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TAX INFORMATION Bulletin

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

A list of the items we are currently inviting submissions on can be found at **www.ird.govt.nz**. On the homepage, click on "Public consultation" in the right-hand navigation. Here you will find drafts we are currently consulting on as well as a list of expired items. You can email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

Below is a selection of items we are working on as at the time of publication. If you would like a copy of an item please contact us as soon as possible to ensure your views are taken into account. You can get a copy of the draft from **www.ird.govt.nz/public-consultation/** or call the Senior Technical & Liaison Advisor, Office of the Chief Tax Counsel on 04 890 6143.

Ref	Draft type/title	Description/background information	Comment deadline
ED0162	Draft standard practice statement: Requests to amend assessments	This draft SPS updates and replaces SPS 07/03: *Requests to amend assessments*. It clarifies how the Commissioner will exercise her discretion under section 113 of the Tax Administration Act 1994 to amend assessments to ensure their correctness. In particular it clarifies how this will be exercised given the way the Commissioner currently deals with the processing of taxpayers' tax returns, telephone enquiries and correspondence. The SPS also explains the relationship between sections 113 and 113A of the Tax Administration Act 1994, and sections 113 and 20(3) of the Goods and Services Tax Act 1985.	11 April 2014
ED0163	Draft determination – General depreciation rate for "Pet grooming and cleaning equipment"	The Commissioner has recently been asked to consider what depreciation rates should apply for items of dog grooming equipment. A generic description has been adopted for various grooming equipment under a new proposed asset category for "Pet grooming and cleaning equipment" to recognise a wider industry scope for pet grooming services.	11 April 2014

Correction – to TIB Vol 25, No 11 (December 2013)

In the item "BR Pub 13/05–13/06: Income tax – Standard project agreement for a public–private partnership", on page 5, under the subheading "Unitary Charge" the bullet points should read:

- The Unitary Charge will be assessable income of the SPV under s CB 1.
- For the purpose of s BD 3, the SPV will derive the Unitary Charge in the income year in which it issues a valid invoice to the Crown.

IN SUMMARY

Binding rulings

Correction to "BR Pub 13/05–13/06: Income tax – Standard project agreement for a public–private partnership" 4

A correction has been made to the bullet points of this binding ruling as published in the *Tax Information Bulletin* Vol 25, No 11 (December 2013), page 5.

Legislation and determinations

Livestock values – 2014 national standard costs for specified livestock 5

This determination sets the national standard costs for specified livestock for the 2013–2014 income year.

Determination FDR 2014/01: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (Russell Investment Company plc: NZDH-A class shares) 7

Any investment a New Zealand resident investor makes in NZDH-A shares issued by Russell Investment Company plc is a type of attributing interest for which a person may not use the fair dividend rate method to calculate foreign investment fund income for the 2015 and subsequent income years.

Determination CFC 2014/01: Non-attributing active insurance CFC status (CIGNA APAC Holdings Limited) 9

This determination applies to CIGNA APAC Holdings Limited and grants non-attributing active CFC status to the specified insurance CFC resident in Taiwan for the 2012–13 to 2014–15 income years.

Determination CFC 2014/02: Non-attributing active insurance CFC status (CIGNA APAC Holdings Limited) 10

This determination applies to CIGNA APAC Holdings Limited and grants non-attributing active CFC status to the specified insurance CFCs resident in Hong Kong for the 2012–13 to 2014–15 income years.

Legal decisions – case notes

Appeal struck out for failure to pay security for costs 11

Mr Patterson filed an appeal for a High Court decision adjudicating him bankrupt. He did not, however, pay security for costs as ordered by the Court of Appeal. The Commissioner of Inland Revenue therefore applied to have Mr Patterson's appeal struck out. The Court of Appeal granted the Commissioner's application and struck out Mr Patterson's appeal because of his failure to pay security for costs and because the appeal itself had no realistic prospect of success.

Residency – RWT and approved issuer levy 12

The Court found the appellants were resident at the relevant time and were, therefore, liable to account for resident withholding tax ("RWT"). Further, the appellants' arrangement was also confirmed a tax avoidance arrangement.

Legal decisions – case notes (continued)

Application to set aside freezing order granted and indemnity costs awarded against Commissioner 14

The Commissioner of Inland Revenue obtained freezing orders over the defendants' bank accounts on 14 November 2013. However, prior to the application being made, and unbeknown to the Commissioner, the defendants had transferred sufficient funds to cover the assessments back to the liquidator of the assessed companies. The defendants' application to set aside the freezing order was granted and indemnity costs awarded against the Commissioner.

Sovereign's appeal dismissed by the Court of Appeal 15

The Court of Appeal dismissed Sovereign Assurance Company Limited's ("Sovereign") appeal of its income tax assessments for the 2000–06 income years. The Commissioner of Inland Revenue reassessed Sovereign in accordance with the accrual regime on the basis that the refundable commission transactions under the treaties were a financial arrangement pursuant to subpart EH of the Income Tax Act 1994.

Liquidation triggers statutory set-off; set-off not a "transaction" for the purposes of the voidable transaction provisions 16

At the date of liquidation, Raiz Enterprises Ltd owed outstanding pay as you earn ("PAYE") and goods and services tax, but was owed a refund for overpaid withholding tax. The Commissioner of Inland Revenue set off the refund against the amount owed. The liquidator's application for orders that the set-off was a voidable transaction was declined.

High Court finds no jurisdiction to judicially review the Commissioner's reassessment of goods and services tax 18

The plaintiff applied for judicial review of the Commissioner of Inland Revenue's reassessment of goods and services tax on a number of grounds. The Commissioner objected to the jurisdiction of the High Court to hear and determine the causes of action based on *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR. The High Court held that it lacked jurisdiction to determine the matter, as the proscription in section 109 of the Tax Administration Act 1994 prevents litigation of "disputable decisions."

High Court grants Commissioner's application to transfer a challenge filed in the Taxation Review Authority to the High Court 19

This case concerns an application by the Commissioner of Inland Revenue for an order transferring a challenge proceeding filed by the taxpayer in the Taxation Review Authority to the High Court under section 138N(2) of the Tax Administration Act 1994. The High Court granted the Commissioner's application, and made an order for transfer.

TRA clarifies scope of "control by any other means whatsoever" associated persons test 20

The Taxation Review Authority ("TRA") found that because two companies, the disputant and Company O were "associated persons" under section 2A(1)(a)(iii) of the Goods and Services Tax Act 1985, the disputant was not entitled to claim the entire goods and services tax ("GST") component of the purchase price of the property purchased from Company O. The GST input credits available to the disputant were instead limited to the GST component of the significantly lower purchase price Company O had originally paid for the property.

Commissioner's statutory demands upheld 22

The companies challenged the statutory demands issued by the Commissioner of Inland Revenue on the grounds that there was a substantial dispute whether or not the debts were owing or due and that the demands ought to have been set aside as an abuse of process. The Court upheld the statutory demand and ordered that the companies pay the amount demanded within 10 working days.

Legal decisions – case notes (continued)

Indemnity costs awarded to the Commissioner 23

The Commissioner of Inland Revenue applied to the Court for indemnity costs in relation to *Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2011] 1 NZLR 336 (HC) which was heard in the High Court in 2011 where the plaintiffs alleged that the original Trinity judgment of the High Court (which led to the Supreme Court decision in *Ben Nevis Venture Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289) should be set aside on the basis that the defendant "presented a false case". The Commissioner sought indemnity costs, increased costs or costs on a 2C basis on the grounds that the plaintiffs' case was vexatious, frivolous or otherwise an abuse of process. The Court determined that the plaintiffs' case was hopeless from the outset and amounted to a collateral attack on the Supreme Court's judgment in *Ben Nevis* and was unnecessary and improper.

