Inland Revenue
Te Tari Taake

CASE SUMMARY

High Court confirms that forfeiture of criminal proceeds is not 'payment in lieu' of tax

Decision date: 18 March 2022

CSUM 22/02

CASE

Li and AA Taxation & Accounting Service Ltd v CoP & CIR [2022] NZHC 514

LEGISLATIVE REFERENCES

Criminal Proceeds (Recovery) Act 2009, ss 21(1)(a), 28(1)(c), 33(1), 35, 59(1)(b), 95

High Court Rules 2016, r 4.4(1)(c)

Tax Administration Act 1994, ss 6, 6A, 89AB(4)(a), 89C(c), 89D(1B)(b), 109, 143B

LEGAL TERMS

Criminal proceeds forfeiture and the Inland Revenue Acts

Summary

Mr Li and his company, AA Taxation & Accounting Service Ltd ("**AA Taxation**") applied for three declaratory orders under Declaratory Judgment Act 1908 to vindicate their contention that the forfeiture of assets by Mr Li and his wife under the Criminal Proceeds (Recovery) Act 2009 ("**CPRA**") may be treated as 'payment in lieu' of tax.

Wylie J declined to grant each of the three declarations sought by Mr Li and AA Taxation.

By way of counterclaim, the CIR sought five declarations on various grounds. Of these:

- Wylie J declined to grant two declarations in relation to whether any assets of AA Taxation were restrained or forfeited in the CPRA proceeding because that issue was not determined in the CPRA proceeding.

- Wylie J granted three declarations sought by the CIR, and emphasised that the relevant restraining orders and asset forfeiture orders did not represent the payment of tax; and the CIR was/is not prevented from collecting the tax owed by Mr Li and/or AA Taxation.

Impact

This case determined an issue which had not previously been before the courts in New Zealand; and therefore, the decision of Wylie J is likely to provide significant guidance for issues at the intersection of criminal proceeds forfeiture and tax liabilities.

In particular, this decision confirms that assets vested in the Crown pursuant to assets forfeiture orders made under the CPRA, where the alleged predicate offending was tax evasion, does not amount to 'payment in lieu' of tax.

In the context of proceedings brought under the CPRA, tax liabilities may only be satisfied through one of the express statutory mechanisms set out in the CPRA.

Facts

In 2008, Mr Li sold a false university qualification to an undercover journalist for $12,000, of which Mr Li retained $3,000. This led to Mr Li being convicted of obtaining by deception, in April 2015.

Because of his involvement in the false diploma scheme, Mr Li drew the attention of the Commissioner of Police ("the **Police**") and its Asset Recovery Unit. In September and

October 2015, the Police obtained restraining orders under the CPRA in respect of assets owned by Mr Li and his wife.

The restraining orders were obtained by Police on the basis of their allegations that Mr Li had benefitted from his significant criminal activity in the sum of $1.8m. The Police alleged primarily that these funds were the proceeds of fraud offending; and a related allegation was tax evasion. The Police alleged Mr Li (and his wife, by virtue of being married to Mr Li) had unlawfully benefitted from significant criminal activity.

The hearing of the CPRA proceeding was set down for July 2017; however, a settlement was reached on the eve of trial. Under the terms of the settlement agreement reached with the Police, Mr Li and his wife forfeited $575,000 of their assets, but otherwise retained their family home. The settlement agreement was approved by the High Court under s 95 of the CPRA on 12 July 2017 (the "**Settlement Agreement"**).

The CIR was not party to the Settlement Agreement and was not involved in any settlement negotiations. The Settlement Agreement expressly said it had *"no bearing on any action that may be taken by the [CIR] in the future, and how [the IRD] may treat the present settlement, if approved, would ultimately be a matter for it. (*Paragraph 2.10 of the Settlement Agreement – reproduced at [66] of decision of Wylie J).

Approximately 12 months after the Settlement Agreement, the CIR reached agreements with each of Mr Li and AA Taxation to amend various tax assessments filed by each taxpayer (the **Amended Assessments**). The Amended Assessments recognised the previously-unreported income derived by Mr Li and AA Taxation, and their resulting liabilities for income tax and GST (plus penalties and interest).

