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Mark Keating

GST Tax Avoidance: A New Zealand Perspective on the Application of Div 165

Mark Keating*

Abstract

The GST regime has now been operating in Australia for a decade.¹ During that period there has been only one reported case on GST tax avoidance. The absence of other cases indicates either the GST regime is working as intended, and there is no avoidance of GST, or the ingenuity of taxpayers seeking GST benefits has simply not been detected by ATO.

A New Tax System (Goods and Services Tax) Act 1999 ("GST Act") contains a number of measures to combat avoidance of GST. There are a range of specific anti-avoidance provisions to counter particular instances of tax avoidance. These specific rules are narrowly targeted provisions to prevent foreseeable instances where taxpayers may otherwise attempt to defeat the normal or expected operation of the relevant statute².

More importantly, Div 165 GST Act contains a broad-ranging general anti-avoidance provision ("GAAR") to prevent abuse of the GST regime.³ Unlike the specific anti-avoidance rules, Div 165 is widely-worded with open-ended application. Such provisions⁴ are designed to apply to the unanticipated and unforeseen behaviour by taxpayers that, although contrary to neither the substantive provisions of the Act nor any applicable specific anti-avoidance provisions, nevertheless breach the scheme and purpose of the relevant statute.

Despite the lack of case law, it can be presumed that tax avoidance is as much a part of the landscape of GST as it is for income tax. But while there have been many income tax avoidance cases litigated over the past decade, there is an understandable dearth of GST cases.

The Australian Administration Appeals Tribunal heard the sole GST avoidance case under Div 165 in 2006. Following the enactment of a GST regime in New Zealand in 1986, it took 15 years for the first case to be considered by the courts under s 76 *New Zealand Goods and Services Tax Act 1985* (NZGSTA). Those initial cases, involving fairly blatant schemes to obtain unwarranted tax benefits, were decided in favour of the Commissioners in both jurisdictions.

It was not until 2007 that New Zealand's Court of Appeal heard two GST avoidance cases, upholding the Commissioner's assessment of tax avoidance in both instances. The decision in one of those cases was subsequently appealed to New Zealand's newly formed Supreme Court,⁵ which eventually upheld the assessment of tax avoidance.

* Senior Lecturer, University of Auckland Business School. The author would like to thank the advice and support given by Kirsty Maclaren.

¹ GST is imposed under *A New Tax System (Goods and Services Tax) Act 1999*, which came into effect on 1 July 2000.

² Commonly specific anti-avoidance provisions stipulate taxpayers must act at market value on normal commercial terms in a timely manner. Examples are found throughout the GST Act, such as s 29-25 (timing for particular taxable supplies and creditable acquisitions), s 9-75 (value of supplies not expressed in money) and s 66-10 (purchases of second-hand goods) and s 72-70 (supplies between associated persons).

³ Division 165 *A New Tax System (GST) Act 1999*.

⁴ See Part IVA *Income Tax & Assessment Act 1937*. The equivalent provisions in New Zealand for income tax is s BG1 *Income Tax Act 2007* and for GST is s 76 *Goods & Services Tax Act 1985*.

⁵ As a reflection of its British colonial history, from 1840 – 2005 New Zealand's highest court of appeal was the Privy Council in London. The right of appeal to the Privy Council was finally abandoned in

These New Zealand cases, involving very different schemes, are the first consideration of GST avoidance by higher courts in either jurisdiction.⁶ Accordingly the reasoning of those decisions provides a useful guide to the potential application of Div 165 in Australia. The cases demonstrate that, like the equivalent GAARs for income tax, Courts are willing to apply anti-avoidance provisions wherever they believe taxpayers' conduct abuses the GST regime. The decisions give the anti-avoidance provisions teeth and provided the Commissioner in both countries with a strong weapon against abusive conduct by taxpayers.

This article examines the GST tax avoidance cases decided in both Australia and New Zealand. It compares them with the application of the income tax general anti-avoidance provisions. Finally the paper provides some guidance on when Div 165 may be applied to schemes, given the different requirements of the GST regime.

1. ROLE OF GENERAL ANTI-AVOIDANCE RULES

General anti-avoidance rules ("GAAR") render void against the Commissioner any arrangement that has the purpose or effect of tax avoidance. The role of this type of provision was explained in the venerable Australian case *FCT v Newton*:⁷

"[The GAAR] is not aimed at fraudulent conduct or at pretended as distinct from real transactions. Such cases need no statutory provision. It is aimed at transactions that are in themselves real and lawful but which the Legislature desires to nullify so far, and only so far, as they may operate to avoid tax."

A GAAR is designed to protect Government revenue from schemes that have in all other respects fully complied with the relevant law but which nevertheless contravene the normal or expected operation of the Act. In the so-called *Trinity* case, the New Zealand Supreme Court explained this reasoning in the following terms:⁸

"Parliament must have envisaged that the way a specific provision was deployed would, in some circumstances, cross the line and turn what might otherwise be a permissible arrangement into a tax avoidance arrangement. ... Thus tax avoidance can be found in individual steps or, more often, in a combination of steps. Indeed, even if all the steps of an arrangement are unobjectionable in themselves, their combination may give rise to a tax avoidance arrangement. ... [The GAAR's] function is to prevent uses of the specific provisions which fall outside their intended scope in the overall scheme of the Act. Such uses give rise to an impermissible tax advantage which the Commissioner may counteract."

Not surprisingly, the operation of a GAAR is both controversial and uncertain. By definition, the general nature of the provision makes its scope and application less certain. This has led some commentators⁹ to draw comparison between the operation of a GAAR and Article 58 of the Soviet-era Russian SFSR Penal Code enacted under

2005, to be replaced by the New Zealand Supreme Court, whose members are all members of New Zealand's own judiciary.

⁶ The sole Australian case to date is *Case 14/2006* 2006 ATC 187, involving almost identical facts to those in New Zealand's *Ch'elle* case.

⁷ (1957) 96 CLR 577, at 646 - 647

⁸ *Ben Nevis Forestry Ventures Ltd & Ors v CIR* [2008] NZSC 115, at para [104], known as the "*Trinity scheme*".

⁹ *Legislation with Retrospective Effect, with Particular Reference to Tax Loopholes and Avoidance*, Prof John Prebble et al, (2006) 22 NZULR 17.

Stalin.¹⁰ This infamous Article made illegal all “counter-revolutionary” or “anti-Soviet” activities, and formally introduced the notion of “enemy of the workers”. It was under this Article that Stalin’s show trials were conducted and many victims of the Great Purge were convicted.

The breadth of Article 58, with its deliberately wide and imprecise meaning, obviously undermined the rule of law. “Article 58 was *carte blanche* for the secret police to arrest and imprison anyone deemed suspicious, making for its use as a political weapon.”¹¹ Most odiously, its lack of clarity made it impossible for defendants to reasonably establish whether any particular conduct was in breach.

While obviously hyperbole,¹² it is submitted that a similar criticism can be made against a GAAR. Taxpayers who have carefully complied with all other provisions of the Revenue Acts, including existing specific anti-avoidance provisions, may nevertheless find themselves in breach of a deliberately ill-defined GAAR. As was explained by the New Zealand High Court in *Miller v CIR*:¹³

“It is the very 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 being their operation when other provisions have had their effect.”

Criticism of the vagueness of a GAAR is common. As one commentator complained:¹⁴

“the problem is an obvious one; how do you know when you have crossed an imaginary line?”

Responding to taxpayer criticism about the difficulty of complying with such nebulous provisions, the Court of Appeal noted:¹⁵ “certainty and predictability are important but not absolute values” and therefore a GAAR must be left as flexible as possible. The criticism by taxpayers was finally addressed in the two most recent¹⁶ New Zealand Supreme Court decisions.^{17 18} In those cases the taxpayers contended the GAAR should be read-down in the interests of taxpayer certainty – but with the result that it would be so narrow as to make it virtually inoperative. In rejecting such a narrow interpretation, the Court of Appeal noted:¹⁹ “this approach does not leave much scope

¹⁰ Article 58 Russian SFSR Penal Code, operative from 25 February 1927.

¹¹ See [http://en.wikipedia.org/wiki/Article_58_\(RSFSR_Penal_Code\)](http://en.wikipedia.org/wiki/Article_58_(RSFSR_Penal_Code)), as at 12 Jan 2009.