Indemnity costs awarded to the Commissioner 24

This was a costs decision in relation to an application by Redcliffe Forestry Venture Limited ("Redcliffe") to set aside a statutory demand made by the Commissioner of Inland Revenue. The Commissioner requested costs on a 2B basis up until 12 September 2013 and thereafter either indemnity or increased costs. Associate Judge Faire accepted the Commissioner's submission that the arguments advanced on Redcliffe's behalf were groundless and unsupported.

Taxpayer unsuccessful in application for order allowing purported objections 24

The applicant sought an order from the Taxation Review Authority ("TRA") directing the Commissioner of Inland Revenue to allow purported late objections. The TRA held that the objections were not made in accordance with the Tax Administration Act 1994 and declined to make the order sought. The TRA also held that the administrative law arguments raised by the applicant did not alter this conclusion.

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR 715)*. You can download this publication free from our website at **www.ird.govt.nz**

CORRECTION TO "BR PUB 13/05–13/06: INCOME TAX – STANDARD PROJECT AGREEMENT FOR A PUBLIC–PRIVATE PARTNERSHIP"

These two public rulings were published in the *Tax Information Bulletin* Vol 25, No 11 (December 2013).

In the section "Public Ruling – BR Pub 13/05: Income tax – Standard project agreement for a public–private partnership – Companies", on page 5, under the subheading "Unitary Charge" the bullet points should read:

- The Unitary Charge will be assessable income of the SPV under s CB 1.
- For the purpose of s BD 3, the SPV will derive the Unitary Charge in the income year in which it issues a valid invoice to the Crown.

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

LIVESTOCK VALUES – 2014 NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK

The Commissioner of Inland Revenue has released a determination, reproduced below, setting the national standard costs for specified livestock for the 2013–2014 income year.

These costs are used by livestock owners as part of the calculation of the value of livestock on hand at the end of the income year, where they have adopted the national standard cost ("NSC") scheme to value any class of specified livestock.

Farmers using the scheme apply the one-year NSC to stock bred on the farm each year, and add the rising two-year NSC to the value of the opening young stock available to come through into the mature inventory group at year-end. Livestock purchases are also factored into the valuation of the immature and mature groupings at year-end, so as to arrive at a valuation reflecting the enterprise's own balance of farm bred and externally purchased animals.

NSCs are developed from the national average costs of production for each type of livestock farming based on independent survey data. Only direct costs of breeding and rearing rising one-year and two-year livestock are taken into account. These exclude all costs of owning (leasing) and operating the farm business, overheads, costs of operating non-livestock enterprises (such as cropping) and costs associated with producing and harvesting dual products (wool, fibre, milk and velvet).

For bobby calves, information from spring 2013 is used while other dairy NSCs are based on the 2012–2013 income and expenditure from a DairyBase sample of owner-operated dairy farms. For sheep, beef cattle, deer and goats, NSCs are based on survey data from the 2011–2012 sheep and beef farm survey conducted by the Beef & Lamb New Zealand Economic Service. This is the most recent information available for those livestock types at the time the NSCs are calculated in December 2013.

For the 2013–2014 income year there has been an increase in the NSCs for all livestock types except bobby calves. For sheep and beef cattle this reflects the increase, in real expenditure, of costs incurred per livestock unit.

The increased NSCs for both rising one-year and rising two-year dairy cattle have come about largely because of a change in the calculation methodology. Direct feed/grazing costs are now allocated directly to rising one-year and rising two-year stock, in order to more accurately reflect the actual cost of production. The effect of the resultant increase in cost is being phased in over the next three years. The decrease in NSC for purchased bobby calves largely results from a decrease in the underlying cost of freight for feed/meal.

The NSCs for deer, dairy goats, and fibre- and meat-producing goats have all increased because of an increase in real expenditure incurred per livestock unit. An increase in feed cost has driven the increased NSC for pigs.

The NSCs calculated each year only apply to that year's immature and maturing livestock. Mature livestock valued under this scheme effectively retain their historic NSCs until they are sold or otherwise disposed of, albeit through a FIFO or inventory averaging system as opposed to individual livestock tracing. It should be noted that the NSCs reflect the average costs of breeding and raising immature livestock and will not necessarily bear any relationship to the market values (at balance date) of these livestock classes. In particular, some livestock types, such as dairy cattle, may not obtain a market value in excess of the NSC until they reach the mature age grouping.

One-off movements in expenditure items are effectively smoothed within the mature inventory grouping, by the averaging of that year's intake value with the carried forward values of the surviving livestock in that grouping. For the farm-bred component of the immature inventory group, the NSC values will appropriately reflect changes in the costs of those livestock in that particular year.

The NSC scheme is only one option under the current livestock valuation regime. The other options are market value, the herd scheme and the self-assessed cost scheme ("SAC") option. SAC is calculated on the same basis as NSC but uses a farmer's own costs rather than the national average costs. There are restrictions in changing from one scheme to another and before considering such a change livestock owners may wish to discuss the issue with their accountant or other adviser.

NATIONAL STANDARD COSTS FOR SPECIFIED LIVESTOCK DETERMINATION 2014

This determination may be cited as "The National Standard Costs for Specified Livestock Determination 2014".

This determination is made in terms of section EC 23 of the Income Tax Act 2007. It shall apply to any specified livestock on hand at the end of the 2013–2014 income year where the taxpayer has elected to value that livestock under the national standard cost scheme for that income year.

For the purposes of section EC 23 of the Income Tax Act 2007 the national standard costs for specified livestock for the 2013–2014 income year are as set out in the following table.

National standard costs for 2013–2014 income year

Kind of livestock	Category of livestock	National standard cost $
Sheep	Rising 1 year	37.70
	Rising 2 year	24.70
Dairy cattle	Purchased bobby calves	170.10
	Rising 1 year	510.00
	Rising 2 year	225.60
Beef cattle	Rising 1 year	369.70
	Rising 2 year	207.80
	Rising 3 year male non-breeding cattle (all breeds)	207.80
Deer	Rising 1 year	124.00
	Rising 2 year	62.10
Goats (meat and fibre)	Rising 1 year	29.00
	Rising 2 year	19.90
Goats (dairy)	Rising 1 year	162.30
	Rising 2 year	28.00
Pigs	Weaners to 10 weeks of age	112.10
	Growing pigs 10 to 17 weeks of age	92.60

This determination is signed by me on the 27th day of January 2014.

Rob Wells
LTS Manager, Technical Standards

DETERMINATION FDR 2014/01: A TYPE OF ATTRIBUTING INTEREST IN A FOREIGN INVESTMENT FUND FOR WHICH A PERSON MAY NOT USE THE FAIR DIVIDEND RATE METHOD (RUSSELL INVESTMENT COMPANY PLC: NZDH-A CLASS SHARES)

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager, Investigations and Advice, under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the Russell Investment Company plc (RIC), an Irish public limited company to which this determination applies, are an attributing interest in a foreign investment fund (FIF) for New Zealand resident investors. RIC is structured as an umbrella fund with segregated liability between sub-funds. Those sub-funds do not have a separate legal personality under Irish law.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in RIC each year.

