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If You Don't Use It You Lose It — s 76 GST Act 1985: The Under-Used Anti-Avoidance Provision

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The general anti-avoidance provision of the Goods and Services Tax Act 1985 has never been successfully applied by Inland Revenue. In the 11 years since GST was first introduced, s 76 has been the most under-used section of the Act. Although judges have argued for its use against seeming tax avoidance arrangements, its exact scope and application remain uncertain. This article examines the elements that make up s 76 and compares s 76 to the general anti-avoidance provision in the Income Tax Act 1994. It discusses how s 76 may be applied and the likelihood of its success against arrangements to avoid GST.

1 INTRODUCTION

The general anti-avoidance provision of the Goods and Services Tax Act 1985 ("the Act") is contained in s 76. That section renders void against the Commissioner arrangements entered into to defeat the intent or application of the Act. Section 76 is intended to protect Government revenue from tax avoidance devices. To achieve this aim s 76 is drafted in general form without reference to specific tax avoidance devices or arrangements. The section is not an independent charging provision, except so far as s 76(1) permits the Commissioner to adjust the amount of tax payable to counteract the tax avoidance arrangement. Instead, the section protects the liability to goods and services tax created under other provisions of the Act. In effect, it supports the more specific provisions of the Act to prevent their frustration by arrangements that would avoid their impact.

Despite the intended policy behind the section, there is little agreement as to its scope and application. The conflicting approaches to s 76 are highlighted in the following quotes:

> "This general anti-avoidance provision [s 76] serves a similar role to section 99 of the Income Tax Act 1976."

> "In light of the different wording, the judicial interpretation of s BB 9 does not appear to be of assistance to the interpretation of [s 76]."

This article will address the role and scope of s 76 as the general anti-avoidance provision of the Act. It will identify the previous application of s 76 and its consideration by the Courts. The article will then analyse the section, identifying the different elements that must be established to bring a transaction within its scope. A discussion follows, encompassing the different **[(1997) Vol 3:4 NZJTLP 224, 225]** views regarding the effectiveness of the section as an anti-avoidance provision. Throughout, s 76 will be compared with the general anti-avoidance provision in s BG 1Income Tax Act 1994.

2 PREVIOUS USE OF SECTION 76

Section 76 is probably the most under-used section of the Act. In the 11 years since the Act came into force there has been only one case directly concerned with the application of s 76. That case, *Variety Leisure Corp Ltd v CIR*, questioned whether the Commissioner could wind up a company for a debt arising from a disallowed GST input credit. The Commissioner alleged that the company deliberately interposed a third party into the chain of supply so as to claim an input credit, and that this constituted an arrangement within s 76. The Commissioner went so far as to argue that he saw no other possible reason for the intermediary's presence. To this Hardie Boys J responded:

> “Whether or not this suspicion is justified I am unable to determine on the material before me, for it was aired only at the last minute … In any event, this application [to wind up the company] does not provide the appropriate method of resolving the question.”

That is the most detailed judicial analysis of s 76 to date. No other case has come before the Courts involving allegations that the taxpayer has entered into an arrangement to defeat the Act. Far from it. It appears that the Commissioner has assiduously avoided relying on s 76.

Case P75 concerned whether the purchase of assets from a business constituted the purchase by the taxpayer of a “going concern” (on which GST is not imposed) or of goods (subject to GST). In ruling in favour of the taxpayer, Judge Barber states:

> “I record that at no stage has the [CIR] endeavoured to deal with this matter as tax avoidance under s 76 of the Act. Indeed, in response to a query from me, Mr Douch has expressly disclaimed the [CIR] taking any such point.”

An even more blatant non-use of s 76 occurred in *Case R1*. In that case, concerning the use of intermediaries so as to ensure the taxpayer obtained a GST input credit, the Commissioner argued that:

- The corporate veil of the various intermediaries be lifted, so as to expose the taxpayer’s involvement in the transaction throughout; and
- The transaction with the intermediaries was a sham.

At no point did the Commissioner seek to avoid the arrangement under s 76. When ruling in favour of the taxpayer, the TRA criticised the approach adopted by Inland Revenue. Judge Willy stated:

> “I would add that it would be equally unfair to [lift the corporate veil] merely to deprive the taxpayer of some taxation advantage it secures as a result of incorporation. The Commissioner has to hand ample power to set aside instruments which defeat the intention and application of the Goods and Services Tax Act in the form of the anti-avoidance **[(1997) Vol 3:4 NZJTLP 224, 226]** provisions contained in s 76. It is not necessary to add to those powers by casting doubt on the benefits and effects of incorporation.”

Likewise in *Case P20*, Judge Barber drew attention to the Commissioner’s failure to resort to s 76 when faced with an alleged abuse of the Act. That case again concerned the use of an intermediary so as to obtain a GST input credit on the purchase of goods. After ruling in favour of the taxpayer, his Honour concluded his judgment with the following comment:

> “I have wondered about the efficacy of this decision in terms of the GST system. It does not seem satisfactory that a beneficial owner is freed from GST by using a nominee to hold assets and so make the supply … Here again is a commercial situation where a purchaser buys free of GST content but is able to obtain an immediate input credit. If nominees are used to hold goods in order to avoid GST, then the Commissioner must be able to invoke the avoidance provisions in s 76 of the Act.”