In January 2019, the CIR issued a statutory demand to AA Taxation to collect the tax assessed as owing under the Amended Assessments. AA Taxation accepted that the tax it owes had been properly assessed; however, AA Taxation asserted the tax owing under the Amended Assessments had already been paid when Mr Li and his wife forfeited their assets under the Settlement Agreement.

In September 2019, Associate Judge Smith set aside the CIR's statutory demand, on the condition that Mr Li seek declaratory orders to *"vindicate its contention that the amount claimed [by the CIR] in the statutory demand should be deemed to have been paid"* by the assets forfeited under the Settlement Agreement. (*AA Taxation & Accounting Service Limited v Commissioner of Inland Revenue* [2019] NZHC 2301 at [83]).

This proceeding arose accordingly, to answer the question of whether the assets forfeited by Mr Li and his wife satisfied the tax liabilities of Mr Li and AA Taxation.

Issues

The first issue was whether to grant the three declarations sought by Mr Li and AA Taxation.

The second issue was whether to grant the five declarations sought by the CIR by way of counterclaim.

(The respective declarations sought are set out below.)

Decision

Statutory framework

Wylie J first considered the statutory framework under the CPRA. The statutory purpose of the CPRA was "clearly expressed"; it seeks to discharge ill-gotten gains and in so doing, "deter significant criminal activity", (Criminal Proceeds (Recovery) Act 2009, s 3.)

To give effect to its purpose, the CPRA established a regime for the restraint and forfeiture of property derived as a result of "significant criminal activity". (Criminal Proceeds (Recovery) Act 2009, s 6.)

After noting the various orders able to be made under the CPRA (and the statutory criteria for making those orders), Wylie J noted that it was only the Police who had the responsibility for invoking the CPRA – and, only the Police were empowered to enter into settlements of CPRA proceedings which provided for the forfeiture of assets to the Crown.

There is no express interface between the CPRA and the Inland Revenue Acts, other than s 98 of the CPRA (which permits the CIR to disclose certain information to the Police).

Wylie J noted there was nothing in the CPRA which empowered the Police to collect tax; and, only the CIR was responsible for collecting the taxes committed to her charge. The CIR also has sole responsibility for the care and management of the taxes covered by the Inland Revenue Acts, although it is the Acts themselves which create the liability for tax.

Finally, Wylie J noted there was nothing in the CPRA which suggested that a forfeiture order amounts to a "tax", or in any way operates to discharge a tax liability. When seen against its statutory purpose, "*Clearly [the CPRA] is not a tax collection statute.*" at [83]. If the CPRA was simply a means of collecting lawful tax debts, it would leave no room for its purpose of deterrence.

The intersection of the CPRA and Inland Revenue Acts

Wylie J noted there were five discrete "*pathways which can lead to the CIR becoming involved in proceedings under the CPRA and which can result in tax being paid or compromised in the course of such proceedings*", namely: at [78].

Under ss 21 and 45 of the CPRA, the Police must serve applications for restraint or forfeiture on any person with an "interest" in the subject property. Wylie J considered it is doubtful whether the CIR (as unsecured creditor) would have a recognised "interest" in restrained property requiring that she be served; however, under ss 21 and 45, the Court can nevertheless order service on other persons if it considers it appropriate to do so. Wylie J took the view that in any case where the Police allege tax evasion, "*service on the CIR might well be wise. Directions as to service can be sought. It would avoid the problems which have arisen in this case.*"

As CPRA proceedings are civil proceedings, the High Court Rules allow the CIR to be joined "*if the CIR's presence before the Court is thought to be necessary to fully determine the issues likely to arise, and she ought to be bound by any orders made*".

Under s 28(1)(c) of the CPRA, the Court can make restraining orders subject to a condition that the restrained property be used to meet the payment of "*any specified debt incurred by the respondent in good faith*". Wylie J noted this pathway was utilised in two earlier proceedings, (*Commissioner of Police v Dotcom* [2012] NZHC 2190) and *(Commissioner of Police v Dotcom* [2012] NZHC 2190).

Under ss 33 and 35 of the CPRA, parties to a settlement may specifically provide for the payment of tax debts out of the proceeds of settlement. Wylie J noted this pathway was utilised in two other, earlier proceedings, *Commissioner of Police v Gong* [2018] NZHC 1859, and *Commissioner of Police v McCarthy* [2013] NZHC 3257.