¹² See footnote 48 where Prebble et al express disavow any moral equivalent between tax avoidance and the crimes against humanity committed by dictatorial regimes in reliance on such criminal codes.

¹³ (1996) 17 NZTC 13,001

¹⁴ *Role of a General Anti-Avoidance Rule in GST*, E Trombitas, NZJTL Vol 13, Sept 2007, at 463.

¹⁵ *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450 at [40].

¹⁶ Both judgments were delivered simultaneously on 19 December 2008. The Supreme Court is New Zealand’s highest Court, following the abolition of the right to Appeal to the UK Privy Counsel in 2004.

¹⁷ *Ben Nevis Forestry Ventures Ltd & Ors v CIR* [2008] NZSC 115, Elias CJ, Tipping, McGrath, Gault and Anderson JJ – dealing with income tax. It is referred to as the *Trinity* case because of the name of the charitable trust used at the centre of the scheme.

¹⁸ *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, Elias CJ, Blanchard, Tipping, McGrath and Anderson JJ – dealing with GST.

¹⁹ *Accent Management and Ors v CIR* [2007] NZCA 230, at [116]

for a general avoidance provision” and criticised the taxpayers’ arguments as “sometimes coming close to maintaining that general anti-avoidance provisions have no role at all”.

In the *Trinity* case, the taxpayers argued they were entitled to make commercial choices to take advantage of the tax benefits available, and the income tax GAAR should be interpreted as narrowly as possible to give taxpayers reasonable certainty in tax planning. In *Glenharrow* the taxpayer argued the GST GAAR ought not be permitted to interfere with a bargain honestly reached by arms-length parties, as to do so would create unwelcome uncertainty for taxpayers.

The New Zealand Supreme Court dismissed both arguments. The Court noted the wording used in the GAARs was deliberately imprecise and the judiciary should not create greater certainty than Parliament has chosen to provide. It reasoned a GAAR must remain deliberately vague because, no matter how carefully such a provision is drafted, the ingenuity of taxpayers cannot be predicted, making it impossible for Parliament to enact a more specifically-worded provision with the flexibility to anticipate future arrangements. Therefore the use of wide and imprecise language is required for a GAAR to regain the flexibility to be applied to novel arrangements.

With regard to the GST GAAR, in *Glenharrow* the Court explained:²⁰

“Uncertainty is inherent where transactions have artificial features combined with advantageous tax consequences not contemplated by the scheme and purpose of the Act. There will also inevitably be uncertainty whenever a taxing statute contains a general anti-avoidance provision intended to deal with and counteract such artificial arrangements. It is simply not possible to meet the objectives of a general anti-avoidance provision by the use, for example, of precise definitions”.

With a notable lack of sympathy for taxpayers, the Court acknowledged that, while there may be difficult cases on the margins, generally an examination of the facts and the economic substance of each arrangement “will make it possible to decide on which side of the line a particular arrangement falls.”²¹

Finally, for taxpayers seeking certainty, the Supreme Court recommended that they utilise the statutory Binding Ruling process²² to test the Commissioner’s view as to the tax effectiveness of their arrangements, prior to entering into them. That may be unwelcome advice to taxpayers who have experienced the increasing cost and extended delays typical of the Binding Ruling regimes in both Australia and New Zealand.²³ This somewhat harsh attitude was justified by a leading commentator:²⁴

²⁰ *Glenharrow Holdings Ltd v CIR* [2007] NZSC 116, at [48]

²¹ *Ben Nevis Forestry Ventures Ltd & Ors v CIR* [2008] NZSC 115, at [112]

²² A procedure contained in New Zealand’s *Tax Administration Act* whereby taxpayers may apply to have a proposed transaction approved by the Commissioner. Once issued, the Ruling is binding upon the Commissioner. However, the process has been widely criticised for its delay and expense.

²³ See Div 359 *Australian Taxation Administration Act 1953* and Part V *New Zealand Tax Administration Act 1994*.

²⁴ “Retrospective Legislation: Reliance, the Public Interest, Principles of Interpretation and the Special Case of Anti-Avoidance Legislation”, Prebble et al, *NZULR*, Vol 22, Dec 2006, at 281.

“Despite their claims to the contrary, people caught by such provisions generally do intend to minimise tax. What they are relying on in such situations is ... a hope or expectation that their arrangements will pass as effective for tax. When an assessment catches such transactions a sense of moral outrage seems inappropriate.”

The result of this muscular interpretation of the GAAR is to deliberately create uncertainty for taxpayers so as to give them pause before embarking on possibly abusive tax arrangements. The uncertainty over the precise scope of the GAAR may therefore serve a second purpose of discouraging such abusive behaviour.

This approach contrasts with the requirements stipulated by the European Court of Justice in *Halifax plc v Commissioners of Custom and Excise*.²⁵ that “the requirement of legal certainty must be observed strictly in cases of rules liable to entail financial consequence, in order that those concerned may know precisely the extent of the obligations which they imposed on them.”²⁶ As such it appears the wide Australasian application of GAARs would be contrary to the European Community Sixth Directive restricting the use of anti-avoidance powers in the UK VAT legislation.

2. STATUTORY TESTS FOR GAARS

The Australian and New Zealand GAARs adopt somewhat different tests for what constitutes tax avoidance.

- In Australia the GAAR applies to any scheme with the sole or dominant purpose of providing a tax benefit.
- In New Zealand the GAAR applies where obtaining a tax benefit is more than merely incidental.

On their face the two provisions appear to adopt different thresholds as to what constitutes tax avoidance. While the Australian provision requires a dominant purpose, the NZ provision applies the somewhat lower standard of being more than merely incidental. However, this difference in the applicable standard may be more apparent than real, as schemes that come before the courts generally include uncommercial features that make their tax avoidance purpose obvious, whatever standard is used. Furthermore, the Australian courts have recognised that a genuine commercial rationale for a transaction can nevertheless constitute tax avoidance if that scheme is “tax driven”. This was made clear in *Spotless Services Ltd v FCT*²⁷ where the High Court explained that:

“A particular course of action may be ... both ‘tax driven’ and bear the character of a rational commercial decision. The presence of the latter characteristic does not determine the answer to the question whether ... [the scheme has a] ‘dominant purpose’ of enabling the taxpayer to obtain a ‘tax benefit’.”

²⁵ [2006] BTC 5308.

²⁶ As summarised in “European Court of Justice and the Principle of Prohibiting Abusive Practices in VAT”, Ben Terra *NZJTL*, Vol 13, Sept 2007, at 384.

²⁷ 96 ATC 5201 (HCA)

This approach is mirrored in the New Zealand definition of “tax avoidance” that stipulates it can include arrangements involving “ordinary business or family dealings”²⁸ if the tax benefits of the scheme are more than merely incidental. As a result, it is apparent that both GAARs catch schemes regardless of any underlying commercial rationale. A tax-driven transaction may therefore constitute tax avoidance under the GAAR in both jurisdictions even if it also has a genuine business purpose.

Interestingly, this result clearly conflicts with the ECJ requirement that only arrangements with the sole purpose of obtaining tax advantages with no normal commercial operation may be struck down for VAT purposes.²⁹

Div 165 requires four factors to be satisfied before the Commissioner can negate a tax avoidance scheme. These are:

1. One or more of the steps in the arrangement is a “scheme”,³⁰
2. A “GST benefit”³¹ arises under the scheme,
3. An entity gets a benefit from the scheme, and
4. It is reasonable to conclude, taking into account the statutory factors, that the dominant purpose or principal effect of entering the scheme was to get the GST benefit.

To determine whether the scheme has a dominant purpose or principal effect of tax avoidance, s 165-15 contains a list of factors against which the scheme must be measured. These factors are:

- The manner in which the scheme was entered into,
- The form and substance of the scheme,
- The purpose and object of the GST Act and any relevant provisions,
- The timing of the scheme,
- The period over which the scheme was carried out,
- The effect of the scheme,
- Any change in the participants’ financial position,
- Any other consequences on the participants,
- The nature of the connection between the participants,
- The circumstances surrounding the scheme, and
- Any other relevant considerations.

²⁸ See s 76(2) NZ GSTA.

