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This TIB has no appendix

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LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, the Court of Appeal and the Privy Council.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision. Where possible, we have indicated if an appeal will be forthcoming.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

CROWN FORESTRY RENTAL TRUST LACKS CHARITABLE STATUS

Case: Sir Graham Latimer & Ors (Crown Forestry Rental Trust) v CIR

Decision date: 4 June 2002

Act: Income Tax Act 1976, Income Tax Act 1994

Keywords: Charitable purpose, whether exclusive

Summary

The appellants were unsuccessful in their appeal of the High Court's decision that the Trust is not entitled to the income tax exemption under section 61(25) of the Income Tax Act 1976.

Facts

This was an appeal from the judgment of the High Court reported at [2002] 1 NZLR 535.

On 20 July 1989 the Crown, the New Zealand Maori Council, and the Federation of Maori Authorities Inc executed an agreement to provide for the terms and conditions upon which the Crown would sell existing tree crops on Crown forestry land to commercial purchasers together with a licence to use the land on an ongoing basis. The rent payable by each purchaser was to be put in a fund administered by a rental trust. The interest earned by the investment of the rent was to be made available to assist Maori making claims involving land before the Waitangi Tribunal.

The Crown Forestry Rental Trust ("the Trust") was established in 1989. Under clause 2.1 of its Trust Deed it is stated as being established to:

a) Receive the Rental Proceeds from the Licences;

b) Make the interest, earned from investment of those Rental Proceeds, available to assist Maori in the preparation, presentation and negotiation of claims before the Waitangi Tribunal which involve, or could involve, Licensed Land.

The question in the case was whether the Trust is entitled to income tax exemption under section 61(25) of the Income Tax Act 1976 ("the Act"). The issues before the High Court were:

- Whether the income derived by the Trust is derived by trustees in trust for charitable purposes;
- Whether the charitable focus of section 61(25) is on the income or the Trust;
- Whether the Trust's stakeholder role is a purpose or a power;
- Whether the Trust's stakeholder purpose is ancillary;
- Whether the Trust's stakeholder purpose is charitable;
- Whether the purpose of assisting Maori claimants is charitable.

The High Court held that the Trust had two purposes, only one of which was charitable (assisting Maori claimants) so that it was not entitled to tax exemption under section 61(25). The High Court accepted the Commissioner's submission that the Trust's stakeholder role of retaining and investing capital funds was different from the "receive and hold" obligation of other trusts, that therefore it was a purpose and not just an administrative power, that it was not a purpose ancillary only to its other purpose, and that it was non-charitable.

The Trust appealed against the conclusion that section 61(25) does not apply and the Commissioner cross-appealed against the finding that the assistance purpose is charitable.

Decision

The Court of Appeal concluded that the first limb of section 61(25) does not require that the Trust be established for charitable purposes, merely that the income in question be received for such purposes, in the sense that the trustees are not empowered to hold or apply it for any other purpose. This would be so even in circumstances where the Trust's capital could be applied to a non-charitable purpose, so long as the income already generated was still to be used for a charitable purpose.

On the Commissioner's first cross-appeal issue regarding the purpose of assisting Maori claimants, the Court stated that it was common ground that there must be a two step inquiry. First, whether the purpose is for the public benefit and, if so, whether the purpose is charitable in the sense of coming within the spirit and intendment of the preamble to the Statute of Charitable Uses 1601 (43 Eliz. c4). The Court held that the assistance purpose is of public benefit and that the Maori beneficiaries are a section of the public for trust purposes. On the second step in the inquiry, the Court held that the public benefit was of a charitable character, as it considered the purpose was directed towards racial harmony in New Zealand.

On the second cross-appeal issue regarding payment of the surplus to the Crown, the Court held that this was a purpose for which the income is potentially derived as from the time of its receipt by the trustees, and that, as a matter of law, the purpose could not be regarded as so minor as to be considered merely ancillary to the assistance purpose. The Court was not persuaded by the comparison of the provision to *bona vacantia* because it was not a matter of vesting in the Crown of property which had no owner. It held that the accumulated interest is not given to the Crown for a charitable purpose and that therefore the Trust's purposes are not exclusively charitable. The Court expressed reluctance at reaching that conclusion but was conscious of the potential for abuse of the charitable exemption in section 61(25) in other cases if it were to uphold a tax exemption for income of a trust which need not be applied in the year of receipt for charitable purposes, and could be accumulated from year to year and ultimately paid over for a non-charitable purpose.

