA
• Taxpayers can still try to arrange their affairs to attract a specific GST advantage
Judicial approach to GAAR

Interplay between the GAAR and specific statutory provisions in the GST Context

• Glenharrow Holdings Ltd v CIR (2009) examples of GSTA avoidance opportunities:
  • (i) taxable v non-taxable transactions
  • (ii) mismatching of inputs and outputs
  • (iii) registered v unregistered persons
  • (iv) timing mismatches
  • (v) payments basis taxpayers v invoice basis taxpayers and
  • (vi) inflated prices
• Thus taxpayers can still try to arrange their affairs to attract a specific GST advantage
Judicial approach to GAAR

Interpretation and application of GAAR: Impact of Ben Nevis

• Ben Nevis rejected choice principle
• Ben Nevis rejected legal form approach
• Ben Nevis rejected distinction between “tax mitigation” and “tax avoidance”
• Ben Nevis replaced scheme and purpose approach with parliamentary contemplation test
• Permissible only if (i) use of the section is within parliamentary contemplation or (ii) tax avoidance purpose or effect is merely incidental
Judicial approach to GAAR

Interpretation and application of GAAR: Impact of Ben Nevis

• New “parliamentary contemplation” test: A use that is contrary to “parliamentary contemplation” will be proscribed by the GAAR
• Focus on statutory purpose, not legal form
• Focus on unusual and artificial usage of a section, rather than formal compliance
Judicial approach to GAAR

Interpretation and application of GAAR: Impact of Ben Nevis

• Two step approach:
  • first, “is “the use made of a specific provision … within its intended scope”;
  • second, “in light of the arrangement as a whole” has the taxpayer altered the incidence of income tax in a way which cannot have been within the contemplation and purpose of Parliament”

Two step approach is important where:
• multi-layered transaction where individual steps satisfy the prescribed elements of a specific statutory provision, often with artificial or commercially meaningless steps
• tax schemes utilising more than one specific statutory tax concession
Judicial approach to GAAR

Interpretation and application of GAAR: Impact of Ben Nevis

• A “classic indicator”: “where a taxpayer gains the benefit of the specific provision in an artificial or contrived way”
• Lack of commercial / economic reality another important consideration
• Inclusionary list of factors:
  • “the manner in which the arrangement was carried out”;
  • “the role of all relevant parties and any relationship they may have with the taxpayer”;
  • “the economic and commercial effect of documents and transactions”;
  • “the duration of the arrangement”; and
  • “the nature and extent of the financial consequences for the taxpayer”
Judicial approach to GAAR

Interpretation and application of GAAR: Impact of Ben Nevis

• Particularly a combination of such factors
• Significance of each factor will depend on the facts of the particular arrangement
• Provides the link to the “parliamentary contemplation test” and the generic notions of (i) commercial reality and economic substance and (ii) “artificial [and] contrived” schemes
Judicial approach to GAAR

Ben Nevis factors in a GSTA context

- GSTA is broad base, efficient and neutral: Glenharrow Holdings Ltd v CIR (2009)
- So if GSTA is a factor in structuring, (lack of) neutrality is important
- GSTA based on open market values
- So commercial reality, economic substance and artificiality are important factors
Key GSTA GAAR Cases

• Dearth of cases
• 15 years before the first decision
• Not until 2007 Court of Appeal decision
• Not until 2009 (actually 19 Dec 2008, same day as Ben Nevis) Supreme Court decision

• Important GST cases as examples of potential tax alchemy
  • Ch’elle Properties (NZ) Ltd v CIR (2007)
  • Glenharrow Holdings Ltd v CIR (2009)
  • Education Administration Ltd v CIR (2010)
GSTA GAAR Cases

- Ch’elle Properties (NZ) Ltd v CIR (2007)
- Ashby incorporate 114 companies in 1996 and 1997 (‘Ashby companies’)
- Ashby companies had no assets or bank accounts
- Ashby companies registered for GST on a payments basis
- Ch’elle incorporated by an associate, Wilson, in 1998
- Ch’elle registered for GST on a monthly invoice basis
- Ashby companies registered for GST on a payments basis
- Ch’elle contracted to purchase a section in a subdivision from each of the Ashby companies
- Settlement deferred for periods between 10 - 20 years
- Outcome but for GSTA GAAR? tax alchemy:
  - Ch’elle immediately claim $9m GST input credits while Ashby companies not required to account for GST until payment received in 10 - 20 years time (if ever)
GSTA GAAR Cases