Recently, the judicial demand for the Commissioner to invoke s 76 has become more outspoken. In two recent decisions, Judge Barber was openly critical of Inland Revenue for failing to resort to s 76 against arrangements that he determined were intended by taxpayers to defeat the Act.

In *Case S83* and *Case S84* his Honour again dealt with two cases concerning the deliberate use of intermediaries so as to allow the taxpayer a GST input credit on the purchase of goods. Inland Revenue again argued the matter using only the technical sections of the legislation, electing not to invoke the reconstructive powers of s 76. When ruling in favour of both taxpayers, Judge Barber felt compelled to bring Inland Revenue to task over its refusal to resort to the general anti-avoidance provision. He stated:

> "I have misgivings that the objectors have been able to achieve this input because I think the situation should have been addressed by the respondent Department at the outset, on the basis that the objectors be deemed as registered persons … or the sale was void in terms of s 76 as an arrangement to obtain a GST advantage. I suspect that the objector's success in this case had been achieved through a technical oversight on the part of the Department's staff … I feel that the assessment [based only on the technical grounds] was misconceived and was too narrow."

This open criticism of the lack of recourse to s 76 has led some to question the relevance of an anti-avoidance provision in the GST legislation.

3 DIFFERENT APPROACHES TO SECTION 76

There is no clear or unified view within Inland Revenue or among practitioners regarding the use or effectiveness of s 76 as a tool against alleged tax avoidance arrangements. The disagreement appears to be over how closely the operation of s 76 can be aligned with that of s BG 1.

One view is that, despite the difference in wording, the two sections should be applied in the same manner: that is, by adopting an objective test of avoidance based on the predication test. This position may be summarised as follows:

> "Section 76 directs the Commissioner and the Courts to look to the scheme of the Act, and the underlying policy behind the provisions concerned. This avoids speculation as to the 'purpose' or 'intention' of the individual tax **[(1997) Vol 3:4 NZJTLP 224, 227]** payer involved. If the arrangement defeats the 'intent and application' of the Act, it is automatically void."

The other view, based on the different wording of ss BG 1 and 76, argues that s 76 must be applied as it stands, unrelated to its sister provision in the Income Tax Act 1994. This view may be summed up as follows:

> "The provision is not worded in such a way that the arrangement will be automatically void if a tax advantage can be shown to have arisen. Rather, the correct interpretation of s 76 requires the Commissioner to look at the taxpayer's purpose or intention of entering the arrangement. If Parliament had intended the section to automatically void any arrangement which provided a tax advantage or had the effect of defeating the Act, then the section would have been drafted accordingly. To argue otherwise would require that any tax advantage gained, no matter how small or innocent, would be caught by s 76 despite the fact that the arrangement had a valid business purpose."

This divergence of opinion seems to have led to paralysis — hence the judicial frustration with what appears to be Inland Revenue's refusal to use s 76 to counteract instances of apparent avoidance.

4 ELEMENTS OF SECTION 76

The core elements of s 76 are contained in subs (1). The power of the Commissioner to reconstruct the arrangement and relevant definitions are contained in subss (2) and (4). In this separation of its elements, s 76 is drafted in a similar style to its sister provision in the Income Tax Act 1994.

The key elements of s 76 are that:

- There must be an "arrangement"; and
- The arrangement must have been entered into by the taxpayer to defeat the intent and application of the Act (or any provisions thereof); and
-

- The arrangement must have defeated the Act; and
- The arrangement must have resulted in a tax advantage to the taxpayer.

Each element is discussed separately to identify the scope of s 76.

4.1 Arrangement

The term "arrangement" is defined in s 76(4). Its meaning is identical to the definition found in s OB 1Income Tax Act 1994 and applied in s BG 1 — the general anti-avoidance provision of that Act.

This definition of "arrangement" is based on the meaning given in the leading authority of *Newton v FCT*. In that case the Privy Council stated that:

> "Their Lordships are of the opinion that the word 'arrangement' is apt to describe something less than a binding contract or agreement, something of the nature of an understanding between two or more persons — a plan arranged between them which may not be enforceable at law. But it must in this section comprehend, not only the initial plan, but also all transactions by which it is carried into effect — all the transactions, that is, which have the effect of avoiding taxation, be they conveyances, transfers or anything else. It would be useless for the Commissioner to avoid the arrangement and leave the transactions still standing."

