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**THE SCOPE AND EFFECT
OF SECTION 99**
*Commissioner of Inland Revenue v
BNZ Investments Ltd*

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I ABSTRACT

Until *Commissioner of Inland Revenue v BNZ Investments Ltd* ('BNZI') the concept of an 'arrangement' found in New Zealand's general anti-avoidance provision ('GAP'), although integral to the operation of the provision, had rarely been subject to judicial consideration. This paper outlines the decisions of the High Court and Court of Appeal in *BNZI* which held that, unless a taxpayer is consciously involved in or had a meeting of minds in relation to a tax avoidance transaction, there is no arrangement and the GAP can not be applied against the taxpayer even though they obtain a tax advantage from the tax avoidance.

This paper considers the concept of an arrangement and the definition of it found in the New Zealand GAP. In doing so it suggests that it might have been possible for the courts in *BNZI* to identify an arrangement which encompassed within its scope the redeemable preference share transactions to which *BNZI* were a party. While accepting that an arrangement may exist where there is a meeting of the minds, this paper goes on to question the fundamental assumption of the High Court and the majority of the Court of Appeal that the taxpayer against whom the GAP is applied must be part of that consensus.

Having concluded that the requirement of taxpayer knowledge or participation in the arrangement is an unwarranted requirement, the paper suggests an alternative application of New Zealand's GAP more consistent with the conclusions reached, based on its discussion of the law surrounding both the New Zealand GAP and similar international GAPs. The discussion of this alternative application demonstrates that it was unnecessary and undesirable for the courts to incorporate a requirement of taxpayer involvement as a matter of law before there can be an arrangement under New Zealand's GAP.

The text of this paper (excluding contents page, footnotes and bibliography) comprises approximately 15,000 words.

II INTRODUCTION

In *Commissioner of Inland Revenue v BNZ Investments Ltd* ('BNZI') the Court of Appeal considered the scope of section 99, the general anti-avoidance provision in the Income Tax Act 1976. The decision addresses the important issue of the extent to which the anti-avoidance provision can be extended to catch taxpayers who have limited knowledge and involvement in a tax avoidance arrangement, but who nevertheless benefit significantly from it.

In *BNZI*, both the Court of Appeal and the High Court focused their attention on whether there was an arrangement to which section 99 could apply. In doing so they held that, unless a taxpayer has conscious involvement or is involved in a consensus as to the tax avoidance transactions, section 99 cannot apply to them.

This paper will examine the concept of an arrangement, and the approaches of the courts generally to defining and identifying arrangements. It will question the approach of the courts in *BNZI* to the arrangement issue, in particular their focus on *BNZI*'s level of involvement in the arrangement. An alternative approach to the application of section 99 will be suggested, the focus of which is the arrangement and its effect, rather than the knowledge or involvement of a particular taxpayer. Under the rationale of the courts in *BNZI*, such an approach would be flawed by virtue of its applicability to innocent taxpayers. The perceived shortcomings of this alternative approach will be explored, and it will be demonstrated that even if the criticisms of the approach are accepted, they are not insurmountable, thereby rendering it a preferable approach to that adopted by the courts in *BNZI*.

III THE PROBLEM

A Facts of the *BNZI* Case

The facts of the *BNZI* case are complex. Essentially a dispute arose with regard to income tax assessments issued by the Commissioner in relation to a series of redeemable preference share ('RPS') investments

made by BNZ Investments ('BNZI') in entities provided by Capital Markets Limited ('CML'), a member of the Fay Richwhite Group. Substantial sums were involved with additional tax of \$44 million at stake.

RPS financing was relatively common in the late 1980s and carried with it tax advantages over conventional lending. Funds could be borrowed to invest in RPS and the interest on such borrowings was deductible. Dividends on RPS were tax exempt under the inter-company dividend exemption of the time. In addition, where the RPS issuer had losses to use, or had earned exempt income the fact that dividends were not deductible to them was not significant.

Funds invested by BNZI with CML were deposited with offshore banks through a series of complicated transactions involving a number of entities, some of which were located in tax havens. There were two types of transactions, the MCN transactions, which involved mandatory convertible notes, and the Alasdair/Fenstanton transactions, which involved section 195¹ debentures. These complex transactions took advantage of the tax laws at the time and the interest income from offshore banks was ultimately repatriated to BNZI in a tax exempt form. BNZI and Fay Richwhite had a relatively close working relationship, however BNZI had limited knowledge as to the use of the funds that they had invested with CML. Although BNZI made no formal enquiries as to the use of the funds, they had proceeded on the assumption that CML would utilise tax losses to shelter profits. Nevertheless, BNZI had seen fit to take tax indemnities against CML, as was routine in RPS transactions of the time.

¹ Now Income Tax Act 1994, s FC 2.

IV BNZI - THE HIGH COURT DECISION

A The Parties' Main Contentions

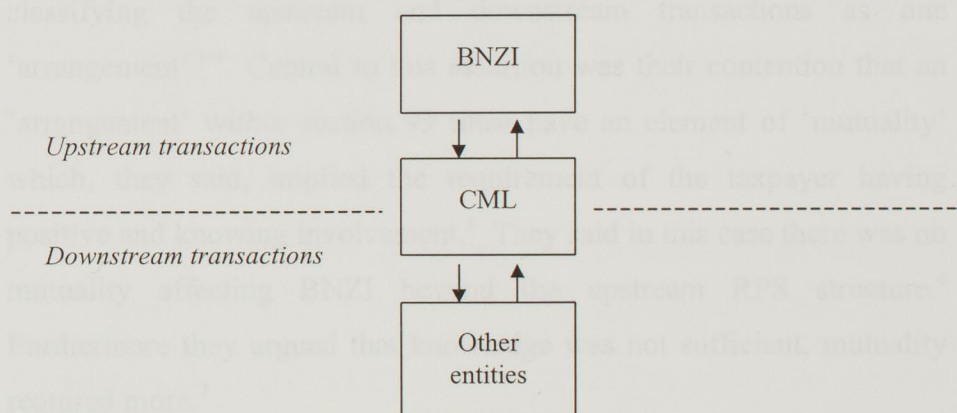
1. The Commissioner of Inland Revenue

The Commissioner sought to use section 99 to counter the tax advantage received by BNZI on the grounds that:

1. the RPS transactions were part of an arrangement which directly or indirectly had more than an incidental purpose or effect of tax avoidance; or
2. whether or not the RPS transactions were part of a void arrangement, BNZI was affected by a void arrangement; and
3. BNZI had obtained a tax advantage from or under that arrangement.²

2. BNZ Investments Ltd

BNZI divided the transactions into separate 'upstream' and 'downstream' transactions, the dividing point being at CML.



BNZI's contentions of most relevance for the purposes of this paper were that section 99 could not be applied to treat the dividends as assessable to them on the grounds that:

² *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,778-15,779 (HC).

1. BNZI had only entered into the upstream transactions which were the relevant 'arrangement' for the purposes of considering the application of section 99 to them, and which did not have tax avoidance as more than an incidental purpose and effect; or
2. If the upstream and downstream transactions could be classified as the relevant 'arrangement', such arrangement did not have tax avoidance as more than an incidental purpose and effect.³

B The Issues and the Approach of the High Court

1. One 'arrangement' under section 99?

a) The parties' main contentions

Justice McGechan adopted BNZI's formulation of the issues and considered first whether the Commissioner was entitled to classify the upstream and downstream transactions as one arrangement for the purposes of section 99(1).

BNZI asserted that there was "no justification in law or in fact for classifying the upstream and downstream transactions as one 'arrangement'."⁴ Central to this assertion was their contention that an 'arrangement' within section 99 must have an element of 'mutuality' which, they said, implied the requirement of the taxpayer having positive and knowing involvement.⁵ They said in this case there was no mutuality affecting BNZI beyond the upstream RPS structure.⁶ Furthermore they argued that knowledge was not sufficient, mutuality required more.⁷

The Commissioner had classified the upstream and downstream arrangements as one, on the basis that the transactions were not conceptually capable of division and that to do so would "deny their

³ *BNZI v CIR*, above, 15,779 (HC).

⁴ *BNZI v CIR*, above, 15,783 (HC) McGechan J.

⁵ *BNZI v CIR*, above, 15,783 (HC) McGechan J.

⁶ *BNZI v CIR*, above, 15,784 (HC) McGechan J.

⁷ *BNZI v CIR*, above, 15,784 (HC) McGechan J.

economic integration and allow form to override substance.”⁸ The Commissioner did not accept that mutuality was required. He set out four alternative policy options in approaching the definition of an arrangement which would implicate the taxpayer in an arrangement based on varying degrees of notice or knowledge of a risk of, or actual tax avoidance. Finally he argued that even if mutuality was required BNZI advanced their money on the understanding that tax minimisation would be achieved and that there was mutuality in that respect, BNZI being ignorant only in respect of the detail.⁹

Justice McGechan preferred the view of BNZI that the arrangements could not be said to be one arrangement and held that mutuality is required before it can be said that a taxpayer is party to an ‘arrangement’,¹⁰ although he added that ‘tacit involvement’ would also suffice.¹¹ He said that “to ‘know’ is not necessarily to ‘arrange’ ... [m]ore is required.”¹² Whether there was tacit involvement, he said was to be determined objectively, and might occur where, for example:

- factual matters point to an inter-connected downstream scheme at risk of avoidance under section 99 and the downstream counterparty is justified in assuming the taxpayer is aware of and comfortable with this risk; or
- a taxpayer is wilfully blind to this risk; or
- a taxpayer suspects or knows such downstream activities will occur and proceeds nevertheless with upstream activities.¹³

He went on to decide that on the facts, BNZI had neither the required conscious nor tacit involvement and that they regarded this as a standard transaction which would fall outside section 99.¹⁴

⁸ *BNZI v CIR*, above, 15,779-15,780 (HC) McGechan J.

⁹ *BNZI v CIR*, above, 15,786 (HC) McGechan J.

¹⁰ *BNZI v CIR*, above, 15,791 (HC) McGechan J.

¹¹ *BNZI v CIR*, above, 15,791 (HC) McGechan J.

¹² *BNZI v CIR*, above, 15,791 (HC) McGechan J.

¹³ *BNZI v CIR*, above, 15,791 (HC) McGechan J.

¹⁴ *BNZI v CIR*, above, 15,793 (HC) McGechan J.

b) Tax avoidance in downstream arrangements

Although he had found that section 99 could not apply to BNZI, Justice McGechan went on to consider the issue of whether there was tax avoidance in the downstream arrangements. While the focus of this paper is on the High Court's approach to the 'arrangement' issue, two of the findings under the 'tax avoidance' issue are worth noting.

The High Court determined that had there been 'one arrangement', the Alasdair/Fenstanton transactions would have been tax avoidance arrangements to which section 99(2) would apply.¹⁵ Second, the High Court said that, in the event of such a finding, BNZI would also be said to have received an indirect tax advantage capable of being countered by the Commissioner through the application of section 99(3).¹⁶

V THE APPROACH OF THE COURT OF APPEAL**A The Issues and Parties' Main Contentions**

The Commissioner appealed against the High Court's decision, and BNZI cross appealed against the Court's decision in relation to the tax avoidance purpose or effect.

The Commissioner's arguments in the Court of Appeal were similar to those he made in the High Court.¹⁷ He submitted that as interdependent transactions, including the sharing of tax advantages, the RPS deals were part of the arrangement within section 99. Alternatively, the Commissioner contended that if knowledge of how the tax advantage was to be obtained was required as part of the plan or understanding, BNZI, having left that part of the arrangement to CML must be taken to have authorised what was done.¹⁸

¹⁵ *BNZI v CIR*, above, 15,803 (HC) McGechan J.

¹⁶ *BNZI v CIR*, above, 15,816 (HC) McGechan J.

¹⁷ The main difference was that his submissions implicating BNZI on the basis of notions of 'notice of tax avoidance' were not advanced due to the High Court's finding of facts in respect of notice.

¹⁸ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,114 (CA) Richardson P.

B The Majority and Justice Blanchard

The majority in the Court of Appeal accepted the High Court's findings of facts and proceeded to consider the arrangement issue.¹⁹ They held that an arrangement "involves a consensus, a meeting of minds between parties involving an expectation on the part of each that the other will act in a particular way."²⁰ They said that the essential thread of the words in section 99(1) is mutuality and that there must be consensus as to what is to be done. The consensus, they said, to constitute an arrangement must encompass explicitly or implicitly the dimension which amounts to tax avoidance, although the taxpayer need not know that it is tax avoidance.²¹

It is not entirely clear what level of consensus the majority required the parties to have, although it appeared to be a relatively high threshold. Justice Blanchard in his separate judgment which was consistent with that of the majority, said that there must be "at least a broad appreciation of the character of what is occurring."²²

Applying that approach to the facts in *BNZI*, the majority held that there was no meeting of the minds between *BNZI* and *CML* as to what steps or activities the latter would undertake downstream.²³ *BNZI* did not know the plan, and nor was there any basis upon which to say that they ought to have known of the tax avoidance.²⁴ There was, the Court held, therefore a natural divide between the upstream and downstream transactions.²⁵

C Justice Thomas - Dissent

Justice Thomas delivered a strong dissenting judgment that will probably be remembered more for his scathing criticism of the Privy

¹⁹ *CIR v BNZI*, above, 17,115 (CA) Richardson P.

