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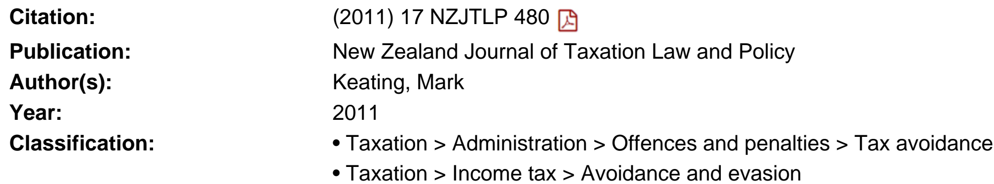

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Reconstruction of Tax Avoidance Arrangements: How Best to Rewrite History?

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One aspect of tax avoidance that has received scant attention in the recent cases is the Commissioner of Inland Revenue's power under s GA 1 of the Income Tax Act 2007 to reconstruct tax avoidance arrangements. Those cases have not explained how the Commissioner should quantify the tax advantage enjoyed by the taxpayer or how that benefit should be counteracted. The courts have apparently refused to require the Commissioner to quantify the "tax advantage" under the arrangement by reference to a "hypothetical situation" or other benchmark. The cases identify no clear basis (and apparently no restriction) on the Commissioner's reconstruction, including the ability to void any non-offending aspects of the arrangement. As a result, the reconstruction adopted in some recent cases has arguably gone further than was necessary to negate the tax benefit enjoyed under the arrangement, effectively penalising the taxpayer. That outcome has led some commentators to call for the reforms limiting the Commissioner's power of reconstruction.

This article reviews the scope of the Commissioner's power of reconstruction in s GA 1. It examines the case law and Inland Revenue policy determining how that power should be applied. Finally, it reconsiders the reconstruction adopted in recent cases to determine whether it correctly counteracts the tax advantage enjoyed under those arrangements.

1.0 INTRODUCTION

In the past decade, New Zealand has experienced a "sea change" in tax avoidance jurisprudence, culminating in three decisions of the Supreme Court. The courts have formulated and applied the new parliamentary contemplation test while rendering redundant much of the previous case law on tax avoidance. Virtually all recent cases have been decided in favour of the Commissioner of Inland Revenue (Commissioner), yet none of those recent cases has adequately considered the extent of the Commissioner's power to reconstruct those arrangements. In particular, those cases have not explained how the Commissioner should quantify the tax advantage enjoyed by the taxpayer under the impugned arrangement. The proper scope and application of that power therefore remains largely untested. In a number of those recent cases, the courts have confirmed a reconstruction by the Commissioner that arguably goes further than is required under s GA 1 of the Income Tax Act 2007 to "counteract a tax **[(2011) Vol 17:4 NZJTLP 480, 481]** advantage" enjoyed by the taxpayer from the arrangement, effectively penalising the taxpayers involved.

This article reviews the scope of the Commissioner's power of reconstruction in s GA 1. It examines the case law and Inland Revenue policy determining how that power should be applied. Finally, it reconsiders the reconstruction adopted in a number of recent cases to determine whether it correctly counteracts the tax advantage enjoyed under those arrangements.

2.0 THE HISTORICAL PROBLEM OF REASSESSING TAX AVOIDANCE ARRANGEMENTS

The Supreme Court in *Ben Nevis* traced the history and development of the general anti-avoidance provision (GAAR) in New Zealand. That details that one of the most significant difficulties historically faced by the Commissioner was that, even after the GAAR had voided a tax avoidance arrangement, it did not impose a new tax liability in its place. This weakness was identified by the courts in a number of cases. For instance, Lord Donovan said of the former equivalent Australian provision (then in s 260 of the Income Tax Assessment Act 1936 (Cth)) in *Peate v Federal Commissioner of Taxation*:

> "When a taxpayer puts an end to one source of income and creates another in its stead, the section does no more than

> destroy the new arrangements so far as the Commissioner and the Act are concerned. This is not enough. The old order is not revived by thus annihilating the new. *What is needed is authority for the Commissioner to make such assessments to tax as in his view are required to prevent the avoidance of tax which would otherwise occur*."

Likewise, Lord Denning recognised that:

> "Section 260 is an annihilating provision. It entitles the Commissioner to disregard the arrangement and ensuing transactions so far as they have the purpose or effect of avoiding tax. However to make the taxpayers liable, the Commissioner must show that something has come into the hands of the taxpayers which he is entitled to treat as income derived by them."

The same problem was identified with the former New Zealand GAAR found in s 108 of the Land and Income Tax Act 1954. In *Mangin v Commissioner of Inland Revenue*, Lord Donovan notes:

> "… the difficulties caused by leaving a section such as s 108 completely silent as to what is to happen once the contract, agreement or arrangement has been declared absolutely void so far as its tax relieving purpose or effect is concerned. Is a vacuum left or is the taxpayer to be deemed to go on deriving the income? What is to happen if, simply in order to avoid tax, he has parted with the source of the income? Or receives money which is capital and not income? Section 108 gives no guidance at all on these points."

For example, in *Commissioner of Inland Revenue v Gerard* the New Zealand Court of Appeal found that the impugned arrangement (a "paddock trust case" involving the diversion of income) was tax **[(2011) Vol 17:4 NZJTLP 480, 482]** avoidance but, because the diverted income never reached the taxpayer's hands, it could not be taxed to him. McCarthy P recognised that the operation of s 108 gave rise to "a world of fiscal phantasy" and called on Parliament to "state in precise language not only what classes of transactions are to be struck down, but what are to be the results of that action."

Accordingly, from the beginning the courts recognised that the GAAR was purely a destructive provision, which voided the offending arrangement but did not provide for any substitute. Accordingly, the GAAR by itself could adequately defeat the taxpayer's arrangement only if, following the annihilation of that arrangement, a taxable situation was revealed. It could not be used to assess the taxpayer for income that was not in fact received. This understanding was confirmed by Richardson J in *Commissioner of Inland Revenue v Challenge Corp Ltd*:

> "… the section was a destructive provision not allowing any reconstruction and it assisted the Commissioner only if following annihilation of the arrangements voided by the section a taxable situation was disclosed."

This weakness in the operation of the GAAR was addressed in 1974 when Parliament replaced the former s 108 with a provision containing more teeth that included an express power to reconstruct the arrangement to impose tax on any taxpayers affected by the arrangement. That power is now found in s GA 1 of the Income Tax Act 2007.

3.0 SECTION GA 1

The power of reconstruction in s GA 1 provides the Commissioner with a substantive power to take the necessary steps to deal with the tax consequences of voiding the tax avoidance arrangement:

> **Commissioner's General Power**
>
> "(2) The Commissioner may adjust the taxable income of a person affected by the arrangement in a way the Commissioner thinks appropriate, in order to counteract a tax advantage obtained by the person from or under the arrangement."

Obviously, this provision expands the Commissioner's power such that he is no longer faced with a vacuum after s BG 1 has voided the arrangement and can now take positive steps to reassess. However, even after the enactment of s GA 1, it was recognised that the section did not itself contain a power of reassessment. This was explained by both the Court of Appeal and the Privy Council in the *Challenge* case. First, Richardson J said:

> "Section 99 is not an independent *charging provision*. It does not itself create a liability for income *tax*."

That function was acknowledged in Inland Revenue's policy statement on the application of the GAAR then found in s 99 of the Income Tax Act 1976: **[(2011) Vol 17:4 NZJTLP 480, 483]**

> "[Section 99] is not an independent charging section except insofar as section 99(3) provides for the reconstruction of an arrangement to counteract any tax advantage obtained, …. It does not itself create a liability for income tax."

Later, the policy explains:

> "As discussed above the section does not itself create a liability for income tax established under the other provisions of the Act."

This view on the role of the GAAR was also confirmed in the draft (and still not finalised) policy statement in 2004:

> "the Commissioner's view is that section BG 1 does not, of itself, create any tax liability. The effect of section BG 1 is that it is a 'destructive' provision. … As a result, where an appropriate taxable situation is disclosed the other provisions of the Act apply to determine the taxation outcome following the voiding of the tax avoidance arrangement. While this may be sufficient to negate any 'tax advantage' in some situations, it is also possible that another reconstruction or adjustment is necessary or more appropriate."

That interpretation is generally accepted to be correct. While the GAAR may void the offending arrangement, neither s BG 1 nor s GA 1 actually provides for the reassessment of participating taxpayers. All assessments raised by the Commissioner rely upon the operation of the black-letter provisions of the Income Tax Act to the reconstructed facts.

4.0 UNINTENDED REFORMS AFFECTING SECTION GA 1

While there has been no substantive reform of the GAAR since 1973, the progressive rewrite of the Income Tax Act has given rise to possibly unintended changes in wording that potentially impact the operation of s GA 1.

4.1 Voiding of Whole Arrangements

The current iteration of s BG 1 is explicit that "a tax avoidance arrangement is void as against the Commissioner". This clear statement operates so that, if tax avoidance is a more than merely incidental purpose, the entire arrangement is void. Presumably, that voiding applies not only to the offending tax avoidance aspects but also to any non-tax avoidance aspects of that arrangement.

[(2011) Vol 17:4 NZJTLP 480, 484]

By contrast, the predecessor to s BG 1, found in s 99 of the Income Tax Act 1976, was a more nuanced provision. That section provided:

> "(2) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely

void as against the Commissioner for income tax purposes *if and to the extent that*, directly or indirectly,—

"(a) its purpose or effect is tax avoidance …"

Accordingly, it seems that the earlier provision voided an arrangement only to the extent to which it constituted tax avoidance, while the present provision makes the entire arrangement void. Where previously certain offending aspects of an arrangement could be strategically negated by the Commissioner using s 99 alone (while leaving the non-offending aspects of that arrangement in place), the current provision does not allow for that targeted use. That change makes the role of s GA 1 more crucial.