The Russell Global Bond Fund (RGBF) is a sub-fund of RIC which invests in a portfolio of transferable debt instruments. RIC issues a class of shares denominated in New Zealand dollars (NZDH-A shares) that provide holders of that class of shares with an interest in the pool of investments held by the RGBF. RIC undertakes hedging for NZDH-A shares, with the intention that this arrangement ensures that the New Zealand dollar value of that class of shares is unaffected by foreign exchange movements.

Section EX 46(10)(c) of the Income Tax Act 2007 would not apply to prevent the use of the fair dividend rate (FDR) method, but would apply if the RGBF represented a separate foreign company and the NZDH-A share class was the only class of shares on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement, including any interposed entities or financial arrangements, in ascertaining whether an investment in a FIF provides the New Zealand-resident investor with a return akin to a New Zealand dollar denominated debt investment.

On this basis, where a New Zealand resident invests in NZDH-A shares issued by RIC and the share class, which has a value in New Zealand dollars, is linked to an interest in a pool of debt securities held by RGBF and effectively hedged against foreign currency movements by RIC, I consider that it is appropriate for those holdings in RIC to be excluded from using the FDR method for the 2015 and subsequent income years.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

1. The non-resident issuer:
    a) is an Irish public limited company established on 31 March 1994 that issues multiple classes of shares;
    b) is known at the date of this determination as Russell Investment Company plc; and
    c) is structured as an umbrella fund with segregated liability between sub-funds; and
2. The attributing interest consists of a New Zealand dollar denominated class of shares, NZDH-A, issued by that non-resident that provides exposure solely to a sub-fund that predominantly (ie, 80% or more by value at a time in the income year) holds transferrable debt instruments, and
3. The investment assets attributable to NZDH-A shares are subject to foreign currency hedging arrangements undertaken by the non-resident for the purpose of eliminating any exchange rate risk for New Zealand investors.

Interpretation

In this determination unless the context otherwise requires:

"Financial arrangement" means financial arrangement under section EW 3 of the Act;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Act; and

"The Act" means the Income Tax Act 2007.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application date

This determination applies for the 2015 and subsequent income years. However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination also applies for an income year beginning before the date of this determination for a person who invests in NZDH-A shares in RIC and who chooses that this determination applies for that income year.

Dated this 3rd day of February 2014.

John Trezise
Investigations Manager

DETERMINATION CFC 2014/01: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (CIGNA APAC HOLDINGS LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). CIGNA APAC Holdings Limited has made application in respect of the CFC set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFC to which this determination applies is:

Name	Jurisdiction
CIGNA Taiwan Life Assurance Company Limited	Taiwan

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Conditions stipulated by the Commissioner

This determination is made subject to the following condition:

- That for the 2013–14 and 2014–15 income years, the business of CIGNA Taiwan Life Assurance Company Limited is continuously producing income, other than income from claims under reinsurance contracts, that is all or nearly all from:
  - premiums from insurance contracts, other than reinsurance contracts, covering risks arising in Taiwan; and/or
  - proceeds from investment assets having a total value commensurate with the value of those insurance contracts.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2012–13 to 2014–15 income years.

This determination is signed by me this 10th day of February 2014.

Bill Acton
Investigations Manager

DETERMINATION CFC 2014/02: NON-ATTRIBUTING ACTIVE INSURANCE CFC STATUS (CIGNA APAC HOLDINGS LIMITED)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

This power has been delegated by the Commissioner of Inland Revenue to the position of Investigations Manager under section 7 of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

Under sections CQ 2(1)(h) and DN 2(1)(h) of the Income Tax Act 2007, subject to sections CQ 2(2B) and DN 2(2), no attributed CFC income or loss arises from a CFC that is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC that is an insurer meeting the requirements of a determination made by the Commissioner under section 91AAQ of the Tax Administration Act 1994 is a non-attributing active CFC. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable CFC amount by section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(b) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of the members of a group of CFCs, if the members satisfy subsection (3). CIGNA APAC Holdings Limited has made application in respect of the members of the group of CFCs set out below.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the members of the group of CFCs satisfy the requirements set out in section 91AAQ(3) of the Tax Administration Act 1994 and are accordingly non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of determination

The CFCs to which this determination applies are:

Name	Jurisdiction
CIGNA Hong Kong Holdings Company Limited	Hong Kong
CIGNA Worldwide Life Insurance Company Limited	Hong Kong
CIGNA Worldwide General Insurance Company Limited	Hong Kong

Interpretation

In this document, unless the context otherwise requires:

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a CFC as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Conditions stipulated by the Commissioner

This determination is made subject to the following condition:

- That for the 2013–14 and 2014–15 income years, the business of the group of CFCs is continuously producing income, other than income from claims under reinsurance contracts, that is all or nearly all from:
  - premiums from insurance contracts, other than reinsurance contracts, covering risks arising in Hong Kong; and/or
  - proceeds from investment assets having a total value commensurate with the value of those insurance contracts.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994 I hereby determine that the above CFCs are non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2012–13 to 2014–15 income years.

This determination is signed by me this 10th day of February 2014.

Bill Acton
Investigations Manager

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, Court of Appeal, Privy Council and the Supreme Court.

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.

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.

APPEAL STRUCK OUT FOR FAILURE TO PAY SECURITY FOR COSTS

Case	Wayne Thomas Patterson v Commissioner of Inland Revenue
Decision date	6 December 2013
Act(s)	Rule 37(1) of the Court of Appeal (Civil) Rules 2005
Keywords	Security for costs, strike out

Summary

Mr Patterson filed an appeal for a High Court decision adjudicating him bankrupt. He did not, however, pay security for costs as ordered by the Court of Appeal. The Commissioner of Inland Revenue ("the Commissioner") therefore applied to have Mr Patterson's appeal struck out. The Court of Appeal granted the Commissioner's application and struck out Mr Patterson's appeal because of his failure to pay security for costs and because the appeal itself had no realistic prospect of success.

Impact of decision

The decision confirms the effect of section 109 of the Tax Administration Act 1994 ("TAA") and the principle that a respondent should not be put to the expense of responding to an unmeritorious appeal where there is no prospect of costs being recovered from the appellant.

Facts

This decision relates to Wayne Thomas Patterson's appeal of a High Court decision adjudicating him bankrupt at the Commissioner's application. To progress the appeal, the Court of Appeal ordered Mr Patterson to pay security for costs of $5,800 by 11 June 2013. Mr Patterson failed to do so and the Commissioner applied to have the appeal struck out pursuant to rule 37(1) of the Court of Appeal (Civil) Rules 2005 ("the Rules").

Decision

The Court of Appeal granted the Commissioner's application and struck out Mr Patterson's appeal. The Court stated that it was well established that a strike out under rule 37(1) of the Rules would be granted where an appellant had failed to pay security for costs and the appeal itself had no realistic prospect of success.

The Court concluded that Mr Patterson's appeal was essentially asking the Court to reconsider the correctness of default assessments that were not challenged in time and were now deemed to be correct. Such reconsideration was expressly prohibited by section 109 of the TAA. Accordingly, the Court of Appeal held that Mr Patterson's appeal had no realistic prospect of success.

In opposing the strike-out, Mr Patterson submitted that, among other things, the Court should not be allowed to use the security for costs requirement as an indirect means of avoiding public law scrutiny by exploiting Mr Patterson's impecuniosity. Mr Patterson also submitted that a strike-out would be unjust on the basis that he had been denied his fundamental right to defend the original bankruptcy proceeding due to counsel error in an earlier District Court proceeding.