COMMISSIONER ORDERED TO PAY TRA COSTS

Case: TRA 33/00 Dec No 11/2202

Decision date: 11 June 2002

Act: Taxation Review Authorities Act 1994

Keywords: Costs, TRA

Summary

The Commissioner was ordered to contribute to the TRA's costs due to delay in conceding the case.

Facts

This was a costs hearing as a result of a previous decision of the TRA (reported as *Case V15* (2002) 20 NZTC 10,174).

In that case the Commissioner conceded the case but was compelled to go to the Authority by the taxpayer's agent who wished to obtain orders as a result of the concession. The Authority declined to make any orders as the case had been conceded and there was no reason to make any orders. At the end of that case the Authority invited the taxpayer to file a memorandum for costs.

The Points of Objection Notice had been filed with the Commissioner in December 1996. In February 1997 the Crown Solicitor had been instructed that the CIR wished to concede the case but due to the perceived effects of *BASF v CIR* (1995) 17 NZTC 12,136 (that the request for a case stated left the CIR without powers other than to put the matter before the Authority), it was considered that the Authority's approval to do this was required before it could be conceded. Through oversight, the Crown solicitor failed to inform the Authority.

The objector, in October 2000, sought the allowing of its objection based upon the Commissioner's failure to state a case. By this time the effects of the so-called *BASF* principle had been trammelled by the Court of Appeal in *Miller v CIR* (1998) 18 NZTC 13,961 so that it was clear the Commissioner could concede a case without the involvement of the TRA and he did so immediately upon getting the application.

The Commissioner pointed out that the TRA has no jurisdiction to award costs between parties, only costs to be paid to the Authority (see section 16(3) and section 22 Taxation Review Authorities Act 1994).

Of the possible grounds that costs could be awarded, only the failure to give adequate notice of concession seemed possible and it was submitted that, in the circumstances outlined above, it was inappropriate to make any order for costs.

The taxpayer argued that the Commissioner's delay should be considered from December 1996 and was inexcusable. Reliance was placed upon section 6 TAA and the New Zealand Bill of Rights Act 1990.

Decision

Barber J agreed that there could not be an award of costs to the objector as this was statutory prohibited.

He did consider that the Commissioner, through the "over-technical view of the situation" taken by his advisors, had failed to concede the case at the earliest possible time. In the Authority's view:

> "the sensible course for the [Commissioner] would have been to advise Mr Russell in about December 1996…that it conceded the case, rather than doing so 5 years later. That was inadequate notice of the concession in all the circumstances. It defies common sense for the advisors of the [Commissioner] to have thought that once an objector has requested a case stated, the [Commissioner] became unable to concede the matter." [paragraph 6]

This was because to concede a case could never be to exercise powers inconsistent with the Authority's having assumed control of the matter.

Costs of $1,000 were ordered payable to the Authority.

COMMISSIONER SUCCESSFUL ON APPEAL: TAXPAYER AFFECTED BY AN AVOIDANCE ARRANGEMENT

Case:	Richard Dale Peterson v CIR (No 2)
Decision date:	14 June 2002
Act:	Income Tax Act 1976
Keywords:	Tax Avoidance, section 99(3), Person affected

Summary

The taxpayer was a person affected by a tax avoidance arrangement and his tax assessment could be adjusted under section 99(3) even though he was not a party to the "meeting of minds" creating the arrangement.

Facts

This was an appeal from the TRA (now reported as *Case U32* (2000) 19 NZTC 9,302). The case involved a tax avoidance scheme based upon the production of the film *UTU*. The Commissioner was successful before the TRA. The taxpayer appealed.