Most tax avoidance arrangements contain both commercial and offending elements. However, the current version of s BG 1 apparently voids both aspects. This means that s GA 1 is the only provision allowing for the targeted reassessment of tax avoidance arrangements. In effect, anything less than the full annihilation of the entire arrangement requires the operation of s GA 1.

Based on that reasoning, it is concerning that the Commissioner's policy would suggest that Inland Revenue is not obliged to have resort to s GA 1 once it has voided an arrangement under s BG 1. That implies that the Commissioner considers it proper to void all aspects of a tax avoidance arrangement, both the offending and the commercial aspects, regardless of whether that is strictly necessary to counteract the tax advantage obtained under that arrangement.

4.2 "Shall" versus "May"

The original incarnations of s GA 1, found in s 99(3) of the Income Tax Act 1976, stipulated that the Commissioner "shall" exercise the power of reconstruction whenever a tax avoidance arrangement was voided. By contrast, all subsequent versions of s GA 1 merely stated that the Commissioner "may" exercise that power. That subtle but potentially significant change in wording was played down by Inland Revenue in its draft policy on tax avoidance:

> "The Commissioner does not consider that this change (from 'shall' to 'may') results in any substantive alteration to the manner in which section GB 1(1) is intended to be applied. Rather, the change more accurately recognises the complementary operation and effect of sections GB 1 and BG 1 …"

While the Commissioner accepts that the change in wording has no substantive effect, the draft policy then claims that the power to reconstruct under s GA 1 had always been entirely discretionary. It states:

> "In the Commissioner's view, the adoption of the word 'may' by the core provisions amendments can be seen as recognising that there will be circumstances when an adjustment by the Commissioner will be necessary, and other times when it will not (as the tax advantage will have been appropriately counteracted by the operation of section BG 1 and the application of other provisions of the Act). Giving the [revised] words of section GB 1 their plain ordinary meaning, the Commissioner has a **discretion** to adjust. Therefore, the **[(2011) Vol 17:4 NZJTLP 480, 485]** Commissioner will have the ability to adjust if, taking into account the scheme of the Act, such an adjustment is necessary to counteract a tax advantage following the voiding of an arrangement."

This view is surprising and can only be based on the presumption that the former wording "shall" actually meant "may" all along. That interpretation is questionable. A more obvious interpretation is that s GA 1 does not create a discretion over *whether* to reconstruct the tax avoidance arrangement but, rather, gives the Commissioner a latitude over *how* that reconstruction should be exercised.

4.3 The Commissioner's Discretion under Section GA 1

Section GA 1 provides that the Commissioner may reconstruct the taxpayer's affairs "in a way the Commissioner thinks appropriate". This wording raises the question of whether the appropriate reconstruction is entirely a matter for the Commissioner's discretion. Certainly, some cases have approached a reassessment relying upon s GA 1 in that manner. For instance, Hammond J in *Peterson* considered that:

> "… it must be particularly difficult to interfere with the Commissioner's exercise of his discretion under s 99(3), for what is involved *is* the exercise of a discretion."

Likewise, in *Miller (No 1)*, the High Court stated:

> "… there can be no reason in principle for the Court to restrain the exercise of the Commissioner's power under subs (3) more than Parliament itself has done in settling the limits of that provision."

But the apparently wide discretion granted to the Commissioner by s GA 1 should not be taken too far. An assessment in reliance on s GA 1 has no special status and is no more left to the discretion of the Commissioner than any other type of assessment. Once a taxpayer challenges that assessment, the court must exercise its own power to determine the correctness of that assessment. That obligation was recognised by Harrison J in *Westpac*, in which his Honour considered that:

> "On a challenge to the Commissioner's reconstruction the court's powers are to confirm, cancel or vary it [under s 138P of the Tax Administration Act 1994]."

As was noted by the Court of Appeal in *Beckham*, the court has all the powers of the Commissioner and need not simply confirm or reject the Commissioner's assessment but can reach its own view on what the correct assessment should be. As a result, a taxpayer may challenge the Commissioner's reconstruction as excessive. This was made clear by Elias CJ and Anderson J in *Ben Nevis*, even if the hurdle taxpayers face is high:

> "… when taxpayers challenge an assessment based on a reconstruction adopted by the Commissioner, the onus is on them to demonstrate, not only that the reconstruction was wrong, but also by how much it was wrong. Unless the taxpayer can demonstrate with reasonable clarity what the correct reconstruction ought to be, the Commissioner's assessment based on his reconstruction must stand."

[(2011) Vol 17:4 NZJTLP 480, 486]

The Supreme Court's language reflects the traditional approach in *Buckley & Young* to resolving taxpayer challenges. The focus is therefore on the correctness of the assessment, not on the discretion exercised by the Commissioner. For instance, when rejecting the argument that the alleged vendetta against JG Russell invalidated the resulting reassessments, the Taxation Review Authority (TRA) concluded:

> "A major submission of the disputant, regarding the vendetta issue, seemed to be that an important aspect of the IRD finding tax avoidance is the use of discretion to subjectively determine the existence of tax avoidance and to reconstruct consequential upon it. In fact, such issues are decided on an objective basis and either assessments based on tax avoidance are correct or not."

This view was confirmed by Heath J in *Alesco New Zealand Ltd v Commissioner of Inland Revenue*. There, his Honour concluded:

> "The Commissioner takes the view that, once an arrangement is treated as void under s BG 1, he is entitled to determine how to counteract the tax advantage gained. On any challenge to this assessment, the Taxation Review Authority or this Court has power to vary that decision [in reliance on s 138P of the Tax Administration Act 1994] … Whether or not a formal reconstruction is undertaken pursuant to s GB 1 of the Act, the test that s 138P applies remains relevant to any assessment made by the Commissioner following invocation of s BG 1."

Later, Heath J concluded:

> "I consider that s 138P … would have provided the jurisdiction for this Court to alter the Commissioner's assessment had there been any basis to do [this]."

All reassessments giving effect to s GA 1 are presumably made under the general power of reassessment in s 113 of the Tax Administration Act 1994. Even settlements of tax avoidance disputes are given effect to under that power. Accordingly, reconstruction is not solely at the Commissioner's discretion. Rather, taxpayers are able to challenge those reassessments not only on the grounds that they are incorrect (that is, on the grounds that s BG 1 ought not to apply) but also as to their quantum (that is, that the reconstruction adopted by the Commissioner is excessive).

4.4 Reassessment of Third Parties

Section GA 1(2) grants the Commissioner the power to reassess not only participants to a tax avoidance arrangement but also any person "affected by the arrangement". However, in **[(2011) Vol 17:4 NZJTLP 480, 487]** *BNZ Investments Ltd v Commissioner of Inland Revenue* the High Court ruled that the lack of knowledge by a third party regarding the activities of other parties to an arrangement meant that:

> "… the Commissioner cannot reconstruct against an entity (BNZI) which did not know of or participate in the downstream transactions which the Commissioner says indicate tax avoidance …"

That decision was upheld by the Court of Appeal. Blanchard J confirmed:

> "The adjustment can be made against both a party to the arrangement and a person affected, who is not necessarily a party. But it can be made only where a tax advantage has been obtained 'under that arrangement'. The Commissioner therefore cannot make an adjustment as against someone who is not a party merely because that person has received a payment subsequent to the operation of an arrangement but outside the arrangement."

That decision (briefly) gave rise to a "fools charter" under which taxpayers were incentivised to know as little about their tax affairs as reasonably possible in order to insulate themselves from the potential application of s BG 1 and reconstruction under s GA 1. But that position was quickly curtailed by the Court of Appeal and then reversed by the Privy Council in the *Peterson* case. In the Court of Appeal, Gault P considered:

> "There will be circumstances in which questions will be raised as to the degree of proximity necessary to qualify as a person affected for the purpose of s 99(3). This will be another aspect of line-drawing, as it was termed in the *BNZ Investments* case, so as to distinguish between a tax advantage that may be legitimately retained and one that is vulnerable to adjustment."

On appeal, the Privy Council unanimously found for the Commissioner on this point, entirely rejecting the narrow approach adopted in *BNZI*. Lord Millett briefly concluded:

> "Their Lordships do not consider that the 'arrangement' requires a consensus or meeting of minds; the taxpayer need not be a party to 'the arrangement' and in their view he need not be privy to its details either. On this point they respectfully prefer the dissenting judgment of Thomas J in *Commissioner of Inland Revenue v BNZ Investments Ltd*."

This view was ultimately confirmed by the Supreme Court in *Ben Nevis*, which considered that:

> "On the ordinary meaning of the language used, Parliament did not confine the reach of what is now s GB 1 to those who were *involved* in the arrangement without being parties. Rather coverage extends to *any person affected* by the arrangement. A taxpayer who claims a deduction in terms of a tax avoidance arrangement can hardly claim not to be affected by the arrangement. There is no principle of interpretation that warrants a reading down of the language used. The position therefore is that this section is to be applied according to its ordinary meaning."

Given that judicial authority and the clear wording of s GA 1, it is generally acknowledged that the Commissioner has the power to counter the tax advantage obtained by any person, whether or not they **[(2011) Vol 17:4 NZJTLP 480, 488]** were party to the arrangement or even aware of the impugned tax avoidance aspects. The only practical limit to this wide power is one of proximity. As recognised by the Court of Appeal in *Peterson*:

> "There will be circumstances in which questions will be raised as to the degree of proximity necessary to qualify as a person affected for the purpose of s 99(3). This will be another aspect of line-drawing, as it was termed in the *BNZ Investments* case, so as to distinguish between a tax advantage that may be legitimately retained and one that is vulnerable to adjustment."

