



Information about the Commissioner's Interpretation Statement on tax avoidance

Issued | Tukuna: 3 February 2023

IS 23/01 FS 1

This Fact Sheet accompanies the Commissioner's Interpretation Statement [IS 23/01](#).

What is the Interpretation Statement about?

The statement is about sections BG 1 and GA 1, the general anti-avoidance provisions of the Income Tax Act 2007.

The statement explains the Commissioner's view of the law on tax avoidance in Aotearoa New Zealand.

The statement is also relevant to the general anti-avoidance provision in the Goods and Services Tax Act 1985 (section 76).

About section BG 1

Tax avoidance arrangements

Section BG 1 is the principal vehicle in the Income Tax Act 2007 to address tax avoidance. Section BG 1 voids a "tax avoidance arrangement" for income tax purposes. Section GA 1 enables the Commissioner to make adjustments where voiding an arrangement under

section BG 1 has not appropriately counteracted any tax advantages arising under a tax avoidance arrangement.

Parliamentary contemplation test

The Supreme Court in *Ben Nevis* considered it desirable to settle the approach to applying section BG 1.¹ This approach is referred to as the “Parliamentary contemplation test”. The Supreme Court confirmed the Parliamentary contemplation test as the proper and authoritative approach to applying s BG 1 in *Penny and Frucor*.²

The Parliamentary contemplation test requires deciding whether the arrangement, when viewed as a whole and in a commercially and economically realistic way, makes use of, or circumvents, specific provisions in a manner consistent with Parliament’s purpose. If not, the arrangement will have a tax avoidance purpose or effect.

The test involves ensuring Parliament’s purpose for the specific provision and its purpose for s BG 1, as the principal vehicle in the Act to address tax avoidance, are achieved. This occurs by the specific provision and s BG 1 working in tandem with each providing the context that defines the meaning and scope of the other. Hence, the Parliamentary contemplation test requires consideration of Parliament’s purpose for the specific provision and its purpose for s BG 1. Parliament’s overall purpose comprises both of these purposes.

The inquiry into Parliament’s purpose under the Parliamentary contemplation test is a hypothetical one. That is, it asks: if Parliament had foreseen the particular arrangement when it enacted the specific provision, would it have viewed the use or circumvention of the specific provision as within the provision’s purpose?

An economic substance approach applies under section BG 1

When applying specific provisions, the true nature of an arrangement is determined by the legal rights and obligations of the transactions entered into and the legal steps that are followed. Generally, tax outcomes under specific provisions do not depend on the economic consequences of transactions.

¹ *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289.

² *Penny v CIR* [2011] NZSC 95, [2012] 1 NZLR 433 (also known as *Penny & Hooper*) at [33] and *Frucor Suntory New Zealand Ltd v CIR* [2022] NZSC 113 at [53].

In contrast, when applying section BG 1 the inquiry is not limited to the arrangement's legal form and an economic substance approach is required. Also, section BG 1 applies to an arrangement as a whole.

Merely incidental test

Section BG 1 will apply if an arrangement has a sole purpose or effect of tax avoidance. Section BG 1 will also apply if an arrangement has multiple purposes or effects and at least one is a tax avoidance purpose or effect that is more than "merely incidental" to the other purposes or effects.

Many of the same factors considered in the Parliamentary contemplation test are relevant to the merely incidental test. The Supreme Court in *Ben Nevis* said it would rarely be the case that the use made of a specific provision which is outside Parliamentary contemplation could result in the tax avoidance purpose being merely incidental.

Key elements of section BG 1

A "tax avoidance arrangement" is an arrangement that has a purpose or effect of tax avoidance that is more than merely incidental.

"Arrangement"

An "arrangement" means an "agreement, contract, plan, or understanding, whether enforceable or unenforceable". It embraces all kinds of concerted action by which persons may arrange their affairs for a particular purpose or to produce a particular effect. It also includes "all steps and transactions by which it is carried into effect".

"Purpose or effect"

The "purpose or effect" of an arrangement is determined objectively. The courts have confirmed that the subjective motive, intentions or purposes of the parties are not relevant. An arrangement's objective purpose is determined by working backwards from the arrangement's effect. If an arrangement has a particular effect, that will be its purpose.

"Tax avoidance"

"Tax avoidance" is defined in the Act but it is also necessary to consider the term's ordinary meaning and the approach taken by the courts to tax avoidance.

“Merely incidental”

A tax avoidance purpose is more than “merely incidental” if it is pursued as an end in itself and does not naturally follow from, attaches to, or is subordinate or subsidiary to the other purposes or effects of the arrangement.

Commissioner’s approach to applying section BG 1

The application of section BG 1 is an intensely fact-based inquiry. The conclusion drawn from the facts needs to be one that is reasonable, logical, convincing and able to be reached given the evidence. It cannot be based on mere speculation or intuitive subjective impressions.

