Practitioner’s viewpoint: A unified theory of tax avoidance?, 01 November 2007

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A review of the law reports shows that weighty tax avoidance decisions have been relatively rare until the last few years. Challenge Corporation Ltd v C of IR (1986) 8 NZTC 5,219 held sway for a considerable period before the Privy Council was asked to consider partnership income diversion in Hadlee and Sydney Bridge Nominees Ltd v Commissioner of Inland Revenue (1993) 15 NZTC 10,106. However, tax avoidance issues are now exercising the appellate courts with greater frequency, and the year 2007 is no exception. In this article, Mark Keating, senior lecturer in taxation tax at the University of Auckland, discusses several cases heard by the Court of Appeal which are destined for consideration by the Supreme Court.

Introduction

In the past months the Court of Appeal (the Court) has delivered four high profile judgments dealing with the application of the general anti-avoidance provision (s BG 1 of the *Income Tax Act 2004*). Given the decisions were highly anticipated, it surprised some commentators that all four decisions were strongly in favour of the Commissioner of Inland Revenue. The Court of Appeal’s pendulum on the issue of tax avoidance seems to have swung firmly towards IRD.

First the Court gave a swingeing judgment against the taxpayers in the Trinity income tax avoidance case. (*Accent Management Ltd* v *C of IR* (2007) 23 NZTC 21,323. See the commentary on that judgment in CCH, *NZ Tax Planning Report*, July 2007.) It then delivered a combined judgment dismissing a number of appeals on substantive and procedural grounds by participants in the JG Russell template arrangement. That judgment, *Wire Supplies Ltd* v *C of IR* (2007) 23 NZTC 21,404, was obviously intended by the Court to provide closure to the seemingly never-ending template litigation. Whether the taxpayer and Mr Russell take the strong hint is doubtful.

Next the Court delivered its first two judgments concerning the scope and application of the general anti-avoidance provision in s 76 *Goods and Services Tax Act 1985* (the GST Act). In both cases the Court took a strong stance against arrangements it considered were artificial and uncommercial, ruling that they breached the intent and application of the GST Act.

This article will consider the recent GST tax avoidance cases and consider whether those cases are consistent with each other and with the *Accent Management* decision. In particular, the article examines the GST judgments to determine whether they extend the reach of general anti-avoidance provisions.

Ch’elle

The *Ch’elle* arrangement was devised and implemented by Mr Nigel Ashby. Mr Ashby incorporated and was the sole director of 114 companies. None of the companies had any assets or even bank accounts. Each company registered for GST on a payments basis as permitted under s 19 on the basis that it would have annual turnover below $1 million.

Next, a friend incorporated Ch’elle Properties (NZ) Ltd. Ch’elle also had no assets or bank account. Although the friend had no experience of the property market, Ch’elle registered for GST on an invoice-basis claiming to conduct the taxable activity of property trading.

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In late 1998 each of the 114 companies entered into conditional sale and purchase agreements with a developer for the purchase of vacant subdivided lots. Each property was purchased for $70,000. In early 1999 each company then on-sold its lot to Ch'elle for an average of $700,000 — a ten-fold increase in the cost of the property or $80 million in total. Settlement of the sale to Ch'elle was deferred for between 10 and 20 years, but Ch'elle immediately paid a cash deposit of $10, thereby triggering the time of supply for GST purposes.

As an invoice-basis taxpayer, Ch'elle claimed an input tax credit of $9 million. Because the 114 companies were registered on a payments basis, they would not be required to return output tax on the transactions until they settled in 10 to 20 years time.

While the arrangements complied with the black-letter law, the Commissioner disallowed the input tax claim on the ground that the arrangement was contrary to the intent and application of the GST Act in breach of former s 76 (repealed on 10 October 2000).

The TRA determined that the wording of the former s 76 imposed a subjective test of the taxpayer's purpose but found that the total lack of commerciality to the various transactions meant that the arrangement constituted tax avoidance (*Case* W22 (2003) 21 NZTC 11,212). The TRA held that the arrangement deliberately exploited the mismatch between invoice and payments basis taxpayers, and therefore defeated the intent and application of the GST Act.