²⁹ See *Halifax and Cadbury Schweppes plc v IRC* [2007] STC 980.

³⁰ As defined in s 165-10(2).

³¹ As defined in s 165-10(1).

These factors mirror the explicit criteria in Part IVA of the *Income Tax Assessment Act* and therefore cases decided under that Part can provide direct guidance on the scope and application of the GST GAAR. As noted in the only Australian case to consider the application of Div 165:³²

“there had been a number of cases in the Australian courts considering Part IVA of the ITA Act. It is clear from the scheme of Div 165 that it is built on principles that are very similar to those found in Part IVA.”

By contrast, the New Zealand legislation contains no signposts to measure the tax avoidance purpose of an arrangement. Instead, the current New Zealand legislation simply leaves it to the Court’s discretion regarding what factors may be relevant to whether an arrangement had the purpose or effect of tax avoidance. However, the courts have themselves identified a number of factors or indicia that, if present, would be indicative of tax avoidance. These factors are, not surprisingly, similar to the statutory criteria prescribed in Div 165 for determining whether an arrangement constitutes tax avoidance.

Perhaps more than any other area, tax avoidance will depend upon the facts determined in each case. The Supreme Court in *Trinity* noted “whether an arrangement is an artifice or involves a pretence will often be highly relevant to whether there is an arrangement that has a purpose or effect of tax avoidance.”³³

Facts which, objectively viewed, appear to demonstrate a lack of commerciality, circularity, or pretence will therefore be just as relevant as the actual arrangement entered into by taxpayers. The Court therefore considered all relevant factors regarding the structure and implementation of the arrangement by the taxpayers:³⁴

“The general anti-avoidance provision does not confine the Court as to the matters which may be taken into account when considering whether a tax avoidance arrangement exists. Hence the Commissioner and the courts may address a number of relevant factors.”

These include:

- the manner the arrangement is carried out,
- the role of the relevant parties and any association they may have,
- the economic and commercial effects of the various steps,
- the duration of the arrangement, and
- the nature and extent of the fiscal consequences.

In *Glenharrow* the Supreme Court warned against “transactions that have artificial features combined with advantageous tax consequences not contemplated by the scheme and purpose of the Act.”³⁵ Specifically with regard to GST, the New Zealand

³² See *Case 14* 2006 ATC 187, at para 153.

³³ *Trinity* at [97].

³⁴ *Trinity* at [108].

³⁵ *Glenharrow* at [48]

Courts have identified a range of factors that will be relevant to whether the GAAR should apply.³⁶ These factors are:

- the relationship between the parties, whether arms-length or associated,
- the amount of GST at issue and the degree to which any supposed commercial transaction to which it relates is dependent upon that GST treatment,
- the normal commerciality of the arrangement,
- the perceived purpose of the particular section being exploited (i.e., the scheme and application of that provision of the Act),
- the experience and substance of the parties in fulfilling the transactions.

These factors are similar to those identified by the ECJ in VAT tax abuse cases such as *Ermsland Starke*.³⁷ VAT avoidance requires a two-step test.³⁸ First there must be an examination of the scheme according to objective factors to determine whether the tax advantage obtained was contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. This “essential aim” must be determined by considering “the real substance and significance of the transactions concerned” taking account of “the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden”.³⁹

As with Div 165, the “essential aim” is not a sole purpose test. There can be a finding of an abusive practice when obtaining a tax advantage constitutes the principal aim of the transaction or transactions at issue.⁴⁰ Furthermore, that aim is determined from the objective facts of the case rather than the subjective aim or intention of the parties engaged in those transactions.

2.1 Role of Scheme and Purpose in Tax Avoidance

It is trite law that not all tax benefits enjoyed by taxpayers constitute tax avoidance. This position is made explicit in the Australian GST Act, which identifies a number of specific choices provided to taxpayers that are protected from the application of Div 165.⁴¹ Taking advantage of these choices therefore cannot constitute tax avoidance, on the grounds the exercise of those choices all conform to the intended operation of the Act. By contrast attempts to take advantage of other supposed choices or incentives beyond those provided in the Act would remain vulnerable to Div 165.

While the corresponding NZ legislation doesn’t specifically identify similar protected choices, the courts have confirmed it will examine whether an arrangement

³⁶ These factors were first identified by the TRA in *Case W22* (2003) 21 NZTC 11,211 and were endorsed by the High Court on appeal in *Ch’elle Property (NZ) Ltd v CIR* (2004) 21 NZTC 18,618.

³⁷ *Ermsland-Starke GmbH v Hauptzollamt Hamburg-Jonas* [2000] ECR I-11569.

³⁸ See *Halifax* at para 86, and UK Revenue and Customs Brief 56/09 at para 4: see <http://www.hmrc.gov.uk/briefs/vat/brief5609.htm>, as 15 Feb 2010.

³⁹ See *Halifax* at para 81.

⁴⁰ See *Parts Services Case*, at para 45 and 62.

⁴¹ See s 165-5(1)(b).

contravenes the intent and application of the Act before finding the resulting tax benefit constitutes avoidance. For instance, in *Glenharrow* the Supreme Court acknowledged:⁴²

“The intention of the Act will be defeated if an arrangement has been structured to enable the avoidance of output tax, or the obtaining of an input deduction in circumstances where that consequence is outside the purpose and contemplation of the relevant statutory provisions. ... An arrangement of this kind is not in accordance with the overall purpose of the Act because it produces a “tax advantage” not within the contemplation of the statute.”

Later the Court confirmed:⁴³

“That is of course consistent with the neutrality and efficiency of the revenue collection rationales that underlie the Act. The corollary is that registered persons should, by the same token, not obtain unacceptable windfall gains from the regime.”

Therefore, only after reviewing the proper operation of the Act was the Court able to conclude the scheme in *Glenharrow* breached the scheme and purpose of the relevant provisions:⁴⁴

“The whole premise of the Act generally and of the secondhand goods provisions in particular is that transactions will be driven by market forces: that their commercial and fiscal effects will be produced by those forces and will not contain distortions which affect (ie defeat) the contemplated application of the GST Act. It is when market forces do not prevail that s 76 is available to the Commissioner.”

In both countries taxpayers retain the right to exercise choices either expressly or implicitly contained in the Act. It is only when those choices give rise to a tax benefit contrary to the scheme of the Act that the GAAR will apply.

3. AUSTRALIAN CASE APPLYING DIV 165

To date, the only Australian case applying Div 165 is *Re VCE*.⁴⁵ That case involved the sale of commercial real estate from an individual to the company he controlled. The property was valued at approximately \$250,000 but was sold to the company for \$768,000, with settlement to take place in 15 years. A deposit of \$550 was paid immediately with two further small instalments payable at 5-yearly intervals until the bulk of the outstanding price was payable in 2018.

The individual was personally registered for GST on the cash basis, and the company was registered on the accruals basis. This meant the company was technically entitled to an immediate input tax credit for the full \$70,000 GST, while the individual was not liable for the equivalent GST output tax for 15 years. Not surprisingly the ATO invoked Div 165 and declared the arrangement void for GST purposes.

⁴² *Glenharrow*, at [40]

⁴³ *Ibid*, at [43]

⁴⁴ *Ibid*, at [47]

⁴⁵ AAT Case 14/2006, reported at 2006 ATC 187

The AAT confirmed the ATO's view. Relying on the interpretation of the similar criteria for income tax avoidance in Part IVA by appellate courts,⁴⁶ the AAT confirmed that Div 165 adopted an almost exclusively objective test, by reference to the statutory criteria in s 165-15, and not a subjective test of the purpose of the participants of the scheme. The AAT then undertook a lengthy analysis of the statutory factors in s 165-15 to be taken into account when determining tax avoidance and concluded that, under virtually all criteria, the transaction "is outside the range of normal commercial dealings. The time between the date of the Agreement and the date of settlement is unusually lengthy".⁴⁷

Most importantly the AAT found that the scheme breached two general requirements implicit in the operation of the GST regime. First, the inordinate delay in settling and paying the purchase price under the transaction contrasted with the normal temporal operation of the Act.