The term was considered by Eichelbaum CJ in relation to s 99Income Tax Act 1976 in the High Court decision in *Hadlee v CIR*. The scope of the "arrangement" in that case was not subsequently considered by either the Court of **[(1997) Vol 3:4 NZJTLP 224, 228]** Appeal or the Privy Council. In the High Court Eichelbaum CJ stated, with regard to the facts in that case:

> "I do not doubt that what occurred here properly comes within the definition. The assignment was one step in a package or scheme, properly seen as a 'plan', prepared for the benefit of those partners who wished to take advantage of it, encompassing the following steps:
>
> "(1. Establishment of a family trust in standard form;
>
> "(2. Incorporation of Sydney Bridge Nominees Ltd to act as trustee;
>
> "(3. Execution of the assignment."

The term "arrangement" therefore encompassed all the steps by which the taxpayer's plan is carried into effect — not merely those steps that produced the tax benefit. Thus, the Court may not divide the taxpayer's conduct into isolated steps so as to focus on the particular aspects that give rise to the tax advantage. Instead, all steps in the process must be taken into account.

One crucial difference between the scope of "arrangements" under s BG 1 and under s 76 is that an arrangement for GST purposes must have been "entered into between persons". This requirement therefore would exclude unilateral arrangements contrived by the taxpayer as they have not been entered into between persons. This requirement is not present in s BG 1 which applies both to unilateral and multilateral arrangements.

This additional requirement under s 76 is explained by reference to the nature of GST as a transaction tax. Unlike income tax (which charges tax on "taxable income"), GST charges only consideration received on the supply of goods and services. As a taxpayer cannot transact with itself, GST is only payable on supplies between taxpayers. Thus only arrangements between persons can affect a taxpayer's liability for GST.

The exclusion of unilateral arrangements is appropriate in the circumstances and does not inhibit the effectiveness of the provision. This reasoning is in line with the Court of Appeal's comments on the scope of the GST Act in *CIR v NZ Refining Co Ltd*.

"It is fundamental to the GST Act that the tax is levied on or in respect of supplies. It is not a tax on receipts or on turnover it is a tax on transactions."

4.2 Arrangement to defeat intention and application of Act

Section 76 applies only to those arrangements that the Commissioner is satisfied were "entered into … to defeat the intention and application of" the Act. This wording raises two separate issues:

- What is the test to determine whether the arrangement was "entered into to defeat" the Act?
- What is the intent and application of the Act?

4.2.1 Entered into to defeat

There is a great deal of uncertainty as to what it means for an arrangement to be "entered into … to defeat" the Act. Presumably, the wording could more precisely read either:

"An arrangement entered into in order to defeat … or"

"An arrangement entered into for the purpose / effect of defeating …"

[(1997) Vol 3:4 NZJTLP 224, 229] The question is whether there must be a subjective or objective intention by the taxpayer to defeat the Act. Must the taxpayer have deliberately intended to defeat the Act, or need this merely be the result?

4.2.2 Inland Revenue's position

Inland Revenue has never publicly addressed the question of how to establish a taxpayer's intent. However, it appears that Inland Revenue prefers the view that the taxpayer's intention should be established objectively.

This conclusion is presumably based on the comparable roles of s 76 and s 99 as general anti-avoidance provisions. The logic appears to be that only an objective test can:

- Give effect to the section as intended by Parliament; and
- Provide certainty as to how and when the section will be used.

In short, it can be argued that s 76 should be approached in the same way as s 99 — that the taxpayer's purpose be established according to the results of their conduct, not their personal motives for entering into the arrangement. Thus, the predication test established in *Newton v FCT* and applied under s BG 1 would be applied under s 76. In Newton Denning LJ stated:

"In order to bring the arrangement within the section you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labeled as a means to avoid tax, then the arrangement does not come within the section.

> ‘In applying the section you must, by the very words of it, look at the arrangement itself and see which is its effect — what it does — irrespective of the motives of the person who made it.’ ”

The predication test was expressly adopted by the Court of Appeal as applicable to New Zealand in *Tayles v CIR.*

Adopting this approach obviously has two advantages for Inland Revenue. First, it avoids needing to prove a taxpayer’s subjective motives. Secondly, it provides a degree of certainty and a wealth of case law showing how the section will be interpreted by the Courts.

4.2.3 Contrary position

Unfortunately, this position cannot be sustained. Instead, the writer proposes that s 76 adopt a subjective test of the taxpayer’s intention.

This alternative argument is based on the quite different wording of ss 76 and BG 1. While s BG 1 refers to a “tax avoidance arrangement” as being one that “has tax avoidance as its purpose or effect”, s 76 does not use those words. Instead, the section applies where an arrangement was “entered into … to defeat the intention of the Act”. With such different wording, it would be wrong to read the two sections as adopting identical tests merely because they serve the same function.

A predication test could be adopted if the section used the words “purpose or effect” but not otherwise. Rather, s 76 must be interpreted as it stands.

4.2.4 Subjective test of taxpayer’s intention

Section 76 requires that the arrangement in question was “entered into to defeat” the Act. Thus, to invoke s 76, the Commissioner must **[(1997) Vol 3:4 NZJTLP 224, 230]** demonstrate that the taxpayer entered into the arrangement “in order to” or “with the intention of” defeating the Act. This approach requires the Commissioner to prove the taxpayer’s intention on a subjective basis.