4.5 Multiple Tax Benefits

The Commissioner is empowered to counteract the tax advantage obtained by each person under the arrangement. This was made clear by the Privy Council in *Miller v Commissioner of Inland Revenue*, which ruled that under s GA 1:

> "… the Commissioner shall adjust the assessable income of *any* person affected by the arrangement to counteract *any* tax advantage that person has obtained. There is no reason why an arrangement should not confer tax advantages upon more than one person and, as their Lordships have already explained, this one plainly did. There were different tax advantages in relation to different payments. … There was no reason why the Commissioner should not adjust the assessable income of each or any of these persons."

There are only two limitations on this wide power.

4.5.1 Commissioner cannot "follow the money"

First, it would be improper for the Commissioner to tailor the reconstruction solely to ensure the maximum recovery of tax. When different taxpayers enjoyed a tax advantage under the same arrangement, the Commissioner could not target one instead of the other simply because that taxpayer was solvent (the so-called "follow the money" approach). That approach was alleged in the JG Russell template cases, in which the Commissioner:

- Abandoned his first reconstruction that had reassessed the trading companies once it became obvious that those entities had deliberately been emptied of assets by the taxpayer in order to prevent any effective recovery from them; and
- Instead, adopted a revised reconstruction that reassessed the individual shareholders personally.

Significantly, the Courts considered that any reassessment based *solely* on the question of taxpayer solvency would be improper:

> "It is outside that power and a misuse of authority for the Commissioner to make an amended assessment on the footing that the person selected may have a greater ability to pay than the trading company through which the individuals concerned derived their income … If the motivation for targeting the individual plaintiffs rather than F was simply because F was not solvent, that could not possibly be justified under s 99(3) and would have to be characterised as an abuse of power."

As a matter of fact, the Court at each level accepted that the Commissioner had not been improperly motivated to follow the money when raising the revised reconstruction. Instead, the Court confirmed **[(2011) Vol 17:4 NZJTLP 480, 489]** that the Commissioner was entitled to consider solvency as *one factor* when determining the correct reconstruction:

> "In the present … Company A and the plaintiffs were potentially liable to a 'counteract' decision a decision based on the greater financial capacity of the plaintiffs was properly open to the Commissioner. It was not 'simply' because of their stronger financial position but, critically, because of that position *coupled with their tax advantage which it was the Commissioner's duty to counteract*. He could not require double recovery by both the plaintiffs and Company A; it was well open to him to prefer to make the recovery against the party which received the economic benefit and against whom the expenditure of public funds by way of recovery would be more likely to be more effective."

So, where the Commissioner can identify multiple taxpayers who enjoyed a tax advantage, then, provided that solvency is not the sole criteria governing the decision, he would be entitled to reassess the solvent taxpayer rather than the insolvent taxpayer under the reconstruction.

4.5.2 No double counting

The statutory limitation in s GA 1(6) prevents the Commissioner from using the reconstruction power to impose tax for the same income on two different taxpayers:

> **No Double Counting**
>
> "When applying [the reconstruction], if the Commissioner includes an amount of income or deduction in calculating the taxable income of the person, it must not be included in calculating the taxable income of another person."

This provision ensures that the Commissioner does not impose tax both under the original (now void) arrangement and also under the reconstruction. Instead, the Commissioner must ensure that any reconstruction adopts and applies a consistent approach so as not to impose double taxation. This was best expressed by the Privy Council in *Miller v Commissioner of Inland Revenue*:

> "Of course [the] assessments would have to be consistent with each other. He could not maintain an assessment on Mr Russell's company on the basis that it had received the whole trading profit but was not entitled to group relief and at the same time assess the shareholders on the basis that they had received the trading profit in the form of remuneration. But provided that he was not using inconsistent hypotheses for his reconstructions, he was in their Lordships' opinion entitled to assess any party who had obtained a tax advantage."

That requirement is tempered by the proviso that inconsistent assessments may be made by the Commissioner when doubt exists as to the appropriate reconstruction, pending the determination of the correct tax position under the challenge procedure. Thus, the "consistent hypothesis" must only be achieved following the resolution of all challenges: in the interim, inconsistency will not invalidate any assessments. This was made clear by the Court of Appeal in *Miller*, which explained:

> "It is not necessary on each occasion when the Commissioner makes an assessment of one taxpayer which is inconsistent with his earlier assessment of a different taxpayer that he simultaneously should amend that earlier assessment. That must ultimately be done or the Commissioner would, in effect, be collecting the same tax twice over, but he is to be allowed some flexibility in the timing of the adjustment to meet administrative demands and to enable him to await the outcome of objection proceedings in relation to the assessments."

[(2011) Vol 17:4 NZJTLP 480, 490]

That approach was confirmed by the Privy Council and has been repeatedly applied by the Australian courts.

4.6 Compensating Adjustment

In what circumstances the Commissioner must make a compensating adjustment under s GA 1(6) is currently being tested in *Russell v Commissioner of Inland Revenue*. Mr Russell is challenging the correctness of assessments taxing him personally for fees charged to clients who participated in the template arrangement. Those clients have already been personally reassessed for the full amount of the profits generated by their companies, without permitting any deduction for the fees retained by Mr Russell's companies under the arrangement. Mr Russell alleged that the requirement for a compensating adjustment precluded that income now being attributed to him on the grounds that it would constitute double taxation.

The High Court rejected that argument and upheld the reassessments. The Court viewed the income attributed to Mr Russell's clients under the template arrangement to be separate from that retained by Mr Russell for his services. As explained by Blanchard J in the earlier template litigation:

> "There is also a complaint that the Commissioner has assessed the disputant entity in respect of all the consulting fees. That does not, however, show any inconsistency. A payment by one taxpayer which is not deductible is frequently assessable in the hands of its recipient."

On that reasoning, the Court upheld the Commissioner's reconstruction attributing all income received under the template arrangement to Mr Russell personally.

5.0 Reconstruction based on a "hypothetical situation"

A significant feature of s GA 1 that has rarely been discussed is whether the reconstruction should be based upon a comparison between the tax effect of the offending arrangement and a "hypothetical situation". The courts have always acknowledged the requirement to identify a "benchmark" or "base case" against which the tax effect of the arrangement must be measured. For instance, the Privy Council in *O'Neil v CIR* explained this requirement:

> "The Commissioner's duty is to make an assessment with regard to what in his opinion was likely to have happened if there had been no scheme. But that does not mean that he is actually rewriting history. The reconstruction is purely hypothetical and provides a yardstick for the assessment."

[(2011) Vol 17:4 NZJTLP 480, 491]

Likewise, in *Gulland* the Australian High Court recognised:

> "The situation that is left after [the GAAR] has done its work is necessarily a hypothetical one having no existence in law or fact; it is the situation that would have existed had the arrangement not produced the specified effect. The difference between the situation which does exist and the hypothetical situation is the 'effect' which attracts the operation of the section."

The basis for the "hypothetical situation" is now spelt out in the Income Tax Act 2007. Sections GA 1(4) and (5) provide:

> **Commissioner's identification of hypothetical situation**
>
> "(4) When applying subsections (2) and (3), the Commissioner may have regard to 1 or more of the amounts listed in subsection (5) which, in the Commissioner's opinion, had the arrangement not occurred, the person—
>
> "(a) would have had; or

"(b) would in all likelihood have had; or

"(c) might be expected to have had.

Reconstructed amounts

"(5) The amounts referred to in subsection (4) are—

"(a) an amount of income of the person:

"(b) an amount of deduction of the person:

"(c) an amount of tax loss of the person:

"(d) an amount of tax credit of the person."

This approach requires a prediction of what might reasonably have been the tax position in the absence of the impugned arrangement. Normally, a pre-existing conduct provides the benchmark against which the tax benefit can be measured. However, where there is no pre-existing conduct the position is more difficult. Then the court is entitled to take notice of what the taxpayers themselves actually did when considering what else may have occurred. This was made clear by Blanchard J in respect of participants to the JG Russell template arrangement:

> "We consider that the likelihood of receipt of moneys by the former shareholders must be judged by what they have actually done. They caused all the profits to be removed from the company. … The desire of the shareholders to extract them is demonstrated by what they actually did."

The only New Zealand case to give a detailed consideration to how the hypothetical situation should be determined is *BNZI*. There, the Commissioner applied s GA 1 to recharacterise exempt dividends into interest for tax purposes. However, BNZI showed that it was highly unlikely that it would ever have entered into an arrangement generating interest receipts. As a result, the Court rejected the Commissioner's reconstruction on the grounds that it was not a realistic "hypothetical situation" under s GA 1(4). The High Court explained:

> "BNZI policy was to enter only into equity *investments*. It did not enter into debt transactions, and would not have done so on this occasion. Nor is there any 'natural order' under which the 'base case' is to be taken as lending at interest attracting higher tax rather than dividend returns on equity."

[(2011) Vol 17:4 NZJTLP 480, 492]

This view was confirmed by the Court of Appeal.

By contrast, the High Court in *Alesco* appears to have rejected that approach. Health J explained the conflicting views as follows:

> "The difference between the Commissioner's approach and that taken by the taxpayers is that the Commissioner contends that he has a discretion to counteract the tax advantage as he thinks fit, whereas the taxpayers contend he is obliged to apply the next best alternative to the transaction undertaken."