"While not making any reference to the time at which the GST is payable on the supply, the clear intention is that a person claiming an input tax credit on the acquisition of the thing cannot claim more than is payable on the supply of that same thing."⁴⁸

And later:

"It is apparent from the scheme of the GST Act that there is meant to be some degree of conformity between the GST that is paid on a taxable supply and the input tax credit on that taxable supply."⁴⁹

Second, claiming an input tax credit today for the expected future value of the property undermined the usual requirement that transactions take place at current market value.

"It is an outcome that favours [the individual] as the net present value of the money in 2003 in the hand is significantly greater than the same amount promised for the payment five and ten years, let alone fifteen years later. In the meantime, the company will have had the advantage of being able to use the \$70,000 paid as a refund by the Commissioner."⁵⁰

Accordingly, the AAT concluded the requirements of Div 165 were made out. Having reached that conclusion, the AAT made a number of additional remarks regarding why Div 165 is necessary to prevent abuse of the GST Act and counteract taxpayers claiming unwarranted input tax credits under such schemes.

"The burden of GST is intended to fall according to its terms which are framed on the basis of there being commercial transactions of some type. ... It is equally clear that GST is not intended to be a source of bounty. ... There is

⁴⁶ At para 78 – 86, referring to the High Court decisions in *FCT v Spotless Services Ltd* 1993 ATC 4104 and *FCT v Hart* (2004) 217 CLR 216. The AAT also noted at para 153 that "there had been a number of cases in the Australian courts considering Part IVA of the ITA Act. It is clear from the scheme of Div 165 that it is built on principles that are very similar to those found in Part IVA."

⁴⁷ At para 122.

⁴⁸ At para 73.

⁴⁹ At para 153.

⁵⁰ At para 118.

an assumption that there will be some correlation between payment of GST and input tax credit. ... An input tax credit does not represent some sort of bounty that the Commissioner bestows upon a person. It is more appropriately regarded as an alleviation of the burden that person has borne in paying the price of the goods or services. In this case the burden and its alleviation have not fallen as the GST Act intended.”⁵¹

Only at the conclusion of its decision, when dealing with penalties, does the AAT acknowledge the similarity in both the facts and principles between *Re VCE* and the New Zealand decision in *Ch’elle Properties Ltd v CIR*.⁵² Nevertheless, the approach of the courts to this type of deferred settlement arrangement is clearly consistent. The fact no appeal was ever heard from *Re VCE*, and no similar arrangements have come before the Australian courts, may indicate that Australian taxpayers have recognised the strong stance likely to be taken by the ATO against this type of GST abuse.

4. NEW ZEALAND CASES APPLYING THE GST GAAR

Given the lack of Australian case law, cases decided under the equivalent New Zealand legislation may provide some guidance to the application of Div 165. In 2008 the New Zealand Court of Appeal and finally the Supreme Court considered the vexed question of when proper GST tax planning crosses the line into impermissible tax avoidance. Although the Courts found the taxpayers correctly applied the black letter GST law in each case, their arrangements nevertheless constituted tax avoidance. In each instance the Court issued strong judgments against arrangements it considered were artificial and lacking commerciality, finding that such arrangements breached the intent and application of the GST Act and were therefore void for tax purposes.

4.1 *Ch’elle*

The impugned arrangement in *Ch’elle Properties (NZ) Ltd v CIR*⁵³ involved 114 companies that each had the same individual shareholder/director. None of the companies had any assets or even bank accounts. Each company registered for GST on a payments basis, as permitted if it had an annual turnover below \$1million.⁵⁴

Simultaneously, a friend of the promoter of the arrangement incorporated *Ch’elle Properties (NZ) Ltd*, another shell company without assets or bank account. Although the friend had no experience in the property market, *Ch’elle* registered for GST on an invoice-basis claiming to conduct the taxable activity of “property trading”.

In late 1998 each of the 114 companies entered into conditional sale and purchase agreements with a third party developer for the purchase of vacant subdivided lots. Each property was purchased for \$70,000. In early 1999 each company then on-sold the land to *Ch’elle* for an average of \$700,000 – a ten-fold increase in the cost of the property or \$80million in total. Settlement of the sale to *Ch’elle* was deferred for

⁵¹ At para 136.

⁵² *Ch’elle Properties Ltd v CIR* [2007] NZCA 256 (CA)

⁵³ (2007) NZCA 256.

⁵⁴ Under s 19 NZ GST Act, the equivalent of s 29-40.

between 10 and 20 years but Ch'elle immediately paid a \$10 cash deposit thereby triggering the time of supply for GST purposes.⁵⁵

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

While the arrangements technically complied with the relevant GST provisions the Commissioner disallowed the input tax claim on the ground that the arrangement was contrary to the intent and application of the GST Act, in breach of the GAAR.

The TRA⁵⁶ ruled the total lack of commerciality of the various transactions meant that the arrangement constituted tax avoidance.⁵⁷ The High Court subsequently rejected the taxpayer's appeal,⁵⁸ finding that the arrangement offended the intent and application of the Act in two ways:

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

The arrangement was therefore void for tax purposes under the GAAR and the taxpayers were not entitled to the input tax credits claimed. The taxpayers again appealed to the New Zealand Court of Appeal.

4.1.1 Court of Appeal decision in Ch'elle

The Court of Appeal unanimously rejected the taxpayer's appeal,⁵⁹ on the basis that, while small mismatches in timing are an inherent feature of the GST regime, input tax claims "will ultimately be balanced by the payment of output tax ... and in the circumstances of this case the balance between outputs and inputs is grossly distorted. ... [Therefore] the 10 to 20 year delay in all circumstances defeats the intent of the Act and accordingly triggers [the GAAR]."⁶⁰

Likewise, while the choice of different accounting basis for GST may result in mismatches between some taxpayers, "that does not mean that a gross mismatch in timing is irrelevant ... The Act seeks to limit the nature and degree of such mismatching."⁶¹

⁵⁵ S 9 GST Act 1985 the equivalent of s 29-5. .

⁵⁶ Taxation Review Authority, New Zealand's specialist tax disputes authority established under the *Taxation Review Authority Act 1994*. It is the initial forum for most tax cases, with appeals from the TRA to the High Court, then onwards to the Court of Appeal and finally (if granted leave) to the Supreme Court.

⁵⁷ Case W22 (2003) 21 NZTC 11,211.

⁵⁸ *Ch'elle Properties (NZ) Limited v CIR* (2004) NZLR 274.

⁵⁹ (2007) 23 NZTC 21,442.

⁶⁰ *Ibid*, at [42]

⁶¹ *Ibid*, at [50]

By using 114 different companies so that each had a turnover below the \$1million statutory threshold for taxpayers to remain on a payments basis, the arrangement effectively circumvented the sections prescribing registration and accounting basis. “As a result, the degree of mismatch contemplated and tolerated by the Act escalated to a level which could never have been intended”.⁶²

On this point the Court concluded:⁶³

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

Of particular importance was the unanimous endorsement of the High Court’s finding that the GAAR involved an objective test. The Court of Appeal stated:⁶⁴

“Mr Hayes, for the appellant, contended that s 76 required a subjective intent. This cannot be the case. This would lead to the anomalous situation where an identical transaction might in one case be sustainable, but in another struck down as tax avoidance because in the first instance the operator mistakenly, naively, unrealistically or opportunistically was of the view that what was being done was unassailable. The second, however, which involved a more confident person who thought it was worth ‘having a go’, would be struck down. It is the objective assessment of the arrangement which will provide the answer as to whether it defeats the intention and application of the Act and is therefore void.”

This finding had particular relevance to the subsequent *Glenharrow* decision (discussed below). Although the *Ch’elle* taxpayers applied for leave to appeal the case to the New Zealand Supreme Court, their application was rejected. Accordingly that decision stands as the leading decision on this type of arrangement, which seeks to exploit the mismatch between taxpayers who use a payments and invoice basis. The Court of Appeal’s reasoning in *Ch’elle* has been applied in subsequent decisions on this type of arrangement in both New Zealand⁶⁵ and Australia.⁶⁶

4.2 Glenharrow

The *Glenharrow* arrangement dealt with a much more contentious transaction. It involved the claim for a second-hand goods input tax credit on the purchase of a 10-year mining license.⁶⁷

⁶² Ibid, at [51]

⁶³ Ibid, at [41]

⁶⁴ Ibid, at [25]

⁶⁵ *Case X23* (2006) 22 NZTC 12,290 and *Case X25* (2006) 22 NZTC 12,303.