Assistance with how such intent is established may be found in other sections that adopt a subjective test of the taxpayer’s intention, such as s CD 4Income Tax Act 1994. The second limb of that section applies where the taxpayer has a subjective purpose of resale at the time the personal property was acquired. This provision has been the subject of much case law regarding the requirements for proving a taxpayer’s subjective intention.

Cases decided under s CD 4 show that a taxpayer’s purpose may be drawn from the results of their conduct. In other words, a subjective intention can be established by a mix of taxpayer evidence and objective factors. In this important respect, s 76 differs significantly from s BG 1.

4.2.5 Dominant purpose to defeat Act

A further difference between s 76 and s BG 1 is the scope of the intention required. Section BG 1 applies to any “tax avoidance arrangement” that:

- Has tax avoidance as its purpose or effect; or
- Has tax avoidance as one of its purposes or effects where the arrangement has more than one.

Furthermore, the term is drafted widely so as not to exclude arrangements with a purpose or effect of tax avoidance that results from ordinary business or family dealings. Only arrangements that have tax avoidance as a “merely incidental” effect fall outside the wide scope of the section.

By contrast, s 76 presumes a single intent “to defeat the intent or application of the Act”. On this wording, to defeat the Act must be the sole, or at least dominant, intent before the section will apply. A mixed intent or one that is less than dominant would presumably not come within the section.

This reasoning is based on authorities regarding the purpose of resale required under s CD 4. Those cases have consistently interpreted the second limb of s CD 4 as applying only to the taxpayer's dominant purpose. A subsidiary purpose or intent is not within the scope of the section.

To catch a taxpayer's non-dominant intention would require an express provision to that effect, as can be found in s CD 1(2)(a) and in s OB 1. The absence of such a provision in s 76 can only mean that a lesser intention is not caught. Arrangements that can be explained by other commercial or family motives may therefore escape s 76, even where a tax advantage was a factor (though not the dominant one) in entering into the arrangement.

It seems that only the most blatant and artificial transactions which have no commercial reality and cannot be explained on other grounds are likely to come within the section.

4.2.6 Standard and onus of proof

As with s BG 1, the standard of proof required to prove the taxpayer's intention will be the normal civil standard of the balance of probabilities.

Richardson J in *National Distributors* pointed out that, under s 36Inland Revenue Department Act 1974, the onus of proving a **[(1997) Vol 3:4 NZJTLP 224, 231]** taxpayer's intention falls on the taxpayer. At p 6,351 his Honour noted:

> "Where subjective purposes are in issue the statements of the taxpayer, or of someone who can speak for the taxpayer, are obviously important evidence. But for obvious reasons they must be assessed and tested in the totality of circumstances … Actions may speak louder than words and the totality of circumstances may negate the asserted purpose of the purchase."

Ultimately, as with all areas of tax law, the onus remains on the taxpayer to establish not only that the Commissioner's assessment is wrong but also by how much it is wrong: see *Lowe v CIR.*

4.3 To defeat the intent and application of the Act

Section 76 will apply only where the Commissioner is satisfied that the arrangement was entered into "to defeat the intent and application of the Act". Thus, a simple tax advantage alone (even if intended by the taxpayer) will not bring an arrangement within s 76. The Commissioner must prove the advantage was accrued by somehow defeating the intention and application of the Act.

The wording used in s 76 is strikingly different from that of s BG 1. Section BG 1 applies to any arrangement entered into with a purpose of "tax avoidance". That term is defined in s OB 1 as directly or indirectly:

- Altering the incidence of tax;
- Relieving any person from liability to pay tax; or
- Avoiding, reducing, or postponing any liability to tax.

In this way, s BG 1 attacks transactions that have a certain proscribed effect. If the arrangement avoids, reduces, or postpones tax, it may fall within the section.

By contrast, s 76 does not act against a proscribed effect but rather against a proscribed intention — that of defeating the intention or application of the Act. Where this is established, the Commissioner has the power to "counteract any tax advantage obtained". A tax advantage itself is not proscribed; only one that is obtained by defeating the intention and application of the Act is caught.

An arrangement may be entered into for the intention of obtaining a tax advantage but will not come within s 76 unless it was intended to defeat the Act. In this respect, s 76 differs significantly from the more direct approach adopted under s BG 1 (which appears to be based on the presumption that any tax advantage obtained must per se have arisen from the taxpayer's intention to defeat the Act).

“Defeat” can be interpreted as synonymous with “frustrate” or “render ineffective”. An arrangement must therefore have the effect of frustrating the intent or application of the Act before it may be voided by the Commissioner. In more familiar terms, s 76 permits taxpayers to bend the rules but not deliberately break them.

5 INTENT AND APPLICATION OF ACT

What is the intent and application of the Act and how may taxpayers arrange their affairs so as to defeat it?