The taxpayer invested in the production of *UTU* by way of equity and debt financing. Some of the alleged debt financing was borrowed from *UTU* Funding Limited which, in turn, borrowed most of the funding from Glitteron Films, some $1,142,000 (the balance was from NZ Film Commission (as to $400,000) and a private individual). The taxpayer claimed a deduction for his share of the expenditure and for the costs of borrowing. The funding was paid to *UTU* Productions under a "production deed" and *UTU* Productions made the actual film.

The TRA considered the loans from Glitteron Films to be a sham and a fraud on both investors and the CIR as the alleged funding was circular and the loans were never actually made. Thus expenses relating to those loans were non-deductible (regardless of any application of section 99 ITA 1976) as were certain alleged expenses incurred.

On appeal, it was argued by the taxpayer that he had entered the production deed to **buy** a film for a fixed price. That he (and the other investors) were purchasers of a film under the production deed and not the makers of one. Thus what the actual costs of the film were (regardless of any sham or fraud in its funding) are irrelevant as he was buying that completed film at an agreed price.

The Commissioner argued two points:

- That the production deed between the taxpayer and "*UTU* Productions" was to **make** a film, not merely buy one. That the relationship between the investors (the taxpayer) and *UTU* Productions was an agency one, meaning the taxpayer made the film by his agent *UTU* Productions; and
- That, notwithstanding the first point, that section 99(3) applied as the taxpayer was a person affected by a tax avoidance arrangement even if he was not a party to that arrangement or did not know of the fraudulent behaviour of Glitteron Films and *UTU* Funding. The tax arrangement was the funding from *UTU* Funding and the artificially inflated expenses.

Decision

The Production Deed

Justice Hammond noted the business concerns at the time the production deed was entered into for deductibility of expenses incurred by "passive" investors (the expenses were incurred in 1982 and 1983, predating *Grieve*) while noting the deductibility of film expenses to actual makers of films. He then examined the Production Deed.

His Honour identified

> "the flaw in the Commissioner's argument, [that] agency is not an 'all or nothing' thing. That is, it may not cover all the aspects of a relationship." (at paragraph 54)

Justice Hammond considered that a limited, specific agency could co-exist with a fixed price contract:

> "To my mind, this composition arrangement was an agreement to purchase the film, at a fixed price, but with the management of the making of the film in the hands of the Production Company under the overall supervision of the Executive Committee for these investors. Such "additional" agency powers as were conferred on the Production Company were collateral, and quite specific, and limited. Hence, basically the production Company was supplying a service on a commercially adverse basis—for the best price it could obtain.
>
> In the result, in my view it goes too far to make the blanket statement that there was somehow an overarching principal and agency relationship (albeit in the context of a joint venture) between the Equity Participants [the taxpayer] and the Production Company.

> For myself, I find no difficulty in saying that there was a fixed price contract with the Production Company to supply certain services, but also having specific authority (within the terms of that service arrangement) to undertake certain designated agency functions. But those agency functions do not of themselves alter the character of the fixed price arrangement." (at paragraph 56-57)

The taxpayer was successful on this ground.

Section 99(3)

Turning to the arrangement, Justice Hammond acknowledged the impact of *BNZI* but concluded there was no dispute between the parties that there was a tax avoidance arrangement, albeit that the taxpayer was not a party to that arrangement. Making specific mention of Blanchard J's dicta from *BNZI* (at paragraph 175) to the effect a non-party can be affected by an arrangement, His Honour then went on to consider the impact of section 99(3):

> "At the end of the day, or so it seems to me, there is no escaping from the proposition that the equity Partners in this case filed accounts and tax returns for the [film] project and those accounts and returns included the correctly) disallowed items by the Commissioner. … It is difficult, if not impossible, therefore to see how the objector could now go back on the way in which the matter was accounted for by him. In the result, in my view, Mr Peterson did obtain an advantage, albeit indirectly, through a share of the inflated price of the film."

The Commissioner was successful on this ground. Hammond J accepted the correctness of the Commissioner's adjustment.

ENLARGEMENT OF TIME

Case:	TRA 032/01 – Interlocutory Decision
Decision date:	11 June 2002
Act:	Tax Administration Act 1994, Taxation Review Authorities Act 1994, Taxation Review Authorities Regulations 1998
Keywords:	District Court Rules, enlargement of time

Summary

A successful application by the Commissioner for an enlargement of time under Rule 6 of the District Court Rules for the filing and service of a notice of defence.