The High Court rejected the taxpayer's appeal (*Ch'elle Properties (NZ) Ltd* v *C of IR* (2007) 23 NZTC 21,442). Rodney Hansen J concluded that the arrangement offended against the intent and application of the GST Act in two ways:

- the underlying legislative intention was that an overall balance should be maintained between the outputs and inputs of a registered person, and
- there should be some reasonable correspondence between the time at which outputs and inputs in relation to a particular supply are accounted for.

In reaching his decision Rodney Hansen J determined that the former s 76 required an objective test and therefore did not rely upon the subjective motives of the taxpayers to the arrangement. Ch'elle appealed.

Court of Appeal decision in Ch'elle

In a brief but well reasoned judgment the Court of Appeal unanimously rejected the taxpayer's appeal. While small mismatches in timing are an inherent feature of the GST regime, input tax claims " ... will ultimately be balanced by the payment of output tax … in the circumstances of this case the balance between outputs and inputs is grossly distorted … The 10 to 20 year delay in all the circumstances defeats the intent of the GST Act and accordingly triggers s 76." (see para [41]–[42])

Likewise, while the choice of different accounting bases for GST may result in mismatches between some taxpayers, "that does not mean that a gross mismatch in timing is irrelevant on a s 76 question. The Act seeks to limit the nature and degree of such mismatching."

By using 114 different companies in order to stay below the $1 million statutory threshold, each company remained on a payments basis and the arrangement effectively circumvented s 76. "As a result, the degree of mismatch contemplated and tolerated by the Act escalated to a level which could never have been intended."

On this point the Court concluded (para [41]):

> "The wider the temporal gap between the taxpayer's eligibility for an input tax credit and its liability for output tax, the less likely the arrangement conforms with the intent of the Act. We do not suggest that the Act intends that there be no delay, but that significant delay can indicate a crossing of the line into tax avoidance."

Of particular importance was the Court's unanimous endorsement of the High Court's finding that s 76 involved an objective test.

> "[25] Mr Hayes, for the appellant, contended that s 76 required a subjective intent. This cannot be the case. This would lead to the anomalous situation where an identical transaction might in one case be

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> sustainable, but in another struck down as tax avoidance because in the first instance the operator mistakenly, naively, unrealistically or opportunistically was of the view that what was being done was unassailable. The second, however, which involved a more confident person who thought it was worth 'having a go' would be struck down. It is the objective assessment of the arrangement which will provide the answer as to whether it defeats the intention and application of the Act and is therefore void."

This finding has particular relevance to the *Glenharrow* decision.

Glenharrow

The *Glenharrow* arrangement ([2007] NZCA 256) dealt with a much more contentious arrangement. It involved the claim for a second-hand goods input tax credit on the purchase of a 10-year mining license.

The mining license was issued in 1990 but had not been operated by its original holder. In 1994 the license was sold to local prospectors for $100. In 1996 it was on-sold to Mr Meates for $10,000. In 1997 Glenharrow Holdings Ltd, a $100 shelf company, began negotiations for the purchase of the license. Mr Meates requested his brother provide a revised valuation of the license that, depending upon methodology, ranged from $45 million to $180 million.

Following brief negotiations Glenharrow agreed to purchase the license for $45 million. The purchase price was satisfied in two ways:

- Glenharrow paid $80,000 in cash, and
- the remaining $44,920,000 was provided by Mr Meates as vendor finance, which was secured by a mortgage over the shares in Glenharrow and the mining license.

The parties agreed that interest and principal repayments would be funded out of profits derived from the successful exploitation of the license.

Glenharrow began to exploit the license but, due to both legal and practical difficulties, it was able to mine only 36 tonnes rather than the expected 15,000 tonnes. However, from that limited operation Glenharrow did make further payments of $210,000.