[(1997) Vol 3:4 NZJTLP 224, 232] Unlike the Income Tax Act 1994 which contains its own purpose provisions in Part A, the Goods and Services Tax Act 1985 does not spell out its intent and application. The long title to the Act describes it as:

> “An Act to make provision for the imposition and collection of goods and services tax”

This vague statement provides little help. Instead, the intent and application of the Act must be gleaned from the scheme and purpose of the legislation itself.

A succinct and practical guide to the “scheme and purpose” approach to interpreting revenue statutes was provided by Richardson J in his paper “Appellate Court Responsibilities and Tax Avoidance” delivered at Monash University in 1964. In that paper, his Honour described the approach as follows:

> “The twin pillars on which our approach to statutes rests are the scheme of the legislation and purpose of the legislation. Consideration of the scheme of the legislation requires a careful reading in its historical context of the whole Act including the long title, analysing its structure and examining the relationship between the various provisions and recognising any discernible themes and patterns and underlying policy considerations. It presupposes that in that way the study of the statute or of a group of sections may assist in the interpretation of a particular provision in its statutory context. It may provide a detailed guide to the intentions of the framers of the legislation and in so doing may cast light on the meaning of the provision in question.”

His Honour accepted that the scheme and purpose approach may not furnish an answer to all the interpretation problems which may arise. Nevertheless, he was satisfied that the emphasis on trying to discern the scheme and purpose is likely to lead to the resolution of interpretation problems in the tax field that best reflect the intention of Parliament as expressed in the statute. See also statements on the purposive approach to interpreting revenue statutes by Richardson J in *Challenge Corp Ltd v CIR* and McKay J in *CIR v Alcan NZ Ltd.*

The starting point for determining the intent and application of the Act is the wording of the Act itself. It is Parliamentary intent, as expressed in the words of the Act, which is crucial. Thus, an examination of the provision that is allegedly being defeated is required in each instance to determine what its true intent and application should be in comparison to the manner in which it has been applied by the taxpayer.

This article is not the place to conduct a full examination of the intent and application of the Act. However, it is unusual for such an analysis to be required before a general anti-avoidance provision can apply.

Presumably, the intent and application of the Act was adopted as a yard-stick because of the homogenous nature of the GST Act. The Act is a single taxing statute imposing tax on the supply of goods and services unadulterated by other tax considerations. This purity contrasts markedly with the many different charging provisions and concessions contained in the Income Tax Act 1994.

Another consideration is that GST involves a “netting off” by taxpayers of the output tax they must pay against the input credits to which they are entitled. Thus, both revenue and timing advantages are routinely available to taxpayers under the Act. To simply attack tax advantages would therefore be nonsense. Instead, it is only when those advantages are obtained contrary to the intended operation of the Act that the avoidance provision will apply.

The wording of s 76 directs the Commissioner away from simply assessing an arrangement in light of its results (the tax benefit produced) and **[(1997) Vol 3:4 NZJTLP 224, 233]** instead focuses on whether that benefit was obtained contrary to the intent of the Act. Thus, benefits that were deliberately sought by taxpayers may stand, provided they are consistent with the intent of the legislation, while benefits obtained contrary to the statutory scheme will not. In effect, s 76 seeks to protect the scheme of the Act

against arrangements that would defeat it, not merely to over-turn tax advantages obtained by taxpayers.

By adopting this approach, s 76 is fundamentally different from the general anti-avoidance provision of the Income Tax Act 1994.

5.1 Can taxpayers defeat the intent and application of the Act?

By their very nature, general anti-avoidance provisions are invoked only when taxpayers have obtained an unwarranted tax advantage yet still managed to comply with the technical requirements of the Act. Mere compliance with the Act will not mean that a taxpayer has complied with its intent or application. This fact is made explicit in s 76.

There has been considerable judicial debate on the extent to which anti-avoidance provisions should be applied to circumstances where taxpayers order their affairs so as to take advantage of some specific concession or beneficial treatment under the Act. Is any benefit gained a defeat of the Act or merely the result intended by the Act itself?

In blatant cases, the Court has quickly found the taxpayer guilty of avoidance. See, for example, the recent decision of Baragwanath J in *Miller v CIR* where his Honour stated:

> "It is of the nature of tax avoiders to manoeuvre skilfully around the express rules of the general law and the tax legislation and end with the innocent submission — as I have not infringed them I have succeeded. That is the very reason for generally expressed anti-avoidance provisions which begin their operation when other provisions have had their effect."

In other, less obvious, cases the Courts have recognised the right of taxpayers to arrange their affairs so as to bring themselves within (or beyond) the scope of a given section. In deciding these cases, the Courts weigh up the nature of the benefit being sought, the extent to which the taxpayer has artificially acted in order to come within the relevant provision, and the application of what has become recognised as the "choice principle".