The Interpretation Statement discusses the relevant case law on tax avoidance. Based on analysing the relevant case law, the Commissioner’s approach to applying section BG 1 to an arrangement involves undertaking several steps as described next.

1) Understanding the legal form of the arrangement by identifying and understanding:

- All the steps and transactions that make up the arrangement.
- The commercial or private purposes of the arrangement.
- The arrangement’s tax effects and how they have been achieved by the arrangement based on the legal rights and obligations created. This requires identifying and understanding:
 - the specific provisions that apply to the arrangement, and why they apply; and
 - any relevant provisions that do not apply and why they do not apply.

2) Identifying and understanding Parliament’s purpose for the specific provisions that are used or circumvented by the arrangement.

Parliament’s purpose is identified from the text of the specific provisions, the statutory context, case law and relevant extrinsic material.³

The Commissioner considers that, in some cases, a helpful practical technique may be to consider “facts, features or attributes” for a specific provision. Once Parliament’s purpose for a specific provision has been ascertained, that purpose may be translated into facts

³ Extrinsic materials are documents produced in the course of enacting legislation (see [3.22] of the Interpretation Statement).

Parliament would expect to see present or absent to give effect to that purpose. The purposes might translate into legal, commercial, economic, or other concepts (features or attributes). This is because a specific provision sets out a legal rule that will be activated or satisfied by the existence (or non-existence) of certain explicit and implicit facts, features or attributes.

3) Understanding the commercial and economic reality of the arrangement as a whole by using the factors identified by the courts.

Under the section BG 1 inquiry it is necessary to view in a commercially and economically realistic way the arrangement's use or circumvention of the specific provisions. The courts have referred to a number of factors that can assist with this including:

- whether the taxpayer has gained the benefit of the specific provision in an artificial or contrived way, or by pretence;
- the manner in which the arrangement is carried out;
- the role of all relevant parties and their relationships;
- the economic and commercial effect of documents and transactions;
- the nature and extent of the financial consequences;
- the duration of the arrangement;
- whether there is circularity in the arrangement;
- whether there is inflated expenditure or reduced levels of income in the arrangement;
- whether the parties to the arrangement have undertaken limited or no real commercial or economic risks; and
- whether the arrangement is pre-tax negative.

Of these factors, the presence of artificiality or contrivance is particularly significant because the courts have consistently stated that obtaining tax advantages by artificial or contrived means is a use or circumvention of specific provisions outside Parliament's contemplation.

Understanding the commercial and economic reality of the arrangement may raise doubts as to whether Parliament would have contemplated permissible tax advantages arising under the specific provision in those circumstances. Practically, the technique of using facts, features or attributes may be helpful in some cases with ascertaining whether an arrangement has crossed the line into tax avoidance. This involves considering whether the facts, features or attributes previously translated from Parliament's purpose for the specific provision are consistent with those that are present (or absent) in the arrangement when viewed as a whole and in a commercially and economically realistic way.

4) Considering the implications of the preceding analysis of Parliament's purposes for the specific provisions and the arrangement's purposes, tax effects, and commercial and economic reality as a whole.

Bearing in mind Parliament's purpose for section BG 1 is for it to be the principal vehicle to address tax avoidance, this consideration is likely to highlight a number of interrelated matters, including:

- The presence (or absence) of artificiality, contrivance or pretence.
- The veracity of the arrangement's commercial or private purposes (in contrast to the clarity or otherwise of the arrangement's tax advantages).
- Whether or not the use or circumvention of the relevant specific provisions is consistent with Parliament's purposes for the provisions.

5) Answer the ultimate question under the Parliamentary contemplation test.

Taking into account all the matters considered above, answer the ultimate question under the Parliamentary contemplation test: does the arrangement, viewed in a commercially and economically realistic way, use or circumvent the specific provisions in a manner that is consistent with Parliament's purpose?

If the use or circumvention of the relevant specific provision is not consistent with Parliament's purpose, the arrangement has a tax avoidance purpose or effect.

6) Consider the merely incidental test.

If the arrangement has no other purposes or effects, or the tax avoidance purpose or effect is more than merely incidental, the arrangement is a tax avoidance arrangement.

Section BG 1 will then apply to void the arrangement for income tax purposes.

A flow chart illustrating this approach to applying section BG 1 is included at the end of this Fact Sheet.

Section GA 1

If section BG 1 applies and voiding the arrangement does not appropriately counteract the tax advantages arising under the arrangement, the Commissioner can apply section GA 1 to ensure this outcome. Section GA 1(2) gives the Commissioner a broad and flexible discretion about how to make adjustments to:

- negate any tax advantage arising from a tax avoidance purpose or effect that has not been counteracted by voiding the arrangement, including making appropriate consequential adjustments; and
- reinstate permissible tax outcomes voided by the arrangement.