Mr Meates was not registered for GST while Glenharrow was registered. Glenharrow therefore claimed a second-hand input tax credit of $5 million on the purchase of the mining license. The Commissioner disallowed the input tax claim on the ground the arrangement was a sham and/or breached s 76. The taxpayers challenged the assessment in the High Court (*Glenharrow Holdings Ltd* v *C of IR* (2005) 22 NZTC 19,319).

Despite the Commissioner's best efforts, the High Court found that the arrangement was not a sham. The agreement to purchase the license was genuine and the parties intended to implement it according to its terms. Although the purchase price of $45 million was found to be "grossly inflated" it was a genuinely agreed valuation based on the parties' extremely optimistic assessment. The Court also found that Glenharrow had acquired the license for the principle purpose of making taxable supplies and therefore met the criteria for an input tax credit. Based on those factual findings, the Commissioner's sham argument failed.

Somewhat surprisingly given those favourable findings, Chisholm J nevertheless ruled that the arrangement defeated the intent and application of the GST Act. While acknowledging the honesty of the taxpayers, His Honour stated:

> "[183] ... I have difficulty in accepting that the legislature intended s 76 to be governed by the personal motives of the taxpayer when entering into the arrangement. Apart from producing an erratic application of the section …, such an interpretation would almost certainly render the section virtually useless and destroy its anti-avoidance purpose."

Having reached that decision Chisholm J would normally have been expected to deny Glenharrow its input tax credit. Instead he took the unusual step of determining for himself the market value of the license at approximately $8 million and therefore allowed Glenharrow an input tax credit on that amount.

Glenharrow appealed against the application of s 76 and the Commissioner appealed against the valuation of $8 million: *Ch'elle Properties (NZ) Ltd v C of IR* [2007] NZCA 256.

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Court of Appeal decision in Glenharrow

All members of the Court of Appeal were somewhat uneasy with the High Court's findings regarding the taxpayers' credibility. Their Honours noted that the license had previously been sold for only $100 and $10,000 when it had longer to run. The Court therefore found that the price of $45 million was "artificial" and "totally unrealistic". Even Chambers J (in the minority) felt the license was worth "nowhere near Chisholm J's valuation [of $8 million], and a mile away from the $45 million the parties assumed."

Both *Ch'elle* and *Glenharrow* considered the former wording of s 76 GST Act. That old version applied to arrangements that "defeat the intent and application" of the GST Act. Section 76 was rewritten in 2000 to now apply to arrangements that "have a purpose or effect of tax avoidance", thus bringing it into line with the equivalent wording in s BG 1 *Income Tax Act 2004*.

Given the difference in wording, there was uncertainty over the effectiveness of former s 76. In particular, there was debate over whether s 76 imposed an objective test of the arrangement or a subjective test of the taxpayer's purpose. If in *Glenharrow* the Court of Appeal adopted an objective test, it would be required to ignore the taxpayer's honest purpose and rely only on the non-market price as a basis of applying s 76. This logical consequence of ignoring the taxpayer's motives would therefore produce what many commentators have considered a harsh result.

Does s 76 involve a subject or objective test?

Consistent with its reasoning in the *Ch'elle* judgment (quoted above), the majority in *Glenharrow* adopted an objective test for s 76 and criticised those commentators who had advocated the adoption of a subjective test in order to limit the application of that section.

> "[79] ... We are satisfied that [s 76] does not incorporate a subjective test. To give such an interpretation would render the section, which is intended to operate as a 'backstop' provision, virtually inoperative."

Under that analysis the taxpayer's purpose when entering the arrangement was irrelevant. As a result, Glenharrow's genuine motives for agreeing to the $45 million price and arranging the vendor finance did not preclude the finding of tax avoidance.

By contrast, Chambers J considered that the findings of credibility in favour of Glenharrow precluded s 76 applying. A finding the taxpayer acted in good faith was necessarily inconsistent with tax avoidance.