Facts

The Commissioner on 5 November 2001 received a notice of claim. The date for filing the notice of defence by the Commissioner was incorrectly calculated as 29 January 2002. The actual date by which the Commissioner had to file his notice of defence was 24 January 2002. The notice of defence was sent on 25 January 2002, served on the disputant on 26 January and received by the Taxation Review Authority on 28 January 2002.

The Commissioner sought an enlargement of time under Rule 6 of the District Court Rules to file his notice of defence. The disputant opposed the application.

Decision

Issue One

The Commissioner argued that Regulation 11 provided for two scenarios. First, where the Commissioner has not issued a disclosure notice, Regulation 11 provided that a notice of defence contain such information he would have included in his statement of position had a disclosure notice been issued. Second, where a disclosure notice has been issued, the parties' arguments have crystallised in the statements of position issued. While the disputant must file a notice of claim to initiate the jurisdiction of the Authority, under Regulation 11 there is no requirement on the Commissioner to file a notice of defence. In this case, a disclosure notice had been issued.

His Honour held that Regulation 11 does not abrogate from the general requirements regarding forms and procedures set out in the District Court Rules. It merely makes it clear that, if the Commissioner has not issued a disclosure notice, then the Commissioner's notice of defence must contain such information as the Commissioner would have had to include in his statement of position had such a disclosure notice been served.

That was the point of Regulation 11, not that a notice of defence is not otherwise required. His Honour did comment that Regulation 11 is not happily drafted.

Issue Two

His Honour accepted that Regulation 11(2) is intended to be supplementary to the District Court Rules on statements of defence. The application of the District Court Rules to proceedings before the Authority is specifically addressed in Regulation 4.

Under the District Court Rules, failure to file and serve a statement of defence within the required time frame does not in itself preclude the defendant from late filing and service. A judgment obtained by default runs the risk of being set aside. It is settled law that late filing will not necessarily nullify the statement of defence. Rule 5 of the District Court Rules provides that non-compliance with them will be treated as an "irregularity" and the Court has a discretion as to how that irregularity is treated.

Rather than consider the exercise of his discretion under Rule 5, His Honour focused on the exercise of his discretion under Rule 6.

Issue Three

His Honour saw no inconsistency to preclude the application of Rule 6. While Regulation 11 governs the filing and service of a notice of defence in certain cases, no provision is made within the Regulations (or the Tax Administration Act 1994 or the Taxation Review Authorities Act 1994) to extend the time for filing and service. Previous Court of Appeal judgments that the Authority had no jurisdiction to waive compliance with time limits must now be read against Regulation 4. Rule 6 provides for situations where time limits are imposed but for which there is no specific provision to extend that time. It is settled law that Rule 6 gives an unfettered discretion to enlarge the time for doing any act if that is in the interests of justice.

His Honour held it was in the interests of justice that this dispute be determined on its merits. The Commissioner has provided an adequate explanation for the delay, which was minimal and due to understandable human error. The enlargement of time for filing until 29 January 2002 was granted.

In granting this enlargement His Honour did not accept the disputant's argument that "exceptional circumstances" were required before such an enlargement of time could be granted. The "exceptional circumstances" test is from the pre-litigation dispute resolution procedures set out in the Taxation Administration Act 1994 and general District Court Procedures are not governed by that.

If Parliament had intended that the failure to file a notice of defence in response for a tax case was to be fatal to the defendant's case, then it would have said so in the clearest of terms.

MAIL TO TAX AGENT'S PO BOX EFFECTIVE SERIVCE

Case: Hieber et al v CIR

Decision date: 19 June 2002

Act: Tax Administration Act 1994

Keywords: Effective service, "Place of abode or business", see section 14 TAA

Summary

Service to the tax agent's PO Box was effective as the PO Box was the place of business for receiving mail.

Facts

This was a review of a decision of Master Kennedy-Grant regarding the effective service of notices upon the taxpayer (reported as *Hieber & Ors v CIR; London Continental Limited v CIR* (2002) 20 NZTC 17,562).