²⁰ *CIR v BNZI*, above, 17,117 (CA) Richardson P.

²¹ *CIR v BNZI*, above, 17,117 (CA) Richardson P.

²² *CIR v BNZI*, above, 17,142 (CA) Blanchard J.

²³ *CIR v BNZI*, above, 17,118 (CA) Richardson P.

²⁴ *CIR v BNZI*, above, 17,118 (CA) Richardson P.

Council and its influence in relation to the prevailing approach of form over substance in New Zealand than it will for his comments in relation to the issues of *BNZI*. The judgment is however noteworthy for the different approach Justice Thomas adopts to applying section 99.

Adopting a purposive approach to interpreting section 99, three key factors drove the dissent of Justice Thomas. They were that:

1. arrangement was to be given a wide meaning
2. the scope and effect of an arrangement were to be determined objectively
3. the innocence or ignorance of a participant in the arrangement does not exclude liability.

He held that although *BNZI* were not consciously involved in the specific tax avoidance transaction, the RPS transaction was nevertheless part of the arrangement made or entered into for the purposes of section 99.²⁶ There was, he said, agreement or understanding on the broad components of the transaction²⁷ and that the ignorance or innocence of *BNZI* could not vary the arrangement's effect and should not entitle *BNZI* to take the tax advantage that they obtained from the tax avoidance arrangement.²⁸

VI GROUNDINGS FOR CRITICISM AND COMMENT

The decisions and reasoning of the courts in *BNZI* are interesting for a variety of reasons. Both the High Court and the Court of Appeal focused their decisions on the definition of an arrangement. In doing so, with the exception of Justice Thomas, they approached the question of whether it could be said that there was an arrangement on the basis of the underlying assumption that, for an arrangement to exist, it was necessary that *BNZI* be in some way involved in that arrangement.

²⁵ *CIR v BNZI*, above, 17,118 (CA) Richardson P.

²⁶ *CIR v BNZI*, above, 17,135 (CA) Thomas J dissenting.

²⁷ *CIR v BNZI*, above, 17,135-17,136 (CA) Thomas J dissenting.

²⁸ *CIR v BNZI*, above, 17,139 (CA) Thomas J dissenting.

This section of the paper will consider the definition of an arrangement and the courts' approach to identifying an arrangement under section 99. In doing so, it will first proceed under the assumption that for section 99 to be applied to BNZI, an arrangement in which they were a 'participant' must be identified, an assumption broadly consistent with that of the High Court and the majority of the Court of Appeal. As BNZI clearly had significant involvement in the RPS transactions the paper will therefore discuss whether an arrangement encompassing both these and the downstream transactions may be identified. The paper will then however, go on to question and discuss the validity of reading into the definition of arrangement an element of taxpayer participation as the High Court and majority of the Court of Appeal did.

A Definition of Arrangement

The concept of an arrangement is integral to the operation of section 99. It is clear that in order for section 99 to apply there must be an 'arrangement'.²⁹ In addition, it is the arrangement identified against which the section 99(2) tax avoidance purpose or effect test is applied. It is useful therefore to consider the origins of the statutory definition of 'arrangement', its meaning and to discuss how an arrangement might be identified.

1. History of section 99

Section 99 has its origins in the Land Tax Act 1878 which voided, as between parties to them, "covenants or agreements" which purported to alter the incidence of land tax from the land owner to other persons, such as their tenants.³⁰ A number of similar provisions followed, the scope of which sometimes differed slightly,³¹ however it was not until

²⁹ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,787 (HC) McGechan J.

³⁰ Land Tax Act 1878, s 62.

³¹ For example the Property Assessment Act 1879 s 29 extended to any 'contract, covenant or agreement'.

the Land and Income Tax Assessment Act 1900 that the term 'arrangement' on which the current New Zealand legislation hinges first appeared in a general anti-avoidance provision ('GAP').³²

2. Judicial consideration

The term arrangement has been statutorily defined in New Zealand, however judicial discussion in relation to the meaning of 'arrangement' warrants consideration as it provides substantial insight into the meaning of the New Zealand definition.

Historically the term 'arrangement' did not receive significant attention in the New Zealand courts. In fact there are few cases involving any of the New Zealand GAPs prior to the proliferation of cases in the early 1960s, which continued through the 1970s.³³ In early cases, as has been characteristic of the majority of subsequent cases, the focus of litigation was on whether an accepted contract, agreement or arrangement had the requisite tax avoidance purpose or effect. Similarly issues of knowledge and participation did not arise as early cases typically involved relatively simple arrangements designed to spilt income amongst family members.³⁴ However, while the New Zealand courts did not themselves grapple with the difficult issue of what constitutes an arrangement, they were prepared to adopt the approach of the Australian courts to the issue.

³² Land and Income Tax Assessment Act 1900, s 82. The addition of the term arrangement was important, because as subsequent authorities have illustrated, often the New Zealand GAP has been invoked to counteract complex arrangements involving a number of steps and transactions which are more readily caught under the broad concept of an arrangement than previous more restrictive terms: see ICF Spry *Section 260 of the Income Tax Assessment Act* (2 ed, The Law Book Company Ltd, Melbourne, 1978) 4.

³³ The first reported case involving a New Zealand GAP was *Charles v Lysons* [1922] NZLR 902 (CA).

³⁴ See for example *Commissioner of Inland Revenue v Brown* [1962] NZLR 1091 (SC).

a) *Australian decisions*

In the past, Australia had GAPs similar to those found in New Zealand.³⁵ Justice Isaacs' judgment in *Jaques v Federal Commissioner of Taxation*³⁶ appears to be the first judicial discussion of what is meant by the term arrangement. He noted that:³⁷

arrangement is no doubt an elastic word, and in some contexts may have a larger connotation. But in this collocation it is the third in a descending series, and means an arrangement which is in the nature of a bargain but may not legally or formally amount to a contract or an agreement.

Subsequent to this the High Court of Australia elaborated further on the meaning of arrangement in *Bell v Federal Commissioner of Taxation*.³⁸ The Court said that:³⁹

the word 'arrangement' is the third in a series which as regards comprehensiveness is an ascending series, and [the] word extends beyond contracts and agreements so as to embrace all kinds of concerted action by which persons may arrange their affairs for a particular purpose or so as to produce a particular effect.

While these two cases provide an insight into the meaning the courts have given the term 'arrangement', it was in *Newton v Federal Commissioner of Taxation*⁴⁰, which followed them, that the term was most fully discussed. In that case Lord Denning made the following observations:⁴¹

³⁵ See generally ICF Spry *Section 260 of the Income Tax Assessment Act* (2 ed, The Law Book Company Ltd, Melbourne, 1978) 1-9.

³⁶ (1924) 34 CLR 328 (HCA).

³⁷ *Jaques v Federal Commissioner of Taxation* (1924) 34 CLR 328, 359 (HCA) Isaacs J.

³⁸ (1953) 87 CLR 548 (HCA).

³⁹ *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548, 573 (HCA) Dixon CJ for the Court. Although at first glance the Court may seem to contradict Justice Isaacs by their statement that arrangement is the third in an *ascending* series, they referred to an ascending level of comprehensiveness, whereas Justice Isaacs was referring to a descending level of formality.

⁴⁰ [1958] AC 450 (PC).

⁴¹ *Newton v Federal Commissioner of Taxation* [1958] AC 450, 465 (PC) Lord Denning for the Court.

the word 'arrangement' is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons – a plan arranged between them which may or may not be enforceable in law. But it must in this section comprehend, not only the initial plan but also all the transactions, that is, which have the effect of avoiding taxation.

The approach taken in *Newton* was first adopted by a New Zealand court in *Robertson v Inland Revenue Commissioner*,⁴² a case that involved the meaning of 'transaction'. The *Newton* approach later came to be referred to in GAP cases as early as 1962.⁴³

In 1974 the New Zealand GAP was redrafted in response to a number of factors, not least of which was the recommendation of a taxation review suggesting a clarification of its scope,⁴⁴ the perceived need to strengthen the section in response to a number of technical arguments raised by taxpayers seeking to limit the scope of the section⁴⁵ and a growing level of judicial disquiet as to the section's unsatisfactory nature.⁴⁶ The redrafted section contained a definition of arrangement which encapsulated every element of Lord Denning's conceptualisation of an arrangement and read:⁴⁷

"Arrangement" means any contract, agreement, plan or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect.

Although the definition did not expressly include within its terms the word 'arrangement', it nevertheless represented a clear endorsement by

⁴² [1959] NZLR 492, 499 (SC) McCarthy J (as he then was).

⁴³ *Commissioner of Inland Revenue v Brown* [1962] NZLR 1091, 1095 (SC).

⁴⁴ Taxation Review Committee *Taxation in New Zealand – Report of the Taxation Review Committee* (Government Printer, Wellington, 1967) 267.

⁴⁵ Hon WE Rowling (28 August 1974) 393 NZPD 4108. For a summary of the technical arguments raised and the courts responses to them see ILM Richardson "And Now the New Section 108" [1974] NZLJ 560, 562.

⁴⁶ See for example *Commissioner of Inland Revenue v Gerard* [1974] 2 NZLR 279, 280 (CA) McCarthy P.

⁴⁷ Income Tax Act 1954, s 108. Later adopted in the Income Tax Act 1976, s 99 and now found in the Income Tax Act 1994, s OB 1.

the legislature of the adoption by the New Zealand courts of the *Newton* approach to the meaning of arrangement.

3. What do the words mean?

a) Contract, agreement, plan or understanding

The background to the arrangement definition above suggests a number of things about its meaning. 'Contract' it seems is used in its ordinary sense, meaning a transaction involving a valid offer and acceptance leading to the assumption of legal obligations. 'Agreement' is capable of interpretation narrowly, to mean an agreement which alters the legal rights and obligations of parties to it, or broadly, to mean an agreement in fact not necessarily legally binding.⁴⁸ While it appears that Lord Denning in *Newton* used the term in the narrow sense, the distinction is merely academic, as 'understanding' would clearly extend to agreements in the broader sense of the word in the event 'agreement' was to be read narrowly. 'Plan' is a term that taken on its own is of a slightly different nature from the terms that precede it. However the term should be read in context *ejusdem generis* and with Lord Denning's words 'a plan arranged between them' in mind. It is submitted therefore that the word 'plan' does not detract from the validity of the consensus approach.⁴⁹

Both the High Court and the Court of Appeal acknowledged the definition of arrangement's origin in *Newton*.⁵⁰ Justice McGechan identified the terms in the definition as having one essential common factor of conscious involvement by the taxpayer.⁵¹ However, the context of Lord Denning's use of the words to expand on the meaning of arrangement does not suggest that he used them in any other sense

⁴⁸ ICF Spry *Section 260 of the Income Tax Assessment Act* (2 ed, The Law Book Company Ltd, Melbourne, 1978) 10-11.

⁴⁹ See also *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,787 (HC) McGechan J.

⁵⁰ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,787 (HC) McGechan J and *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,116 (CA) Richardson P.

than their ordinary meaning. For this reason the majority of the Court of Appeal's view that the words require a degree of consensus⁵² seems more appealing.⁵³ It also has the added attractiveness that consensus is a concept well established in law.

In *BNZI* the High Court and the majority of the Court of Appeal were both of the view that two or more people were required for there to be an arrangement.⁵⁴ The majority of the Court of Appeal cited *Davis v Federal Commissioner of Taxation*⁵⁵ as authority that bilaterality is "found in the very nature of the words, contracts, agreements, or arrangements."⁵⁶ The Court in *Davis* were not however considering a provision that included the term 'plan', and it is to this term that Justice Thomas referred to support his view that unilateral arrangements were possible.⁵⁷ Whether unilateral arrangements are embraced by the section 99(1) definition hinges predominantly on the interpretation accorded to the term 'plan'. Based on the discussion of the meaning of plan above, the view that unilateral arrangements are embraced by the section is somewhat dubious. Therefore while it is possible to contemplate situations where one person enters into a series of transactions aimed at tax avoidance,⁵⁸ and conceptually there is no

⁵¹ *BNZI v CIR*, above, 15,787 (HC) McGechan J.

⁵² *CIR v BNZI*, above, 17,116 (CA) Richardson P.

⁵³ The more contentious question of whether the taxpayer against whom section 99 is sought to be applied must be part of this consensus will be discussed below in section VI C 1 Words of section 99.

⁵⁴ *CIR v BNZI*, above, 17,116 (CA) Richardson P and *BNZI v CIR*, above, 15,787 (HC) McGechan J.

⁵⁵ (1989) 86 ALR 195 (FCA).