Glenharrow majority decision

The majority of Robertson and Ellen France JJ acknowledged that s 76 does not deny taxpayers a choice in the way they structure their affairs. Nor does it preclude them from obtaining tax advantages provided under the GST Act. However, mere compliance with the black-letter law will not abrogate the anti-avoidance provision.

Glenharrow claimed that, once third parties agreed the license was worth $45 million, it should preclude the application of s 76, regardless of whether that valuation was mistakenly inflated. It relied upon the leading decisions of *Europa Oil (NZ) Ltd* v *C of IR (No 2)* (1976) 2 NZTC 61,066; [1976] 1 NZLR 546 and *Cecil Bros Pty Ltd* v *FCT* (1964) 11 CLR 430 that the Commissioner may not tell taxpayers how to run their business or how much to pay for their assets. The requirement in s 10 of the GST Act that transactions be undertaken at market value applies only between associated persons. The taxpayers therefore claimed that, as theirs was an arms' length transaction, the intent and application of the GST Act had been fully complied with and s 76 could not apply.

That argument was rejected by the majority for three reasons.

First, the scheme of the GST regime required transactions to be undertaken at (approximately) market value and that "a grossly inflated" transaction therefore defeated the intent and application of the GST Act. While only associated persons are explicitly required to transact at market value, that specific rule merely reflected the general policy of GST. Thus transactions at non-market value were likely to frustrate the scheme of the GST Act.

Second, the scheme of the GST Act recognises that, while mismatches between the timing of input and output tax will occasionally arise, particularly between taxpayers who account for GST on different bases, those mismatches may not be exaggerated. In fact, the very existence of "significant temporal mismatches can indicate a crossing of the line into tax avoidance".

Most importantly, the Court found that the vendor-finance of $44,920,000 was so commercially unrealistic as to make "payment" of that sum for the license merely contingent. The majority explained its reasoning (para [81]–[82]):

> " ... we also consider the Commissioner is right that the arrangement constituted tax avoidance because in economic terms the arrangement 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. … The mere completion of loan documents and the swapping of cheques was insufficient to constitute the economic sacrifice Parliament intended in limiting the secondhand goods refund to the extent that payment is made … $80,000 was paid … The rest, although expressed as an absolute obligation, was, in sensible commercial terms, only conditional.
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> [82] ... Whatever they said on their face, there was an obligation for more than $44 million taken on by a $100 shelf company with no other assets, no guarantees and entirely dependant on the success of a speculative venture…. Thus the economic liability was entirely conditional on success of the Glenharrow project. To treat this as the basis for an input tax credit [upfront] defeated the intent and application of the GST Act. Although there was an expressed legal obligation, it was artificial."

This reasoning would mean that vendor finance is inherently artificial and therefore constitutes a hallmark of tax avoidance. If so, that is a bold finding. It is also contrary to the Commissioner's policy statement (see in *Tax Information Bulletin* ¶511-102 Vol 5, No 11, April 1994) that cheque swaps to implement vendor finance may constitute a valid form of payment for second-hand goods. In that policy Inland Revenue states:

> "Where a cheque is drawn on the vendor's account and credited to the purchaser's account it may be evidence that the vendor has advanced the purchase price to the purchaser. Where a cheque is drawn on the purchaser's account and credited to the vendor's account it may be evidence that the purchaser has used the vendor's advance to pay for the supply. Inland Revenue accepts that payment will occur at the time the cheques are presented and honoured by the bank".

While it may be justified on the facts of this case, it is doubtful that the Court was really intending to describe all vendor-financed transactions as potentially tax avoidance. The majority effectively implied into the GST Act the equivalent of the "money not at risk" rules in s GC 29–31 of the *Income Tax Act 2004* (formerly subpart ES of the *Income Tax Act 1994*). Given that those rules were enacted to counteract arrangements like the *Peterson* case, the majority devoted a large part of the judgment to the application of that decision.