Permissible tax outcomes do not include the tax outcomes from parts of an arrangement that are so interdependent and interconnected with the tax avoidance parts as to be integral to them.

A flow chart illustrating the application of section GA 1 is included at the end of this Fact Sheet.

Where can I find out more?

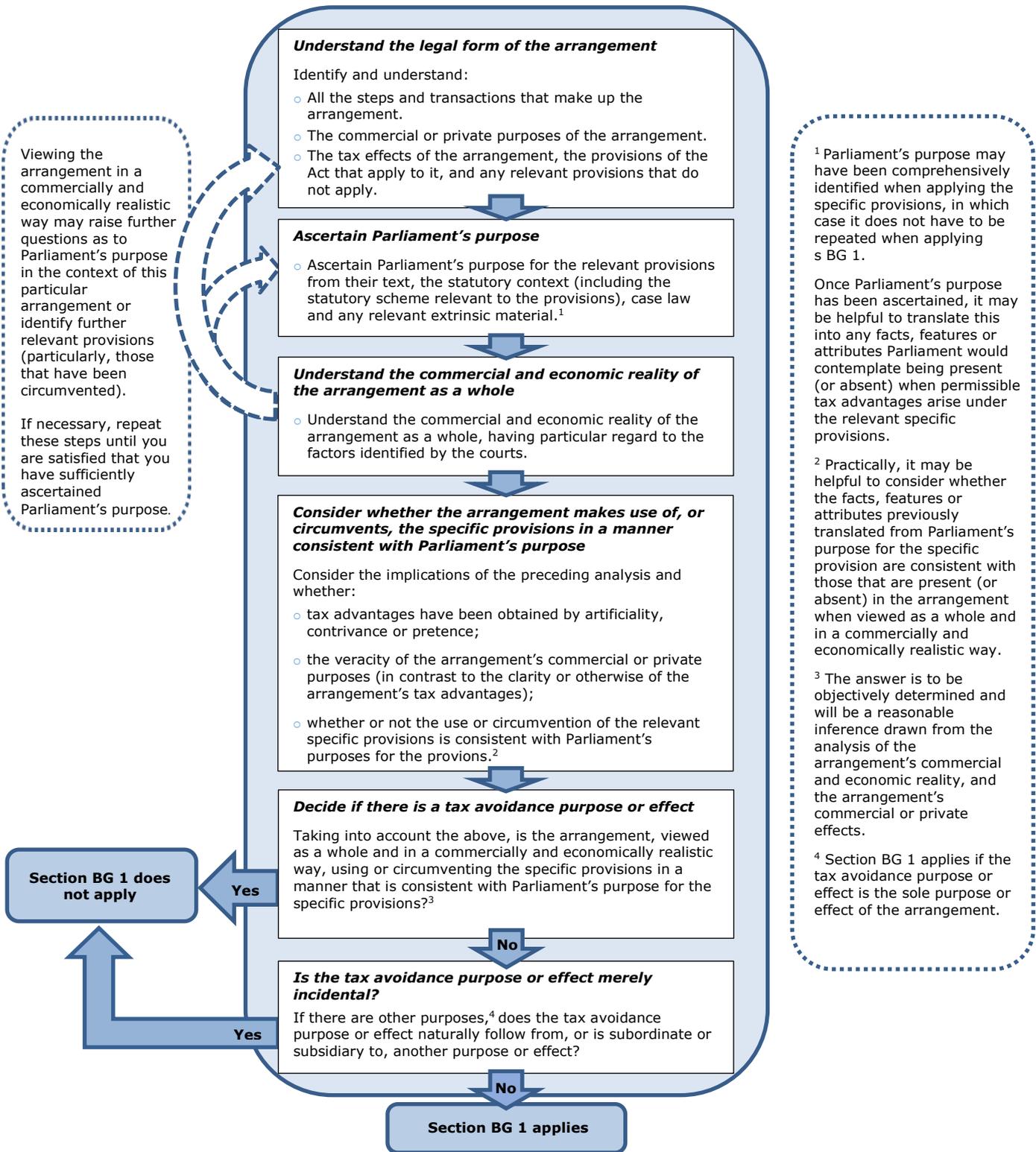
This Fact Sheet is intended to be a quick reference guide. Only the Interpretation Statement should be relied on as reflecting the Commissioner's view of the application of the tax avoidance provisions: Interpretation Statement [IS 23/01](#) *Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007* (Inland Revenue, 2023).

Also refer to these related Questions We've Been Asked. These items illustrate how the Commissioner's approach applies to particular situations:

[QB 23/01](#) *Income tax: scenarios on tax avoidance – 2023 No 1* (Inland Revenue, 2023)

[QB 23/02](#) *Income tax: scenario on tax avoidance – 2023 No 2* (Inland Revenue, 2023)

Flow Chart 1: An approach to the tax avoidance inquiry



Flow Chart 2: An approach to section GA 1

