



QUESTION WE'VE BEEN ASKED

QB 18/08

Binding Rulings – Effect of the Commissioner changing her mind in relation to the application of s BG 1

This Question We've Been Asked (QWBA) is about Part 5A of the Tax Administration Act 1994 and will be of interest to anyone who has been issued a binding private or product ruling for an ongoing arrangement on the application of a general anti-avoidance provision.

This QWBA relates to an issue previously considered by the Taxpayer Rulings Unit and is not connected to the Commissioner's review of the Interpretation Statement on Tax Avoidance.

Key provision

All legislative references are to the Tax Administration Act 1994 unless otherwise stated.

Key terms

general anti-avoidance provision means s BG 1 of the Income Tax Act 2007 and/or s 76 of the Goods and Services Tax Act 1985

Question

The Commissioner has issued a binding ruling that a general anti-avoidance provision does not apply to an ongoing arrangement. She later identifies some concerns that the conclusion may be incorrect and that the anti-avoidance provision may apply.

Can the Commissioner take a different view on the application of a general anti-avoidance provision to an ongoing arrangement when a binding ruling that applies in relation to the general anti-avoidance provision expires?

Answer

Yes. The Commissioner can apply a new interpretation of the anti-avoidance provision to any period following the expiry of the ruling, as long as this does not have the effect of reversing the tax outcomes in the period covered by the ruling. The general anti-avoidance provisions do not require a different approach from other provisions.

Explanation

1. This item considers the situation where a binding private or product ruling has been issued for an ongoing arrangement, and the Commissioner's view of how the legislation applies to the arrangement subsequently changes.
2. It is clear that if a binding ruling exists, the Commissioner cannot change her mind and apply a different interpretation of the taxation laws to the arrangement *during the*

period of the ruling, as long as the ruling has not ceased to apply for another reason. This is the case whether the Commissioner has formally withdrawn the ruling or not.

3. It is also clear that the Commissioner can, as a general matter, apply a different interpretation of the taxation laws *to any period after the ruling expires* where her view of the legislation has changed.

Binding rulings legislation

4. The binding rulings regime was enacted in 1995 to give taxpayers more certainty about their tax affairs through public rulings and taxpayer-specific private and product rulings. Where a binding ruling has been issued that applies to a taxpayer, that taxpayer, by following the binding ruling, can be certain about how the Commissioner will apply the law. An application for a binding private or product ruling must disclose all relevant facts and documents relating to the arrangement for which the ruling is sought.
5. The legislation relating to binding rulings is found in Part 5A. The binding nature of private rulings is in s 91EA(1):

Notwithstanding anything in any other Act, if—

- (a) a private ruling on a taxation law applies to a person in relation to an arrangement and a tax type for an arrangement; and
 - (b) the person applies the taxation law for the tax type in the way stated in the ruling,—
- the Commissioner must apply the taxation law in relation to the person, the tax type, and the arrangement in accordance with the ruling.

6. Section 91EB(1) sets out when a private ruling applies:

A private ruling on a taxation law for a tax type applies to a person in relation to an arrangement—

- (a) only if the taxation law is expressly referred to in the ruling; and
- (b) only for the period or tax year for which the ruling applies.

7. Section 91EB(2) sets out when a private ruling does not apply. This item does not apply if one of the situations in s 91EB(2) applies.
8. Equivalent provisions apply for product rulings (ss 91FA(1) and 91FB).
9. In addition, s 91G provides that a binding ruling does not apply from the date a taxation law is repealed or amended to the extent that the repeal or amendment changes the way the taxation law applies in the ruling.
10. These provisions provide that a binding ruling applies only for the period set out in the ruling. Nothing in the Act deems the approach in the ruling to be correct. The legislation merely requires the Commissioner to apply the tax laws to the person and the arrangement in accordance with the ruling for the period specified in the ruling.
11. As such, the general position is that the Commissioner is required to follow the approach set out in the ruling only for the period of the ruling. Once the term of the ruling has expired, the Commissioner may apply a different interpretation of the taxation laws to future years, if her view has changed, even for an ongoing transaction. The Commissioner will not make the decision to change her mind on an issue covered by a binding ruling lightly. This means that the decision to adopt a different interpretation must be made at an appropriate level in Inland Revenue, which in many cases will require involvement of the Office of the Chief Tax Counsel. The

Commissioner's escalation policy and any relevant care and management factors also need to be taken into account, where appropriate.