⁶⁶ *Case 14/2006* 2006 ATC 187.

⁶⁷ Secs 3A and 20(3) NZGSTA permit taxpayers to claim input tax credits (and potentially cash GST refunds) on the purchase for taxable purposes of second-hand goods (i.e., those owned by persons not registered for GST) to the extent of “payment” for those goods.

The mining license was issued in 1990 but had not been operated by its original holder. In 1994 the license was sold to local prospectors for \$100. In 1996 it was on-sold for \$10,000. In 1997 Glenharrow Holdings Ltd, a \$100 shelf company, purchase the license for \$45million. The purchase price was satisfied in two ways:

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

The parties agreed that interest and principle repayments would be funded out of profits derived from the successful exploitation of the license. No additional security or guarantee was given for the outstanding purchase price.

Glenharrow began to exploit the license but, due to both legal and practical difficulties, conducted only minimal mining. From that limited operation Glenharrow made further payments of only \$210,000.

The vendor was not registered for GST while Glenharrow was registered. Glenharrow therefore claimed a second-hand input tax credit of \$5million on the purchase of the mining license.⁶⁸ The Commissioner disallowed the input tax claim on the ground the arrangement breached the GAAR. The taxpayers challenged the assessment in the High Court.⁶⁹

Although the Commissioner contested the taxpayer's entitlement to an input tax credit under the black letter law, the High Court found that the arrangement was (putting aside the GAAR) effective for GST. The agreement to purchase the license was genuine and the parties intended to implement it according to its terms. Although the purchase price of \$45million was "grossly inflated" it was a genuinely agreed price based on the parties' extremely optimistic valuation.

On the question of whether the arrangement had any real business purpose, the Court found Glenharrow had acquired the license for the principle purpose of making taxable supplies and therefore met the criteria for an input tax credit.⁷⁰ Based on those factual findings, the Commissioner's technical arguments failed.

Nevertheless the Court ruled the arrangement defeated the intent and application of the NZGSTA and was therefore void. While acknowledging the honesty of the taxpayers, the Court stated:⁷¹

"I have difficulty in accepting that the legislature intended s 76 to be governed by the personal motives of the taxpayer when entering into the arrangement. Apart from producing an erratic application of the section ..., such an

⁶⁸ NZ GST is charged at a standard rate of 12.5%, so input tax of 1/9th of the purchase price of goods purchased for the principle purpose of making taxable supplies may be claimed as an input tax credit, under s 3A.

⁶⁹ *Glenharrow Holdings Ltd v CIR* (2005) 22 NZTC 19,319.

⁷⁰ This is the equivalent statutory provision to Division 11-15 of Australia's *A New Tax System (Goods and Services Tax) Act 1999* that permits an input tax credit for purchases "to the extent that you acquire it in carrying on your enterprise".

⁷¹ *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, at [35]

interpretation would almost certainly render the section virtually useless and destroy its anti-avoidance purpose.”

4.2.1 Court of Appeal decision in Glenharrow

From the wording of the Court of Appeal judgment, it is apparent that the members of the Court of Appeal were somewhat uneasy with the High Court’s findings regarding the taxpayers’ credibility, especially as the license had previously been sold for only \$100 and \$10,000. The Court found that the price of \$45million was “artificial” and “totally unrealistic”.

Both *Ch’elle* and *Glenharrow* considered the former wording of the GST GAAR. That old version applied to arrangements that “defeat the intent and application” of the GST Act. The GAAR was rewritten in 2000 to now apply to arrangements that “have a purpose or effect of tax avoidance”, thus bringing it into line with the wording of the income tax GAAR.⁷²

Despite the different wording the Court of Appeal applied the same reasoning as that applicable for income tax and adopted an objective test of whether the arrangement defeated the Act, therefore ignoring the taxpayer’s honest purpose.

“We are satisfied that [GAAR] does not incorporate a subjective test. To give such an interpretation would render the section, which is intended to operate as a ‘backstop’ provision, virtually inoperative.”⁷³

Glenharrow had argued that, once the parties agreed the license was worth \$45million, it should preclude the application of the GAAR, regardless of whether that price was mistakenly excessive. This argument relied upon the venerable decisions of *Europa Oil*⁷⁴ and *Cecil Bros*⁷⁵ that neither the Commissioner nor the Court may tell taxpayers how to run their business or how much to pay for their assets. The requirement that transactions be undertaken at market value for GST purposes applies only between persons who are “associated” for tax purposes under the NZGSTA and therefore prices set at arms-length should not be disturbed by the GAAR.

The Court of Appeal rejected this argument on the grounds the scheme of the GST regime required transactions to be undertaken at (approximately) market value and that “a grossly inflated” transaction therefore defeated the intent and application of the Act. While only associated persons are explicitly required to transact at market value,⁷⁶ that specific rule reflects the general policy of GST that transactions be conducted at realistic prices, which is normally self-policing between non-associated parties. Thus transactions at non-market value were likely to frustrate the scheme of the NZGSTA.

The Court also found the GST regime generally requires neutrality between supplier and recipient. While mismatches between the timing of input and output tax will occasionally arise, particularly between taxpayers who account for GST on different

⁷² See s BG1 *Income Tax Act 2007*.

⁷³ *Glenharrow v CIR* (2007) 23 NZTC 21,564 at [79].

⁷⁴ *Europa Oil (NZ) Ltd v CIR* (No 2) (1976) 2 NZTC 61,066.

⁷⁵ *Cecil Bros Pty Ltd v FCT* (1964) 11 CLR 430.

⁷⁶ S 10 GST Act 1985.

bases, those mismatches may not be exaggerated. In fact, the very existence of “significant temporal mismatches can indicate a crossing of the line into tax avoidance”.⁷⁷ Likewise, transactions with unregistered person must always bear closer scrutiny because they have obvious potential to disturb GST neutrality.

The Court of Appeal found that the vendor-finance of \$44,920,000 in this instance was so totally unrealistic that it did not amount to “payment” for GST purposes. Accordingly, the assessments of tax avoidance were confirmed.

Given the express findings the taxpayers had acted honestly, if over-optimistically, in reaching their bargain that the mining license was worth \$45m, the Supreme Court granted leave for Glenharrow to appeal. This case was therefore the first time the Supreme Court considered the scope and application of the GST GAAR.

4.2.2 Supreme Court decision in Glenharrow

First, the Supreme Court reiterated that the GST GAAR involved an objective test of the purpose of the arrangement and not a subjective review of the state of mind of the participants:⁷⁸

“Whether or not a particular arrangement constitutes tax avoidance should not depend on difficult judgments about what the taxpayer had in mind. If it did, a scheme which was void if devised and implemented by one taxpayer could be immune from s 76 if developed by another ... It requires the Commissioner and the Court to ask what objectively was the purpose of the arrangement, which in turn requires an examination of the effect of the arrangement.”

On that reasoning a taxpayer can honestly but mistakenly commit tax avoidance. If two persons who knowingly inflated the purchase price of second hand goods are guilty of tax avoidance (because their arrangement when viewed objectively gives rise to a tax advantage never intended by the Act), so too must two innocent persons who have mistakenly agreed on an inflated price for the same goods.

This conclusion follows an unbroken line of cases, starting with *Newman v FCT*,⁷⁹ stipulating that the purpose or effect of the arrangement must be determined objectively and not by reference to the motives of the taxpayers, which are irrelevant.⁸⁰ The GAAR “was concerned not with the purpose of the parties but with the purpose of the arrangement. This is a crucial distinction.”⁸¹ In this regard the Australasian GAARs are consistent with the reasoning of the ECJ⁸² that the test of tax abuse is objective in character. Nevertheless the finding of tax avoidance against an apparently honest taxpayer is the most contentious aspect of the *Glenharrow* decision. Many commentators expressed concern the result was too harsh and if taxpayers have a genuine business purpose, the GAAR should not be applied.⁸³

⁷⁷ *Glenharrow Holdings Ltd v CIR* (2007) 23 NZTC 21,564, at [91]

⁷⁸ *Glenharrow Holdings Ltd v CIR* [2008] NZSC 115, at [35]

⁷⁹ [1958] AC 450.