Peterson considered

The *Peterson* decision was considered by the Court of Appeal in *Accent Management*. There the Court dismissed that decision by stating that the different Privy Council judgments "came down to a difference of opinion as to whether the investors had, in truth, suffered the pre-tax economic consequences which were intended by the legislature to be the prerequisite of deductibility."

Similarly in *Glenharrow* the majority distinguished *Peterson*, explaining at para [97]:

> "The difference between the [majority and minority] approaches largely came down to a difference of opinion as to whether the investors had suffered the prerequisite pre-tax economic consequences intended by the legislature."

The Court of Appeal's grounds for distinguishing *Peterson* are not entirely convincing. While acknowledging that the similarly artificial loan in *Peterson* did not defeat the intent of the film depreciation provisions, the Court of Appeal simply concluded that

> "[104] The scheme and purpose of the GST Act is different.

> [105] ... The operation of the Act depends on the integrity of the chain of ownership. Payment by registered person is essential. The scheme requires registered persons to take on more than conditional obligations to pay for the goods/services purchased."

Based on the different requirements of GST and income tax, the majority found the non-commerciality of the vendor finance meant that payment for the license was merely contingent. As a result the taxpayer had not suffered the economic cost of the license that was required under the GST Act and s 76 overrode the entitlement to the second-hand goods credit. Instead, Glenharrow was only entitled to an input credit for the amount of actual cash it paid.

Court of Appeal minority decision

Chambers J issued a rather unusual dissenting judgment. Rather than examine the wording and application of s 76 or consider the application of *Peterson*, His Honour approached the issue on an entirely new basis.

Chambers J felt that the taxpayers, the Commissioner and the other judges were all wrong that the price paid for the license was the face value of $45 million. He found this value was "simplistic and involves looking at only one part of the parties' overall arrangement". Instead, His Honour considered that this value was only part of the consideration that passed between the parties.

In effect, Chambers J held that the value of the supply should be determined under s 10(2) to encompass both:

- money paid (being the $80,000 cash), and
- non-monetary consideration (being the actual value of the promises and obligations taken on by Glenharrow, including the contingent liability to repay the $44,920,000 vendor finance, which he describe as "pretty remote").

On that analysis, Chambers J would have allowed the taxpayer a modest input tax deduction reflecting the actual value of the consideration it paid, by reference to what a third party would have agreed to pay for all rights under the license.

On the question of whether the vendor finance was commercial, His Honour stated (para [156]) that:

> "If A sells B goods for $100, the value of the transaction is $100 whether B has the money in the bank or has to borrow it from C. I accept too that, generally speaking, that would still be the case where A finances B's purchase on normal commercial terms. … But there comes a point, I think, where A's provision of finance may be under such non-commercial terms that the law does require a proper market value of the actual consideration."

Despite the High Court finding that the license was "grossly inflated", Chambers J did not feel that a market value was required in this case. Instead he stated "even if the price was grossly inflated, that of itself could not trigger s 76" as to do so would violate the taxpayer autonomy principle expressed in *Europa Oil* and *Cecil Bros*. Accordingly s 76 did not apply.

That reasoning appears to misunderstand the role of a general anti-avoidance provision in preventing exploitation of black-letter law in a manner contrary to the scheme and purpose of the GST Act. Neither *Europa Oil* nor *Cecil Bros* limits the operation of the anti-avoidance provision nor prohibits the Commissioner from looking behind the price agreed by a taxpayer to determine how it was set or whether it has truly incurred that economic cost.

Furthermore, despite ruling for the taxpayer, Chambers J noted that he " ... of course, had some sympathy for the majority's position. The true consideration for the licence was not, I think, $45 million" (para [175]). But His Honour would have reduced the taxpayers' input tax credit under s 10 and not s 76. In that regard the decision is reminiscent of the *Peterson* decision where tax avoidance did not apply even though the majority acknowledged the taxpayer was not entitled to the tax benefit under the black-letter law but prevailed because of flaws in the Commissioner's pleadings.