⁵⁶ *Davis v Federal Commissioner of Taxation* (1989) 86 ALR 195, 227 Hill J (FCA).

⁵⁷ *CIR v BNZI*, above, 17,133 (CA) Thomas J dissenting. The issue arose in *Federal Commissioner of Taxation v Lutovi Investments Pty Ltd* (1978) 9 ATR 351, 356 Mason and Gibbs JJ where a majority of the High Court of Australia held that a resolution of the Board of Directors was an 'arrangement' although not in the context of a GAP.

⁵⁸ Such as the example used by ICF Spry of a trustee declaring complex trusts in favour of unborn children. ICF Spry *Section 260 of the Income Tax Assessment Act* (2 ed, The Law Book Company Ltd, Melbourne, 1978) 14. This justification is of less significance now however in the light of the section 99(3) power to reconstruct against taxpayers.

sound reason not to include them within the definition,⁵⁹ the prevailing weight of authority in New Zealand suggests that there can be no arrangement without two or more people.

The final point that is apparent from the background to the definition of arrangement is that it is intended to have a very broad scope. As Justice Thomas noted "the definition of 'arrangement' could not be expressed more widely."⁶⁰ Justice McGechan however observed that the requirement that there be an arrangement was an intentional limit on the scope of section 99,⁶¹ and he went on to say that Parliament's "deliberately limited focus [should] be respected and advanced, not subverted by expansionist approaches."⁶² The majority of the Court of Appeal also viewed the requirement of an arrangement as a limit on the scope of section 99.⁶³ It is submitted that, although it is correct to say that an arrangement is required by the section, the extremely broad drafting of the definition is illustrative of the fact that it was not intended to be a significant limit on the application of the section. Thus it was intended that the section could be applied to even the most informal types of arrangements and that the section 99(2) test of tax avoidance would then act to limit the section's scope, by distinguishing between acceptable tax mitigation and non-acceptable tax avoidance.⁶⁴ The adoption of a broad definition is consistent with the past approach of the courts in Australia and the definition of a 'scheme' now found in the Australian GAP,⁶⁵ as well as being consistent with the

⁵⁹ C Ohms "Section 99: The General Anti-Avoidance Rule – Analysis and Reform" (1994) 1 NZJTL 87, 93.

⁶⁰ *CIR v BNZI*, above, 17,131 (CA) Thomas J dissenting.

⁶¹ *CIR v BNZI*, above, 17,117 (CA) Richardson P.

⁶² *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,788 (HC) McGechan J.

⁶³ *CIR v BNZI*, above, 17,115-17,116 (CA) Richardson P.

⁶⁴ *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513, 561 (PC) Lord Templeman.

⁶⁵ Income Tax Assessment Act 1936 (Aus), s 177A.

approach of the Canadian courts to the definition of 'transaction' in Canada.⁶⁶

b) Including all steps and transactions by which it is carried into effect

While both courts in *BNZI* considered the meaning of the terms "contract, agreement, plan or understanding", the judgments spend little time considering the meaning and effect of the words "including all steps and transactions by which it is carried into effect" also included in the definition of arrangement.

The rationale for the inclusion of these words is illuminated by Lord Denning in *Newton*. He noted that the term 'arrangement' must "comprehend not only the initial plan but also all the transactions by which it is carried into effect", for it would be useless for the Commissioner to avoid the arrangement and leave the transaction still standing.⁶⁷ Furthermore, since the definition applies to arrangements that are not necessarily legally enforceable, to make them 'void' would not necessarily have any impact. Thus it is necessary to include within the arrangement the steps and transactions that give effect to it so that they too may be voided under the section.⁶⁸

The majority of the Court of Appeal noted that these words do not extend the 'arrangement'. They said that what they must be taken to mean is that the scope of the arrangement is determined by the initial consensus.⁶⁹ It would seem, based on Lord Denning's comments in *Newton*, that this interpretation has substantial merit. Therefore the scope of the arrangement should be determined by the initial arrangement, and while the arrangement includes those steps and

⁶⁶ J R Owen "Statutory Interpretation and the General Anti-Avoidance Rule: A Practitioner's Perspective" (1998) 46 CTJ 233, 236.

⁶⁷ *Newton v Federal Commissioner of Taxation* [1958] AC 450, 465 (PC) Lord Denning for the Court.

⁶⁸ ICF Spry *Section 260 of the Income Tax Assessment Act* (2 ed, The Law Book Company Ltd, Melbourne, 1978) 11.

⁶⁹ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,117 (CA) Richardson P.

transactions by which it is effected, the words cannot be used as a mechanism to extend the scope of the arrangement beyond that initially contemplated.

In *BNZI* Justice McGechan referred to evidence that when BNZ became aware that they would have considerable trading losses, they made known to CML that they were reluctant to continue with RPS investments. However, due to considerable pressure from CML based on commitments CML had already made, BNZ were forced to continue.⁷⁰ In the light of evidence of this pressure it is somewhat surprising that the courts did not give greater consideration to whether it could be said that BNZI's RPS investment was part of the downstream tax avoidance arrangement by virtue of the fact that the RPS investment was a step or transaction by which the tax avoidance arrangement was carried into effect. Given CML's insistence that BNZ continue, it would appear that the RPS investment was clearly contemplated as part of the initial arrangement. In fact Justice McGechan was prepared to find that "there is no doubt that BNZI's RPS transactions caused the downstream arrangements in a 'but for' sense",⁷¹ thus it would seem that not only was the RPS transaction contemplated, but it was clearly an essential and necessary step in order to give effect to the downstream arrangement. Accordingly it would appear at least arguable that the RPS transaction was a step or transaction by which the downstream agreement was carried into effect.

4. *Identifying the arrangement*

The Valabh Committee noted that "as a matter of practice the courts and the revenue do not appear to have had much difficulty with the definition [of arrangement] and have interpreted the scope as narrowly or as widely as the Commissioner contends."⁷² Identification of the

⁷⁰ *CIR v BNZI*, above, 17,112 (CA) Richardson P.

⁷¹ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,789 (HC) McGechan J.

⁷² The Valabh Committee *Key Reforms to the Scheme of Tax Legislation* (Wellington, October 1991) 13.

arrangement has not in the past been an issue upon which the courts have focused, and it has also been said that it is not ordinarily necessary for the courts to set out all of the steps which are part of an arrangement.⁷³ It is nevertheless crucial that the relevant arrangement under section 99(1) be identified with some clarity as the issue of the tax avoidance purpose or effect under section 99(2) must be determined in relation to the identified arrangement.⁷⁴ Different formulations of the arrangement may result in different conclusions as to the tax avoidance purpose or effect.⁷⁵ It is necessary therefore to consider how an arrangement is identified.

a) *Identifying part of a broader arrangement*

It is common for an arrangement to comprise a number of contracts or agreements or a number of steps and transactions. In *FCT v Peabody*⁷⁶ the High Court of Australia considered the Commissioner's identification of the 'scheme' to which he purported the Australian GAP applied. In addressing this issue the Court accepted the Commissioner's identification of a scheme which was a narrower part of the broader scheme initially identified.⁷⁷ They said that although the Commissioner may not identify part of a scheme where the circumstances are incapable of standing on their own without being robbed of all practical meaning, that does not mean that if part of the scheme may be identified as a scheme in itself the Commissioner is precluded from relying upon it.⁷⁸ The result of allowing this approach is that it is legitimate for the taxing authority to ignore a wider arrangement, that may have been entered into for reasons other than tax avoidance, and focus on one

⁷³ ICF Spry *Section 260 of the Income Tax Assessment Act* (2 ed, The Law Book Company Ltd, Melbourne, 1978) 14.

⁷⁴ *Davis v Federal Commissioner of Taxation* (1989) 86 ALR 195, 226 Hill J (FCA).

⁷⁵ GT Pagone QC "Tax Planning or Tax Avoidance" (2000) 29 ATR 96, 108. See also N Orow "The Future of Australia's General Anti-Avoidance Provision" (1995) 1 NZJTL 225, 229.

⁷⁶ (1994) 181 CLR 359 (HCA).

⁷⁷ *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, 384 (HCA) Judgment of the Court.

⁷⁸ *FCT v Peabody*, above, 383-384 (HCA) Judgment of the Court.

aspect of the scheme.⁷⁹ The Canadian GAP also expressly allows for this approach to be taken.⁸⁰

This approach has been labelled the 'sub-scheme' approach.⁸¹ The New Zealand courts however have not demonstrated a willingness to adopt such an approach.⁸² Thus, in *Case U6*⁸³ the Taxation Review Authority said that the Commissioner's position was "fundamentally flawed" where he sought to treat one aspect of a broader investment scheme as the relevant arrangement under section 99.⁸⁴ The Authority said "the offending transaction must be treated as a whole. It is impermissible to attempt to sever parts of it [...] and characterise them as infringing section 99."⁸⁵

The approach adopted in *Case U6* is consistent with that approved by the House of Lords in *Inland Revenue Commissioners v Brebner*.⁸⁶ That case involved a section which allowed the cancellation of a tax advantage obtained under a transaction if the taxpayer could not show that the transaction which gave rise to the tax advantage did not have obtaining a tax advantage as one of its main objectives.⁸⁷ In *Inland Revenue Commissioners v Brebner* there were a number of transactions relating to a wider share purchase agreement and its financing. The House of Lords rejected the Commissioner's attempt to divide the wider arrangement into separate parts and to determine the object of each part in isolation for the purposes of the application of the section. Lord Pearce upheld the Special Commissioners' decision and said that in applying the section they had "rightly approached the transaction as a

⁷⁹ C Ohms "Section 99: The General Anti-Avoidance Rule – Analysis and Reform" (1994) 1 NZJTL 87, 93. Compare *FCT v Peabody* (1993) 93 ATC 4104, 4111 (FCA) Hill J.

⁸⁰ Income Tax Act 1952, s 245(3)(b) which defines an 'avoidance transaction' as "any transaction that is part of a series of transactions that would result ... in a tax benefit."

⁸¹ Ohms, above, 93.

⁸² J Bassett "Developments in Tax Avoidance" [2000] NZTPR 25, 26.

⁸³ (1999) 19 NZTC 9,038 (TRA).

⁸⁴ *Case U6* (1999) 19 NZTC 9,038, 9,059 (TRA) Willy DCJ.

⁸⁵ *Case U6*, above, 9,059 (TRA) Willy DCJ.

⁸⁶ [1967] 2 AC 18 (HL).

⁸⁷ Finance Act 1960 (UK), s28.

whole from a broad common-sense view."⁸⁸ The justification for his approval of this approach was his view that the section, which focused on a transaction's main object, would be robbed of all practical meaning if one had to isolate and ascertain the object of one part of the arrangement divorced from the object of the arrangement as a whole.⁸⁹

This justification is, to a significant extent, applicable to section 99 in the sense that the more narrowly the arrangement is identified, the more readily the requisite tax avoidance purpose or effect of the arrangement is likely to be established. The justification is not however as applicable to the Australian GAP since Part IVA expressly provides that the question of purpose may be determined by reference to part of a scheme.⁹⁰

The New Zealand courts' rejection of the sub-scheme approach is considered pragmatically sound.⁹¹ Furthermore it is consistent with the Consultative Committee's view that although extraordinary and superfluous tax elements that form part of the arrangement under review could have section 99 applied to them by viewing them removed from the broader arrangement of which they are part, on balance, they said "there must be an opportunity to achieve non-tax objectives in a tax efficient manner and that the appropriate restraint on excessive tax effectiveness is simply the dominant objective test."⁹²

However, although the Australian GAP does refer to 'part of a scheme'⁹³ the High Court of Australia pointed out in *FCT v Peabody* that the definition of scheme did not include part of a scheme.⁹⁴ Therefore, at a conceptual level, based on the words of section 99, the

⁸⁸ *Inland Revenue Commissioners v Brebner* [1967] 2 AC 18, 26 (HL) Lord Pearce.

⁸⁹ *IRC v Brebner*, above, 27 (HL) Lord Pearce.

⁹⁰ Income Tax Assessment Act 1936 (Aus), s 177D.

⁹¹ C Ohms "Section 99: The General Anti-Avoidance Rule – Analysis and Reform" (1994) 1 NZJTL 87, 93.

⁹² The Valabh Committee *Final Report of the Consultative Committee on the Taxation of Income from Capital* (Wellington, October 1992) 26.

⁹³ Income Tax Assessment Act 1936 (Aus), s 177A(5) and s 177D.

⁹⁴ *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359, 384 (HCA) Judgment of the Court.

principle in *FCT v Peabody* that, if part of an arrangement can stand on its own as an arrangement, then that part may itself be identified as an arrangement, is also valid under the New Zealand GAP. Thus if subsequent New Zealand courts decide to follow the rejection of the sub-scheme approach in *Case U6*, they will need to do so on the basis of a gloss read into section 99.

b) Identifying a broader arrangement

Regardless of whether or not a narrower part of a broader arrangement can be identified for GAP purposes, it has long been recognised that a transaction may merely be part of a wider arrangement which may be identified for the application of a GAP.⁹⁵ However, while the courts have recognised that a broader arrangement may be identified, the basis on which they determine the scope of that broader arrangement is not readily apparent. It is possible however to draw on English authorities to suggest an appropriate basis for such a determination.