12. The existence of a binding ruling does not mean that the conclusion in the ruling is (necessarily) correct; rather, the ruling binds the Commissioner as to how she will apply the taxation laws during the period of the ruling.

Effect of anti-avoidance provisions

13. It might be argued that this general position should not apply in the context of general anti-avoidance provisions, on the basis that the effect of the general anti-avoidance provisions is that a "tax avoidance arrangement" is void against the Commissioner.
14. The general anti-avoidance provisions apply to an entire "arrangement" and not to specific income years or a specific part of the "arrangement". Therefore, it could be argued that where the Commissioner has ruled that a general anti-avoidance provision does not apply, albeit for a set period, the effect of s 91EA(1) is that the entire arrangement that is the subject of the ruling is treated as not being void against the Commissioner, even if the Commissioner changes her mind.
15. The Commissioner considers that such an argument is inconsistent with the provisions of the Act that apply to rulings and the policy behind the rulings regime. One purpose of the binding rulings regime, as set out in s 91A, is to provide taxpayers with certainty about the way the Commissioner will apply taxation laws. As discussed above, a binding ruling provides certainty to a taxpayer only for the period stated in the ruling. This is consistent with comments made by officials in the 1994 document *Binding Rulings on Taxation: A discussion document on the proposed regime* that the Commissioner is bound by a ruling only while it remains in force.
16. **Binding rulings are not law, but are the Commissioner's interpretation of the law in a form that binds the Commissioner for the period of the ruling. The legally binding nature of a ruling means that even if the Commissioner considers the ruling's conclusion to be incorrect, she is precluded from applying the correct interpretation to the transaction for the period of the ruling.**
17. However, the existence of a ruling stating that a general anti-avoidance provision does not apply to an arrangement does **not mean that the transaction is not a "tax avoidance arrangement"**. Despite the existence of a favourable ruling, s BG 1 or s 76 may have always applied to void the relevant arrangement. Following expiry of the ruling, the Commissioner is not prevented from treating the arrangement as void in accordance with the relevant anti-avoidance provision, as long as she follows the approach in the ruling for the period that it applied. As noted above, the decision that the anti-avoidance provision applies must be made at the appropriate level in Inland Revenue, **and the Commissioner's escalation policy needs to be taken into account.**
18. Judicial review concepts, such as estoppel and legitimate expectation, also do not apply to prevent the Commissioner from being able to change her mind where she has issued a binding ruling in relation to a general anti-avoidance provision. In general, the courts have held that these concepts have limited application to the Commissioner and that the Commissioner cannot be estopped because of a legitimate expectation based on the **Commissioner's past statements or actions. The only exception to this is where a taxpayer has a binding ruling that applies to a particular arrangement and the relevant period, which the courts have accepted is the only way in which to bind the Commissioner (see, for example, *Westpac Banking Corp v Commissioner of Inland Revenue* (2008) 23 NZTC 21,694).**

19. An argument that the existence of a binding ruling for a certain period gives rise to a legitimate expectation that the Commissioner will continue to apply the same approach following expiry of the ruling must fail, as the binding rulings regime is quite clear about the scope and application of rulings.
20. Therefore, nothing in the binding rulings legislation suggests that the general position will not apply in relation to the general anti-avoidance provisions.