⁸⁰ See also the New Zealand case of *Ashton v CIR* [1975] 2 NZLR 717.

⁸¹ *Glenharrow* at [38].

⁸² In cases such as *BLP Group plc v Commissioner of Customs & Excise* [1995] STC 424.

⁸³ *Role of a General Anti-Avoidance Rule in GST*, E Trombitas, NZJTLTP Vol 13, Sept 2007.

The Supreme Court ruled that the unusual wording of former s 76 did not alter its scope and application as a general anti-avoidance provision, because “the current version of the section merely states expressly what was implicit in the former version.”⁸⁴

Applying that reasoning to the facts, the Supreme Court asked whether “the intention of the Act will be defeated if the arrangement has been structured to enable the avoidance of output tax or the obtaining of an input deduction in circumstances where that consequence is outside of the purpose and contemplation of the relevant statutory provisions.”

After reviewing the history and role of GST in New Zealand, the Court concluded:

- there will usually be, over time, some balancing of inputs and outputs by a supplier;
- taxpayers should not obtain unacceptable windfalls in their dealings with unregistered persons;
- parties should generally be dealing with each other at approximately market value; and
- timing differences between input and output tax ought not to be exploited.

The Supreme Court stated:⁸⁵

“GST was intended to be broad-based, efficient and neutral. Nevertheless ... tax avoidance opportunities notably remain at the boundaries between taxable and non-taxable transactions and between registered and unregistered persons. Accordingly, the general anti-avoidance provision was considered necessary.”

Considering the facts in *Glenharrow*:⁸⁶

“there is potential for registered taxpayers knowingly or otherwise to create distortions at the boundary between themselves and unregistered persons. The same can occur where transactions are between those registered on a payments basis and those registered on an invoice basis (as in *Ch’elle* and *Nicholls*). The general anti-avoidance provision is available to stop or counteract both these distortions.”

Given the clearly inflated purchase price and the unusual method of payment by way of vendor-finance, the Court confirmed the arrangement constituted tax avoidance in breach of the GAAR.

5. SHOULD DIV 165 OVERRIDE OTHER PROVISIONS OF THE GST ACT?

A common complaint and regular difficulty with the application of Div 165 is how it should operate beside the other provisions of the GST Act. Tension arises as to whether it should be applied widely in such a way as to potentially make all tax

⁸⁴ *Glenharrow*, at [36]

⁸⁵ *Ibid*, at [42]

⁸⁶ *Ibid*, at [46]

advantages vulnerable to attack as tax avoidance, even if the relevant Act's specific provisions have been complied with, and even when no specific anti-avoidance rule embedded in the relevant tax concessions has been contravened.

This problem arises most commonly in relation to income tax, which includes a range of incentives and concessionary provisions that Parliament intended be available to taxpayers.⁸⁷ Many commentators question the extent to which a GAAR should be used to prevent taxpayers accessing those legitimate tax benefits.⁸⁸

Australian courts have previously struggled with this question regarding what became known as "the doctrine of choice" that effectively granted taxpayers the right to structure their affairs specifically in order to take advantage of incentives or omissions in the Act. In *WP Keighery Pty Ltd v FCT*⁸⁹ the Australian High Court stated:⁹⁰

"Whatever difficulties there may be in interpreting [GAAR], one thing at least is clear: the section intends only to protect the general provisions of the Act from frustration, and not to deny to taxpayers any right of choice between alternatives which the Act itself lays open to them."

It was the Court's adherence to this doctrine that ultimately led the Australian Parliament to effectively legislate it away by the effective replacement of former s260 with the more toothsome current version in Part IVA.⁹¹ Nevertheless, it must be recognised that a general anti-avoidance provision "lives in an uneasy compromise with other specific provisions ... it is not the function of GAAR to defeat other provisions of the Act or to achieve a result which is inconsistent with them."⁹² This reasoning was followed by a subsequent Court of Appeal judgment *BNZI*.⁹³

The Supreme Court in the recent *Trinity* tax avoidance case⁹⁴ finally determined that two competing interests must be balanced in the application of GAAR:

- the operation of specific provisions, many of which provide a legitimate incentive to which taxpayers are properly entitled to avail themselves, and
- the principle that even strict compliance with specific provisions will not abrogate the application of GAAR.

The Court stated:⁹⁵

"We consider Parliament's overall purpose is best served by construing specific provisions and the GAAR so as to give appropriate effect to each. They are meant to work in tandem ... Neither should be regarded as

⁸⁷ Known to economists as "tax expenditure".

⁸⁸ See *Judicial Techniques for Controlling the NZ General Anti-Avoidance Rule; the Scheme and Purpose Approach, from Challenge Corporation (1986) to Peterson (2005)*, Paper presented at the Tax Administrators Conference held in Sydney 20-21 April 2006, D Dunbar.

⁸⁹ (1957) 100 CLR 66

⁹⁰ *Ibid*, at 93 – 94.

⁹¹ See the recent decisions under Part IVA, such as *FCT v Spotless Services Ltd* 96 ATC 5201 and *FCT v Hart* (2004) 217 CLR 216.

⁹² *Challenge Corporation Ltd v CIR* [1986] 2 NZLR 513, per Richardson J, at 549.

⁹³ *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450 (referred to as the *BNZI* case).

⁹⁴ *Ben Nevis Forestry Ventures Ltd v CIR* [2008] SC 116.

⁹⁵ *Ibid*, at [103].

overriding. Rather they work together. The presence in New Zealand legislation of a GAAR suggests that our Parliament meant it to be the principal vehicle by means of which tax avoidance is addressed.”

On that reasoning it is apparent not everything that comes within the literal wording of Div 165 will properly constitute “tax avoidance”. So when will a taxpayer’s conduct “cross the line”⁹⁶ between legitimate tax planning (based on the use of specific provisions) and become tax avoidance?

6. NEW ZEALAND EMPHASIS ON ECONOMIC REALITY

In its two recent decisions the New Zealand Supreme Court ruled that the single most important indicia of tax avoidance is whether the tax consequences of the transaction are at odds with its economic effect. Although the *Trinity* and *Glenharrow* cases involved very different factual scenarios under different Acts⁹⁷, the decisions apply consistent principles and clear sign-posts regarding tax avoidance, which may give guidance to the application of Div 165.⁹⁸

The Supreme Court stressed taxpayers must bear the true economic cost of any tax benefit they claim. In doing so the Court freely permitted itself to analyse the economic substance of the arrangement to determine whether it fell properly within the black letter law or was caught as tax avoidance.

The starting point of this economic analysis was the Privy Council’s decision in *Challenge Corp*. There Lord Templeman found “a tax avoidance arrangement was one where a taxpayer derived a tax advantage from a transaction without suffering the reduction in income, loss or expenditure which Parliament intended those qualifying for a reduction in tax liability to suffer.”⁹⁹

The Supreme Court expressly adopted the reasoning in the *Challenge* case that the appropriate test of tax avoidance is whether the commercial reality of a transaction is consistent with its legal form. In *Trinity* the Court considered the use of promissory notes payable in 50 years to purchase intangible property (which the taxpayers immediately depreciated for income tax) meant the purchase price had not really been paid by the taxpayers. It therefore concluded:¹⁰⁰

“the purported payment did not give rise to any economic consequences on either side. ... The payment of the insurance premium by means of the promissory note was, in commercial terms, no payment at all.”

⁹⁶ “Crossing the line” is an metaphor used repeatedly by New Zealand Courts: see *BNZI* at [40] which talks of “line drawing and setting of limits”, and *Accent Management* at [146] which refers to “an exercise in line-drawing” and the *Trinity* scheme as “well and truly across the line” into tax avoidance.

⁹⁷ *Trinity* dealt with depreciation of intangible property under the Income Tax Act 2007 while *Glenharrow* dealt with second-hand goods input tax under the GST Act 1985.

⁹⁸ Indeed, the *Glenharrow* judgment repeatedly cross-refers to the reasoning in the *Trinity* decision to support its conclusions.

⁹⁹ *Challenge Corp* at 561.

¹⁰⁰ *Ben Nevis*, at [147]

In a statement that could apply directly to claims for a creditable acquisition under Div 11, the Supreme Court ruled:¹⁰¹

“the appellants will receive the benefits of tax deductions but probably never incur the real expenditure. ... The Court is permitted, when considering the question of tax avoidance, to examine the commercial nature of the incurred cost and any factors that might indicate that the expenditure will never be truly incurred.”