The English courts have, in recent years, created what has become known as the 'doctrine of fiscal nullity.' *WT Ramsay v Inland Revenue Commrs*⁹⁶ is regarded as the fountainhead of the doctrine of fiscal nullity,⁹⁷ however the doctrine has been developed in a number of cases.⁹⁸ Essentially the doctrine enables the court to treat a pre-ordained series of transactions as a composite whole for the purposes of the application of taxing provisions, rather than the court being restricted to applying the provision to each individual step.⁹⁹ A feature of fiscal nullity cases is that typically the courts identify and determine the extent

⁹⁵ *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548, 573 (HCA) Dixon CJ for the Court.

⁹⁶ *Macniven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] 1 All ER 865, 874 (HL) Lord Hoffman.

⁹⁷ [1982] AC 300 (HL).

⁹⁸ See for example *Furniss (Inspector of Taxes) v Dawson* [1984] AC 474 (HL) and *IRC v McGuckian* [1997] 1 WLR 991 (HL) and *Macniven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] 1 All ER 865.

⁹⁹ *WT Ramsay v Inland Revenue Commrs* [1982] AC 300, 323-324 (HL) Lord Wilberforce.

of the broader arrangement in question and discuss the principles by which they do so.

To determine whether there is a broader composite transaction for fiscal nullity purposes the courts have regard to whether the series of transactions in question was pre-ordained at the time of the first transaction.¹⁰⁰ Although the meaning of 'pre-ordained' has been subject to judicial disagreement, the prevailing view is that for a series to be pre-ordained it must be 'practically certain' at the time of the first step, that the further steps will be carried through to completion.¹⁰¹ Lord Oliver elaborated on the meaning of "practical certainty" saying that:¹⁰²

it is essential that at least principle terms should be agreed to the point at which there is no practical likelihood that the transaction will not take place.

He went on to note that it is not sufficient that the transaction that occurs is of a kind contemplated.¹⁰³

The Supreme Court of Canada has said that the doctrine of fiscal nullity is not applicable in Canada as it was perceived to conflict with the principle in *IRC v Duke of Westminster*¹⁰⁴.¹⁰⁵ Similarly, in Australia the Full High Court in *John v Federal Commissioner of Taxation*¹⁰⁶ said that there was no room for the application of the doctrine of fiscal nullity due to the presence of the Australian GAP.¹⁰⁷

¹⁰⁰ *Craven (Inspector of Taxes) v White* [1989] AC 398, 515 (HL) Lord Oliver.

¹⁰¹ *Craven v White*, above, 516-517(HL) Lord Oliver. See also *Furniss (Inspector of Taxes) v Dawson* [1984] AC 474 (HL).

¹⁰² *Craven v White*, above, 517 (HL) Lord Oliver.

¹⁰³ *Craven v White*, above, 517 (HL) Lord Oliver. The minority in *Craven (Inspector of Taxes) v White* preferred a less restrictive approach and took the view that pre-ordained meant no more than that the relevant transactions have been planned in advance as a whole, with evidence of advanced agreement on later stages being no more than "useful evidence" of this: see *Craven (Inspector of Taxes) v White* [1989] AC 398, 522 (HL) Lord Goff dissenting.

¹⁰⁴ [1936] AC 1, 19 (HL) Lord Tomlin. This is commonly referred to as the form over substance approach.

¹⁰⁵ *Stuart Investments Limited v Her Majesty the Queen* [1984] CTC 294 (SCC).

¹⁰⁶ (1989) 89 ATC 4101 (HCA).

¹⁰⁷ *Johns v Federal Commissioner of Taxation* (1989) 89 ATC 4101, 4,110 (HCA).

In the New Zealand legal context, the doctrine of fiscal nullity has been the subject of judicial discussion on a number of occasions. However, despite this and the recommendation by the Committee of Experts that this matter be clarified by legislative amendment,¹⁰⁸ no definitive conclusion has yet been reached on the doctrine's place in New Zealand tax law.¹⁰⁹

In *IRC v McGuckian*¹¹⁰ Lord Cooke said that the doctrine does not depend on GAPs such as that found in New Zealand, rather that it is "antecedent to or collateral with them."¹¹¹ Similarly, the Committee of Experts in their report were of the opinion that there is no reason why the doctrine of fiscal nullity should be precluded from applying in New Zealand by virtue of the fact that a statutory GAP exists.¹¹²

However there are views resisting the application of the doctrine in New Zealand. In the High Court for example, Justice Baragwanath commented that it is unnecessary for the courts in New Zealand to develop a concept of fiscal nullity to protect the tax base due to the presence of the GAP.¹¹³ Similarly, in *BNZI* Justice McGechan expressly rejected the Commissioner's contention that 'Ramsay type' analysis was appropriate. He said that he was unable to accept that "the threshold question of 'arrangement' was determined, *or even much assisted*, by

¹⁰⁸ Committee of Experts on Tax Compliance *Tax Compliance – Report to the Treasurer and Minister of Revenue* (Wellington, December 1998) 128.

¹⁰⁹ <http://www.brookers.co.nz>, G Cole *Smart Tax Commentary - Income Tax Act 1994 Commentary - ITAC Part BG 1 [Avoidance]* (Last updated 30 May 2001). See further D Coull "Application of the fiscal nullity doctrine in New Zealand" [2001] NZTPR 17-21.

¹¹⁰ [1997] 1 WLR 991 (HL).

¹¹¹ *IRC v McGuckian* [1997] 1 WLR 991, 1005 (HL) Lord Cooke. See also recent comments in the Privy Council that the doctrine of fiscal nullity had "taken over" some of the work that provisions such as the New Zealand GAP used to do, implicitly suggesting therefore that the doctrine was applicable in the New Zealand context: *Commissioner of Inland Revenue v Auckland Harbour Board* (2000) 20 NZTC 17,008, 17,012 (PC) Lord Hoffman. Note also the language adopted by Lord Hoffman in *O'Neil v Commissioner of Inland Revenue* (2001) 20 NZTC 17,051, 17,057 (PC) which is consistent with the language of fiscal nullity cases.

¹¹² Committee of Experts on Tax Compliance *Tax Compliance – Report to the Treasurer and Minister of Revenue* (Wellington, December 1998) 128.

¹¹³ *Miller v Commissioner of Inland Revenue; McDougall v Commissioner of Inland Revenue (No 1)* (1997) 18 NZTC 13,001, 13,036 (HC) Baragwanath J.

Ramsay doctrine as to composite transactions.”¹¹⁴ He said that the “doctrine was not, and is not, intended to determine the scope of an ‘arrangement’ within the special and exhaustive definition contained in section 99(1).”¹¹⁵ It is interesting to note however that Justice McGechan said in relation to the *Ramsay* doctrine that “[c]ertainly, it can be useful and applicable in ascertaining the ‘purpose’ of an arrangement as established.”¹¹⁶

In *Craven (Inspector of Taxes) v White* Lord Oliver said:

[i]n the ultimate analysis, most, if not all, revenue cases depend upon a point of statutory construction, the question in each case being whether a particular transaction or a particular combination of circumstances does or does not fall within a particular formula prescribed by the taxing statute as one which attracts fiscal liability. As part of that process it is, of course, necessary for the courts to identify that which is the relevant transaction or combination before construing and applying it to the statutory formula. Reduced to its simplest terms that is all that *Ramsay* did.

In applying section 99, the courts in New Zealand are required to do exactly that which his Lordship describes above, that is identify an arrangement under section 99(1), and apply section 99(2) to that arrangement. Indeed, the fact noted by Lord Templeman that section 99 would apply to a number of English fiscal nullity cases, including *Ramsay*, is illustrative that there is a considerable degree of overlap between section 99 and the fiscal nullity doctrine.¹¹⁷

In addition, the English courts’ approach to identifying a composite arrangement is consistent with what little case law exists on how an ‘arrangement’ is to be identified under a GAP in the nature of section 99. In *Bell v Federal Commissioner of Taxation* the Court seemed to determine the extent of the wider arrangement by looking at

¹¹⁴ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,789 (HC) McGechan J.

¹¹⁵ *BNZI v CIR*, above, 15,789 (HC) McGechan J.

¹¹⁶ *BNZI v CIR*, above, 15,789 (HC) McGechan J.

the preconcerted plan.¹¹⁸ Justice Speight in the New Zealand Court of Appeal took a similar approach saying that:¹¹⁹

the whole scheme must be examined going back to the original plan if there is evidence of one and to the steps which have ... been taken in pursuance of that plan.

Indeed the majority of the Court of Appeal in *BNZI* agreed that the scope of the arrangement was to be determined by the initial consensus.¹²⁰

Furthermore, *Ashton v CIR*,¹²¹ one of the few New Zealand cases which has directly addressed the arrangement issue, is also consistent with the approach to identifying the arrangement in *Ramsay* analysis. In the context of determining whether a certain transaction formed part of the relevant arrangement, President McCarthy relied on the high degree of interdependence between steps in a broader transaction when he treated all the steps in question as part of one wider arrangement.¹²²

Therefore given these similarities in approaches to determining the extent of an arrangement, it is submitted that regardless of whether or not the doctrine of fiscal nullity as a whole has a place in New Zealand tax law, there is no good reason why the New Zealand courts should not draw on the approaches of the English courts to identifying the relevant arrangement under the doctrine, for the purposes of developing a coherent approach to the application of section 99(1). This suggestion has judicial support. In *Mills v Dowdall*,¹²³ a case which concerned matrimonial property legislation, Justice Cooke (as he then was)

¹¹⁷ *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1986] 2 NZLR 513, 562 (PC) Lord Templeman.

¹¹⁸ *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548, 573 (HCA) Dixon CJ for the Court.

¹¹⁹ *McKay v Commissioner of Inland Revenue* (1973) 3 ATR 379, 391 (CA) Speight J (emphasis added).

¹²⁰ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,116-17,117 (CA) Richardson P.

¹²¹ [1974] 2 NZLR 321 (CA).

¹²² *Commissioner of Inland Revenue v Ashton* [1974] 2 NZLR 321, 329-330 (CA) McCarthy P.

¹²³ [1983] NZLR 154 (CA).

considered the appropriate approach to take to a series of transactions intended to act in combination. He referred to the *Ramsay* approach and saw no reason why it could be applied not only to tax cases, but also more widely.¹²⁴ There is also support for this contention from Canada, where although fiscal nullity has been rejected, many commentators consider *Ramsay* type analysis may be of relevance to interpreting the words 'series of transactions' found in the Canadian GAP.¹²⁵

It is worth considering therefore whether the Commissioner should have been able to successfully argue that the BNZI RPS transactions were part of a wider arrangement encompassing the downstream tax avoidance transactions. To apply the *Ramsay* analysis to the facts of *BNZI* it is necessary to consider whether at the time of the initial agreement the series of transactions was pre-ordained. The agreement between CML and BNZI was that BNZI would advance finance to CML in return for RPSs which would pay dividends at agreed rates reflecting 50% of the tax saving generated by the downstream transactions. Crucially however, CML did not disclose any aspect of the downstream transactions to BNZI. Thus while it was agreed that CML would utilise the funds advanced to generate supernormal returns via tax effective structuring, BNZI did not know the nature of the structure to be used. Evidence was accepted that BNZI proceeded on the assumption that a commonplace loss utilisation scheme would be used. In the view of Justice Blanchard, BNZI did not even have a broad appreciation of the character of what was occurring downstream.¹²⁶ In terms of *Ramsay* analysis, this level of agreement is insufficient.¹²⁷ The threshold is therefore relatively high, and even if it could be met in *BNZI*, it would still be necessary to consider whether the downstream

¹²⁴ *Mills v Dowdall* [1983] NZLR 154, 157 (CA) Cooke J.

¹²⁵ D Finkelstein (ed) *Canadian Tax Service* (Looseleaf, Thompson Canada Ltd, Ontario) Income Tax Act (RSC 1985) Part XVI para 245-108. See also J Tiley "Series of Transactions" in Report of the Proceedings of the Fortieth Tax Conference (Canadian Tax Foundation, Ontario, 1988) 8:1, 8:5-8:6 and B Arnold "The Canadian General Anti-Avoidance Rule" [1995] BTR 541, 549.

¹²⁶ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,142 (CA) Blanchard J.

transactions were practically certain to occur at the time of the RPS agreements, in the sense that there was no practical likelihood that at the time of the RPS agreement, the downstream transactions would not follow. This aspect of the *Ramsay* analysis would appear to be more readily satisfied on the facts of *BNZI*. While it is not clear, it seems likely that CML would have had the downstream arrangements in place at the time they agreed to the RPS deal as is suggested by the speed with which the downstream transactions occurred and the fact that BNZI had been pressured by CML to continue with RPS deals because of 'commitments' they had entered into.