The Commissioner had sent section 17 notices (and a letter referring to the effects of section 21 TAA 1994) to a tax agent's PO Box number. Failure to comply with the notices meant that the taxpayers could not adduce any evidence regarding overseas payments due to the operation of section 21(2) TAA.

The taxpayers challenged this and had argued that there was no effective service, as section 14 TAA 1994, which the taxpayers argued was mandatory, did not recognise posting to a PO Box number as an effective method of service. The taxpayers also argued that as the notices were not sent to the taxpayers themselves but to their tax agent, then there was no service on them. Before the Master, the taxpayers were successful on the first ground (that the service was ineffective) but not the second (that the tax agent could not accept the notices effectively).

Both parties appealed.

Decision

Justice Baragwanath accepted the Commissioner's submissions and dismissed the taxpayers' submissions.

Service on the PO Box

Relying upon the Interpretation Act 1999 and Lord Simon in *Maunsell v Olins* [1975] AC 373 at 391 who said:

> "statutory language must always be given presumptively the most natural and ordinary meaning which is appropriate in the circumstances".

Baragwanath J referred to the

> "eloquent expression of the truism that the meaning of a word can only be understood in its context" (at paragraph 18).

Thus he considered a PO Box was a place of business (within section 14) for the purpose of receiving mail:

> "There is in my opinion no impediment, logical or verbal, to treating an accounting firm's post office box as a -or indeed the- "place of business" for the purposes of receiving mail." (at paragraph 19, emphasis Judge's own)

His Honour went on to speculate, in *obiter dicta*, that use of email would also be within section 14 as a place of business of receiving mail (at paragraph 20).

Baragwanath J continued to conclude that section 14 was facilitative (at paragraph 31) but issued the warning that

> "the Commissioner would be ill advised to stray off the beaten path of section 14." (at paragraph 33)

But because he concluded the PO Box was a place of business for receiving mail the Commissioner had not strayed from section 14.

Effective notice on the taxpayers

He then rejected the taxpayers' arguments that no other person was authorised to act for them noting that Mr Hieber had, by letter, elected to use the tax agent as the address for service for all his interests) paragraphs 34 to 37).

He noted that service was made on tax counsel for the taxpayers and there was deliberate decision not to comply. He concluded:

> "The plaintiffs [the taxpayers'] having made their election are committed to it." (paragraph 26)

He considered that service on one partner of a terminated partnership was effective service on them all (paragraphs 38 to 45), saying:

> "the policy of the law that the rind should accompany the fruit applies in this context: the former partners may not have the benefit of being able to mount a full case on relationship to the partnership without accepting the burden of the application of section 21 [subsection section 21(5) TAA 1994] to that former partnership." (paragraph 43)

He also considered notice to one trustee was notice to all (paragraphs 46 to 50) and notice to the directors of a company was notice to the company (paragraph 51).

REGULAR FEATURES

DUE DATES REMINDER

July 2002

5 Employer deductions and employer monthly schedule

Large employers ($100,000 or more PAYE and SSCWT deduction per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due
- *Employer monthly schedule (IR 348)* due

8 Provisional tax instalment due for people and organisations with March balance date

22 Employer deductions

Large employers ($100,000 or more PAYE and SSCWT deduction per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due

Employer deductions and employer monthly schedule

Small employers (less than $100,000 PAYE and SSCWT deductions per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due
- *Employer monthly schedule (IR 348)* due

FBT return and payment due

31 GST return and payment due

August 2002

5 Employer deductions and employer monthly schedule

Large employers ($100,000 or more PAYE and SSCWT deduction per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due
- *Employer monthly schedule (IR 348)* due

20 Employer deductions

Large employers ($100,000 or more PAYE and SSCWT deduction per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due

Employer deductions and employer monthly schedule

Small employers (less than $100,000 PAYE and SSCWT deductions per annum)

- *Employer deductions (IR 345)* or *(IR 346)* form and payment due
- *Employer monthly schedule (IR 348)* due

30 GST return and payment due

These dates are taken from Inland Revenue's Smart business tax due date calendar 2002 - 2003