Chambers J concluded that the majority's finding that the vendor finance was contingent "does not in my mind support an avoidance conclusion. They conclude that the legal obligation falling on Glenharrow was 'artificial'. I cannot see how that conclusion can stand with the findings Chisholm J made … That the

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business enterprise proved to be unsuccessful, despite the best efforts and intentions of the parties, cannot justify a later recharacterisation of the GST claim.” (para [172]–[173])

A unified theory of tax avoidance?

Taken together the decisions in *Accent Management*, *Ch’elle* and *Glenharrow* appear to propose something of a unified theory of tax avoidance. In all three cases the Court of Appeal followed a fairly traditional analysis to determine whether the tax benefit claimed by each taxpayer corresponded with the scheme and purpose of the relevant provisions, applying the well established reasoning in *Challenge Corporation Ltd* v *C of IR* (1986) 8 NZTC 5,219; [1986] 2 NZLR 513 (PC) and *C of IR* v *Peterson* (2005) 22 NZTC 19,098; [2006] 3 NZLR 433 (PC). The Court considered whether each arrangement involved elements of pretence and artificiality that would constitute a breach of the GST Act. In particular, the Court examined whether the taxpayers had actually suffered the economic loss required under the GST Act before the tax benefit properly arose.

In all three cases the Court of Appeal found that the arrangements were highly artificial and lacking in commercial substance. The taxpayers in both *Accent Management* and *Ch’elle* were found to have deliberately and knowingly entered into that artificial arrangement in order to obtain the tax advantages. As a result, the decisions in those cases seem fully justified.

But the taxpayer in *Glenharrow* had not knowingly attempted to defeat the GST Act. In fact the High Court expressly found the taxpayers acted honestly for commercial purposes — it was just that they were wildly over-optimistic in their valuation resulting in a “grossly inflated” purchase price. Those findings make this case the most contentious decision.

Even faced with an honest taxpayer, the majority in *Glenharrow* felt confident to uphold tax avoidance. This decision applies the long line of cases, starting with *Newton v FCT* and including *Challenge*, that the test for tax avoidance is entirely objective. The Court of Appeal therefore found that the taxpayers’ motive when entering the arrangement in *Glenharrow* was irrelevant.

Once the Court identified elements of artificiality and found that the taxpayers had obtained a tax benefit for which they had not incurred the full economic cost, the arrangement breached the scheme and purpose of the GST Act and therefore constituted tax avoidance.

If the taxpayers had deliberately inflated their valuation and knowingly entered into the transaction to obtain an input tax credit far in excess of the true cost of the license, there would be little doubt the arrangement would defeat the GST Act and therefore should be void under s 76. The only difference between that arrangement and the actual arrangement in *Glenharrow* is the honest intention of the taxpayers. And since tax avoidance is determined objectively according to the arrangement itself, and not subjectively according to the motives of the taxpayers involved, the same result must follow.

As the Court stated in *Ch’elle*, tax avoidance cannot depend upon the intention or honesty of the individual taxpayers. It therefore seems that an honest motive will not preclude a finding of tax avoidance if the arrangement is, when objectively considered, uncommercial.

This raises the question of how evidence of a taxpayer’s subjective purpose should be considered. In both *Accent Management* and *Ch’elle* the Court found that the taxpayers deliberately structured their arrangements to exploit the GST Act and thereby obtain their tax advantage. Evidence regarding the taxpayers’ deliberate exploitation of the GST Act was used to support the finding of tax avoidance.

But if the test for tax avoidance is truly objective, such subjective evidence should be irrelevant. Yet it is clear that in both cases the Court was greatly influenced by this evidence. Certainly it would be strange if, despite clear evidence of a taxpayer’s actual motive to avoid tax, the Court found objectively that the arrangement did not have that purpose or effect. As the taxpayers in *Accent Management* and *Ch’elle* deliberately set out to avoid tax, the findings of tax avoidance in those cases can largely be explained on that basis.

However, where the evidence demonstrates no tax avoidance motive it is less obvious that the Court should ignore that honest intention — yet that is what the majority did in *Glenharrow*.