An alternative approach would be to focus on the agreement between CML and the downstream entities. To do so is more difficult, due to the focus of the courts on the facts in relation to the upstream agreement. However, if it could be said that at the time the downstream transactions were agreed there was agreement that CML would obtain finance via an RPS deal with BNZI and there was no practical likelihood it would not occur, it would be arguable to say that there was a single pre-ordained arrangement comprising the upstream and downstream transactions. This analysis is a more contentious approach and it is arguably a strained application of the *Ramsay* type analysis since it does not focus on the agreement entered into by the relevant taxpayer as the *Ramsay* cases do. If this approach is however valid, whether it would be possible to identify the arrangement as a pre-ordained one would depend on further information in relation to the nature of the downstream arrangement.

5. Arrangement - Conclusion

The concept of arrangement has been drafted in extremely broad terms, and while the courts have from time to time grappled with how to identify the arrangement's scope, in the end it has not in the past been considered difficult to fit some form of agreement within the definition

¹²⁷ *Craven (Inspector of Taxes) v White* [1989] AC 398, 517 (HL) Lord Oliver.

of an arrangement.¹²⁸ The discussion above has suggested that it might have been possible to bring within an arrangement the RPS transaction of BNZI either as being a step or transaction by which an arrangement was carried out, or adopting the *Ramsay* analysis, by virtue of the fact that the RPS deal was part of a pre-ordained arrangement encompassing the downstream transactions. The conclusion that this might have been possible does not necessarily lead to the conclusion that, had the High Court and Court of Appeal majority identified the arrangement in this way, the result of the case would have been that the arrangement was void as a tax avoidance arrangement. The courts would still have had to go on and consider if the broad arrangement identified could be said to have the requisite tax avoidance purpose.

B The Approach to Interpretation of Section 99

The discussion above has implicitly accepted that for section 99 to apply to BNZI, it was necessary to identify an arrangement that encompassed the RPS deal to which BNZI were a participant. It is however by no means clear that this is actually required by the terms of section 99. In determining the section 99(1) question of whether there was an arrangement, a common theme and focus of all the judgments in the *BNZI* cases was the consideration of whether BNZI had knowledge of, involvement in, or could in some way be implicated with the downstream tax avoidance transactions. This section of the paper will discuss the validity of according such importance to the 'participation' in the arrangement of the taxpayer against whom it is sought to apply section 99.

1. The approach of the courts in BNZI

Both the High Court and the majority of the Court of Appeal placed significant weight on the fact that BNZI had no knowledge of or involvement in the downstream tax avoidance transactions to reach their conclusion that there was no arrangement under section 99(1). In the

¹²⁸ NHM Forsyth QC "The General Structure of Part IVA" (1981) 10 ATR 132.

High Court Justice McGechan said that “there *must be* conscious or tacit involvement before a taxpayer can be said to be party to an arrangement.”¹²⁹ Conscious involvement, he said, required more than to merely know or have notice of something, since “to know is not necessarily to ‘arrange’ ... [m]ore is required.”¹³⁰ It is clear therefore, under the High Court approach, that as a matter of law, before an arrangement could even be held to exist, the taxpayer against whom section 99 was to be applied would need to be found to have the requisite level of involvement in the activity sought to be rendered void. Justice McGechan held that on the facts BNZI had neither the required conscious nor tacit involvement in the downstream transactions.¹³¹ Crucially therefore, he concluded that “I find BNZ/BNZI were not party to an ‘arrangement’ within s[ection] 99 involving the downstream transactions. Section 99 *cannot* apply.”¹³²

Similarly, the majority of the Court of Appeal took the approach that for there to be an arrangement under section 99(1) there must be consensus between parties.¹³³ That consensus they said “must encompass explicitly or implicitly the dimension which actually amounts to tax avoidance; albeit the taxpayer does not have to know that such dimension amounts to tax avoidance.”¹³⁴ There must be consensus as to what is to be done.¹³⁵ Therefore, while they differ slightly from the High Court in the nature of the involvement a taxpayer must have in an arrangement, it is implicit in their reasoning that they too required, as a matter of law, that the relevant taxpayer have a certain level of involvement before an arrangement can be said to exist.

¹²⁹ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,791 (HC) McGechan J (emphasis added).

¹³⁰ *BNZI v CIR*, above, 15,790-15,791 (HC) McGechan J.

¹³¹ *BNZI v CIR*, above, 15,793 (HC) McGechan J.

¹³² *BNZI v CIR*, above, 15,793 (HC) McGechan J (emphasis added).

¹³³ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,117 (CA) Richardson P.

¹³⁴ *CIR v BNZI*, above, 17,117 (CA) Richardson P.

¹³⁵ *CIR v BNZI*, above, 17,117 (CA) Richardson P.

2. A matter of fact and degree or a matter of law?

It is interesting that both the High Court and the majority of the Court of Appeal adopted this approach in the light of the fact that often in tax law, issues are determined "as a matter of fact and degree." Thus issues of capital/revenue distinctions,¹³⁶ apportionment of expenditure,¹³⁷ reasonableness of remuneration paid,¹³⁸ whether a taxpayer is carrying on a business¹³⁹ and whether investments were acquired with a purpose of resale¹⁴⁰ are just a few of the issues where the courts determine the outcome as a matter of fact and degree.

It has long been accepted that section 99 must be given a non-literal interpretation. Thus in *Commissioner of Inland Revenue v Gerard* President McCarthy noted with reference to New Zealand's GAP prior to section 99:¹⁴¹

it cannot be given a literal application, for that would, the Commissioner has always agreed, result in the avoidance of transactions which were obviously not aimed at by the section. So the Courts have had to place glosses on the statutory language in order that the bounds might be held reasonably fairly between the Inland Revenue authorities and taxpayers.

However, the glosses the courts have applied to section 99 to make it function effectively, like those in other parts of tax law, have in the past been considered as a matter of fact and degree rather than being required as a matter of law. Thus as President Woodhouse stated, in a

¹³⁶ *Henwood v Commissioner of Inland Revenue* (1995) 17 NZTC 12,271 (CA) and *Poverty Bay Electric Power Board v Commissioner of Inland Revenue* [1999] 2 NZLR 438 (CA).

¹³⁷ *Europa Oil (New Zealand) Ltd v Commissioner of Inland Revenue* [1970] NZLR 321 (CA).

¹³⁸ *Troon Place Investments Ltd v Commissioner of Inland Revenue; GS Mathews (Chemist) Ltd* (1995) 17 NZTC 12,175 (HC).

¹³⁹ *Commissioner of Inland Revenue v Stockwell* [1993] 2 NZLR 40 (CA).

¹⁴⁰ *T Piers and Ors Trustees of the Alexander and Alexander Pension Plan v Commissioner of Inland Revenue* (1995) 17 NZTC 12,283 (HC).

¹⁴¹ *Commissioner of Inland Revenue v Gerard* [1974] 2 NZLR 279, 280 (CA) McCarthy P.

leading authority on section 99 in New Zealand, *Commissioner of Inland Revenue v Challenge Corporation Ltd*.¹⁴²

in the end, like so much else in the law, the breadth of the qualifying phrase in section 99(1)2(b), and so the ambit of the section itself will be discovered as a matter of fact and degree on a case by case basis.

More recently it was noted that "what is legitimate 'mitigation' and what is illegitimate 'avoidance' is in the end to be decided by the Commissioner, Taxation Review Authority and ultimately the courts, *as a matter of judgement*."¹⁴³

It is argued by some that to approach the GAP in such a way, and to leave the law relating to the provision open and flexible gives rise to uncertainty. Speaking of Australia's previous GAP one commentator said "the section in its operation lacks one element which is socially and commercially essential in a taxing statute: certainty."¹⁴⁴

The response to this criticism is twofold. The first response is that the legislature intended to and has deliberately chosen to leave the GAP flexible in its operation. President Woodhouse in *Commissioner of Inland Revenue v Challenge Corporation Ltd* discussed this at some length and noted that although a more detailed amendment was considered during the redraft, it was deemed unacceptable.¹⁴⁵ A similar point was made more recently when it was said that "Parliament has deliberately left [section BG 1] open textured."¹⁴⁶

The second response to this criticism is that uncertainty in the operation of the section is desirable for the reason that it makes the section more effective. This point has been made a number of times,

¹⁴² [1986] 2 NZLR 513, 534 (CA) Woodhouse P.

¹⁴³ *Miller v Commissioner of Inland Revenue; McDougall v Commissioner of Inland Revenue* (1997) 18 NZTC 13,001, 13,031 (HC) Baragwanath J (emphasis added).

¹⁴⁴ M J Trebilcock "Section 260: A Critical Examination" (1964) 38 ALJ 237, 247.

¹⁴⁵ [1986] 2 NZLR 513, 534 (CA) Woodhouse P.

¹⁴⁶ *Miller v CIR; McDougall v CIR*, above, 13,030 (HC) Baragwanath J.

perhaps most notably by the Committee of Experts in *Tax Compliance* when they said:¹⁴⁷

if a general anti-avoidance provision is to be effective, it cannot be precise. Although this feature of an anti-avoidance provision means less certainty for taxpayers, the Committee believes that this cost is outweighed by the benefit provided by the flexible wording of the general anti-avoidance rule, allowing the court to address new and different types of tax avoidance arrangements.

It has also been said of GAPS that their vagueness protects them from attack as it denies lawyers and accountants the clear target of specific legislation which makes them prone to manipulation.¹⁴⁸

Thus while the level of involvement by a taxpayer may arguably be an important factor worthy of consideration when the courts are addressing the issue of whether there is an arrangement under section 99(1), it is submitted that it would be more appropriate for the courts to consider it as one factor, along with others, to determine whether as a matter of fact and degree there is an arrangement. By reading a gloss into the terms of section 99 requiring taxpayer involvement as a matter of law, the courts in *BNZI* could be criticised for attempting to render certain what the legislature and previous courts have, time and time again, left uncertain. In doing so the courts not only potentially undermine the effectiveness of section 99, but put themselves at risk of allegations of blurring the role of the legislature as law maker, and that of the courts to interpret law.

C Relevance of Taxpayer Involvement

Whether it was appropriate that the courts required taxpayer involvement as a matter of law can be questioned. A more fundamental

¹⁴⁷ Committee of Experts on Tax Compliance *Tax Compliance – Report to the Treasurer and Minister of Revenue* (Wellington, December 1998) 129.

¹⁴⁸ D Crerar "Interpretations of GAAR: Before and Beyond McNichol and RMM" (1997) 23 *QueensLJ* 231, 251 citing in support CFL Young "The Attribution Rules: Their Uncertain Future in the Light of Current Problems" (1987) 35 *Can Tax J* 275, 310.

question is whether or not in addressing the arrangement issue the involvement of a particular taxpayer should be considered at all.

1. Words of section 99

Although the words of section 99(1) support the conclusion that for there to be an arrangement there must exist a consensus between parties, it is submitted that on their terms they import no need that the taxpayer against whom section 99 is to be applied be in some way involved in the arrangement. In fact, read in the context of the rest of section 99 there is a strong argument that to import such a requirement is inappropriate. Section 99(2) says:¹⁴⁹

Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly, -

(a) Its purpose or effect is tax avoidance; or ...

whether or not any person affected by that arrangement is a party thereto.

Section 99(2) clearly applies to *every* arrangement that has tax avoidance as *its* purpose or effect. The focus of the section is on the arrangement, not the taxpayer.¹⁵⁰ The scheme of the section is such that section 99(2) requires the focus to be placed on the arrangement as identified under section 99(1). Section 99(1) imports no requirement to consider whether any particular taxpayer was a participant, it simply exists as a section to help identify those contracts, agreements, plans and understandings to which the rest of section 99 will be applied. Although the arrangement must be "made or entered into" there is no requirement that the relevant taxpayer be a party to the arrangement in any sense of the word, before section 99 can be applied against them.

¹⁴⁹ (Emphasis added).

¹⁵⁰ *Withey v Commissioner of Inland Revenue* (1998) 18 NZTC 13,606, 13,608 (HC) Baragwanath J.

To the contrary, section 99(2) takes care to extend the ability to avoid arrangements to where persons affected are not 'parties'.¹⁵¹

2. *What does 'party' mean?*

As discussed, section 99(2) expressly extends beyond those who are party to the arrangement by virtue of the words "whether or not any person affected by that arrangement is a party thereto." It is therefore important to understand what is meant by 'party' in the context of section 99. In contract law, when one refers to a 'party' one refers to the persons whose communications with each other have resulted in the agreement.¹⁵² However in section 99 the term 'party' is used in relation to an 'arrangement'. As discussed, an arrangement is a very broad concept and includes far more than contracts. It is suggested in this context, that to be a party to an understanding for example, one would expect that a person had a degree of participation or involvement in that understanding. Therefore, 'party' in section 99(2) is used in a broader sense than that one would normally associate with contract law. Additionally, as noted, the section is clearly intended to extend beyond such parties, and therefore to require taxpayer participation in an arrangement before the GAP can apply is at odds with the words of the section.