• Court of Appeal: arrangement was designed to defeat the intention and application of the GSTA contrary to s 76
• As with BG1, the purpose of s 76 was to strike down arrangements that frustrated the taxing regime despite technical compliance with substantive taxing provisions
• GSTA predicated on an overall balance between a registered person’s liability to pay output tax and entitlement to receive input tax credits
• The different accounting bases meant that there was a mismatch of timing of when an input tax credit was claimed and payment of output tax on the supply
• Timing difference (10-20 year gap) meant arrangement defeated the intended balance between input and output tax
• Rationale for the number of Ashby companies was to ensure each was under the $1m threshold
Key GSTA GAAR Cases

• Glenharrow Holdings Ltd v CIR (2009)
• Glenharrow: shelf company with a share capital of only $100
• Glenharrow registered for GST on an invoice basis
• Meates not registered for GST
• Glenharrow purchased from Meates a mining licence (second hand goods) for $45m
• Mining licence originally issued 1990
• On-sold 1994 for $100
• On-sold to Meates in 1996 for $10,000
• Note: divergence as to whether $45m was inflated?
• High Court: “grossly inflated”
• Court of Appeal: “artificial” and “totally unrealistic”
• Supreme Court: disagreed, not artificially inflated
Key GSTA GAAR Cases

- Glenharrow paid a deposit of $80,000 (provided by a shareholder) and claimed input tax credit on that amount
- Vendor finance for rest ($44,920,000)
- Glenharrow extracted only $210,000 worth of minerals
- Glenharrow claimed input tax credit for the tax fraction at the time (one-ninth) of $44,920,000, namely $9m
- Outcome but for GSTA GAAR? tax alchemy:
  - Glenharrow immediately claimed $9m GST input credits (and intended annually for 9 years)
  - While payment of $44,920,000 would never occur as Glenharrow virtually uncapitalised and mine unprofitable
- Meates not required to account for GST
Key GSTA GAAR Cases

• Supreme Court: arrangement was designed to defeat the intention and application of the GSTA contrary to s 76
• The purpose of s 76 was to strike down arrangements that frustrated the taxing regime despite juristic compliance with substantive taxing provisions
• Arrangement was artificial with no economic effect other than attempting to claim a GST input tax credit
• Because of the vendor finance and reality that payment would never be made, no consideration truly paid
• No economic cost of the goods as intended by Parliament before an input credit could be claimed
• No economic effect other than attempting to claim a GST input tax credit
• This tax advantage was not merely incidental to the parties commercial decisions
Key GSTA GAAR Cases

• Purpose: an objective test deduced from arrangement itself
• Did not matter if honestly believed the purchase price not inflated; objectively it was not realistic
• Premise of GSTA, and secondhand goods provisions in particular, that transactions would be driven by market forces
• Commercial and fiscal effects would be driven by such market forces, not distortions
• When market forces do not prevail s 76 applies
• Here the GST distortion was not price but “payment”
• GST refund disproportionate to economic burden
• Further distortion as Meates was not registered for GST and thus no corresponding payment of GST
• Distortions plainly defeated intent and application of GSTA
• Consequences outside the purpose and contemplation
Key GSTA GAAR Cases

• Education Administration Ltd v CIR (2010)
• Grimmett and Grove created two companies to develop a software program
• Education Administration owned by the Grove family trust
• Responsible for marketing and selling the software
• Registered for GST on a monthly invoice basis
• Administration Systems owned by Grimmett
• Registered for GST on a six-monthly payment basis
• Administration Systems to charge Education Administration for development of software at hourly rate of $160 plus GST
• Administration Systems would invoice Education Administration for the full amount
• But only required payment of 10%; further 90% to be paid out of future sales
• Education Administration ultimately struck off companies register
Key GSTA GAAR Cases

• Outcome but for GSTA GAAR? tax alchemy:
• Education Administration immediately claimed GST input credits for the total amount invoiced
• Education Administration used the GST refund to pay the Administration Systems agreed 10% of the invoice
• Administration Systems not required to account for GST until payment received at best in two – three years (if ever)
• GST refund effectively provided interest free venture capital for a speculative software package risk free
Key GSTA GAAR Cases

• High Court: Section 76 applied as the arrangement between the two companies had the purpose or effect of tax avoidance
• More than incidental to the commercial purpose of developing the software
• Applying Ben Nevis, arrangement was structured in a way that could not be contemplated by Parliament
• Arrangement was artificial and contrived
• Two separate companies was artificial and contrived
• The different accounting bases meant that there was a mismatch of timing of input tax credits claimed and payment of output tax on the supply
• Education Administration claiming GST credits on amounts that might never become payable
• Hourly rate charged was inflated to artificially increase the amount of the invoices and thus GST refund
Conclusion

• The dearth of authority on s 76 is clearly not because of an absence of avoidance opportunities
• Limited case law shows how an abuse of GSTA extends the tax equivalent of alchemy
• Like the ancient magical practice, taxpayers create GST credits and strike gold
• However, s 76 GSTA combats such arrangements, the courts applying the Ben Nevis approach in a GST context