So taxpayers may be damned by evidence of their guilty minds but cannot save themselves with evidence of their honest intention. It seems the Commissioner can use subjective evidence where it points towards a tax avoidance motive but can disregard subjective evidence of an honest motive.

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Tax avoidance amounts to "crossing the line"

All three Court of Appeal decisions found tax compliance was a continuum and described tax avoidance as "crossing a line" presumably drawn by the scheme and purpose of the particular legislation. This language was also adopted by the Court of Appeal in another recent decision, *BNZ Investments Ltd v C of IR* [2007] NZCA 356. That case concerned discovery and secrecy issues in the pending tax avoidance litigation over structured finance transactions entered into by a number of banks.

Under these "repo deals" a subsidiary of the bank would purchase an equity interest in a special purposes issuer that was the subsidiary of a substantial foreign counterparty. In economic substance, the bank was providing funding to the counterparty but the bank's return was in the form of distributions from the issuer. The bank would deduct its own funding costs and other fees while treating the distributions from the issuer as either:

- exempt from tax under the conduit tax relief rules, or
- relieved from tax under the foreign tax credit rules.

The Commissioner alleged that these repo deals were a "template" that was devoid of commercial purpose other than the exploitation of tax asymmetry by the bank and the counterparty who shared the resulting tax benefit. The Commissioner has described the transactions as "mass-marketed tax technology" and "off the peg tax schemes", and therefore breached s BG 1 *Income Tax Act 1994*.

To prove the template nature of the repo deals entered into by *BNZ* the Commissioner proposed to release other banks' documents. *BNZ* applied to exclude these documents as irrelevant and because their disclosure would breach the Commissioner's duty of secrecy owed to the other banks under s 81 of the *Tax Administration Act 1994*.

The Court of Appeal unanimously ruled in favour of the Commissioner, allowing the release of all potentially relevant documents regardless of their secrecy. In doing so the Court expressly endorsed "the right of the Commissioner to advance the case he wishes to rely upon rather than a case the banks would prefer to meet" (para [34]).

During the course of that judgment, the Court also explained the test it is now applying in tax avoidance cases. It stated at para [43]:

> "The current test involves a perhaps impressionistic and open-textured approach which may turn on evaluative judgments, for instance as to the degree of contrivance and artificiality and/or whether a line has been crossed."

This has led some commentators to suggest the traditional "sniff test" of tax avoidance has now been replaced by a "line-crossing test". However this may simply be a matter of semantics, and whether this new test is any easier to apply in practice is uncertain.

Conclusion — Taxpayer must really suffer the economic cost

The *Accent Management*, *Ch'elle* and *Glenharrow* taxpayers had scrupulously organised their affairs to comply with the black-letter law while managing to take advantage of an inflated purchase price that would not actually be paid until much later (if at all). In each case the Court of Appeal analysed the scheme and purpose of the relevant legislation and found the taxpayer had not actually suffered the economic cost required.

While the taxpayers in both *Accent Management* and *Ch'elle* had deliberately and knowingly entered into their arrangements to obtain their tax advantage, *Glenharrow* had not. Nevertheless, the objective test for tax avoidance meant that it too had infringed the scheme and purpose of the GST Act and therefore s 76 applied.

The courts in each case ruled that tax consequences should reflect and at least generally accord with the economic effects of the transaction. If those results differ too widely, particularly because the price is inflated and the cost has not yet been actually paid, then that arrangement will defeat the statutory scheme and purpose.

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These three cases therefore send a strong message that taxpayers who enter arrangements with tax consequences that belay the true economic cost (whether intentionally or inadvertently) may have “crossed the line” into tax avoidance. Accordingly all decisions send a single message on tax avoidance.

Note: leave to appeal has been granted by the Supreme Court regarding the *Accent Management* and *Glenharrow* decisions, which will be heard early in 2008. The Supreme Court declined to grant leave in the *Ch’elle* case, perhaps reflecting the egregious nature of the arrangement in that case.

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