5.1 Requirement for Consistent Hypotheses

When determining the "tax advantage obtained from or under the arrangement", it is important that the same hypothetical situation should be used by the Commissioner both:

- When determining whether the taxpayer has actually avoided tax under s BG 1 (that is, under the definition of “tax avoidance” in s YA 1); and
- When counteracting the “tax advantage” under s GA 1(2).

For instance, it would be improper for the Commissioner to use one analysis of what tax has been avoided and different analysis when quantifying the tax advantage to be reconstructed. This point can be demonstrated with a simple example:

> “A taxpayer wishes to undertake a refinancing. There are three different legal ways for the taxpayer to achieve this:
>
> “• Option 1 would give rise to nil tax;
>
> “• Option 2 would give rise to $50 tax;
>
> “• Option 3 would give rise to $100 tax.
>
> “The taxpayer implements Option 1. The Commissioner alleges that Option 1 constitutes tax avoidance.”

When determining whether there has been “tax avoidance” under Option 1, the Commissioner must identify (and presumably quantify) precisely what tax has been avoided. The Commissioner may accept that Option 2 would not constitute tax avoidance. The Commissioner therefore, presumably, determines that the taxpayer has avoided $50 in tax by adopting Option 1. But having made that determination, it would be improper for the Commissioner to counteract the “tax benefit” by reconstructing the taxpayer’s affairs to implement Option 3, with the resulting $100 tax liability. Such an approach would constitute “over-reconstruction” of the arrangement as it would go further than necessary to counter the tax advantage and would amount to imposing an additional tax liability.

Unfortunately, this requirement for consistency does not resolve all questions. In particular, using that example, could the Commissioner simply disregard Option 2 entirely? In other words, could the Commissioner use a consistent hypothesis that Option 3 is the preferred hypothetical situation both for determining whether tax has been avoided under s BG 1 and for what adjustments are required under s GA 1? Such an approach would not offend the requirement for consistency, but it may nevertheless **[(2011) Vol 17:4 NZJTLP 480, 493]** offend the principle that the Commissioner “is not entitled to act arbitrarily in disregard of the law or facts as known to him. If the assessment is not made on an intelligible basis, it cannot stand.”

In order to determine which counterfactual the Commissioner should use as the benchmark for his adjustment, it is important that s GA 1 permits the Commissioner only to counteract the “tax advantage” obtained under the arrangement and no more.

5.2 Quantifying the “Tax Advantage”

Strangely, “tax advantage” is not defined in either the Income Tax Act 2007 or the Goods and Services Tax Act 1985. The Commissioner therefore has no statutory guidance on how to quantify the tax advantage. Presumably, the Commissioner must quantify the tax advantage by determining what tax should properly have been paid. The clearest consideration of this point came from the High Court in *BNZ Investments Ltd v Commissioner of Inland Revenue*:

> “The submission notes that ‘tax advantage’ is not a defined term. … What is required, it is said, under s 99(2) is [a] ‘comparison of the base tax liability that would have arisen to the taxpayer if he had not entered into the arrangement, with the taxpayer’s tax liability as a result of and following entry into the arrangement’. It is only where there is “a change in base tax liability (the ‘tax advantage concept’), that the taxpayer could have been said to have obtained a ‘tax advantage’.”

This reasoning is implicitly confirmed by Inland Revenue in the draft policy statement on tax avoidance, INA0009, which states that

the tax benefit must correspond with the particular type of "tax avoidance" that is being countered:

> "While there is no definition of the term, its sense must include the benefit of the tax avoidance which (but for s 99) the Commissioner was entitled to conclude the plaintiffs have achieved. … Therefore, a 'tax advantage' involves an income tax benefit or a better income tax position. Such a tax advantage must be obtained by way of altering … relieving … avoiding, or reducing or postponing the burden of a liability to income tax … **and as such will generally correlate with the tax avoidance identified pursuant to section BG 1 as arising under the tax avoidance arrangement**. This is consistent with the words of section BG 1(2) which states 'the Commissioner, in accordance with Part G, may counteract a tax advantage obtained by a person from or under a tax avoidance arrangement'."

What is clear is that the Commissioner is only empowered under s GA 1 to counteract the tax benefit and no more. While the Inland Revenue draft policy on s BG 1 claims a wide discretionary power over when and how s GA 1 should be applied, it also acknowledges:

> "… the Commissioner's discretion in making an adjustment is not completely unfettered. While the Commissioner is broadly able to make such adjustments as are considered necessary to counteract a tax advantage, the adjustment must be only for the purpose of countering the tax advantage."

[(2011) Vol 17:4 NZJTLP 480, 494]

So, the Commissioner cannot use s GA 1 to cancel legitimate tax benefits obtained by the taxpayer that do amount to tax avoidance. This limit was recognised by the High Court in *BNZ Investments Ltd v Commissioner of Inland Revenue*:

> "[Section GA 1] empowers the Commissioner to adjust to counter any 'tax *advantage*' obtained, and no further. … I have no doubt [it] is intended to counteract tax advantages obtained out of avoidance, but not otherwise. Where tax advantages are increased through avoidance over a base level which would have existed in any event, it is that increment above base level which is to be counteracted, not the legitimate base level itself."

Despite that reasoning, Inland Revenue's draft policy statement rejects any suggestion that the Commissioner is obliged to have regard to the "hypothetical situation" identified under s GA 1(4). Instead, it claims that the Commissioner is not bound by any hypothetical comparison. Inland Revenue considers that it may dispense with the requirement to identify and apply the "hypothetical situation" and, instead, simply "look at the matter broadly". On that approach, the draft policy concludes that "the Commissioner has a wide discretion in how he determines the amount of adjusted income."

Recent statements by the Supreme Court in *Ben Nevis* are ambiguous on this point:

> "That general power under s GB 1(1) [of the Income Tax Act 1994] was supplemented by a specific power vested in the Commissioner [under what is now s GA 1(4) and (5) of the Income Tax Act 2007] whereby he could have regard to such gross income, allowable deductions and available net losses as he considered the appellants 'would have, or might be expected to have, or would in all likelihood have, had if the arrangement had not been made or entered into'."

While obviously the Commissioner does have a wide discretion over how to counteract the tax advantage obtained, it is doubtful whether "the Commissioner is not required to have resort to [the current subsections (4) and/or (5)] in the making of an adjustment under section [GA 1(1)]" as claimed by the draft policy. Rather, the Commissioner's apparent discretion to "look at the matter broadly" may actually be more limited and taxpayers may still challenge any reconstruction as excessive. For instance, in *BNZI* both the High Court and the Court of Appeal recognised that only tax advantages, not other forms of advantage, can be reconstructed under s GA 1. On that point, the High Court reasoned:

> "Reconstruction under s 99(3) can only take place if the taxpayer (BNZI) has obtained a 'tax advantage'. This requires a

> change in the base tax … 'Tax advantage' does not mean 'economic advantage'. For a tax advantage to occur, there must have been an alteration in tax which otherwise would have been imposed."

Presumably, the extent of any tax advantage is a factual question based on what tax liability the taxpayer would likely have incurred but for the arrangement. The best expression of this approach can be found in the Australian High Court judgment in *Peabody* (discussed below).

[(2011) Vol 17:4 NZJTLP 480, 495]

6.0 NEW ZEALAND TAXPAYERS ARGUE FOR ALTERNATIVE RECONSTRUCTIONS

To date, most New Zealand tax avoidance cases have focused on the question of whether s BG 1 applies. Comparatively little consideration has been given to the correctness of the reconstruction. For instance, the three tax avoidance cases decided by the Supreme Court include only a minimal discussion of the resulting reassessments. It is almost as if, after finding that the arrangements constituted tax avoidance, the courts have simply upheld the Commissioner's reassessments without a separate consideration of s GA 1. This lopsided approach may reflect a range of factors:

- First, the taxpayers focus on preventing the operation of s BG 1, which limits the scope for arguing in the alternative that, if s BG 1 did apply, the resulting reassessments were excessive. Raising arguments over the proper reconstruction may carry the whiff of defeat.
- Second, any of the potential reconstructions would be extremely adverse to the taxpayers. The facts often make it difficult for taxpayers to point to any "legitimate tax benefits" from the arrangement they should be entitled to keep.
- Finally, there seems an implicit attitude by the courts that "a taxpayer who plays with a tax avoidance fire can scarcely complain of burnt fingers". Having found the taxpayers to have engaged in avoidance, courts appear reluctant to come to their aid by mitigating the consequences. The same judges, who have repeatedly refused to provide certainty to taxpayers on the line between legitimate tax planning and tax avoidance, appear to have taken the hard-nosed attitude that any taxpayer who puts a toe over that line can expect to lose the entire foot.

It is therefore not surprising that the question of the proper reconstruction has been little considered. Instead, the courts have generally:

- Not required the Commissioner to identify the hypothetical situation relied upon to quantify the tax advantage; and
- Rejected claims by the taxpayer that the reconstruction goes further than is necessary to counteract the tax advantage.

This approach has led a group of prominent commentators to call for a statutory reform of s GA 1 to clarify:

> "the particular tax advantage resulting from tax avoidance, and that only that tax advantage would be overridden by the GAAR, not other tax consequences of the arrangement that do not result from tax avoidance. In other words, the GAAR should operate to 'knock out' tax avoidance, but should not give Inland Revenue the discretion to penalise taxpayers by also knocking out other, legitimate tax consequences of the arrangement. **[(2011) Vol 17:4 NZJTLP 480, 496]**

The cases below demonstrate the often inconsistent approach to determining the proper reconstruction and the apparent reluctance to impose any discipline on the exercise of that discretion. Those cases are then compared with Australian cases, which adopt a much more balanced approach to reconstruction.