Application of the new position and shortfall penalties

21. It is clear that the Commissioner is not able to apply the new position retrospectively to the period to which the ruling applied. The new position can only ever take effect following the expiration of the ruling. This means that care needs to be taken to ensure that applying the new position to the subsequent period does not have the effect of reversing the tax outcomes in the period that was covered by the ruling. In some situations, this may be difficult (if not impossible) to achieve.
22. Legally, the Commissioner is required to follow the approach set out in the ruling only for the period of the ruling. To obtain certainty on whether the same interpretation will apply in future years of an ongoing transaction, a taxpayer should apply for a reissue of the ruling.
23. Once the term of the ruling has expired, the Commissioner is legally permitted to apply a different interpretation of the taxation laws to any period that is not covered by the ruling. However, in specific cases the Commissioner may determine that it is appropriate to only apply the new interpretation prospectively, taking into account the particular circumstances of the case and relevant care and management factors. This would need to be considered on a case by case basis.
24. Where the Commissioner has issued a binding ruling based on a particular interpretation of the law, it would be very difficult to argue that that interpretation was **not "as likely as not to be correct"**. Accordingly, where a taxpayer relies on an interpretation in a ruling, they will not have **taken an "unacceptable tax position"** and shortfall penalties will not apply.
25. If the taxpayer continues to apply the same interpretation following expiry of the ruling, **it is highly unlikely that a "shortfall penalty" would apply, unless, for example the** ruling has ceased to be valid due to factual or legislative changes, there have been relevant developments in case law or the Commissioner has advised the taxpayer of a change in interpretation (either specifically or through a public statement). This would need to be considered on a case by case basis.

Other matters

26. It might be considered that the Court of Appeal decision in *Simunovich Fisheries Ltd v Commissioner of Inland Revenue* (2002) 20 NZTC 17,456 (CA) requires a different outcome from the position outlined above. In that case, the Court of Appeal held that it was inconsistent for the Commissioner to treat an asset of the taxpayer as having a different character on sale from its characterisation at the time of purchase in a situation where the statute linked the treatment between the two.
27. There may be rare situations involving particular types of legislative provisions where parallels can be drawn with *Simunovich* and the existence of a ruling means the Commissioner cannot apply a different approach in the future. This is more likely to be the case if there were a statutory requirement to carry over a treatment from one period to another, such as in the trading stock and loss carry forward provisions.

However, the general anti-avoidance provisions do not contain or give rise to such a requirement, so the principle in *Simunovich* does not require a different outcome.

28. The position outlined above for the general anti-avoidance provisions would also generally apply for *specific anti-avoidance provisions*, although its application is slightly more complex and will depend on the nature of the specific provision. For specific anti-avoidance provisions that apply to ongoing arrangements (such as s GB 35(2) of the ITA), the Commissioner will be bound for only the period of the ruling. For specific anti-avoidance provisions that apply to a single event or a set point in time (such as s GB 21 of the ITA), the existence of a ruling that applies for that point in time will have the practical effect that the Commissioner is unable to change her mind.
29. The following examples are included to help in explaining the application of the law.

Examples

Example 1 - Commissioner changing view on application of s BG 1 of the Income Tax Act 2007 following expiry of a ruling

The Commissioner has issued a ruling that s BG 1 does not apply to a complex financing transaction. The period of the ruling is three years, but the transaction is ongoing. The applicant did not apply for a reissue of the ruling.

In year five, following the expiry of the ruling, the Commissioner determines that the transaction is a "tax avoidance arrangement" and that s BG 1 should apply. The Commissioner can apply s BG 1 to the periods following expiry of the ruling, including year four, as long as doing so does not change the treatment for the period to which the ruling applies.

Example 2 – impossible to apply new interpretation

An applicant has entered into an ongoing management agreement, under which they pay a lump sum fee on day one. The Commissioner has issued a ruling that an amount is deductible in full when it is paid, which results in the taxpayer having a loss to carry forward.

Following the expiry of the ruling, the Commissioner determines that s BG 1 applies to the Arrangement, and that the amount should have been treated as not being deductible, with the effect that the taxpayer should not be able to carry forward the loss.

As denying the loss carry forward would have the effect of reversing the decision in the ruling, the Commissioner is unable to do so.

References

Subject references

anti-avoidance
private rulings
product rulings

Legislative references

Goods and Services Tax Act 1985 – s 76
Income Tax Act 2007 – ss BG 1, GB 21 and
GB 35(2)
Tax Administration Act 1994 – ss 91A, 91EA(1),
91EB(1), 91FA(1), 91FB(1) and 91G

Case references

*Simunovich Fisheries Ltd v Commissioner of
Inland Revenue* (2002) 20 NZTC 17,456 (CA)
*Westpac Banking Corp v Commissioner of
Inland Revenue* (2008) 23 NZTC 21,694

Other references

New Zealand Government, *Binding Rulings on
taxation: A discussion document on the
proposed regime* (1994)