5.2 The choice principle

The choice principle is based on the proposition that particular sections of the Act present taxpayers with a choice of alternative courses of action. These choices are deliberately created and accord with the scheme and purpose of the Act. Therefore, deliberately exercising that choice so as to obtain a tax advantage should not be invalidated by the operation of a general anti-avoidance provision. To deny the taxpayer's election would defeat or frustrate the intent and policy of the legislation conferring the benefit.

The choice principle was most clearly articulated in *WP Keighery Pty Ltd v FCT.* In that and later cases, the Court determined that the Act provided alternative bases of assessment, between which the taxpayer may choose. And that choice, even if motivated by the desire to obtain the best tax advantage, will not constitute tax avoidance. A good summation of this approach was given by Mason J in *Cridland v FCT:*

> "The decision in *Mullins* case and the passages from the judgment to which I have referred show that the principle which under **[(1997) Vol 3:4 NZJTLP 224, 234]** lies the *Keighery* case is not as narrow as the primary judge supposed it to be. It is not confined to cases in which the Act offers two alternative bases of taxation; it proceeds on the footing that the taxpayer is entitled to create a situation by entry into a transaction which will attract tax consequences for which the Act makes specific provision and that the validity of the transaction is not affected by s 260 merely because the tax consequences which it attracts are advantageous to the taxpayer and he enters into the transaction deliberately with a view to gaining that advantage."

The choice principle has generally been recognised as applicable in New Zealand but honoured more in the breach than the observance. Perhaps the most exhaustive discussion came from the Court of Appeal in *CIR v Challenge Corp Ltd.* The majority, Cooke and Richardson JJ, felt that the choice provided by s 191 (and the existence of a specific anti-avoidance provision within that section) should not be over-ridden by the blunt application of s 99.

Richardson J stated:

> "to do no more than adopt a course which the Act specifically contemplates as effecting a tax change does not affect the taxpayer's 'liability' for income tax in the statutory sense and does not result in an alteration in the incidence of income tax contemplated by the Act."

Later on, Richardson J expressed the rationale behind the choice principle, as it applied in the present case:

> "On the analysis of the role of s 191 in the statutory scheme, and of the terms of the provision itself, I am satisfied that to treat the arrangements carried through in this case as tax avoidance within s 99(1) would defeat, not promote, the legislative purposes involved."

Cooke J also adopted the choice principle as the correct law:

> "Where a particular section conferring tax concessions or rights has its own anti-avoidance provision … the preferable inference seems to me to be that the special provision is exhaustive in its own field. Within that field a taxpayer is entitled to assume that he has a right to order his affairs to take advantage of the benefits conferred by the section, provided only that he does not fall foul of the special provision. Outside that field there may still be room for s 99 to operate."

The majority decision of the Privy Council in Challenge, focusing as it does on tax mitigation, rejected outright the choice principle. This was made clear by Lord Templeman:

> "Whatever the circumstances or complications, if a taxpayer asserts a reduction in assessable income, or if a taxpayer seeks tax relief without suffering the expenditure which qualifies for such relief, then tax avoidance is involved and the Commissioner is entitled and bound by s 99 to adjust the assessable income of the taxpayer so as to eliminate the tax advantage sought to be obtained."

Despite this clear statement, few would assert that the choice principle is a dead letter or is inapplicable to New Zealand. See, for example, the statements of Baragwanath J regarding "proper" and "improper" tax avoidance arrangements in *Miller v CIR*. Thus it is accepted that, for any benefit to be obtained, a taxpayer must negotiate any specific anti- **[(1997) Vol 3:4 NZJTLP 224, 235]** avoidance provisions contained in the relevant section and avoid the general provision.

5.3 Choice principle applied to s 76

In relation to GST, the anti-avoidance provision in s 76 has supremacy over other provisions of the Act. The primacy of s 76 is written into the section itself. By measuring any arrangement against the intent and application of the Act, s 76 envisages that other specific provisions may be manipulated by taxpayers against their intended function — and that recourse will be had to s 76 to negate this arrangement, thereby returning the taxpayer to the correct position.

Applying this reasoning, a taxpayer must not only comply with the precise wording of the section on which it seeks to rely but also must not fall foul of s 76. To that end, the taxpayer must not be seeking to apply the black letter of any other section in such a way as to defeat the intent and application of the Act.

While this approach seems obvious, its application has proved far more difficult. Many arrangements which may be considered against the application of s 76 do not involve defeat of the Act per se. Rather, taxpayers might order their affairs in such a way as to bring them within the simple and plain meaning of the Act. The Act is then applied to the arrangements in the usual way. There is less of an abuse of the Act than a tailoring by the taxpayer of their affairs so as to fall within it — and thus gain the benefits the Act provides.

Many potential avoidance arrangements involve the correct application of the statute to transactions deliberately brought about by taxpayers so as to come within the Act. In such a way taxpayers seek merely to apply the Act to their new facts, not to defeat it. As most transactions are genuine (even if deliberately tailored with tax benefits in mind), could it really be said that they are intended to defeat the Act?