6.1 The Trinity Arrangement

The facts in the *Trinity* tax avoidance arrangement are well-known. An immediate deduction for the future payment of an inflated licence fee to a charity for the use of its forestry land was found to constitute tax avoidance. When considering the appropriate reconstruction, the taxpayers claimed that, if they were not entitled to the full amount of the inflated deduction, they should at least be given a reduced deduction for the cost of licensing the land. In effect, the taxpayers asked: if $2 million for that licence was impermissible tax avoidance, what amount could properly be permitted? This argument was explained by the Court of Appeal as follows:

> "Mr Judd argued that all that was wrong with the licence premium was that it was too large. He said that it followed, logically, that there was a point at which the licence premium would have been acceptable. By completely disallowing the deduction the judge therefore took more from the taxpayers than was necessary to counteract their illegitimate tax deductions."

Despite the logic of that argument, the Court of Appeal refused to permit the taxpayers any deduction for the licence. William Young P said:

> "The effect of s BB 9 and GB 1 is that the scheme is void as against the Commissioner. Under that void scheme, the taxpayers claimed deductions to which they were not entitled. The entirety of the deductions was thus illegitimate and their extent provides the measure of the tax advantages which the Commissioner must counteract. The counter-factual envisaged by s GB 1(a) is the position 'if that arrangement had not been made or entered into'. There is thus no need for the Commissioner (or court) to conjure up an alternative and more effective scheme into which the taxpayers might have entered."

This approach was confirmed by the Supreme Court. Significantly, it appears that the taxpayers had failed to provide any evidence to support an alternative reconstruction:

> "In this case we are of the view that the appellants have not shown that the Commissioner's assessment based on his reconstruction was wrong. Even if they had shown that to be so, they have not shown on any reasonably clear basis to what extent it should be varied. The appellants did not submit any specific proposed reconstruction of their own, the validity of which the Court could then have evaluated. The Commissioner's assessment must therefore stand."

The taxpayers may have been correct that *some* deduction ought to have been permitted for the licence but they had failed to adequately quantify how much. This failure is a warning for other **[(2011) Vol 17:4 NZJTLP 480, 497]** taxpayers of the importance of substantiating any alternative reconstruction with the necessary evidential foundation.

6.2 *Glenharrow*

The contemporaneous Supreme Court decision in *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* involved the sale of a mining licence (previously purchased for $10,000) for $45 million. The taxpayers paid only $220,000 of that amount over the period of the licence but immediately claimed a GST input tax credit for the full purchase price. After finding that the arrangement avoided tax, the High Court permitted the taxpayers an input tax credit for the market value of the mining licence. On appeal, neither the Court of Appeal nor the Supreme Court permitted that reconstruction, limiting the input credit to the amount actually paid. The Supreme Court explained:

> "The Commissioner has a discretion in this respect. He chose to exercise it by treating the deposit as the only payment made by *Glenharrow* in the taxable period in respect of which the refund was claimed and allowed a refund of the tax fraction of that payment. That, it seems to us, was an entirely proper exercise of the discretion. It was in accordance with the reality of what had occurred during that period."

6.3 *Penny and Hooper*

The *Penny and Hooper* case included almost no consideration of the tax advantage enjoyed by the taxpayers under their arrangements. Perhaps, that simply reflects that the Commissioner's reconstruction was appropriate. From the outset, the Commissioner decided not to void the whole arrangement and tax the surgeons on the entire business profit but simply to adjust the amount of salary paid to the surgeons. Ultimately, this reconstruction was upheld by the Supreme Court, which found that only the non-market salary (and not the taxpayer's structure itself) constituted tax avoidance.

Interestingly, that was the same reconstruction as adopted on very similar facts in *Case W33* (known as the "dentist trust case"). In that case, the Commissioner's original reconstruction had annihilated the taxpayer's structure and assessed the entire business profit to the dentist. However, Judge Barber rejected that reconstruction on the grounds that it went further than was necessary to counteract the tax advantage enjoyed by the taxpayer under the arrangement.

> "The Commissioner readjusted income under s 99(3) to tax to the dentist disputant *all* the profit from the dentistry practice. In my view, the Commissioner should merely have taxed the dentist at a salary level of $120,000, rather than on all the said dentistry profits or on the actual $80,000 paid him by the corporate trustee."

[(2011) Vol 17:4 NZJTLP 480, 498]

Significantly, *Case W33* is the only instance in which the court has interfered with the Commissioner's reconstruction:

> "In the present case, the Commissioner treated the income of the trust under the restructuring as the income of the taxpayer. That seems to me to go too far. … I consider that not all income of the trading trust should have been treated as income of the disputant dentist. This scheme went off the rails from a taxation point of view because the salary of the disputant dentist was fixed too low at $80,000 per annum and should have been fixed at approximately $120,000 per annum."

Based on that approach, the TRA concluded:

> "In my view, the Commissioner should merely have taxed the dentist at a salary level of $120,000, rather than on all the said dentistry profits … In terms of s 99(2) the trading trust arrangement is void against the Commissioner, but under s 99(3) the income of both the objectors is to be adjusted so as to counteract any tax advantage obtained by them. In my view, it is not appropriate to annihilate the new structure for tax purposes but it needs to be made appropriate for tax purposes ie made into a new arrangement which does not involve tax avoidance."

The correctness of that aspect of the TRA's decision was implicitly endorsed in *Penny and Hooper*. Unfortunately, the underlying reasoning has not been followed in later cases.

6.4 The Structured Finance Cases

The structured finance litigation concerned the correct tax treatment of a number of "repo deals" entered into by the major trading banks. Under the deals, a bank would deduct its cost of borrowing, the guarantee fee paid to the counterparty and the net cost of the interest rate swap, while treating the distributions from the issuer as either exempt or relieved from tax.

The High Court ruled in favour of the Commissioner in both substantive challenges, finding that the arrangements constituted tax avoidance. By way of reconstruction, the Commissioner denied all deductions under the arrangements, including the interest costs actually incurred. The banks argued that the reconstruction was excessive; these High Court judgments contain the most detailed consideration of the proper reconstruction. In particular, the banks put forward alternative reconstructions that denied deduction of the GPF but still permitted deduction of the interest costs. The bank's argument was explained by Wild J in *BNZ* as follows:

> "… if the pricing of the GAR/GPFs and swaps was outside a reasonable range of values, the prices should only be

disallowed to the extent that they were outside market parameters. If I found that the guarantee fees were not an expense incurred as a matter of 'commercial reality', the BNZ conceded they should be disallowed, but that should not affect the deductibility of the Bank's funding costs."

In *Westpac*, Harrison J rejected an alternative reconstruction that re-priced or simply omitted the GPF, concluding: **[(2011) Vol 17:4 NZJTLP 480, 499]**

> "the Commissioner is not required to postulate an alternative beneficial transaction into which the taxpayer might have entered but did not do so."

Later, Harrison J explained:

> "[The Commissioner] is not under any further duty to determine precisely what constitutes the tax avoidance or identify a particular aspect giving rise to a tax advantage. To the extent that he may be under such an obligation, the Commissioner's reassessment manifests his satisfaction that the tax advantages he counteracts are the same as those identified by [the bank itself] – the deductions for funding costs including swap losses and the GPF. … the Commissioner is not bound to isolate out and counteract only particular elements giving rise to a tax advantage."

Focusing particularly on the GPF, his Honour declined to compare the actual tax avoidance arrangement with a non-offending "transaction that the parties 'could in all commercial likelihood have entered into' without the GPF." His Honour concluded that such an alternative transaction was unlikely and, therefore, could not displace the Commissioner's own reconstruction.

Unfortunately for the banks, their own staff had repeatedly calculated the "benefit" or "profit" under the repo transactions by reference to the funding cost incurred by the banks. Accordingly, the Commissioner's own reconstruction merely piggy-backed on that approach and was, therefore, difficult for the taxpayer to displace. As a result, Harrison J in *Westpac* concluded:

> "While only the GPF was unlawfully deducted … none of the deductions would have been generated without completion of the transaction as a whole. All its elements were integral. The bank was able to set-off or deduct all expenses against its other New Zealand income as a result."

Of most concern to taxpayers was Harrison J's statement that s GA 1 is not limited to denying deductions only to the extent to which they are found to be non-market:

> "I disagree with Mr Green that … the general anti-avoidance provision was not applicable to the extent of the amount of a deduction which was at an actual arm's length market value. … The Commissioner has determined that Westpac's tax advantage was, as noted, for all deductions claimed on Koch. As I have found, he is not obliged to sever off part of a deduction on the basis that the expense might hypothetically have been incurred if the GPF was fixed at a market rate."

Based on that reasoning, the High Court in both cases confirmed the Commissioner's reconstruction and disallowed the banks' financing costs.

In the JG Russell template cases, the reconstruction denied a deduction for actual payments made by taxpayers to a third party, but those payments were uncommercial and had been paid as a fee to the promoter of the arrangement. However, the reconstruction in the structured finance cases went further, and is the first instance in which a market-value expense actually paid by the taxpayer to a third **[(2011) Vol 17:4 NZJTLP 480, 500]** party had been denied under s GA 1. Perhaps, this aspect of the judgment above all others caused most disquiet among commentators:

> "The consequence of this approach is that the consequences for the taxpayer (in terms of disallowance of the claimed tax

consequences) may be entirely disproportionate to the extent of the alleged tax avoidance."

6.5 *Krukziener*

The case that most highlights the problem of "over-reconstruction" is *Krukziener v Commissioner of Inland Revenue*. That case involved interest-free loans to a property developer from his various companies and trusts. Despite overseeing a number of profitable developments, the developer was paid only a minimal salary for his services. The developer funded his rather lavish lifestyle with drawings from his current accounts with his companies and trusts, which were financed by external lenders at commercial interest rates but on-lent to him interest-free.