No costs were sought by the Commissioner, and hence none were awarded.

RESIDENCY – RWT AND APPROVED ISSUER LEVY

Case	Vinelight Nominees Limited & Anor v Commissioner of Inland Revenue
Decision date	16 December 2013
Act(s)	Income Tax Act 1994, Tax Administration Act 1994
Keywords	Residency, approved issuer levy, resident withholding tax, statute bar, evidence exclusion rule

Summary

The Court found the appellants were resident at the relevant time and were, therefore, liable to account for resident withholding tax ("RWT"). Further, the appellants' arrangement was also confirmed a tax avoidance arrangement.

Background

This was an appeal by the appellants against the decision of the High Court upholding the Commissioner of Inland Revenue's ("the Commissioner") assessments (*Vinelight Nominees Limited v Commissioner of Inland Revenue* [2012] NZHC 3306, an appeal of a decision of the Taxation Review Authority ("TRA") in *Case 11/2011* (2011) 25 NZTC 15,177).

Facts

The Chin family carried on business in New Zealand through Vinelight Investments Limited ("VIL"). VIL's business activities were financed by interest-free loans made by a Hong Kong registered company also owned by the family—Weyand Investments Limited ("Weyand").

In 1998, the family affairs were reorganised on advice from Ernst & Young. Briefly, the Vinelight Trust ("the Trust") and its corporate trustee, Vinelight Nominees Limited (Vinelight), were created. VIL assumed an obligation to pay management fees to Vinelight with Vinelight assuming liability for the debt then owed by VIL to Weyand (with interest now payable). The shares in Weyand were transferred from Rodney and Sandra Chin to their three children who also joined them as directors of Weyand. Vinelight then registered as an approved issuer for the purposes of approved issuer levy ("AIL") and the loan from Weyand was registered as a security. From 1998 to 2005, Vinelight paid AIL at the rate of two per cent on the amounts of interest paid.

In 2003, the arrangement was altered after an opinion provided by Ernst & Young recommended changes including the resignation of Rodney and Sandra Chin as directors of Weyand (and the children in anticipation of their return to New Zealand) and that the directors should hold directors' meetings in Hong Kong.

The Commissioner assessed Vinelight for RWT for the periods 31 March 1999 to 31 December 2002 and for non-resident withholding tax ("NRWT") for the periods ended 31 October 2003 to 28 February 2005. Weyand was also assessed for income tax for the years ended 31 March 1999 to 31 March 2003.

Decision

The Court dismissed the appeal.

Residency

The Court agreed with the earlier decisions in the TRA and the High Court that at all material times, until its affairs were restructured, Weyand's centre of management lay in New Zealand. The Court noted that the conclusions of fact reached in the lower courts were not in fact disputed before the Court of Appeal and also added that the New Zealand and Hong Kong bank accounts were managed by Rodney and Sandra Chin in New Zealand.

Further, the Court did not accept that the Court should distinguish between acts of "superior" and "administrative" management, noting that this approach would have hearing authorities treating some dimensions of management as wholly irrelevant while conflating the test of "centre of management" in section OE 2(1)(c) with the "acts of directors" test in section OE 2(1)(d) of the Income Tax Act 1994 ("the Act").

Was Vinelight Nominees liable to account for RWT?

There were four sub-issues:

1. Did section 138G of the Tax Administration Act 1994 ("TAA") preclude Vinelight from making arguments under section NF 2(4)(b)(ii) of the Act?
2. If not, were the interest payments made part of Vinelight's taxable activities for the purposes of section NF 2(4)(b)(ii)?
3. Did section NF 5 of the Act apply so as to exclude Vinelight for liability to deduct RWT?
4. Was the Commissioner time-barred from making RWT assessments for the 1999 to the 2001 income years?

Section 138G

The Court noted that section 138G of the TAA requires that the parties make full disclosure in their respective statements of position ("SOP") to ensure as far as possible tax disputes are resolved in dialogue between taxpayers and the Commissioner, not in litigation.

The Court noted that the appellants' claim under section NF 2(4)(b)(ii) of the Act did not surface until counsel opened his case before the TRA.

The Court stated that neither party's SOP identified the taxable activity issue at all. While the Commissioner listed section NF 2 in a list of provisions relied upon in her SOP in support of an unrelated proposition, this was listed only because it is the charging provision for RWT and could not put in issue all of its requirements. The Court noted that a reasonable person would not think the Commissioner had made taxable activity an issue merely by listing section NF 2 for a wholly unrelated and uncontroversial purpose. Further, the Court concluded that Vinelight knew all along that the Commissioner relied upon section NF 2 and therefore could have denied liability under that provision in its own SOP.

While the Court declined to address the merits of the submissions on the issue, for completeness the Court referred to the TRA's conclusion that the interest was paid in the course of Vinelight's taxable activities.

Section NF 5

The Court concluded that Vinelight's claim that it was not liable to deduct RWT, as it had on reasonable grounds and having made all reasonable inquiries concluded that Weyand was non-resident, could not succeed.

The Court noted that the High Court appeared to accept the appellants' argument that the "all reasonable inquiries" test was confined to inquiries as to facts. However, the Court disagreed, seeing no reason to confine the natural meaning of the language in that way. The Court noted that in this setting, it may well be reasonable to expect some taxpayers to make inquiries of a relevantly qualified professional advisor, observing that the reasonableness requirement extends to the content of the taxpayer's inquiries.

As for the "reasonable grounds" requirement, the Court accepted that advice from a qualified advisor may supply reasonable grounds provided the taxpayer has made reasonable inquiries of the advisor.

The Court considered that Vinelight had not actually concluded that Weyand was non-resident and in fact (agreeing with the High Court) all Vinelight did was follow a course of action devised by Ernst & Young, assuming it would work. The Court accepted that advice was not given by Ernst & Young on this point until 2003 and did not accept that residency advice was implicit in earlier work provided by Ernst & Young.

Time bar

The appellants argued that while RWT returns were not filed, a return need not be filed in the prescribed form and, in this case, the AIL returns were sufficient.

The Court noted that section 50 of the TAA provides that every person required to deduct RWT shall deliver to the Commissioner a statement in a form authorised by the Commissioner showing such details in relation to the payment of RWT as the Commissioner may prescribe. The Court concluded that the Commissioner has prescribed the form IR 15P (as opposed to the IR 15A for the return of AIL) and therefore agreed with the High Court that the time bar did not apply in this case.

Tax avoidance arrangement

The Court (agreeing with both the TRA and the High Court) found that the arrangement was a tax avoidance arrangement. Further, the Court concluded that the tax avoidance was not only a more than merely incidental purpose of the arrangement. Rather, it was the dominant purpose of the arrangement.

Reconstruction

There were two sub-issues:

1. Did section 138G of the TAA prevent the appellants from challenging the Commissioner's reconstruction?
2. If not, was the Commissioner's reconstruction possible in law?

Section 138G

The Court, agreeing with both the TRA and the High Court, considered that the reconstruction issue had not been sufficiently disclosed in the SOPs. While the Commissioner raised the reconstruction power, that discussion was directed to a different issue, namely who might suffer the consequences of reconstruction. The Court concluded that the Commissioner could not reasonably be expected to appreciate that an issue arose about her capacity to reconstruct.

Was reconstruction possible in law?