In *Glenharrow* the Supreme Court considered the use of vendor finance did not amount to actual payment for the mining license for GST purposes.

“In reality the only part of the price which in economic terms would ever be paid” was the \$80,000 deposit and the further \$210,000. The vendor finance amounted to “a ‘pay as you go’ transaction so as to produce an artificial effect with consequent tax advantage, contrary to all economic reality. In economic terms there was no consideration in money given by Glenharrow because of the commercial impossibility of payment by it in the circumstances where it was virtually uncapitalised and not supported by its shareholders. The terms of the arrangement ... had no reality as a ‘cash’ transaction, despite being structured as if it were.”¹⁰²

It is important to note that in neither *Trinity* nor *Glenharrow* did the Court focus upon the inflated amounts the taxpayers agreed to pay as being crucial to the tax avoidance analysis – rather it was the lack of actual payment of the agreed amount that was decisive. In *Glenharrow* the Court expressly stated “it is not the price but the ‘payment’ that created the distorting effect.”¹⁰³

Accordingly, these cases expressly did not over-turn the long-standing rule in *Cecil Bros Pty Ltd v FCT*¹⁰⁴ and *Europa Oil (NZ) Ltd v CIR*¹⁰⁵ that it is not for the Commissioner or the Court to tell a taxpayer how much to spend in obtaining its income. Those cases remain good law. Rather, when considering whether a taxpayer is entitled to a creditable acquisition, the criteria should be whether it has actually paid the amount it claimed. The taxpayer must have truly suffered the economic cost of the purchase it has claimed. Anything less may not be sufficient.

7. SHOULD GAAR BE APPLIED DIFFERENTLY FOR GST?

Until the Supreme Court delivered the *Glenharrow* decision there was some debate as to whether the GAAR should be applied differently for GST and Income Tax. At the time of the introduction of the GST regime, leading Australian tax jurist Justice Hill speculated that differences between the underlying principles and operation of direct

¹⁰¹ Ibid, at [127] – [128]

¹⁰² Ibid, at [53]

¹⁰³ Ibid, at [51]

¹⁰⁴ (1964) 111 CLR 430.

¹⁰⁵ (1976) 2 BZTC 61,066 (PC).

and indirect taxation could require a different approach.¹⁰⁶ Likewise, the New Zealand Inland Revenue Department's own Policy Advice Division noted:

"There are conceptual differences between GST and income tax, and differences in the avoidance tests in the GST Act and the Income Tax Act (which will continue to exist in the reworded section 76). For example, as the Court of Appeal stated in *CIR v New Zealand 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...'¹⁰⁷

In *Ch'elle* the TRA acknowledged the "fundamentally different philosophy of the GST legislation compared with that of the Income Tax Acts".¹⁰⁸

"It points to a significant difference in the way in which the GST avoidance provision is intended to operate. Uniquely, any GST avoidance provision must deal both with escaping from a liability to pay output tax and the right to claim an input deduction. The amended s 76 attempts to meet this requirement."

Nevertheless, the Courts have subsequently given little thought to whether there are unique features of the GST regime that would impact upon the application of the GAAR. As a result, New Zealand Inland Revenue has now recommended that the two GAARs be interpreted consistently in order to "allow a similar analysis and application of case law when determining avoidance has occurred."¹⁰⁹

Despite that view there are a number of different features between GST and income tax that ought to impact how and when Div 165 will apply.

First, the intent and application of the GST Act must be gleaned from the scheme and purpose of the relevant legislative provisions the taxpayer has sought to exploit. There are many cases concerned with how tax legislation should be interpreted and what it is intended to achieve.¹¹⁰ The basis of statutory interpretation is determining what Parliament intends in relation to the specific provision. In effect, the Courts must determine whether Parliament intended particular sections to be used by the taxpayers in that way. This analysis is always a difficult.

A number of cases have examined the scheme and purpose of the NZ GST Act.¹¹¹ Interestingly, the cases that have devoted most attention to the intended operation of

¹⁰⁶ *GST – An Income Tax to be Interpreted by Reference to Income Tax Principles or Just Another Consumption Tax*, DG Hill, Australian Tax Forum (2002) Vol 17:3 at 229.

¹⁰⁷ *GST: A Review - A Government Discussion Document*, NZ Inland Revenue Department, March 1999, at 6.22

¹⁰⁸ *Case W22* (2003) 21 NZTC 11,212, at [173]

¹⁰⁹ TIB Vol 12:12 December 2000.

¹¹⁰ In New Zealand see *CIR v Alcan New Zealand Ltd* (1994) 16 NZTC 11,175 which requires a purposive interpretation of tax legislation, under s 5 *Interpretation Act 1999*. In Australia see *Marsh v FCT* 85 ATC 4345 which requires an interpretation that best promotes the purpose or object underlying the Act, under s 15AA *Acts Interpretation Act 1901 (Cth)*

¹¹¹ Examples include *Databank Systems Ltd v CIR* (1989) 11 NZTC 6,093 regarding exempt supplies, *CIR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 regarding what supplies fall within the Act, and *Wilson & Horton v CIR* (1995) 17 NZTC 12,325 regarding zero-rating.

the GST regime as a whole have been those concerning tax avoidance in order to determine whether the taxpayer's conduct has contravened the Act. For instance, prior to the decisions in *Ch'elle* and *Glenharrow* there were no cases assisting with the interpretation of the registration threshold or second hand goods rules.

But mere compliance with the specific provisions does not mean Div 165 will not apply. In *Ch'elle* the taxpayer attempted to argue that:¹¹²

“as the Act had been complied with, neither its intent nor its application had been defeated. ... that, if the arrangement complies with the legislation, it should not be found to have defeated its intent and application”.

But, as in all tax avoidance cases, this argument was rejected.¹¹³ In fact, unless there has been complete compliance with all those other sections, the arrangement will fail on technical grounds and the Commissioner need not resort to the GAAR to counteract the tax benefits obtained.

Unfortunately, whether the scheme and purpose of the Act has been defeated may come down to what is colloquially referred to as a “sniff test”. Is the transaction carried out in the same way as other similar transactions? Is there an understandable commercial aspect to the transaction? If the transaction differs from ordinary commercial practices, how does it differ? Is it this particular difference that generates the tax advantage?

8. A SUGGESTED METHOD FOR APPLYING DIV 165

One way of determining whether Div 165 should apply is to consider the nature of GST as a comprehensive Value Added Tax. GST is a broad-based consumption tax applying to virtually all transactions. Unlike most countries, Australia applies GST at a single rate of 10%.¹¹⁴ The definition of “supply” is “any form of supply whatsoever”.¹¹⁵ Only narrowly prescribed supplies are exempted or excluded from GST.

When examining the all-encompassing nature of a GST regime, the New Zealand Court of Appeal has noted it “breathes comprehensiveness and one of the outstanding features of the legislation compared with direct tax regimes elsewhere is the breadth of the cover and the limited number of exceptions.”¹¹⁶

The philosophy behind the operation of any GST regime was explained thus:¹¹⁷

“GST is a broad based consumption tax. The objective is to levy a tax on total consumption expenditure. To keep the administration of the tax as simple as possible it will be charged at a single rate and will apply, with very few exceptions, to all goods and services”.

¹¹² *Ch'elle Properties (NZ) Ltd v CIR* (2004) 21 NZTC 18,618, at [35] (HC)

¹¹³ For instance, see the Supreme Courts discussion on this point in *Glenharrow*, at [31] – [32].

¹¹⁴ S 9-70.

¹¹⁵ S 9-10.

¹¹⁶ *CIR v Databank Systems Ltd* [1989] 1 NZLR 422, at 431.

¹¹⁷ NZ IRD PIB No 143, *Broad Principles of GST*, October 1986.

The broad nature of GST was also explained in the leading New Zealand text, *GST – A Practical Guide*.¹¹⁸ In the Introduction, the author recognises:¹¹⁹

“The comprehensiveness of the tax complements its underlying simplicity, virtually all commodities and transactions are subject to GST principles. Also, GST is generally charged at a single standard rate.”