Upholding the TRA decision in *Case Z23*, the High Court found that the arrangement constituted tax avoidance on the grounds that the interest-free loans made to the taxpayer were entirely uncommercial. The High Court also confirmed the Commissioner's reconstruction recharacterising those loans as income to the developer. That reconstruction is arguably incorrect for a number of reasons.

First, it is noteworthy that the High Court judgment is entirely silent on the question of the proper reconstruction. There is neither an examination of what "tax advantage" the taxpayer had gained under the arrangement, nor any consideration of what "hypothetical situation" the arrangement was measured against. Instead, having upheld the allegation of tax avoidance, the High Court simply confirmed the Commissioner's reconstruction without any further analysis.

Second, the Court confirmed that there was nothing inherently wrong with proprietors of a business drawing funds from their current accounts to fund their lifestyle. Instead, the problem was both the amount of the drawings (more than $3 million) and how long they remained outstanding (more than 10 years). As a result, it was not the loan arrangements themselves but the way in which they were used that constituted tax avoidance.

Finally, the real "tax advantage" under the arrangement was not the enjoyment of the loans by the taxpayer but their interest-free nature. Borrowing funds provides no immediate tax benefit as those sums, which must be repaid, are not income. If those loans ceased to be repayable, then they would become "debt remission income" under the financial arrangement rules. Yet in the *Krukziener* case, part of the loans had already been repaid and the rest still remained payable. Instead, it was the fact that the taxpayer paid no interest on those loans that constituted the real benefit. On that analysis, reconstructing the arrangement to treat the loans (including the amount already repaid) as income appears unjustifiably excessive.

[(2011) Vol 17:4 NZJTLP 480, 501]

A proper reconstruction should have focused upon the true nature of the "tax advantage" enjoyed by the taxpayer under the arrangement, being the ability to borrow large sums over a long period without the obligation to pay interest. Interest-free loans made available to employees (as a fringe benefit) or to shareholders (as a dividend) are already adequately taxed in virtually all circumstances. Only because this taxpayer deliberately provided those interest-free loans through a trading trust did they not attract a tax liability. Had those loans been taxed as a fringe benefit or a dividend, there simply would have been no tax avoided. And that is the obvious and common "hypothetical situation" the Commissioner and the Court should have used for the purpose of quantifying the tax advantage enjoyed under the arrangement. In those circumstances, s GA 1 ought to have imposed tax on the amount of interest not charged to the taxpayer, as that reconstruction would have fully counteracted the tax advantage he enjoyed. By contrast, the reconstruction actually imposed was unreasonably punitive.

6.6 *Alesco*

The most recent case to consider the appropriateness of the Commissioner's reconstruction was *Alesco New Zealand Ltd v Commissioner of Inland Revenue*. In that case, the Australian parent company elected to fund its wholly-owned New Zealand subsidiary using hybrid optional convertible notes ("OCN"). Under Determination G22, those OCNs gave rise to a deemed interest deduction for the New Zealand subsidiary without requiring any actual interest payment to its Australian parent. This arrangement ensured that non-resident withholding tax (NRWT) was not charged in New Zealand nor was the Australian parent liable for tax upon that deemed interest. That form of inter-group financing was found by Heath J to be "an artificial device" and having "the absence of any economic or commercially rational basis". The arrangement therefore breached parliamentary contemplation and was void against the Commissioner. In reaching that conclusion, Heath J placed great emphasis on "the economic reality of the transaction." Significantly, when considering the appropriate reconstruction to counteract the tax advantage, his Honour found:

> "It was always intended that real money would flow from Alesco Corp to Alesco NZ. That could have been achieved in a number of ways – for example, by capital injection, a loan at market value interest rates, an interest free loan or an 'unbundled' transaction involving elements of debt and equity."

The taxpayer therefore argued that if the OCNs were an impermissible form of intergroup financing, then the next most likely alternative under s GA 1(4) was a loan at market value. Interestingly, such a loan would have actually generated greater interest deductions to the New Zealand subsidiary than were deemed for the OCN under Determination G22 (even if those interest payments then incurred an NRWT liability and were taxable to the parent in Australia). However, Heath J rejected that argument **[(2011) Vol 17:4 NZJTLP 480, 502]** on the grounds that a reconstruction could not be permitted to put the taxpayer in a better position than that which it obtained under the arrangement.

Unfortunately, while his Honour refused to accept the taxpayer's proposed hypothetical alternative, his Honour did not himself identify a better alternative. His Honour simply denied all interest deductions without explaining why none of the alternative financing options involving interest payments were appropriate. Instead, the Court appears to have reconstructed the arrangement on the basis that the funds were simply advanced interest-free.

This reconstruction is questionable on two grounds. First, there was no evidence that the parties ever considered providing the finance on this basis. In effect, the Commissioner and the Court have adopted a hypothetical reconstruction of the arrangement that the parties themselves never contemplated. Second, as a matter of law, it is doubtful that an interest-free loan was even a permissible alternative as inter-group financing on that basis would almost certainly constitute transfer pricing in breach of ss GC 6 to GC 14 of the Income Tax Act 2007. Accordingly, this reconstruction does not appear to conform to the requirement in s GA 1(4) that the reconstruction should impose the proper tax position the taxpayer would have or would likely have had if the arrangement had not occurred.

7.0 THE EQUIVALENT AUSTRALIAN APPROACH TO RECONSTRUCTION

The Australian GAAR in Part IVA of the Income Tax Assessment Act 1936 (Cth) includes an equivalent power of reconstruction in s 177F. That section allows the Commissioner to counteract any tax benefit obtained under a tax avoidance arrangement. Section 177C requires that the "tax benefit" to be countered be measured according to a comparison with:

> "the assessable income of the taxpayer … where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer … if the scheme had not been entered into or carried out."

That wording is very similar to s GA 1(4) of the Income Tax Act 2007. Accordingly, the interpretation and application of that provision by the Australian courts provides assistance with the approach to be taken in New Zealand.

Firstly, the Australian courts have uniformly required that the determination of tax avoidance and the quantification of the resulting tax benefit must be consistent. The Australian Commissioner cannot allege that tax has been avoided on one basis and then attempt to reconstruct that arrangement on another basis. This requirement for consistency was made clear by the Australian High Court in *Peabody*. That case also held that the existence of a tax benefit must be established as an objective fact based on what the taxpayer would reasonably have done but for the offending arrangement. The High Court explained:

> "A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable."

[(2011) Vol 17:4 NZJTLP 480, 503]

That approach allows the taxpayer to prove, on a reasonable expectation, that there is no tax benefit or that it is less than that determined by the Commissioner.

The most recent case to consider this question was the Full Federal Court decision in *RCI Pty Ltd v Federal Commissioner of Taxation*. That case involved a complex international corporate restructuring that produced a tax benefit in Australia. The

Commissioner alleged that the entire arrangement constituted a tax avoidance arrangement and denied the Australian tax benefit. However, the taxpayers produced substantial evidence showing the significant genuine commercial benefits that accrued to the international group from the restructuring. The taxpayers also showed that the group had considered a number of different restructuring options that each achieved those commercial benefits but produced different tax consequences in Australia – yet none of those proposals included the alternative used by the Commissioner in his reconstruction. Put simply, the taxpayers claimed that there were a number of different options for achieving their commercial outcome but none of those options included the one relied on by the Commissioner.

In support of its reconstruction, the Commissioner argued:

> "[W]e submit our submission is reasonable … We don't say it is the only counterfactual. We don't even say it is necessar[ily] the most probable counterfactual, but it meets the threshold."

This approach followed the arguments raised in the earlier *AXA* case, in which the Commissioner had argued that he was not bound to measure the tax benefit according to what the taxpayer itself was likely to have done but, instead, was obliged only to reconstruct the arrangement on any reasonable basis. There, the Commissioner submitted that:

> "[I]t is enough if it might reasonably be expected that the amount would be included in the assessable income in the sense that there might be a number of reasonable expectations and it is sufficient if, on any one of those, the amount would have been included in the assessable income."

The approach of the Commissioner was rejected in both *AXA* and *RCI*. The quantum of the tax benefit is a question of fact, so taxpayers can lead evidence as to what alternative arrangements they may (or may not) have entered into. The Court in *RCI* explained that the taxpayer:

> "has not established that the Commissioner's counterfactual is unreasonable, but that is not the statutory question. … the statutory question is one for objective enquiry and determination – what the taxpayer might reasonably be expected to have done if it had not entered into the scheme."

Significantly, the Court in *RCI* stressed that such evidence must be clear and contemporaneous if it is to amount to anything more than pure speculation. However, the Court admitted the possibility that:

> "the absence of any tax benefit obtained in connection with the scheme might be established by demonstrating the illogicality of the taxation consequences upon which the Commissioner's counterfactual is predicated."

[(2011) Vol 17:4 NZJTLP 480, 504]

Based on the taxpayer's compelling contemporaneous evidence, the Court accepted that the Commissioner's counterfactual was reasonable but, nevertheless, was not as likely as the various alternatives actually considered by the taxpayer when it entered into the arrangement. Accordingly, the reconstruction proposed by the Commissioner could not stand.

8.0 CONCLUSION

While there has been detailed and repeated consideration of the application of the GAAR in New Zealand in recent years, there has been comparatively little examination of the operation of the resulting power of reconstruction. The few courts that have considered the matter have adopted inconsistent reasoning and often paid scant attention to the actual wording of s GA 1. In contrast with the approach in Australia, the New Zealand courts have apparently refused to require the Commissioner to quantify the "tax advantage" under the arrangement by reference to a "hypothetical situation". As a result, there seems to be no clear basis (and apparently no restriction) on the Commissioner's ability to counteract the offending arrangement, including any non-offending aspects.