The appellants submitted that the reconstruction power does not extend to adjusting tax rates.

The Court concluded that the Commissioner did not adjust the gross resident withholding income, any deductions or available losses. Rather, the Court considered that NRWT is payable when a payment of non-resident withholding income is made, and where NRWT is not paid, the sum in default becomes a statutory debt payable to the Commissioner. In this case, the Commissioner did not need to adjust the level of non-resident withholding income. Rather, she only needed to assess Vinelight for NRWT on its reported non-resident withholding income. Accordingly, the Court considered that the Commissioner did not exercise her power of reconstruction.

Shortfall penalties

The Court considered that none of the grounds of appeal were about as likely as not to be correct and that the arrangement was entered into for the dominant purpose of avoiding tax. Accordingly, the shortfall penalties were correctly imposed by the Commissioner under sections 141B and 141D of the TAA.

APPLICATION TO SET ASIDE FREEZING ORDER GRANTED AND INDEMNITY COSTS AWARDED AGAINST COMMISSIONER

Case	Commissioner of Inland Revenue v Marcus Seymour Dymock and Charlotte Jane Dymock [2013] NZHC 3346
Decision date	16 December 2013
Act(s)	n/a
Keywords	Freezing order, indemnity costs

Summary

The Commissioner of Inland Revenue ("the Commissioner") obtained freezing orders over the defendants' bank accounts on 14 November 2013. However, prior to the application being made, and unbeknown to the Commissioner, the defendants had transferred sufficient funds to cover the assessments back to the liquidator of the assessed companies. The defendants' application to set aside the freezing order was granted and indemnity costs awarded against the Commissioner.

Impact of decision

There is a responsibility on parties who apply for a freezing order *ex parte* to ensure the Court is properly informed. This responsibility is not discharged by saying that they were relying on someone else to keep them up to date.

Facts

This decision relates to an application by the defendants to set aside an *ex parte* freezing order over funds of $462,000 held by the second defendant ("Mrs Dymock") in a personal account.

The first defendant ("Mr Dymock") was the sole shareholder of three related companies. The companies were placed into voluntary liquidation on 25 June 2013. At the date of liquidation, two of the companies had, between them, $1.3 million in funds from the proceeds from a sale of land. In mid-August 2013, an interim distribution of $1.3 million was made to Mr Dymock as sole shareholder.

The Commissioner contends that the two companies are related by common ownership to the original owner of the land, the third of the Dymock companies. On 1 November 2013, the Commissioner issued default assessments for the two companies totalling $462,018.92.

The Commissioner considered that the full $1.3 million should be returned to the liquidator. However, the liquidator only sought $450,000 from Mr Dymock to be added to the $25,000 he already held. The combined total of which would therefore meet the default assessment if that proved to be the liability.

The Dymocks agreed to return $450,000, but there were complications in the funds being transferred, resulting in delays. The liquidator said he would update the Commissioner when the funds had been transferred. He did not do that. As it happens, the money did arrive at the liquidators on 4 November 2013.

The Commissioner sought to obtain undertakings from the liquidator that the money be preserved to satisfy her debt. The undertakings were not provided.

On 8 November 2013, the Commissioner filed an *ex parte* application for a freezing order over funds of up to $462,000 in Mr and Mrs Dymock's bank accounts. The order was granted on 14 November 2013.

Complications with the implementation of the freezing order meant that instead of only $462,000 being frozen, all funds in the accounts were frozen. Mrs Dymock encountered difficulties in paying for expenditure. On 18 November 2013, revised orders were sought limiting the freezing order to one specific account owned by Mrs Dymock.

Decision

Whether there was a need for the freezing order

In reliance on section 301 of the Companies Act 1993, the Commissioner submitted that she was not in control of the sum sought in the substantive proceedings. It was also submitted that more money may be needed as there is an on-going investigation, the liquidator's fee to take into account and the tax losses said to be available not yet being accepted.

The Court found that the purpose of the substantive proceeding was fulfilled. The Court noted that the Commissioner was the only creditor, suggesting her ranking as creditor in the liquidation would remain unchallenged. The Commissioner's desire for the sum to be more was considered irrelevant by the Court as nothing beyond $462,000 had been sought. The Court found that there was no basis for the continuation of the freezing order and it was subsequently discharged.

Whether there was a risk of dissipation

In her application for a freezing order, the Commissioner had argued that there was a risk of dissipation on the basis that (a) the assets were liquid assets, (b) Mr Dymock had gone to the Netherlands, (c) Mr Dymock had a poor history of tax compliance, and (d) there was an on-going investigation.

The Court was satisfied that the Commissioner had failed to establish a risk of dissipation. This view was supported by the fact that Mr Dymock had returned to the country before the application was filed, the audit investigations did not add any worth as a factor indicating risk and, in respect to his history of tax compliance, Mr Dymock always paid assessments once finalised.

In respect of the Commissioner's description of Mr Dymock's tax history as one of "poor tax compliance", the Court noted that more care was needed with the language used and the claims made. Specifically, the Court stated that "more objectivity is required, and a clear basis for any such claim articulated" (*Commissioner of Inland Revenue v Marcus Seymour Dymock* [2013] NZHC 3346 at [25]).

Whether the application was misleading

The Court identified a number of errors in the affidavit filed in support of the freezing order that were "significant, avoidable, and troubling", and which suggested "a lack of objectivity and care that should not be found in a document filed to support *ex parte* orders of this type" (at [36]).

Whether indemnity costs should be awarded

The Court found a combination of factors made an award of indemnity costs appropriate. These factors were that:

1. there was no sound basis for the orders once the liquidator received funds to a sum equivalent to that sought in the proceedings;
2. enquiries should have been made as to the location of the funds prior to the application being filed in the Court;
3. the unsubstantiated claim that Mr Dymock may have left New Zealand permanently, although not deliberate, is at the upper end of misleading the Court.

SOVEREIGN'S APPEAL DISMISSED BY THE COURT OF APPEAL

Case	Sovereign Assurance Company Limited v Commissioner of Inland Revenue
Decision date	17 December 2013
Act(s)	Income Tax Act 1994
Keywords	Accrual rules, capital/revenue distinction

Summary

The Court of Appeal dismissed Sovereign Assurance Company Limited's ("Sovereign") appeal of its income tax assessments for the 2000–06 income years. The Commissioner of Inland Revenue ("the Commissioner") reassessed Sovereign in accordance with the accrual regime on the basis that the refundable commission transactions under the treaties were a financial arrangement pursuant to subpart EH of the Income Tax Act 1994 ("the Act").

Impact of decision

This decision reinforces the Court's acceptance of the primacy of the accrual rules over other provisions in the Income Tax Acts. It also provides (obiter) discussion on the capital/revenue distinction by the Court of Appeal.

Facts

This appeal relates to the tax treatment of cash flows arising under certain reinsurance treaties entered into between Sovereign and a number of German reinsurance companies. By agreement, the treaty between Gerling-Konzern Glonale ("Gerling") and Sovereign was accepted as being representative of the treaties with the other German reinsurance companies (Hanover Re and Cologne Re).

The treaties provided for two money flows between Sovereign and Gerling:

1. a premium paid by Sovereign to Gerling to reinsure a defined portion of the life insurance policies issued by Sovereign. In return, Gerling assumed liability to make payment of a defined portion of any claim that was subsequently made (referred to as the "mortality risk"); and
2. the commission paid by Gerling to Sovereign (quantified as a multiple of the initial premium received by Sovereign on new policies).