Finally, s 59(1)(b) of the CPRA allows the Court to give directions that may be necessary or convenient to give effect to forfeiture orders. Wylie J considered it arguable that the Court has implied powers to direct the manner in which the Official Assignee must dispose of forfeited property.

Wylie J noted that none of these five pathways were utilised by Mr Li in the CPRA proceeding, despite Mr Li being represented by solicitors at the time at [79]. Therefore:

> [80] In my judgment, the [Police], Mr Li and Ms Wang, as the parties to the settlement recorded in the settlement memorandum did not, at the time, intend that the funds they proposed should be forfeited

were to be attributed to offset Mr Li's and AA Taxation's tax liabilities, once those liabilities were finally determined by the CIR.

On that basis, Wylie J turned to consider the declarations sought.

Declarations sought by Mr Li and AA Taxation

1. *... that the funds paid in the Settlement Agreement and identified as tax are to be attributed to the tax assessments finalised for the plaintiffs;*

Wylie J noted the declaration sought was poorly framed as it assumed the Settlement Agreement identified a portion of the funds forfeited were on account of tax. While the Settlement Agreement referred to the parties' competing contentions as to the possible tax liability for Mr Li, no portion of the forfeited sum were identified as tax or stated that they should be attributed to any tax liabilities.

The declaration sought also assumed AA Taxation was entitled to the benefit of settlement. It was not: it was not a party to the CPRA proceeding or the Settlement Agreement.

Finally, Wylie J noted the declaration sought is inconsistent with the purpose of the CPRA. Any property forfeited pursuant to an assets forfeiture order vests in the Crown absolutely; it is a "one-way" transaction. By contrast, in making a tax payment, nothing is forfeited. Rather, a person who pays tax engages in a "two-way" transaction which satisfies a debt owed by that person to the Crown in accordance with his or her statutorily assessed liability under the Inland Revenue Acts.

Wylie J declined to grant the first declaration sought by Mr Li and AA Taxation.

2. *... that the funds paid to the Official Assignee under the Settlement Agreement, and identified as tax, are held by the Official Assignee on trust for the [CIR];*

Wylie J noted there were similar problems with the second declaration sought. Again it assumed part of the funds paid to the OA as part of the Settlement Agreement were identified as tax (they were not). And, it assumed AA Taxation had some rights arising out of settlement, but Wylie J found it had no such rights.

It was also noted that the declaration ignores the provisions of the CPRA, which expressly directs the OA to deal with forfeited assets in accordance with the 'payment waterfall' specified in s 82(1) of the CPRA (first to recover the Assignee's costs, then to repay any costs for legal aid, then towards any reparation or offender levies or fines, and then finally to pay any surplus to the Crown). The payment of tax is not one of the specified priority payments in s 82 of the CPRA and there is simply no basis to assert the OA holds property on trust for anybody other than the Crown.

Wylie J declined to grant the second declaration sought by Mr Li and AA Taxation.

3. *...that the funds paid, and identified as tax under the Settlement Agreement [were] not entitled to be collected by the [Police and that] the Settlement Agreement is therefore void.*

Wylie J repeated that no funds were identified as tax. It was noted that the Police have no authority to collect tax, and the Police did not purport to do so. The Police acted in accordance with the CPRA, and there was no irregularity in the process followed by the Police and there was nothing to impugn the validity of the Settlement Agreement. The Settlement Agreement was approved by the Court and there was no appeal against that decision.

Wylie J declined to grant the third declaration sought by Mr Li and AA Taxation.

Declarations sought by the CIR by way of counterclaim

1. *...that no assets of AA Taxation were subject to the restraining orders made in the CPRA proceedings;*

Wylie J noted AA Taxation did not take any steps to lodge an interest in the restrained property, and none of its interests/assets were restrained or referred to in the Settlement Agreement.

Against that background, however, Wylie J noted Mr Li's case was that he intermingled funds belonging to AA Taxation with his and his wife's funds. Although the Police had its own competing assertions, the ownership of the assets were not determined by the Court. Wylie J noted the competing assertions as to ownership were not necessary for the Court to make restraining orders: part of the funds in Mr Li's bank account were tainted as a result of his fraud offending – and that alone was sufficient to taint the whole of the funds in the account.