The approach applied in recent cases both gives too much discretion to the Commissioner in exercising the power of reconstruction and introduces further elements of uncertainty into an already difficult area. That uncertainty has led a group of prominent commentators to call for a statutory reform of s GA 1:

> "We recommend that section GA 1 be amended to clarify that the tax advantage to be counteracted by Inland Revenue must be commensurate with the relevant tax avoidance. … Such an amendment is necessary to ensure that Inland Revenue's reconstruction power does not confer on Inland Revenue a discretion to override tax consequences not resulting from the relevant tax avoidance."

While the author agrees with that aim, it is argued that an amendment of s GA 1 is not required. If applied correctly, then the current section would require the Commissioner to properly identify the tax advantage enjoyed by the taxpayer to ensure that only that benefit is counteracted. Unfortunately, neither the Commissioner nor the courts have so far approached the section with the required level of discipline.

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FOOTNOTES

1 This is the terminology and conclusion reached by Craig Elliffe and Jess Cameron "The Test for Tax Avoidance in New Zealand: A Judicial Sea Change" (2010) 16 NZBLQ 440.

2 For statistics on the volume of tax avoidance litigation, see Mark Keating and Kirsty Keating "Tax Avoidance in New Zealand: The Camel's Back that Refuses to Break!" (2011) 17 New Zealand Journal of Taxation Law and Policy 115.

3 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[2008] NZSC 115, [2009] 2 NZLR 289, (2009) 24 NZTC 23,188 at 321-325, 23,205-23,207, [71]-[83].

4 *Peate v Federal Commissioner of Taxation*(1966) 116 CLR 38 at [55].

5 Ibid, at [22].

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

7 Ibid, at 596.

8 *Commissioner of Inland Revenue v Gerard*[1974] 2 NZLR 279 (CA).

9 *Commissioner of Inland Revenue v Gerard*[1974] 2 NZLR 279 (CA) at 280-281.

10 *Challenge Corp Ltd v Commissioner of Inland Revenue*[1986] 2 NZLR 513, (1986) 8 NZTC 5,001, (1985) 9 TRNZ 81 (CA) at 547, 5,019, 99.

11 Amended by s 8 of the Land and Income Tax Amendment Act (No 2) 1974.

12 Income Tax Act 2007, s GA 1(2).

13 *Challenge Corp Ltd v Commissioner of Inland Revenue*, above n 10, at 548, 5,019, 101.

14 Inland Revenue "Explanation to the Application of Section 99 of the Income Tax Act 1976" (1990) 1(8) Tax Information Bulletin, Appendix C at 1.

15 Inland Revenue "Explanation to the Application of Section 99 of the Income Tax Act 1976" (1990) 1(8) Tax Information Bulletin, Appendix C at 1.

16 Inland Revenue *Interpretation of Sections BG 1 and GB 1 of the Income Tax Act 2004* (Wellington, 2004) at 65, [5.1.2]-[5.1.3].

17 For example, see Garth Harris and others *Income Tax in New Zealand* (Thomson Brookers, Wellington, 2004) at [26.8.2]. However, see the contrary view expressed by Justice G Tony Pagone "Aspects of Tax Avoidance: Trans-Tasman Observations" (paper presented to International Fiscal Association Conference, Wellington, March 2011). His Honour stated: "It is a legislative

feature of the anti avoidance provisions both in Australia and in New Zealand that tax is imposed through the anti avoidance provisions where tax would not otherwise be payable. The anti avoidance provisions themselves impose tax and not merely operate to make the other provisions operate." While, practically, this imposition of additional tax may be the consequence of the operation of the GAAR, as a matter of law any new tax liability under the subsequent reassessment arises under the (now applicable) black-letter law.

18 Any altered interpretation based on the change in wording in s BG 1 and/or s GA 1 runs contrary to the savings provisions in s ZA 3, which stipulate that the Income Tax Act 2007 contains "the provisions of the Income Tax Act 2004 in rewritten form, and are intended to have the same effect as the corresponding provisions". The revised wording in s GA 1 is not included in sch 51 to the Income Tax Act 2007, which identifies the small number of intended changes in the Income Tax Act 2007.

19 Emphasis added.

20 This view was advanced by the Commissioner in *Alesco New Zealand Ltd v Commissioner of Inland Revenue*HC Auckland CIV-2009-404-2145, CIV-2009-404-4528, CIV-2010-404-4693, CIV-2011-404-4025, 12 December 2011 at [48(a)].

21 Inland Revenue *Interpretation of Sections BG 1 and GB 1 of the Income Tax Act 2004* (Wellington, 2004) at 69, [5.4.4].

22 Inland Revenue, above n 21, at 69-70, [5.4.7]-[5.4.8].

23 Any altered interpretation runs contrary to the savings provisions in s YB 4(3) of the Income Tax Act 1994, which stipulated that the changes in wording used in that Act "are not intended to affect the interpretation or effect of the provisions of the Income Tax Act 1976".

24 *Peterson v Commissioner of Inland Revenue (No 2)*(2002) 20 NZTC 17,761 (HC) at 17,774, [70].

25 *Miller v Commissioner of Inland Revenue (No 1)*(1997) 18 NZTC 13,001 (HC) at 13,036.

26 *Westpac Banking Corp v Commissioner of Inland Revenue*(2009) 24 NZTC 23,834 (HC) at 23,942, [625].

27 *Beckham v Commissioner of Inland Revenue*[2008] NZCA 301, (2008) 23 NZTC 22,066.

28 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[2008] NZSC 115, [2009] 2 NZLR 289, (2009) 24 NZTC 23,188 at 345, 23,222, [171].

29 *Buckley & Young Ltd v Commissioner of Inland Revenue*[1978] 2 NZLR 485, (1978) 3 NZTC 61,271, (1978) 2 TRNZ 485 (CA).

30 This approach is consistent with that applied in Australia; see *Deputy Federal Commissioner of Taxation v Richard Walter Pty Ltd*(1995) 183 CLR 168, 29 ATR 644, 94 ATC 4067; and *Federal Commissioner of Taxation v Stokes*34 ATR 478, 97 ATC 4001 (FCA).

31 *Case Z19*(2009) 24 NZTC 14,217 (TRA) at 14,237, [95].

32 *Alesco New Zealand Ltd v Commissioner of Inland Revenue*HC Auckland CIV-2009-404-2145, CIV-2009-404-4528, CIV-2010-404-4693, CIV-2011-404-4025, 12 December 2011.

33 Ibid, at [151]-[152].

34 Ibid, at [160].

35 *Accent Management Ltd v Commissioner of Inland Revenue (No 2)*(2007) 23 NZTC 21,366 (CA).

36 *BNZ Investments Ltd v Commissioner of Inland Revenue*(2000) 19 NZTC 15,732 (HC).

37 Ibid, at 15,811, [169].

38 *Commissioner of Inland Revenue v BNZ Investments Ltd*[2002] 1 NZLR 450, (2001) 20 NZTC 17,103 (CA) at 497, 17,142, [175]. See also the reasoning of the majority at 465-467, 17,117-17,118, [50]-[55].

39 *Commissioner of Inland Revenue v Peterson*[2003] 2 NZLR 77, (2003) 21 NZTC 18,060 (CA) at 86, 18,068, [44].

40 *Peterson v Commissioner of Inland Revenue*[2006] 3 NZLR 433, (2005) 22 NZTC 19,098 (PC) at 444, 19,108-19,109, [34].

41 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[2008] NZSC 115, [2009] 2 NZLR 289, (2009) 24 NZTC 23,188 at 344, 23,222, [168].

42 *Commissioner of Inland Revenue v Peterson*[2003] 2 NZLR 77, (2003) 21 NZTC 18,060 (CA) at 86, 18,068, [44].

43 *Miller v Commissioner of Inland Revenue*[2001] 3 NZLR 316 (PC) at 331, [31], also reported as *O'Neil v Commissioner of Inland Revenue*(2001) 20 NZTC 17,051 (PC) at 17,061, [31].

44 *Miller v Commissioner of Inland Revenue*[1995] 3 NZLR 664, (1995) 17 NZTC 12,341 (CA) at 672, 12,348.

45 *Miller v Commissioner of Inland Revenue*(1997) 18 NZTC 13,001 (HC) at 13,045-13,046.

46 *Miller v Commissioner of Inland Revenue*, above n 43, at 332, [31], also reported as *O'Neil v Commissioner of Inland Revenue*, above n 43, at 17,061, [31].

47 *Miller v Commissioner of Inland Revenue*[1999] 1 NZLR 275, (1998) 18 NZTC 13,961 (CA) at 292, 13,972-13,973.

48 *Miller v Commissioner of Inland Revenue*[2001] 3 NZLR 316 (PC), also reported as *O'Neil v Commissioner of Inland Revenue* (2001) 20 NZTC 17,051 (PC).

49 For example, see *Richard Walter Pty Ltd v Federal Commissioner of Taxation*96 ATC 4550; *Federal Commissioner of Taxation v Futuris Corp Ltd*2008 ATC 20-039; and *ANZ Banking Group Ltd v Federal Commissioner of Taxation*2003 ATC 5041.

50 *Russell v Commissioner of Inland Revenue*(2010) 24 NZTC 24,463 (HC). [Editor's note: The appeal to the Court of Appeal was dismissed in a decision issued on 19 April 2011: *Russell v Taxation Review Authority*[2011] NZCA 158, (2011) 25 NZTC ¶20-044, [2011] NZAR 310.]