Sovereign then made "commission repayments" to Gerling, in defined portions, out of subsequent years premiums for as long as those policies remained in force. Sovereign was not required to pay these "refundable commissions" if any individual policy lapsed. (This description of the money flows was that used by the Commissioner and the Courts rather than by Sovereign and the German Reinsurers themselves, see [72].) However, there were overall arrangements between Sovereign and Gerling as moderated by a bonus account. The bonus account kept track of total money flows in both directions with an ultimate purpose of enabling the calculation of any profit share to which Sovereign would become entitled if the bonus account went into credit after the reinsurer was fully repaid.

Sovereign accounted for those money flows by returning the refundable commissions as assessable income when they were received from Gerling and then deducting the commission repayments (being the base component received from Gerling plus the interest component) as a deductible expense when paid to Gerling. Sovereign's position was that the money flows were components of a contract of insurance that could not be "unbundled" and in their entirety were an excepted financial arrangement.

The Commissioner had reassessed Sovereign in accordance with the accrual regime on the basis that the refundable commission transactions under the treaties were a financial arrangement pursuant to the Act.

In the High Court, Dobson J agreed with the Commissioner that these four flows of money under the treaties could be "unbundled" for tax purposes and it was only the tax treatment of the flows of money attributable to the refundable commission payments and commission repayments that were the subject of the appeal.

In the High Court, Dobson J upheld the Commissioner's assessments on the basis that the refundable commission payments and repayments between Sovereign and Gerling constituted a financial arrangement for the purposes of the accrual rules and were taxable in accordance with subpart EH of the Act. The deduction of the interest component was spread over the life of the arrangement. Accordingly, the refundable commission payments received by Sovereign from the German reinsurers were not accessible income and the commission repayments were not deductible expenses as returned by Sovereign in the 2000–06 income years.

On appeal, Sovereign argued that the transaction fell within section EH 10(2) of the Act so that the accrual rules did not apply (this was an argument that the base component of the transaction was attributable to a sale of property). Sovereign argued that the refundable commissions received were income earned by "sales of cash flows" from ceding the persistency risk (the risk that new life insurance contracts would be cancelled by the insured before the costs incurred in writing a new policy were recouped) to the German reinsurers. Sovereign further argued that, while there was a financing element to the treaties, they were not loans because the treaties did not provide a requirement for the commissions to be repaid. Sovereign argued there was merely an "expectation" to make the repayment of the refundable commissions. Therefore, in Sovereign's submission, the refundable commissions were not a "debt or debt instrument" for the purposes of the accrual rules (as per the definition of financial arrangement in EH 14 of the Act).

The Commissioner argued that the refundable commissions were subject to the accrual rules and that only the interest component was deductible (and spread).

Decision

Harrison J (also giving the reasons of Miller J as White J gave his own reasoning) dismissed Sovereign's appeal and upheld the Commissioner's assessment. At [48]:

> We agree with Mr Goddard. In this Court, as in the High Court, Mr McKay accepts that the commission transactions fell within the broad definition of a financial arrangement. The financing component of the treaty was an arrangement whereby Sovereign obtained money from Gerling (the commission payments) in consideration for promising to pay money in the future (the commission repayments). This element of deferred consideration is central to the rules. So, too, is the regime's inherent dilution of the orthodox distinction between capital and revenue, ensuring a neutral tax treatment regardless of form. The focus is on the economic effect of the transaction – in this case the commissions and other repayments.

Harrison J then went on to discuss (from [61] onwards) the legal nature of the base component and the principles and case law relevant to the capital/revenue distinction. His Honour concluded that the refundable commission payments were not derived as income and that the repayment of the base component of the commission repayment was not incurred in deriving income. His Honour stated, at [125], that the legal character of the commission arrangements was that of a loan.

White J agreed with the majority's decision that the Commissioner's application of the accrual rules was correct. He stated, at [130], that in his view, it was not necessary to address Sovereign's submissions on the basis that the accrual rules did not apply.

LIQUIDATION TRIGGERS STATUTORY SET-OFF; SET-OFF NOT A "TRANSACTION" FOR THE PURPOSES OF THE VOIDABLE TRANSACTION PROVISIONS

Case	David Harlock v Commissioner of Inland Revenue [2013] NZHC 3389
Decision date	17 December 2013
Act(s)	Companies Act 1993, Income Tax Act 2007
Keywords	Set-off, voidable transaction

Summary

At the date of liquidation, Raiz Enterprises Ltd ("the company") owed outstanding pay as you earn ("PAYE") and goods and services tax ("GST"), but was owed a refund for overpaid withholding tax. The Commissioner of Inland Revenue ("the Commissioner") set off the refund against the amount owed. The liquidator's application for orders that the set-off was a voidable transaction was declined.

Impact of decision

There are no implications arising from this judgment.

Facts

This decision relates to an application for orders under section 295 of the Companies Act 1993 ("the CA") that the set-off of an income tax refund against outstanding PAYE and GST was a "voidable transaction" for the purposes of section 292 of the CA.

The applicant, David Harlock, was the liquidator of the company. The Commissioner claimed that when the company ceased business it owed her the sum of $77,055.51 for unpaid PAYE and $179,264.27 for unpaid GST, a total of $256,319.78.

On 22 May 2013, prior to the company going into liquidation, it filed its income tax return for the 2013 year. The return gave rise to an income tax refund of $98,998.88. The company offered the refund as part of a payment proposal to pay its outstanding arrears over time.

On 28 May 2013, the Commissioner declined the payment proposal but advised the company's accountant that the refund would be set off against the arrears.

However, the refund was not transferred until 18 June 2013, after the Commissioner received legal advice about the transfer on 12 June 2013.

By then the company had been placed into voluntary liquidation (on 5 June 2013).

On 25 July 2013, the applicant issued a voidable notice. The Commissioner did not respond to the voidable notice within the statutory timeframe, or at all. Pursuant to section 294(3) of the CA, a voidable transaction is automatically set aside if a voidable notice is not responded to within the statutory timeframe.

On 25 September 2013, the applicant filed these proceedings to enforce payment of the voidable notice.

Decision

Section 292

The parties were not able to agree about the circumstances in which the Commissioner applied the refund. The applicant argued that the offer of the refund as part of the payment proposal amounted to a "request" pursuant to section RM 10(2) of the Income Tax Act 2007 ("the ITA") so the set-off was, therefore, a "transaction" between the company and the Commissioner. The Commissioner argued that the set-off was a unilateral action, which did not constitute a "transaction" as defined in the ITA.

The Court found that there was no evidence to suggest that the set-off was carried out at the request of the company, noting that the payment proposal had been declined (*Harlock v Commissioner of Inland Revenue* [2013] NZHC 3389, at [35]). The Court concluded that the set-off was not a voidable transaction that was caught by section 292 because it did not literally fall within the description of a transaction. That was because it took place after the end of the specified period (at [38]).

The Court also noted that section 292 referred to transactions "by the company", which suggested that the expression did not extend to unilateral actions or decisions of third parties which the company did not participate in. In addition, the definition was phrased as meaning specific categories of transactions, which did not include being subjected to a set-off under the taxation legislation (at [41]).

Further, there was persuasive authority of the Court of Appeal that a set-off is not a transaction to which section 292 applies (*Commissioner of Inland Revenue v Smith* [2000] 2 NZLR 147 (CA)).