3. *Restriction of section 99(1) to parties illogical*

The approach of the High Court and the majority of the Court of Appeal, by focusing on taxpayers and their level of involvement in the arrangement when determining the section 99(1) threshold, is not only inconsistent with the words of section 99, but clearly leads to a narrower scope of the section than the legislature has expressly contemplated. Justice McGechan in his judgment noted that:¹⁵³

¹⁵¹ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,787 (HC) McGechan J.

¹⁵² AG Guest (ed) *Chitty on Contracts* (27 ed, Sweet & Maxwell, 1994) 901.

¹⁵³ *BNZI v CIR*, above, 15,787 (HC) McGechan J.

Although section 99(2) does take care to extend the ability to avoid arrangements to where persons affected are not parties to the arrangement, this does not affect the threshold requirement for an arrangement between parties in the first place.

He went on to conclude that as BNZI were not party to an 'arrangement' within section 99 involving the downstream transactions, section 99 could not apply.¹⁵⁴ The approach adopted by the High Court requires that the taxpayer be in some way involved, or 'party' to the tax avoidance arrangement before the section 99(1) threshold is met. It is difficult to reconcile this approach with the words of section 99(2). If the relevant taxpayer must be 'party' to the arrangement before section 99 can be applied to them, the express extension of section 99(2) to avoid tax avoidance arrangements whether the taxpayer is party or not is rendered impotent. It is submitted that this is a significant flaw in the Court's approach, and one equally applicable to the approach adopted by the majority of the Court of Appeal. However, while both Courts acknowledged the section 99(2) extension beyond parties that led to this flaw, neither of the Courts attempted to explain their effect under the approach they adopted to section 99(1).

Justice Thomas in his dissent makes a similar observation with regard to the High Court and majority's requirement of taxpayer participation by reference to section 99(3). Where an arrangement is void under section 99(2), section 99(3) gives the Commissioner the ability to counteract any tax advantage obtained from or under that arrangement by *any person affected* by the arrangement. Justice Thomas noted that:¹⁵⁵

if a person affected by the arrangement is subject to the Commissioner's powers, and therefore not necessarily involved or aware of its tax avoidance implications, it is difficult to see why a party would need to be consciously involved or agree to the tax avoidance. It would be anomalous if a person was excluded from an

¹⁵⁴ *BNZI v CIR*, above, 15,793 (HC) McGechan J.

arrangement because he or she was not aware of the tax avoidance, but another person who is also not aware of the arrangement but is affected by it could be subject to reassessment under section 99(3).

Justice Blanchard attempted to address this point in his judgment by saying that although an adjustment may be made against a taxpayer affected by, but not necessarily party to the arrangement, this could only be done where the tax advantage has been obtained by the taxpayer "under that arrangement."¹⁵⁶ He went on to say that the higher dividends received by BNZI that were funded by the downstream tax avoidance arrangement were not obtained under that arrangement. With respect, section 99(3) also allows an adjustment where tax advantage has been obtained *from* a tax avoidance arrangement, an issue Justice Blanchard does not address.

Furthermore, and more fundamentally, by requiring that BNZI be a participant in the downstream tax avoidance arrangement, the very question of whether the tax advantage they may or may not have received from or under that tax avoidance arrangement cannot even arise. For under the approach adopted by Justice Blanchard and the majority, because BNZI was not a participant in that arrangement, there is no arrangement under section 99(1) to which the section can even apply.

4. *Directly or indirectly*

The section 99(1) definition of 'tax avoidance' further supports the argument that it is inconsistent with the words of the section to require the taxpayer to be in some way party to the arrangement. Tax avoidance is defined to include:

- (a) Directly or indirectly altering the incidence of any income tax:
- (b) Directly or indirectly relieving any person from liability to pay income tax:

¹⁵⁵ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,132 (CA) Thomas J dissenting.

¹⁵⁶ *CIR v BNZI*, above, 17,142 (CA) Blanchard J.

- (c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax.

Section 99(2) also gives the ability to avoid an arrangement where it has either a direct or an indirect tax avoidance purpose or effect. As Justice Thomas said in *BNZI* "the repeated use of the word 'indirectly' is not decisive, but it must count against an interpretation which would restrict an arrangement to those who are consciously involved in it."¹⁵⁷ This is a valid observation, for if the application of section 99 were limited to instances where the taxpayer was a participant, the instances where an indirect tax avoidance purpose or effect could be counteracted would be considerably limited.

5. Words of new legislation

To date, most case law on New Zealand's GAP has been determined under section 99. However, this provision is now found in three parts of the Income Tax Act 1994.¹⁵⁸ The sections enacted are largely the same as section 99, and what changes were made were not intended to change the previous policy relating to the operation of the section.¹⁵⁹ Having said that, the argument, based on the wording of the section, that the taxpayer affected by an arrangement need not be a participant in the relevant arrangement is even more persuasive under the terms of the Income Tax Act 1994. Section OB 1 defines a 'tax avoidance arrangement' as "an arrangement, *whether entered into by the person affected or another person*, that directly or indirectly" has a tax avoidance purpose or effect.¹⁶⁰ So while the arrangement must be entered into, there is express recognition of the fact that the relevant taxpayer need not be the same person who entered into the arrangement.

¹⁵⁷ *CIR v BNZI*, above, 17,132 (CA) Thomas J dissenting.

¹⁵⁸ Income Tax Act 1994, ss BG 1, GB 1 and BB 9.

¹⁵⁹ Inland Revenue Department *Tax Information Bulletin* (Wellington, 1996) 8 TIB 9, 8.

¹⁶⁰ (emphasis added).

6. *The Commerce Act 1986*

The majority in the Court of Appeal placed reliance on the Commerce Act 1986 and cases decided under it for guidance on how to approach the section 99(1) arrangement issue. Justice Thomas in his dissent was critical of such reliance because:¹⁶¹

1. the Commerce Act and the Income Tax Act have different objectives; and
2. determining that a meeting of the minds is required to complete an arrangement or understanding does not resolve the question of whether all taxpayers participating in that arrangement must be aware of the specific step or transactions which will amount to tax avoidance.

The second of these criticisms relates to the issue of taxpayer participation and touches the heart of the issue not satisfactorily addressed in the High Court and majority of the Court of Appeal judgments. Both the Income Tax Act and the Commerce Act use the terms contract, arrangement and understanding and it may therefore be acceptable to draw on judicial statements as to the meaning of those terms as discussed in the context of Commerce Act cases.¹⁶² Nevertheless, this does not address the question of whether the relevant taxpayer must be one of those involved in the meeting of the minds. The Commerce Act decisions do not provide any assistance to the courts in this regard because the scope of that Act is comprehensively dealt with in its penalty provisions. Section 80 of the Commerce Act expressly extends the scope of that Act to include those who have entered into the arrangement, have aided, abetted, counselled, procured or induced another to enter into the arrangement or have been directly or indirectly knowingly concerned in or party to the contravention of another person. This is in stark contrast to section 99 which simply extends to those affected by an arrangement.

¹⁶¹ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,134 (CA) Thomas J dissenting.

¹⁶² Commerce Act 1986, s 27.

7. New Zealand case law

Interpreting a previous New Zealand GAP,¹⁶³ Justice Turner in the Court of Appeal held that the section could only be applied to parties to an arrangement.¹⁶⁴ However, subsequent to this President McCarthy rejected an argument in the Court of Appeal that the section did not apply on the basis that the taxpayer was not a party, in the strict sense of the word, to the arrangement. The Court said that the section would apply to others if it could be shown that the arrangement was procured by or with the connivance of the taxpayer.¹⁶⁵

President McCarthy's judgment in *Commissioner of Inland Revenue v Ashton*¹⁶⁶ affirmed the decision in *Udy v Commissioner of Inland Revenue*,¹⁶⁷ a case that articulated well the reasons why such a restriction was not justified. In *Udy v Commissioner of Inland Revenue* Chief Justice Wild said that although at first sight Justice Turner's view (stated above) was logical, it did not accord with authority.¹⁶⁸ He went on to note that section 108 contained no such limitation.¹⁶⁹ He said that "it is the alteration of the incidence of income tax in any way and the relief from liability of any person that the section hits at" and he saw nothing in the section's language which suggested it needed to be limited to those party to the transaction.¹⁷⁰ Drawing on *Newton* he observed that the focus of the section was on the arrangement, not the taxpayer, and said that while in most cases the taxpayer will be a party to the transaction, the courts have applied the section where the taxpayer was not legally a party.¹⁷¹ In the opinion of Chief Justice Wild

¹⁶³ Land and Income Tax Act 1954, s 108.

¹⁶⁴ *Wisheart, Macnab, and Kidd v Commissioner of Inland Revenue* [1972] NZLR 319 (CA) Turner J (emphasis in the original).

¹⁶⁵ *Commissioner of Inland Revenue v Ashton* [1974] 2 NZLR 321, 329 McCarthy P (CA).

¹⁶⁶ [1974] 2 NZLR 321(CA).

¹⁶⁷ [1972] NZLR 714 (SC).

¹⁶⁸ *Udy v Commissioner of Inland Revenue* [1972] NZLR 714, 719 (SC) Wild CJ.

¹⁶⁹ *Udy v CIR*, above, 719 (SC) Wild CJ.

¹⁷⁰ *Udy v CIR*, above, 719 (SC) Wild CJ.

¹⁷¹ *Udy v CIR*, above, 719 (SC) Wild CJ.

therefore, the GAP could be applied *at least* where the taxpayer procured the making of the transaction.¹⁷²

Subsequent to these decisions the legislature amended the New Zealand GAP to include the words “whether party or not”, thereby removing the scope for taxpayers to limit the scope of the section by technical arguments such as that accepted by Justice Turner in *Wisheart, Macnab, and Kidd v Commissioner of Inland Revenue*.¹⁷³

More recently, when discussing who the Commissioner may subject to reassessment under section 99(3), Justice Blanchard said “he must believe that in terms of the taxing statute that the person is properly assessable, rather than being simply, for example, a relative or friend, *not party to the impugned* arrangement, to whom moneys or other assets have passed.”¹⁷⁴ Justice McGechan in the High Court downplayed the significance of this statement, saying that at most it recognises that recipients may fall outside arrangements.¹⁷⁵ To the extent that this statement could be taken to suggest that a taxpayer must be party to an arrangement it is submitted that it would be inconsistent with both authority and the terms of the section itself.

Thus while it is usual for the taxpayer to be party to the impugned arrangement, it is by no means necessary. The section imports no such requirement for it focuses on the arrangement, rather than the taxpayer, and it is the alteration of the incidence of tax that the section hits out at. Therefore for the same reasons that a taxpayer need not legally be party, it is consistent with authority and the section to suggest that taxpayer involvement is also unnecessary.

¹⁷² *Udy v CIR*, above, 720 (SC) Wild CJ (emphasis added).

¹⁷³ [1972] NZLR 319 (CA).

¹⁷⁴ *Miller v Commissioner of Inland Revenue; Managed Fashions Ltd v Commissioner of Inland Revenue* (1998) 18 NZTC 13,961, 13,970 (CA) Blanchard J for the Court.

¹⁷⁵ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,788 (HC) McGechan J.

8. The Australian GAP

Until relatively recently, Australia had a GAP similar to section 99,¹⁷⁶ however it was thought to be ineffective and was therefore replaced by Part IVA of the Income Tax Assessment Act 1936.¹⁷⁷ Part IVA sets out in much greater detail the scope and effect of the Australian GAP. Essentially the Part gives statutory effect to the predication approach set out in *Newton*, although it does clarify the breadth of the provision's effect, otherwise seen to have been problematic under the previous GAP for leading to unreasonable results.¹⁷⁸

Part IVA allows the Commissioner to cancel a tax benefit where it has been obtained in connection with a "scheme" to which the Part applies.¹⁷⁹ Section 177D in the Australian Act serves the same function as section 99(2) and says that Part IVA applies where the relevant taxpayer receives a tax benefit "whether or not that person who entered into or carried out the scheme or any part of the scheme is the relevant taxpayer."¹⁸⁰ Clearly therefore the Australian general anti-avoidance provision does not contemplate the taxpayer involvement of the type the courts in *BNZI* suggested section 99 does.

The High Court case of *Peabody v Federal Commissioner of Taxation*¹⁸¹ illustrates the application of Part IVA. The case involved a series of complicated transactions undertaken to float a company in a tax efficient manner. The Court held that Part IVA applied to Mrs Peabody, a non-party taxpayer with apparently limited conscious involvement in the scheme attacked.¹⁸² This case illustrates that in Australia it need not be the relevant taxpayer's purpose to obtain a tax

¹⁷⁶ Income Tax Assessment Act 1936 (Aus), s 260.

¹⁷⁷ G T Pagone QC "Tax Planning or Tax Avoidance" (2000) 29 ATR 96, 100.