51 See *Miller v Commissioner of Inland Revenue*[1999] 1 NZLR 275, (1998) 18 NZTC 13,961 (CA).

52 Ibid, at 304, 13,981-13,982.

53 The title to s GA 1(4) is "Commissioner's Identification of Hypothetical Situation".

54 *Miller v Commissioner of Inland Revenue*, above n 48, at 329, [22], also *O'Neil v Commissioner of Inland Revenue*, above n 48, at 17,059, [22].

55 *Gulland v Federal Commissioner of Taxation*(1985) CLR 55 at 81.

56 *Miller v Commissioner of Inland Revenue*, above n 51, at 301, 13,980.

57 *BNZ Investments Ltd v Commissioner of Inland Revenue*(2000) 19 NZTC 15,732 (HC) at 15,810, [164].

58 *Commissioner of Inland Revenue v BNZ Investments Ltd*[2002] 1 NZLR 450, (2001) 20 NZTC 17,103 (CA).

59 *Alesco New Zealand Ltd v Commissioner of Inland Revenue*HC Auckland CIV-2009-404-2145, CIV-2009-404-4528, CIV-2010-404-4693, CIV-2011-404-4025, 12 December 2011 at [153].

60 As defined in s YA 1 of the Income Tax Act 2007.

61 *Lowe v Commissioner of Inland Revenue*[1981] 1 NZLR 326, (1981) 5 NZTC 61,006, (1981) 4 TRNZ 233 (CA) at 348, 61,026, 255.

62 Curiously, that term was previously defined in the former GST GAAR in s 76(4) but was repealed in 2000 when the GST GAAR was rewritten to mirror that found in the Income Tax Act.

63 *BNZ Investments Ltd v Commissioner of Inland Revenue*(2000) 19 NZTC 15,732 (HC) at 15,809, [161].

64 Inland Revenue *Interpretation of Sections BG 1 and GB 1 of the Income Tax Act 2004* (Wellington, 2004) at 68, [5.3.4]-[5.3.5] (emphasis added).

65 Ibid, at 70-71, [5.1.2]-[5.1.6].

66 Ibid, at 71, [5.1.7].

67 *BNZ Investments Ltd v Commissioner of Inland Revenue*(2000) 19 NZTC 15,732 (HC) at 15,815, [199]-[200].

68 As suggested by Judge Barber in *Case Z19*(2009) 24 NZTC 14,217 (TRA) at 14,258, [224].

69 Inland Revenue *Interpretation of Sections BG 1 and GB 1 of the Income Tax Act 2004* (Wellington, 2004) at 72, [5.1.11].

70 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[2008] NZSC 115, [2009] 2 NZLR 289, (2009) 24 NZTC 23,188 at 345, 23,222, [169].

71 Inland Revenue, above n 69, at 73, [5.1.13].

72 *BNZ Investments Ltd v Commissioner of Inland Revenue*, above n 67, at 15,810, [164].

73 *Peabody v Federal Commissioner of Taxation*(1994) 181 CLR 359 at 385.

74 In *Ben Nevis*, only three of 219 paragraphs; in *Glenharrow*, only one of 56 paragraphs; in *Penny and Hooper*, nil paragraph.

75
See CCH Australian Federal Tax Reporter (ITAA 1936 & Others) at 81-265, which reviews a number of Australian cases demonstrating this attitude.

76
See the discussion on the courts' continued refusal to provide certainty in Mark Keating and Kirsty Keating "Tax Avoidance in New Zealand: The Camel's Back that Refuses to Break" (2011) 17 New Zealand Journal of Taxation Law and Policy 115.

77 Taxation Committee of the New Zealand Law Society, Corporate Taxpayers Group and Taxation Committee of the New Zealand Institute of Chartered Accountants "Improving the Operation of New Zealand's Tax Avoidance Laws" (October 2011) at 2, [1.4(a)(i)].

78 See the full analysis and discussion of that judgment in Craig Elliffe and Mark Keating "Tax Avoidance – Still Waiting for Godot?" (2009) 23 NZULR 368.

79 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*[2008] NZSC 115, [2009] 2 NZLR 289, (2009) 24 NZTC 23,188, upholding the decisions in *Accent Management Ltd v Commissioner of Inland Revenue*[2007] NZCA 230, (2007) 23 NZTC 21,323 and *Accent Management Ltd v Commissioner of Inland Revenue*(2005) 22 NZTC 19,027 (HC).

80 *Accent Management Ltd v Commissioner of Inland Revenue*[2007] NZCA 230, (2007) 23 NZTC 21,323 at 21,359, [152].

81 Ibid, at 21,359, [155].

82 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*, above n 79, at 345, 23,222, [170].

83 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*, above n 79, at 345, 23,222, [171].

84 *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*[2008] NZSC 116, [2009] 2 NZLR 359, (2009) 24 NZTC 23,236.

85 Again, see the full analysis and discussion of that judgment in Craig Elliffe and Mark Keating "Tax Avoidance – Still Waiting for Godot?" (2009) 23 NZULR 368.

86 *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*(2005) 22 NZTC 19,319 (HC).

87 *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*, above n 84, at 383, 23,249, [55].

88 *Penny v Commissioner of Inland Revenue*[2011] NZSC 95, (2011) 25 NZTC ¶20-073.

89 *Case W33*(2004) 21 NZTC 11,321 (TRA).

90 Ibid, at 11,334, [75].

91 Ibid, at 11,331, [51]-[52].

92 Ibid, at 11,334, [75]-[76].

93 Under s CB 10 or s LC 1 of the Income Tax Act 2004.

94 *BNZ Investments Ltd v Commissioner of Inland Revenue*(2009) 24 NZTC 23,582 (HC) and *Westpac Banking Corp v Commissioner of Inland Revenue*(2009) 24 NZTC 23,834 (HC).

95 *BNZ Investments Ltd v Commissioner of Inland Revenue*, above n 94, at 23,675, [533].

96 *Westpac Banking Corp v Commissioner of Inland Revenue*, above n 94, at 23,942, [623].

97 *Westpac Banking Corp v Commissioner of Inland Revenue*, above n 94, at 23,946, [639] and [641].

98 *Westpac Banking Corp v Commissioner of Inland Revenue*, above n 94, at 23,948, [655].

99 See the similar reasoning and conclusion reached by Wild J on this point in *BNZ Investments Ltd v Commissioner of Inland Revenue*, above n 94, at 23,676, [538]-[540].

100 *Westpac Banking Corp v Commissioner of Inland Revenue*, above n 94, at 23,946, [641]. See a similar finding in *BNZ Investments Ltd v Commissioner of Inland Revenue*, above n 94, at 23,676, [539]-[540].

101 *Westpac Banking Corp v Commissioner of Inland Revenue*, above n 94, at 23,950, [664] and [667].

102 *Miller v Commissioner of Inland Revenue*[1999] 1 NZLR 275, (1998) 18 NZTC 13,961 (CA) at 304, 13,981-13,982.

103 Taxation Committee of the New Zealand Law Society, Corporate Taxpayers Group and Taxation Committee of the New Zealand Institute of Chartered Accountants "Improving the Operation of New Zealand's Tax Avoidance Laws" (October 2011) at 29, [4.15].

104 *Krukziener v Commissioner of Inland Revenue (No 3)*(2010) 24 NZTC 24,563 (HC).

105 *Case Z23*(2010) 24 NZTC 14,334 (TRA).

106 *Krukziener v Commissioner of Inland Revenue (No 3)*, above n 104, at 24,575, [52].

107 *A Taxpayer v Commissioner of Inland Revenue*(1997) 18 NZTC 13,350 (CA).

108 See s EW 29(9) of the Income Tax Act 2007.

109 Under s CZ 10 of the Income Tax Act 2007.

110 Under ss CD 4 and CD 39 of the Income Tax Act 2007.

111 Being "distributions from a complying trust" under s HC 20 of the Income Tax Act 2007.

112 *Alesco New Zealand Ltd v Commissioner of Inland Revenue* , , , .

113 Ibid, at [147(b)].

114 Ibid, at [124].

115 Ibid, at [131].

116 Ibid, at [107].

117 "It is doubtful whether Heath J is correct that 'an interest free loan' was actually a permissible option for this inter-group financing as it would constitute transfer pricing in breach of ss GC 6 to GC 14 of the Income Tax Act 2007.

118 See s 177C(1)(a) of the Income Tax Assessment Act 1936 (Cth).

119 *Federal Commissioner of Taxation v Peabody*28 ATR 344.

120 Ibid, at 353.

121 For example, see *Federal Commissioner of Taxation v Trail Bros Steel & Plastics Pty Ltd*(2010) 186 FCR 410; and *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd*(2010) 189 FCR 204.

122 *RCI Pty Ltd v Federal Commissioner of Taxation*2011 ATC ¶20-275.

123 Ibid, at [132].

124 *Federal Commissioner of Taxation v AXA Asia Pacific Holdings Ltd*, above n 121.

125 *RCI Pty Ltd v Federal Commissioner of Taxation*, above n 122, at [140].

126 *RCI Pty Ltd v Federal Commissioner of Taxation*, above n 122, at [136].

127 For statistics on the volume of tax avoidance litigation, see Mark Keating and Kirsty Keating "Tax Avoidance in New Zealand: The Camel's Back that Refuses to Break!" (2011) 17 New Zealand Journal of Taxation Law and Policy 115.

128 Taxation Committee of the New Zealand Law Society, Corporate Taxpayers Group and Taxation Committee of the New Zealand Institute of Chartered Accountants "Improving the Operation of New Zealand's Tax Avoidance Laws" (October 2011) at 29, [4.17].