The Court also rejected the applicant's submission that amounts due to be refunded under section RM 2 of the ITA were held in trust by the Commissioner pending payment (at [51]).

The Court later went on to consider whether the operation of section 294 of the CA (which automatically voids a transaction if a voidable notice is not responded to within the statutory timeframe) prevented the Commissioner from arguing that the set-off was not a "transaction".

The Court found that the giving of a notice under section 294 was not sufficient to deem what would otherwise not be a "transaction" under section 292, to be such (at [72]). Therefore, section 294 did not prevent the Commissioner from arguing that the set-off was not a transaction.

Section 310

The Court suggested that the liquidation of the company triggered the operability of section 310 of the CA as the statutory authority for the set-off, rather than section RM 10 of the ITA (at [62]). The Court observed that the Commissioner is subject to the provisions of the CA just as any other individual is (at [63]).

Noting that section 310 takes effect upon the liquidation of a company, the Court stated (at [68]):

> Therefore it was the statutory and automatic netting that took effect with the commencement of liquidation on 5 June 2013 rather than the account that the respondent stated on 18 June 2013 which was of crucial effect. That conclusion must mean that any entitlement that the Commissioner had to the $99,000 approximately was not referable to a transaction which breached section 292 CA …

LEGAL DECISIONS – CASE NOTES

Requirement of a preference

Given the conclusion above that the set-off was not a "transaction" within section 292 of the CA, the Court was not required to determine this issue. However, it noted that a "reasonably complex calculation" would need to have been carried out to determine the matter (at [76]).

HIGH COURT FINDS NO JURISDICTION TO JUDICIALLY REVIEW THE COMMISSIONER'S REASSESSMENT OF GOODS AND SERVICES TAX

Case	Peter William Mawhinney as trustee of the Forest Trust v Commissioner of Inland Revenue & Registrar of the Taxation Review Authority [2013] NZHC 3564
Decision date	23 December 2013
Act(s)	Goods and Services Tax Act 1985, Tax Administration Act 1994, Interpretation Act 1999
Keywords	Judicial review, reassessment, natural justice, maladministration, deemed acceptance, jurisdiction

Summary

The plaintiff applied for judicial review of the Commissioner of Inland Revenue's ("the Commissioner") reassessment of goods and services tax ("GST") on a number of grounds. The Commissioner objected to the jurisdiction of the High Court to hear and determine the causes of action based on *Tannadyce Investments Ltd v Commissioner of Inland Revenue* [2011] NZSC 158, [2012] 2 NZLR ("*Tannadyce*"). The High Court held that it lacked jurisdiction to determine the matter, as the proscription in section 109 of the Tax Administration Act 1994 ("TAA") prevents litigation of "disputable decisions."

Impact of decision

The Courts will uphold the decision on *Tannadyce*.

Facts

The Forest Trust ("the Trust") claimed a refund of $67,011.65 for the GST period ended 31 July 2009. The Commissioner used section 89C(eb) of the TAA to make a reassessment of that amount, which she reassessed to nil, without issuing a notice of proposed adjustment ("NOPA").

The Trust issued its own NOPA in relation to that reassessment, and the Commissioner responded with her notice of response ("NOR"). The Trust claimed that the Commissioner's NOR was issued out of time and therefore the Commissioner was deemed to have accepted the Trust's adjustment.

The trustee of the Trust, Peter Mawhinney, applied for judicial review in relation to the Commissioner's reassessment, pleading five separate but interconnected grounds:

1. The Commissioner's use of section 89C(eb) was unlawful as the section does not authorise the Commissioner to assess or disallow refunds. Further, there is nothing in the Goods and Services Tax Act 1985 that excludes GST from being applied to fraudulent activity.
2. The Commissioner's reassessment was made in breach of natural justice.
3. The Commissioner's failure to reassess the corresponding output tax in the GST period ended 30 September 2010 was unreasonable and amounted to conscious maladministration.
4. The Commissioner failed to respond to the Trust's NOPA in time and so the Trust's NOPA was deemed to be accepted under section 89H(2) of the TAA.
5. The Commissioner breached three statutory duties:
   a) a duty under the Interpretation Act 1999 to interpret the Inland Revenue Acts by ascertaining their meaning from their text and in light of their purpose;
   b) a duty under section 111 of the TAA to issue a NOPA to the Trust as soon as convenient after making an assessment; and
   c) a duty to observe the principles of natural justice.

The Commissioner objected to jurisdiction on the basis that the statutory disputes and challenge procedures under Parts 4A and 8A of the TAA preclude judicial review, in accordance with the Supreme Court's decision in *Tannadyce*.

Decision

The Court found that Mr Mawhinney could invoke the statutory disputes and challenge procedure to raise each of the five issues.

Issue 1

The proper assessment of the GST in question was plainly a matter that was able to be resolved in the statutory disputes and challenge procedure. Anything of relevance to the correct assessment could be considered in that process, including the fraudulent activity issue.

Issue 2

Any relevant breach of natural justice could be resolved or ameliorated in the disputes and challenge procedure because that procedure involves the potential exercise of the same powers that are available to the High Court on an application for judicial review.

Issue 3

The Commissioner had issued a NOPA in respect of the period ended 30 September 2010. Accordingly, Mr Mawhinney was able to have the Commissioner's failure to reassess the corresponding output tax considered and determined in the disputes and challenge process.

Issue 4

The issue concerning whether the Commissioner was deemed to have accepted the Trust's NOPA was one that could be considered in the disputes and challenge process.

Issue 5

Each of the alleged breaches of statutory duty could be raised and considered in the disputes and challenge process.

Conclusion

Accordingly, the Court had no jurisdiction to determine the causes of action against the Commissioner and the application as against the Commissioner was dismissed.

Costs

The Court understood Mr Mawhinney to be an undischarged bankrupt and therefore inferred no issue as to costs arose.

HIGH COURT GRANTS COMMISSIONER'S APPLICATION TO TRANSFER A CHALLENGE FILED IN THE TAXATION REVIEW AUTHORITY TO THE HIGH COURT

Case	Commissioner of Inland Revenue v Kensington Developments Limited [2013] NZHC 3537
Decision date	20 December 2013
Act(s)	Tax Administration Act 1994
Keywords	Transfer, section 138(N), *Erris Promotions, McIlraith, Dandelion Investments Ltd, Deepsea Seafoods (No 1)*

Summary

This case concerns an application by the Commissioner of Inland Revenue ("the Commissioner") for an order transferring a challenge proceeding filed by the taxpayer in the Taxation Review Authority ("TRA") to the High Court under section 138N(2) of the Tax Administration Act 1994 ("TAA"). The High Court granted the Commissioner's application, and made an order for transfer.

Facts

This decision involved an application made by the Commissioner seeking orders to transfer challenge proceedings (*Kensington Developments Ltd (in receivership) v Commissioner of Inland Revenue* (TRA 28/11)) filed by the respondent, Kensington Developments Limited ("Kensington"), in the TRA to the High Court. The Court granted the Commissioner's application, and made an order for transfer.

The application was made in reliance on section 138N(2) of the TAA, which provides that the Commissioner "… may apply to the High Court to have the challenge transferred to the High Court". Although there is no stipulated procedure to follow in making such an application, the Court acknowledged that making an originating application under Part 19 of the High Court Rules was appropriate.

Decision

Is the dispute of sufficient complexity to warrant transfer?