¹⁷⁸ Pagone, above, 101 and 104. The predication principle was enunciated by the Privy Council in *Newton v Federal Commissioner of Taxation* [1958] AC 450, 466 Denning LJ (PC).

¹⁷⁹ Income Tax Assessment Act 1936 (Aus), s 177F(1). "Scheme" is defined as including an "arrangement" Income Tax Assessment Act 1936 (Aus), s 177A.

¹⁸⁰ Notably its focus in determining whether there is a tax avoidance purpose or effect is on the persons who made or entered into the scheme.

¹⁸¹ (1994) 181 CLR 359 (HCA).

advantage, it might be that of another person who made or entered into the scheme.¹⁸³ There is no discussion in the case as to the extent of Mrs Peabody's knowledge of or involvement with the scheme, however this is quite consistent with the view that taxpayer involvement is not relevant when identifying the relevant arrangement.

Recently the Second Commissioner of the Australian Tax Office presented a paper to give practical advice on Part IVA.¹⁸⁴ He referred to the Australian revenue department's decision making process which is consistent with the argument that the taxpayer need not be a party to the arrangement.¹⁸⁵ The first three steps of the process are to identify the scheme, identify the tax benefit, and identify the taxpayer to target. Step four then assesses whether the person(s) who entered into or carried out the scheme did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme.¹⁸⁶ This process confirms that the first step should always be identifying the relevant arrangement, and that this should be done without reference to the involvement of any taxpayer.

The express terms of the current Australian GAP are by no means analogous to the terms of section 99. Part IVA is set out in significant detail in comparison to the broad terms of section 99. However the definitions of 'scheme' and 'arrangement' in each of these GAPs are not significantly different, and do not on their terms appear to warrant different judicial approaches to them in relation to the issue of taxpayer participation. The law on which Part IVA is based developed from cases decided under GAPs similar in nature to New Zealand's GAP. The stated intention in the Explanatory Memorandum to Part IVA was that the Part was to encapsulate the approach of Lord Denning in

¹⁸² *Peabody v Federal Commissioner of Taxation* (1994) 181 CLR 359, 386 (HCA).

¹⁸³ P Harris (2nd Commissioner) "Australia's General Anti-avoidance Rule: Part IVA Has Some Teeth But Are Some Missing?" [1998] BTR 124, 132.

¹⁸⁴ P Harris (2nd Commissioner) "Australia's General Anti-avoidance Rule: Part IVA Has Some Teeth But Are Some Missing?" [1998] BTR 124.

¹⁸⁵ M D'Ascenzo "A Practical Guide on Part IVA" (2001) 30 ATR 89.

¹⁸⁶ D'Ascenzo, above, 91-92.

Newton.¹⁸⁷ In the light of this commonality of background and the significant influence of the *Newton* approach still reflected in both the New Zealand and Australian GAPs, there is a persuasive case that the New Zealand GAP should be interpreted and applied in a manner broadly consistent with Part IVA and the cases decided under it.¹⁸⁸

9. The Canadian GAP

Since 1988 Canada has also had a GAP similar to that found in New Zealand.¹⁸⁹ The section applies to 'avoidance transactions'. A 'transaction' is defined in the legislation as including an arrangement or event,¹⁹⁰ and an 'avoidance transaction' means any transaction that would result in a tax benefit unless the transaction may reasonably be considered to have been undertaken or arranged for bone fide business purposes other than to obtain the tax benefit.¹⁹¹ Like the New Zealand and Australian GAPs, the Canadian section focuses on the transaction and imports no requirement of taxpayer involvement. Where a transaction is an avoidance transaction, section 245(2) provides that the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that would result directly or indirectly from that transaction.

To date the Canadian GAP has not been subject to significant judicial interpretation.¹⁹² One recent Canadian case however suggests that Canadian law will be interpreted in a manner consistent with the view that the taxpayer against whom the section is applied need not be a participant in the arrangement. Judge Bowie in *OSFC Holdings Ltd v The Queen* said:¹⁹³

¹⁸⁷ Commonwealth Department of the Treasury, *Australia Income Tax Laws Amendment Act (No.2) 1981: Explanatory Memorandum* (Australia, 1981).

¹⁸⁸ C Ohms "Part IVA and *FCT v Peabody*" (1995) 1 NZJTL 249, 267.

¹⁸⁹ Income Tax Act RSC 1985, s 245.

¹⁹⁰ Income Tax Act RSC 1985, s 245(1).

¹⁹¹ Income Tax Act RSC 1985, s 245(3).

¹⁹² V Krishna QC "The Scope of GAAR" (2000) 10 CCT 1.

¹⁹³ [1999] 3 CTC 2649, 2666 (CTC) Bowie TCJ.

[s]ubsection (2) is carefully worded to make it clear that the recipient of the tax benefit need not be the same person who enters into or orchestrates the transaction or series of transactions.

It is submitted therefore, that to focus on whether or not a particular taxpayer is involved or a participant in an arrangement before deciding whether an arrangement exists is inconsistent with the words and the scheme of section 99. Taxpayer involvement should be by no means determinative. Previous New Zealand cases have extended the scope of section 99 beyond parties and such an approach is consistent with the approaches adopted to this issue in other jurisdictions with similar GAPs.

VII AN ALTERNATIVE APPROACH

A The Approach

Given the questions that have been raised in relation to the appropriateness of focusing on taxpayer involvement in determining the arrangement issue, and bearing in mind Justice McGechan's observation that there is wisdom in the approach to the interpretation of tax legislation that begins with a consideration of the words in issue,¹⁹⁴ it is suggested that there is an alternative interpretation of section 99 under which no requirement of taxpayer participation in the relevant arrangement is read into the section. There are three key steps to this alternative approach.

1. Section 99(1) – is there an arrangement?

Section 99(1) defines an arrangement for the purposes of section 99. Thus before section 99(2) is applied it is important to identify the arrangement to which it will be applied. This approach differs from that adopted by the High Court and the Court of Appeal significantly in that no question of taxpayer participation arises. The approach proceeds on

¹⁹⁴ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,787 (HC) McGechan J.

the basis that just because a certain taxpayer is not party to an arrangement, does not preclude the existence of an arrangement at all. On the facts of *BNZI* for example the arrangement identified might be an arrangement between CML and the offshore entities. As suggested above, *Ramsay* type analysis may be instructive at this stage to assist in determining the true scope of the arrangement.

2. *Section 99(2) – is it a tax avoidance arrangement?*

Section 99(2) analysis focuses on the arrangement identified in the section 99(1) analysis to determine if it is a tax avoidance arrangement. If the arrangement identified does not have the requisite tax avoidance purpose or effect then section 99 cannot be invoked to avoid the arrangement. It is in this stage of the analysis that the scope of section 99 is narrowed. This can be contrasted with the *BNZI* decisions where a significant restriction on the scope of section 99, in the form of the taxpayer participation requirement, was effected at the first stage of determining whether an arrangement even existed.

3. *Reconstruction*

If the arrangement is a tax avoidance arrangement, section 99(2) makes it void for income tax purposes, and section 99(3) can be applied to counteract any tax advantage received from or under the arrangement by a taxpayer affected by the arrangement. Under this step, taxpayers such as *BNZI* who have been affected by a tax avoidance arrangement may be targeted and have their tax advantage counteracted. Once again, no question of the participation or involvement of the taxpayer arises. All that must be established is a tax advantage obtained from or under a void tax avoidance arrangement.

To apply this analysis to the present facts, one result might be that the downstream transactions are found to constitute an arrangement between CML and the downstream entities involved for the purposes of

section 99(1).¹⁹⁵ If that was the arrangement identified, it would then be necessary to consider whether it was an arrangement to which section 99(2) applies. Focusing on the arrangement identified, as contemplated by section 99(2), there is an arrangement, made or entered into, with a tax avoidance purpose or effect,¹⁹⁶ that has affected BNZI.¹⁹⁷ Under this analysis, assuming that the High Court's findings in relation to tax avoidance are correct and adopting them for the purposes of argument, it would appear that that BNZI do in fact fall within the scope of section 99 and the Commissioner would be entitled to counteract any tax advantage obtained by them from or under the arrangement.¹⁹⁸

This approach is logical and consistent with the scheme of section 99. Section 99(2) has the purpose of determining the arrangements to which section 99 applies and it is therefore suggested that issues in relation to the scope of the GAP would be more logically addressed under section 99(2).

VIII A FLAWED APPROACH?

Arguably the interpretation advocated above is flawed by virtue of the fact that it has the effect of extending section 99's coverage to 'innocent' taxpayers. It applies section 99 on a straight cause and effect basis.

A driving factor in the High Court's decision to adopt the approach that it did was that Parliament would not have intended such an effect of section 99. The Court considered that there were "real difficulties in a concept which drags a taxpayer within a multi-step arrangement on a

¹⁹⁵ This analysis proceeds on the assumption that the rejection of the sub-scheme approach in *Case U6* discussed above does not preclude the identification of such an arrangement.

¹⁹⁶ Accepting the High Court's findings in relation to the Alasdair/Fenstanton transaction.

¹⁹⁷ Based on the High Court's finding that BNZI obtained a tax advantage from the Alasdair/Fenstanton transaction.

¹⁹⁸ Income Tax Act 1976, s 99(3).

simple basis of taxpayer knowledge.”¹⁹⁹ Justice McGechan said that the “perfect innocence no knowledge” situation does not constitute an ‘arrangement’, and considered that it would be “unfair and disruptive” to hold otherwise.²⁰⁰ Similarly, in the Court of Appeal the majority were heavily influenced in their decision by the concept of ‘equity’. They said that:²⁰¹

[t]he justification for construing the concept of arrangement in that way is that it would be inequitable for a taxpayer who enters into an apparently unobjectionable transaction to be deprived of its rights thereunder merely because unknown to the taxpayer, the other party intended to meet its obligations under that transaction, or in fact did so, in a legally objectionable way.

A Rebuttal

While these criticisms may correctly refer to the effect such an interpretation might have, they are not necessarily valid.

The words of the section must be remembered. As President Cooke has noted “the width and tenor of [section 99], an enlarged version of section 108 of the 1974 Act, can be underestimated if one does not keep its terms in mind prominently.”²⁰² The words of the section require the analysis to focus on the arrangement and its purpose or effect, rather than applying ‘to a taxpayer’. It is the alteration of the incidence of tax that counts. It is for this reason that it has been said that conceptually there is no good reason why the character of a transaction should be viewed differently where the tax benefit was an unintended benefit or consequence of what was done, for the ultimate impact on the revenue, or the incidence of tax would be the same

¹⁹⁹ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,788 (HC) McGechan J.

²⁰⁰ *BNZI v CIR*, above, 15,788 (HC) McGechan J.

²⁰¹ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,117 (CA) Richardson P.

²⁰² *Hadlee v Commissioner of Inland Revenue* (1991) 13 NZTC 8,116, 8,121 (CA) Cooke P.

regardless of what the intention of the parties was.²⁰³ The New Zealand GAP reflects this conceptual rationale and adopts an objective approach whereby tax avoidance is determined by what the transaction effects and motive is irrelevant. It is therefore considered irrelevant to explore the motivating intention of individual participants and ignorance or even infancy is beside the point,²⁰⁴ even though this could lead to inequitable results.

It is also important that the nature of tax avoidance is not confused with evasion and other forms of impermissible tax related conduct which are prohibited by statute. As Justice Fullagar once noted "[t]he word 'avoidance', unlike the word 'evasion', does not, in my opinion, involve any notion of active or passive fault on the part of the taxpayer."²⁰⁵ Tax avoidance therefore is not concerned with the 'moral culpability' of the taxpayer such as is the case with evasion. A taxpayer is entitled to mitigate his or her liability to tax. An arrangement may however be void as a tax avoidance arrangement, even though the arrangement falls squarely within the provisions of the Income Tax Act, if it yields a level of income that although 'correct', is a result that Parliament did not intend.²⁰⁶ Tax evasion on the other hand involves arrangements outside the law in which the liability to tax having been incurred, is concealed or ignored.²⁰⁷ In the case of evasion a taxpayer's calculation of income is wrong and there is therefore no need to adjust a taxpayer's assessable income under a provision like section 99.²⁰⁸

Section 143B of the Tax Administration Act 1994 deals with evasion. It provides that evasion is committed where a person

²⁰³ N F Orow "Towards a Conceptually Coherent Theory of Tax Avoidance – Part 2" (1995) 1 NZJTL 307, 316-317.

²⁰⁴ *Withy v Commissioner of Inland Revenue* (1998) 18 NZTC 13,606, 13,609 (HC) Baragwanath J.

²⁰⁵ *Australian Jam Co Pty Ltd v Federal Commissioner of Taxation* [1953] ALR 855, 861.

²⁰⁶ Committee of Experts on Tax Compliance *Tax Compliance – Report to the Treasurer and Minister of Revenue* (Wellington, December 1998) 119.