6 TAX ADVANTAGE

The term “tax advantage” is defined in s 76(4). This includes (but is presumably not limited to):

- Any reduction in the liability of any registered person to pay tax;
- Any increase in the entitlement of any registered person to a refund; or
- Any reduction in the total consideration payable by any person in respect of any supply of goods and services.

Although not specifically mentioned, it is presumed that a timing advantage in favour of the taxpayer could constitute a “tax advantage” within the meaning of the section. It is the nature of GST that taxpayers often receive a refund of input tax in advance of their liability to return output tax in relation to that supply. That result is built into the Act and arises to various degrees under all transactions, whether avoidance arrangements or otherwise. Many alleged tax avoidance arrangements have merely sought to maximise this timing difference to their advantage.

Any analysis of the tax advantage obtained from an arrangement must involve a comparison of the result actually achieved with a hypothetical alternative that would presumably have occurred but for the arrangement. Thus, the Court must examine not only whether an advantage was obtained but also whether that advantage would otherwise not have arisen. If the advantage would have been obtained both **[(1997) Vol 3:4 NZJTLP 224, 236]** under the arrangement and under its hypothetical alternative, it will not come within the scope of the avoidance provision: see *Peabody v FCT.* Furthermore, the extent of that advantage will often vary according to which hypothetical alternative is adopted — Inland Revenue usually adopting the least advantageous to the taxpayer.

It is a question of fact as to what would have occurred (and the tax consequences) had the arrangement not been entered into. Presumably the Court must determine the best hypothetical alternative position and then compare this to the actual result achieved — the difference being the tax advantage obtained under the arrangement.

7 POWERS OF THE COMMISSIONER

Section 76, like s GB 1, provides the Commissioner with wide powers to counteract tax benefits obtained by the operation of an arrangement to which s 76 applies. These powers allow the Commissioner to treat as void any arrangement that purports to provide any taxpayer with a tax advantage. To this end the Commissioner:

> “shall adjust the amount of tax payable by any registered person (or refund to that person by the Commissioner) who is affected by the arrangement … in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained …”

In addition to the general discretion to adjust the liability for GST, the Commissioner is provided with a number of specific powers to effect this adjustment. These powers are set out in s 76(2). They are drafted widely so as to ensure the Commissioner can effectively remedy or reverse the result of the offending arrangement. The specific powers include:

- Deeming any person to be registered;
- Deeming any goods or services subject to the arrangement to have been supplied by a registered person in the course of their taxable activity;
- Deeming any supply to have taken place in any taxable period; and
- Deeming any supply to have been made for open market value.

Due to the different nature of the respective taxes, the reconstructive powers of the Commissioner under s 76 are quite different to those provided under s GB 1.

The specific powers granted under s 76 are deliberately tailored to the workings of the GST Act as a transaction tax imposed on the supply of goods and services by registered persons.

The specific powers granted to the Commissioner take the nature of GST into account. They ensure that no tax advantage can be gained by an arrangement passing supplies between registered and unregistered persons — except as expressly recognised and provided for by the Act. These powers effectively allow the Commissioner to bring within the scope of the Act supplies that, because of the arrangement, might otherwise fall outside its scope.

8 RECONSTRUCTION

As with s GB 1, any reconstruction of a taxpayer's position under s 76 can only be achieved through the standard assessment system. Section 76 does not provide its own charging provision. Rather, it allows the Commissioner to apply the other provisions of the Act free from the consequences that would normally result from the arrangement in question. As a result, any assessment issued by the Commissioner when exercising his discretion under s 76 must take place through the mechanism of the ordinary assessment procedure under s 27.

[(1997) Vol 3:4 NZJTLP 224, 237] Any reconstruction is directed "to counteract any tax advantage obtained" by the taxpayer. The Commissioner must therefore:

- Determine the tax advantage obtained; and
- Determine the tax position of the taxpayer but for the void arrangement.

Presumably this process requires the Commissioner to apply the Act to the taxpayer's hypothetical position had the arrangement not been entered into. The Commissioner must then compare this result to the actual advantage obtained and then reconstruct the taxpayer's position so as to negate the tax advantage.

Any assessment so issued must be reasonable and supportable by the Commissioner based on the evidence available. In short, the Commissioner cannot exercise his power of reconstruction arbitrarily but must be able to support any assessment both on the facts available and on the application of the law to those facts: see *Peabody v FCT.*

9 ASSESSMENT

The method of assessment under the Act is the same as that applied for assessments under the Income Tax Act 1994, ie those set out in the new disputes regime. Section 31 specifically states that all assessments issued under s 27 are to be dealt with under Parts IVA and VIIIA of the Tax Administration Act 1994. As a result, the same rules of assessment and procedure that apply to assessments of GST in ordinary circumstances will apply to assessments following the application of s .

On this issue Hardie Boys J stated in *Variety Leisure Corp v CIR:*

> "It is not clear to me, and the point was not canvassed at the hearing, what rights of objection the plaintiff has if, as is virtually certain, the Commissioner acts under s 76, but as at present advised I cannot think that his decision would be entirely immune from appeal or review."