Somewhat less clear was the degree of 'tainting' in respect of the family home or the cash seized by Police; however, the extent to which (if at all) AA Taxation owned any restrained assets was never determined in the CPRA proceeding – and so therefore, Wylie J declined to grant the first declaration sought by the CIR by way of counterclaim.

2. *...that the on-notice restraining orders in the CPRA proceedings were not intended to meet the tax debts of Mr Li and Ms Wang or the tax debts of AA Taxation*

Wylie J noted there was no provision made for the payment of tax debts in the restraining orders or Settlement Agreement (or in any other document put before Wylie J). At the time of the restraining orders, Mr Li had not taken any steps in relation to (or even acknowledged) his tax liability. Similarly, there was no evidential foundation for the contention that the restrained property was to be used to meet Mr Li's, his wife's or AA Taxation's tax debts.

Wylie J granted the second declaration sought by the CIR by way of counterclaim.

3. *...that no assets of AA Taxation form part of the assets forfeiture orders in the CPRA proceedings;*

Wylie J noted that for the same reasons as the first declaration, he declined to grant the third declaration sought by the CIR by way of counterclaim.

4. *...that the assets forfeiture orders in the CPRA proceedings do not represent the payment of tax or alternatively, if they do represent the payment of tax, that they only represent the payment of the tax liabilities of the respondents to the CPRA proceedings;*

Wylie J examined the Settlement Agreement – and in particular, paragraph 2.10 of that Agreement (which expressly said it did not bind the CIR). The Settlement Agreement did not provide that the forfeited assets were to be used to discharge the tax liabilities of Mr Li, his wife, and/or AA Taxation.

In granting the fourth declaration sought by the CIR, Wylie J commented at para [101], "That is not however to say that the CIR should ignore the circumstances which had arisen when she is exercising her discretion whether or not to seek to recover the tax assessments made."

5. *...that the effect of the settlement memorandum was not to prohibit the CIR from collecting the tax that was owed by Mr Li and/or AA Taxation or alternatively, if the effect of the settlement memorandum is to prohibit the CIR from collecting any tax, that it is only the tax owed by Mr Li and not by AA Taxation.*

Wylie J confirmed the CIR was not so prohibited. The Settlement Agreement expressly recorded it had no bearing on the CIR – and so it does not prohibit the CIR from collecting the tax owed by Mr Li and/or AA Taxation.

"Double recovery"

The final part of the judgment addresses concerns raised by counsel assisting the Court as to the appearance of "double recovery". Wylie J discussed these concerns in the context of a recent decision by Duffy J *(Commissioner of Police v Nabawi* [2021] NZHC 2413), which dealt with an application by Police for restraining orders which relied solely on tax evasion as the predicate offending.

In *Nabawi,* Duffy J found any 'benefits' derived through tax evasion may be "cancelled out" by recovery action taken by the CIR under the TAA.

The primary point from *Nabawi* is that tax evasion does not extinguish an evader's tax liability; tax evasion merely (temporarily) avoids that liability. Thus, if or once the CIR quantifies the liability and seeks to recover (collect) that liability, a respondent to a CPRA proceeding will have derived less of a benefit from their tax evasion than if they had not been caught (unless "*the additional disposable income derived from tax evasion is used to*

acquire assets that rapidly inflate in value, [then] the resulting profits may survive the effect of any tax recovery by the IRD").

While Duffy J was prepared to restrain Mr Nabawi's property (pending a full hearing for the forfeiture of that property), her Honour signalled to Police that before forfeiture orders could be made, evidence would be required from IRD as to the amount of Mr Nabawi's tax liability. The reason is that any "benefit" the Police asserted Mr Nabawi had unlawfully derived from tax evasion would be reduced by any present tax liability faced by Mr Nabawi.

Wylie J was careful to note that *Nabawi* can be distinguished from the present case: in *Nabawi*, the Police relied solely on tax evasion as the predicate offending, whereas in Mr Li's case, tax evasion was incidental to his primary (fraud) offending. Nevertheless, Wylie J agreed with the observations of Duffy J at [53] and [54] of *Nabawi*, the essence of which said the Police should obtain evidence from the CIR if or when allegations of tax evasion are made in a proceeding brought by Police under the CPRA.

About this document

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