²⁰⁷ *2001 New Zealand Master Tax Guide* (2001, CCH New Zealand Ltd, Auckland) 1098.

knowingly does, or omits to do, one of a number of specified acts such as withholding information, and intends to evade the assessment or payment of tax by themselves or another, or to obtain a refund or payment of tax that they or the other person is not legally entitled.²⁰⁹ A breach of this section can result in a criminal penalty.²¹⁰

Conceptually therefore there is a distinction between tax avoidance, the focus of which is on the arrangement and the alteration of the incidence of tax, and evasion and other knowledge offences, the focus of which is on the state of mind of the taxpayer who did or did not do certain acts.

Furthermore, it is interesting to note that, as discussed above,²¹¹ the courts in Australia and Canada, which have comparable GAPs to New Zealand and whose GAPs extend to taxpayers who are not involved in an arrangement, have not felt that it is necessary to read into their GAPs a threshold requirement of taxpayer involvement in an arrangement in order to prevent inequitable results. In fact, although the current Australian GAP sought to address problematic issues of the uncertainty of the scope of the previous Australian GAP,²¹² in drafting Part IVA the Australian legislature did not seek to do so by restricting the definition of scheme. To the contrary the definition of scheme was extended to include unilateral arrangements.

Read literally, it has been shown that section 99 does not require an examination of the extent of a taxpayer's knowledge, involvement or culpability in relation to an arrangement. Thus while one might therefore question their relevance in this context, nevertheless it may be

²⁰⁸ J Prebble "Criminal Law, Tax Evasion, Shams and Tax Avoidance: Part 1 – Tax Evasion and General Doctrines of Criminal Law" (1996) 2 NZJTL 3, 5.

²⁰⁹ The Tax Administration Act 1994, section 143A also provides that a criminal offence is committed where a person knowingly does or omits to do a number of other specified acts set out.

²¹⁰ The Tax Administration Act also provides for civil penalties for evasion and other knowledge offences: Tax Administration Act 1994 s 141E.

²¹¹ See Part VI C 8 The Australian GAP and Part VI C 9 The Canadian GAP.

²¹² Commonwealth Department of the Treasury, *Australia Income Tax Laws Amendment Act (No.2) 1981: Explanatory Memorandum* (Australia, 1981).

that in order to reach a workable approach to section 99, it is necessary to concede, as the Commissioner did, that there is appeal in an interpretation of the section which would not apply to innocent taxpayers on a straight cause and effect basis.²¹³

'Innocence' as discussed here, it should be noted, is used in a broad sense and refers to taxpayers such as the consumer in the following example used in the *BNZI* case:

A car dealer is involved in a tax avoidance arrangement. As a result of this he sells a car more cheaply than he otherwise would have to a consumer.

It seems unlikely that Parliament would have intended that the Commissioner could apply section 99 to the consumer by virtue of the fact that they had been affected by a tax avoidance arrangement. In the *BNZI* case although the Commissioner conceded that an approach with such an effect would not be desirable, he submitted that *BNZI* were not in a position of innocence, and therefore his submissions did not address in detail means of preventing such an effect in the approaches he argued should be adopted.²¹⁴

IX LIMITING THE SCOPE OF SECTION 99

A Limits on the Face of the Section

Section 99 contains a number of limits within its terms. The two main limits are that of an arrangement and a tax avoidance purpose or effect. Another is that the Commissioner's ability to reconstruct under section 99(3) is limited to the extent of the tax advantage obtained by the taxpayer from or under the arrangement. The meaning of 'tax advantage' was addressed by Justice McGechan in *BNZI*. He accepted that a tax advantage was not the same as an economic advantage. However, he held that in *BNZI* the downstream tax avoidance

²¹³ *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15,732, 15,785 (HC) McGechan J.

²¹⁴ *BNZI v CIR*, above, 15,785-15,786 (HC) McGechan J.

arrangement enabled CML to pay a higher tax free dividend to BNZI than would otherwise have been possible. The extra amount was accordingly an indirect tax advantage.²¹⁵

A further limit on the scope of the section is the relationship between section 99(1) and 99(2). Sometimes a transaction may form part of a broader arrangement and therefore related transactions such as BNZI's RPS deal may sometimes fall within the ambit of a tax avoidance transaction. This does not however necessarily mean that the Commissioner will automatically attempt to define arrangements as broadly as possible to claw back as much of the tax advantage generated as possible. The reason for this is that, as discussed above in relation to the sub-scheme approach, just as it is generally easier to establish this purpose or effect if the arrangement is identified narrowly; it is likely to be more difficult to establish it for a broader arrangement. In effect therefore there is a trade off for the Commissioner who will generally seek to define the arrangement as narrowly as possible, and this should serve as protection for taxpayers.

B Possible Glosses to Limit the Scope of Section 99

In the past the courts have read glosses into section 99 to ensure its workability. Two possible limiting glosses are discussed below.

1. Limit based on section 99(1) 'arrangement'

The limit adopted by the High Court and the Court of Appeal was to limit the scope of section 99 by increasing the threshold at the section 99(1) arrangement stage to require that the taxpayer be in some way involved in the arrangement as a matter of law. While this approach may be effective in limiting the section's scope, as has been discussed, such a limit leads to inconsistencies between the effect of the section as applied and the words of the section. This approach raises the threshold requirement of the section by narrowing the concept of

²¹⁵ *BNZI v CIR*, above, 15,815-15,816 (HC) McGechan J.

'arrangement', something which had been defined very broadly. From a logical point of view the approach is also difficult to reconcile, for it seems problematic to say that just because a particular taxpayer is not involved in an arrangement, no arrangement exists at all. If such a limit is to be adopted, as suggested above,²¹⁶ it is more appropriate that taxpayer involvement be considered as a matter of fact and degree, rather than as a matter of law.

2. *Limit based on section 99(2) 'affected by'*

The alternative approach to the application of section 99 can be varied by reading a gloss into section 99. Section 99(3) allows the assessable income of a taxpayer 'affected' by a tax avoidance arrangement to be reconstructed so as to counteract any tax advantage obtained from or under it. It is this section that would most readily be applied to a party such as BNZI, who although not directly involved in the tax avoidance arrangement, have been affected by it through their receipt of a tax advantage. A gloss could be read into this section that the effect on the taxpayer affected be one that was more than an incidental effect of the arrangement, to be determined as a matter of fact and degree. This would address the criticism that the alternative approach applies on a straight cause and effect basis, by limiting the applicability of section 99 to 'innocent' taxpayers.

Applying such an approach to the facts of *BNZI*, the tax benefit could be counteracted, because although the taxpayer had limited knowledge of the arrangement, a dominant effect of the arrangement was that BNZI received a higher tax free dividend. That this effect was more than a merely incidental effect in the nature of a side effect is illustrated by the fact that there was an agreement that 50% of the tax saving generated would be passed to BNZI. In the car buyer example, on the limited facts set out it is unlikely that the effect on the car buyer would be more than a merely incidental effect of the arrangement. It is

²¹⁶ See section VI B 2 Matter of fact and degree or matter of law?

likely that the arrangement would have been set up in such a manner that the vendor received the tax benefits, in contrast to the structure in *BNZI* where the tax saving was designed to be shared. Whether the effect was more than merely incidental would however be a matter of fact and degree to be determined in light of all the facts.

This gloss is a preferable means of limiting section 99. It is consistent with the words and scheme of section 99. It maintains an objective approach, the focus of which is on the arrangement identified and its effect. Conceptually it is consistent with the notion that where an arrangement is a tax avoidance arrangement and the incidence of tax is altered, the motives and knowledge of individuals should not be considered, since the effect of the arrangement is still the same. It does however provide a means by which to draw a line to break a simple chain of cause and effect. Pragmatically it is also sound, for it recognises that in most instances someone benefiting from a tax avoidance arrangement such as *BNZI* will not be completely innocent, even though they may have limited knowledge of the tax avoidance steps and transactions that create the tax advantage. Often, as was the case in *BNZI*, promoters of tax driven schemes are careful to ensure that those who invest in them are not privy to the intricacies of how the tax savings are generated.

X CONCLUSION

An arrangement is a concept fundamental to the operation of section 99. Without one the section cannot come into force. When an arrangement is identified, the question of tax avoidance purpose or effect must be established by reference to that arrangement. Given its fundamental nature, the lack of litigation or judicial consideration of the scope of this broad concept is surprising. The reason for this is perhaps that typically tax avoidance cases have focused predominantly on whether an accepted arrangement is a tax avoidance arrangement for the purposes of reassessing the income of a taxpayer clearly involved in the arrangement.

This paper has discussed the concept of an arrangement under section 99, and in doing so has made particular reference to the facts and issues that arose in the *BNZI* case. The legislative history of the definition of an arrangement and judicial discussion of the concept of an arrangement have been outlined. This discussion of the context from which the definition of arrangement emerged provided an insight into the meaning of the words found in the definition. It was accepted that the words 'contract, agreement, plan or understanding' found in the definition import the need for a degree of consensus between parties. However, consensus is just one aspect of the definition of arrangement, and this paper has suggested that the *BNZI* RPS transactions could arguably fall within the scope of an arrangement by virtue of the fact that they were a step or transaction by which the downstream tax avoidance transactions were carried into effect, or alternatively because the RPS transactions comprised part of a broader interrelated arrangement which also encompassed the downstream tax avoidance transactions.

Having discussed whether it was possible to identify an arrangement which encompassed the RPS transactions for the purposes of section 99, the paper went on to question whether it was actually necessary to do so in order to reassess a tax advantage obtained by a taxpayer from or under a tax avoidance arrangement. It did so by questioning the fundamental assumption common to both the decision of the High Court and the majority of the Court of Appeal in *BNZI* that for section 99 to be applied to a taxpayer, the particular taxpayer must, as a matter of law, have had some degree of knowledge of or involvement in the tax avoidance arrangement. It was suggested that, while typically a taxpayer who receives a tax advantage from or under an arrangement will have the level of involvement the New Zealand courts suggested was required, such involvement should not be determinative of whether or not an arrangement exists for the purposes of section 99. It was demonstrated that to make such a factor determinative is not only inconsistent with the words and scheme of

section 99, but also with the decisions of New Zealand courts. In addition, reference was made to the legislation and approach of the courts in other jurisdictions with GAPs similar to that found in New Zealand where no requirement of taxpayer involvement is found.

An alternative approach to section 99 was suggested, the focus of which is on the arrangement and which imports no requirement of taxpayer involvement, rather requiring only that the taxpayer be affected by the arrangement in question. It was acknowledged that this approach is open to the criticism that it may lead to the application of section 99 against 'innocent' taxpayers. This was the justification of the New Zealand courts in adopting the approach they did in *BNZI*. The validity of this criticism was questioned, and the paper went on to demonstrate that even if one accepts this justification as valid, the solution adopted by the New Zealand courts was by no means the only way, or in fact the preferred way such a problem could be overcome.

In *BNZI*, opinion within the Court of Appeal was divided in relation to the impact that the restrictive approach adopted by the Court to the threshold issue of arrangement would be likely to have. The Commissioner contended that the approach of the majority of the Court would enable promoters of tax avoidance structures to insulate their customers from the tax avoidance arrangement by ensuring that they remain ignorant of the mechanism to be used to obtain the tax advantage. Justice Blanchard considered this concern to be unrealistic and exaggerated.²¹⁷ He felt that taxpayers would be unwilling to part with large sums of money and to incur the risks associated with obtaining a tax advantage without their advisers first gaining a sufficient understanding of what was to occur in a tax-driven scheme.²¹⁸ However, Justice Thomas considered that there was force in the Commissioner's argument,²¹⁹ and that Justice Blanchard had "seriously

²¹⁷ *Commissioner of Inland Revenue v BNZ Investments Ltd* (2001) 20 NZTC 17,103, 17,142 (CA) Blanchard J.

²¹⁸ *CIR v BNZI*, above, 17,143 (CA) Blanchard J.

²¹⁹ *CIR v BNZI*, above, 17,139 (CA) Thomas J dissenting.

[under-estimated] the ingenuity of the tax avoidance industry."²²⁰ He felt that it would be naïve to assume taxpayers would not adopt a tax-driven scheme where they have limited knowledge of the tax avoidance mechanism to be used.²²¹

The facts of *BNZI* are an illustration of the fact that Justice Blanchard's assumptions as to the behaviour of taxpayers may not be entirely valid, and suggest that the Commissioner's contention may not be as unrealistic and exaggerated as Justice Blanchard suggests. Indeed the decision in *BNZI* is also illustrative of the fact that the restrictive approach adopted by the New Zealand courts to the arrangement issue in section 99 does provide the promoters of tax-driven schemes with a degree of scope to shelter not only their clients' income from taxation, but also their clients from the scope of the general anti-avoidance provision.

²²⁰ *CIR v BNZI*, above, 17,139 (CA) Thomas J dissenting.

²²¹ *CIR v BNZI*, above, 17,139 (CA) Thomas J dissenting.

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