10 CONCLUSION

The uncertainty of s 76 may explain its lack of use. Despite its similar function, s 76 bares little similarity in scope or application to s BG 1. The different wording of s 76 indicates that it will only apply where the taxpayer's subjective dominant intention was to gain a GST advantage in breach of the Act. This contrasts markedly with s BG 1 which examines the purpose and intent of the

arrangement (not the taxpayer) on an objective standard.

Due to these differences, case law decided under the general anti-avoidance provision of the Income Tax Act is of little assistance. Rather, s 76 must be applied according to its own terms. So far Inland Revenue has not applied s 76. This indicates either that arrangements to defeat the Act do not occur or, if they do, Inland Revenue has been reluctant to rely on the uncertain assistance of s 76. If the latter is true (as the author suspects) then s 76 has failed to achieve its intended purpose.

As it is currently worded, s 76 would apply only to the most single-minded and blatant arrangement. This was arguably not the intention of Parliament when it drafted the section. Accordingly, if it is to have any meaning, s 76 should be redrafted as part of the current review of the Act being undertaken within Inland Revenue. This redrafting should make the scope and application of s 76 more apparent. Until that occurs, any proposed use of s 76 as an anti-avoidance device appears to be an empty threat.

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FOOTNOTES

1 Section 76(3) contains a specific anti-avoidance provision aimed at taxpayers who split a taxable activity between associated persons so as to avoid the registration threshold under s 51(1). The scope of this paper is confined to the general anti-avoidance provision contained in subss (1), (2) and (4), and will not address the specific anti-avoidance provision in s 76(3).

2 PIB 143 (February 1986) on GST Act 1985.

3 McKenzie, *New Zealand Goods and Services Tax Guide*, Auckland, CCH New Zealand Ltd, para 34-220.

4 The Goods and Services Tax Act 1985 came into force on 1 October 1986: s 8(1).

5 (1988) 10 NZTC 5,255; 12 TRNZ 246.

6 Ibid p 5,258; p 249

7 (1992) 14 NZTC 4,504, also reported as *Case 67* (1992) 17 TRNZ 322.

8 Ibid p 4,507; pp 325-326.

9 (1994) 16 NZTC 6,001, also reported as *Case 46*(1993) 18 TRNZ 399.

10 Ibid p 6,018; p 423.

11 (1992) 14 NZTC 4,136, also reported as *Case 7*(1992) 16 TRNZ 566.

12 *Case S83*(1996) 17 NZTC 7,515 and *Case S84*(1996) 17 NZTC 7,526.

13 Ibid p 7,534.

14 (1958) 11 ATD 442.

15 (1989) 11 NZTC 6,155; 13 TRNZ 373.

16 Ibid p 6,171; p 392.

17 Section BB 1Income Tax Act 1994.

18 Section 8(1)Goods and Services Tax Act 1985.

19 (1997) 18 NZTC 13,187.

20 Op cit n 14, p 445.

21 [1982] 2 NZLR 726; (1982) 5 NZTC 61,311; 5 TRNZ 881.

22 [22]Defined in s OB 1Income Tax Act 1994.

23 For example, see *National Distributors Ltd v CIR*(1989) 11 NZTC 6,346; 13 TRNZ 671.

24 Defined in s OB 1.

25 Op cit n 23.

26 Op cit n 23.

27 (1981) 5 NZTC 61,006; 4 TRNZ 233.

28 The first two limbs of “tax avoidance” under s have been criticised as inapplicable: see C Ohms, “Section 99: The General Anti-avoidance Rule — Analysis and Reform” (1994) 1 NZJTLP 87, expressly adopted by Baragwanath J in *Miller v CIR*(1997) 18 NZTC 13,127.

29 (1986) 8 NZTC 5,001; (1985) 9 TRNZ 81.

30 [1994] 3 NZLR 439; (1994) 16 NZTC 11,175; 18 TRNZ 715.

31 (1997) 18 NZTC 13,219, 13,240.

32 (1975) 100 CLR 66.

33 77 ATC 4,538, 4,542.

34 Op cit n 29.

35 Ibid p 5,023; p 105.

36 Ibid p 5,026; p 108.

37 Ibid p 5,015; p 96.

38 (1986) 8 NZTC 5,219,; 10 TRNZ 161, 5,227, 169.

39 (1997) 18 NZTC 13,001.

40 Invariably the taxpayer is seeking an input credit under s 20 on the purchase of second-hand goods from an unregistered person. Commonly this practice involves either a sale by the non-registered person to his or her GST registered company or trust, or the use of a non-registered intermediary to purchase goods and on-sell them to the registered person. Such transactions are known as “sale-to-self arrangements” and in some instances involve supplies at an inflated price so as to increase the input credit available on the purchase.

41 (1994) 181 CLR 359

42 Ibid.

43 (1988) 10 NZTC 5,255,; 12 TRNZ 246, 5,258, 249.