McKenzie then goes on to describe how the entire framework of the Act is intended to support this broad application.

“Despite the underlying simplicity of the tax and its comprehensiveness, the implementation and maintenance of the GST regime has necessitated detailed legislation. The GST Act embodies the basic principles discussed above. It also provides both for supporting concepts, which are required to ensure that the tax works in practice, and for an administrative framework for the tax.”¹²⁰

This view was confirmed by the Supreme Court in *Glenharrow*:¹²¹

“GST was intended to be broad-based, efficient and neutral. Nevertheless, compliance and administration costs preclude perfect neutrality ever being achieved. Tax avoidance opportunities notably remain at the boundaries between taxable and non-taxable transactions and between registered and unregistered persons. Accordingly, a general anti-avoidance provision was considered necessary.”

In short, a GST regime is intended to establish the frame-work and give effect to a broad-based consumption tax. While the Australian legislation contains a limited number of concessions and exemptions,¹²² the over-all scheme of the GST Act is coherent, in that it neither favours nor adversely affects any particular type of supply. The intention of the regime is to be virtually non-distortionary to individual taxpayers and the economy as a whole. In theory then, GST should not have any impact on the spending or investment decisions of taxpayers. If a taxpayer receives any supply, it will pay GST based on the value of that consumption, and taxpayers should generally not take GST into account when making business or consumption decisions. Thus, any time GST does become a motive for action, the taxpayer may have breached the principle of tax neutrality underlying the Act.

Unfortunately, taxpayers are ingenious in their methods of seeking to exploit or misapply the Act in order to obtain tax benefits. In the cases that have come before the Courts, the taxpayers have arranged their affairs so as to ensure they qualify for some GST benefit.

But by taking those steps the taxpayers obviously gave GST too great a consideration in their decision-making. In light of the broad scope of GST, taking those steps in order to obtain a tax benefit should contravene the theoretically neutral nature of the

¹¹⁸ *GST – A Practical Guide*, A McKenzie, CCH (NZ) Ltd, Ed 5, 2007.

¹¹⁹ *Ibid*, at p IX.

¹²⁰ *Ibid*, at X

¹²¹ At [42]

¹²² Mainly for supplies of food, health or education which are classified as “GST-free” and get the same GST treatment as zero-rated exports.

tax. As such, any scheme that requires additional or unusual steps in order to obtain a GST benefit may indicate it breaches the intent and application of the Act. The Commissioner may then negate any tax benefit achieved under such a scheme.

An additional feature is the nature of GST as a transaction tax. Income tax incorporates a number of different treatments for income, deductions, and timing. It creates a range of different regimes for various entities or transactions. In doing so, there are many provisions that either seek to encourage or discourage particular behaviour. These are the incentive regimes Courts are careful not to permit a GAAR to negate.

By contrast, the GST regime is almost entirely homogenous in its application. It contains few express choices, and these are all expressly identified and protected from the application of Div 165.¹²³ Attempting to take advantage of other supposed choices or incentives beyond those provided in the Act would remain vulnerable to Div 165.

The broad based and flat rate of GST show it is intended to neither favour nor adversely affect any particular type of supply. The GST regime does not contain the type of incentive provisions that make the Income Tax GAAR so difficult to apply. So taxpayers generally cannot claim to have structured their affairs so as take advantage of any type of GST concession. For instance, in *Re VCE* the AAT ruled that the taxpayer's choice of GST accounting basis did not constitute a choice or election under the GST Act so as to exclude Div 165.

9. SHOULD FEATURES OF TAX AVOIDANCE REQUIRE DISCLOSURE?

The factors listed in s 165-15 provide tools to determine the purpose of the taxpayer and/or the effect of the scheme. However, schemes that obviously have a tax avoidance purpose or effect under those factors are not automatically void. It requires the intervention of the ATO to invoke Div 165. Accordingly, schemes that are not detected remain in place and the relevant tax benefits are wrongfully retained by participants.

To assist with the detection of such schemes, in 2004 the UK revenue authority introduced a disclosure regime¹²⁴ in relation to arrangements that are intended to give any person a VAT advantage. The main obligation for disclosure rests with those taxable persons who are party to the scheme, whether or not they obtain the tax advantage. If disclosure is not made, then any benefits otherwise available under the scheme (whether otherwise permissible or not) are automatically withheld. In effect, disclosure of the scheme to the authorities is a pre-requirement for the tax benefit to be claimed, whether or not that scheme ultimately constitutes tax avoidance.

Disclosure is required in two broad categories:

¹²³ See s 165-5(1)(b).

¹²⁴ Her Majesty's Revenue and Customs Notice 700/8 (August 2004), superseded by Notice 700/8 (February 2006).

- Listed VAT avoidance schemes: these are schemes that are described in the relevant legislation. Currently, ten schemes have been listed.
- Hallmarked schemes: these are schemes that include or are associated with a hallmark of avoidance prescribed in the relevant legislation. Currently, there are eight hallmarks of avoidance.

The listed schemes are certain arrangements that have previously been identified by the revenue as constituting tax avoidance or, at best, tax aggressive behaviour. Such schemes involve lengthy settlement periods, particular types of supplies and certain cross-border transactions. All similar schemes are therefore presumed to be suspect by Her Majesty's Revenue and Customs (HMRC), which requires all taxpayers involved in those schemes to declare their involvement.

In addition to the particular schemes, another category requiring disclosure are any transactions of whatever kind involving one or more of a number of "hallmarks" of tax avoidance. So any supply of any kind of goods or services that involve such a hallmark immediately becomes subject to disclosure to HMRC. The hallmarks are:

- confidentiality agreements;
- agreements to share a tax advantage;
- contingent fee agreements;
- prepayments between connected parties;
- funding by loans, share subscriptions or subscriptions in securities;
- off-shore loops;
- property transactions between connected persons; and
- issue of face-value vouchers.

Disclosure of participation in any relevant scheme is required to be made either by the promoter (if one exists) or the taxpayer within 30 days of the due date of the affected VAT return. Disclosure must be made to a designated "Anti-Avoidance Group". It effectively requires taxpayers conducting these types of schemes to identify themselves to HMRC. Presumably the effect is to make participation in this type of tax aggressive scheme less desirable on the grounds the attention of authorities is virtually guaranteed.

New Zealand flirted with the introduction of a similar scheme for income tax arrangements in 2002.¹²⁵ The proposal would have required registration with Inland Revenue (IRD) of certain schemes and notification of that registration to investors.

¹²⁵ Inland Revenue Department Officials Paper : Mass-marketed Tax Schemes, 14 January 2002.

Unless the scheme was registered, no tax benefits flowing under that scheme could be claimed by participants.

Ultimately the proposal requiring registration of schemes with IRD was abandoned and any GST benefits obtained under such schemes must be countered using the GAAR. Interestingly, the tax benefit obtained in *Re VCE* exhibits one of the hallmarks of tax avoidance identified by the UK revenue, namely a property transaction between connected persons, which would have required the taxpayer to bring its scheme to the notification of the ATO.

10. CONCLUSION

Both the *Ch'elle* and *Glenharrow* decisions support the broad interpretation and application of a GAAR for GST. They stipulate that artificial arrangements involving inflated valuations devised in order to take advantage of a mismatch between different categories of taxpayer will not be permitted. Furthermore, the GST Act is premised on actual payments made at (approximately) market value in a timely manner. So arrangements that involve deferred settlements (as in *Ch'elle*) or that are funded by money-go-rounds (as in *Glenharrow*) will not be allowed for GST purposes.

These unanimous decisions clearly put New Zealand and Australian taxpayers on notice that, if their schemes lack commerciality or they do not suffer the true economic cost of a creditable acquisition, they will not be permitted to take advantage of the resulting GST benefit. In its newsletter to clients in December 2008 international accounting firm PriceWaterhouseCoopers explained:¹²⁶

“the Supreme Court’s decisions raise the bar for all taxpayers.”

If Australian Courts follow the New Zealand decisions on GST tax avoidance, the opportunity for taxpayers to abuse the GST Act will be greatly reduced.

¹²⁶ PWC Tax Tips, “Tax Avoidance – A New Era?”, Issue 13/2008, at: http://www.pwc.com/en_NZ/nz/tax-tips/taxtips13_2008.pdf