In finding that the challenge was moderately complex, Allan J rejected Kensington's submissions that no actual tax had been avoided and the losses had not been offset against any income. His Honour observed that nevertheless the losses remain available for offset, and that tax loss companies can have considerable commercial value. Further, Allan J admitted the Commissioner's submission that Mr Russell's actions as a receiver is relevant "… as part and parcel of its determination of commerciality issues" (*Commissioner of Inland Revenue v Kensington Developments Limited* [2013] NZHC 3354 (at [30]) and formed part of the overall picture.

The Court found that the tax value involved was moderately high when compared to other cases in which tax of hundreds of millions of dollars is in issue. However, the Court noted that the amount of tax in this case is by no means negligible. Although not determinative, on balance, the factors considered here favoured a transfer to the High Court.

Precedential value

The Court considered the Commissioner's submission that issues raised in this dispute are identical to those in other disputes and under active investigation by Inland Revenue; having already arisen in respect to some assessments and being likely to arise in the future. Allan J concluded that any judgment in the present case will likely serve as a precedent for a number of other cases, identifying that the tax treatment of substantial claimed losses would be affected.

Likelihood of appeal

Mr Judd, counsel for Kensington, submitted that it is not appropriate for the Commissioner to assume an appeal is likely, in that "… it may be an abuse of process …" (at [63]) for any party to decide an appeal against an adverse decision was likely prior to that decision being made.

The Court upheld the decision in *Commissioner of Inland Revenue v Deepsea Seafoods (No 1) Ltd*, (2004) 21 NZTC 18,469 (HC)), stating that it is well established that the likelihood of an appeal from a first instance decision is a highly relevant factor to the determination of an application under section 138N(2). The Court considered (a) the large sum involved, (b) the precedential value the decision would carry and (c) Mr Russell's tendency to exercise his rights of appeal as factors leading to a high prospect of an appeal occurring.

Vendetta allegations

Mr Judd urged the Court not to make too much of Kensington's complaints about the behaviour of the Commissioner and her staff in the challenge proceeding before the TRA. Mr Judd relied on the fact that Mr Russell had been making such allegations in proceedings for many years without it having any discernible impact on the TRA's ability to adjudicate the matter. Alan J said that Mr Judd was in effect suggesting "Mr Russell's bark is worse than his bite" (at [72]).

The allegations made in Kensington's notice of claim raised administrative law issues that could not be overlooked. The Court noted that if Kensington had wished to reduce the likelihood of a transfer to the High Court it should have "… framed its points of claim in a less strident fashion" (at [73]).

Other factors considered

Kensington raised an earlier unsuccessful application to transfer a proceeding in which Mr Russell was involved (*JM Webster Ltd v Commissioner of Inland Revenue*, HC Auckland M1052/96, 3 August 2004), despite vendetta allegations being raised. Allan J concluded that the application was unsuccessful in that case because the TRA at that time, Judge Barber, had extensive knowledge of the Russell template and so the High Court concluded that he was best placed to hear the matter. As Kensington is not a Russell template case, and Barber is no longer a TRA judge, those grounds did not apply here.

His Honour also confirmed in response to Kensington's submission that section 6 of the TAA should be accorded primacy in considering the transfer application, that section 6 did not create rights enforceable by the taxpayer.

In rejecting Kensington's submissions on section 27 of the New Zealand Bill of Rights Act, Justice Allan concluded that there was nothing to suggest Mr Russell was being discriminated against by the Commissioner in her making this application.

Allan J admitted that the convenience (informality, confidentiality) and cost advantages (lay representation, no costs award) of the TRA were relevant, but concluded they were not determinative.

Finally, the Court found that the Commissioner's delay in making the application (18 months after the challenge commenced) was a neutral factor as Kensington did not claim it had been prejudiced by the delay, and delay itself had not been considered relevant in previous transfer applications.

Conclusion

Considering these four factors collectively, the Court was persuaded to order the transfer of the proceeding to the High Court.

TRA CLARIFIES SCOPE OF "CONTROL BY ANY OTHER MEANS WHATSOEVER" ASSOCIATED PERSONS TEST

Case	TRA 021/12; [2013] NZTRA 11
Decision date	17 December 2013
Act(s)	Goods and Services Tax Act 1985
Keywords	Associated person, control, "by any other means whatsoever", GST

Summary

The Taxation Review Authority ("TRA") found that because two companies, the disputant and Company O were "associated persons" under section 2A(1)(a)(iii) of the Goods and Services Tax Act 1985 ("GST Act"), the disputant was not entitled to claim the entire goods and services tax ("GST") component of the purchase price of the property purchased from Company O. The GST input credits available to the disputant were instead limited to the GST component of the significantly lower purchase price Company O had originally paid for the property.

Impact of decision

The TRA has clarified the interpretation of section 2A(1)(a)(iii) of the GST Act, finding that it was intending to operate as a "catch all" provision covering the association of companies by control, not specifically covered by the tests under subparagraphs 2A(1)(a)(i) and (ii).

Facts

Mr A is the sole director of both the disputant company and Company O. The disputant company is wholly owned by Company W, of which Mr A is the sole director and shareholder. Company O is wholly owned by Company F, which is in turn wholly owned by Mr A. Company F holds 75% of the shares in Company O for the benefit of the LM Trust and the remaining 25% of the shares for the benefit of Mr A.

In October 2004, Company F (or nominee) purchased a property ("the Property") for a total purchase price of $847,000. This included a GST component of $94,111.12. Company F then nominated Company O as purchaser. Company O then began to develop the Property into an apartment block complex.

In July 2008, Company O and the disputant company entered into a sale and purchase agreement for the Property. Mr A signed the agreement on behalf of both companies. The purchase price including GST was $8,034,750, which was to be paid in 18 instalments by book entry to Company O. The disputant company claimed GST input credits in respect of those 17 instalments, paid in the GST periods between July 2008 and October 2009.

Decision

Sinclair J began by noting that the disputant and Company O were not "associated" companies under section 2A(1)(a)(i) or the test under section 2A(1)(a)(ii) of the GST Act. The focus of the case would therefore be on section 2A(1)(a)(iii). Section 2A(1)(a)(iii) states that two companies are "associated persons" for the purposes of the GST Act if, amongst other things, a group of persons has "control of each of those companies by any other means whatsoever". In essence, Sinclair J found that section 2A(1)(a)(iii) was sufficiently broad to apply in the present case, and held that both the disputant and Company O were controlled by Mr A and that the two companies were "associated persons" under section 2A(1)(a)(iii).

In considering the purpose of section 2A(1)(a)(iii), Her Honour referred to the Inland Revenue Department Commentary on Taxation (Annual Rates, GST, and Miscellaneous Provisions) Bill [Wellington: Policy Advice Division of Inland Revenue Department, May 2000] which summarised the amendments concerning input tax deductions for second-hand goods:

> The amendment limits the credit available in relation to supplies of second-hand goods between associated parties to the GST component (if any) of the purchase price to the vendor to remove the incentive to enter into transactions primarily to gain the input tax credit.

Sinclair J then considered the meaning of "control", as it appears in section 2A(1)(a)(iii). Her Honour accepted the Commissioner's submission that "control" has predominantly been held to mean legal control and found that Mr A did have legal control of each of the companies through voting interests. Sinclair J noted that section 2A(1)(a)(iii) was also wide enough to include other forms of control.

The TRA referred to *IRC v Bibby and Sons Limited* [1945] 1 All E R 667 (HL), which held that the fact a shareholder was a trustee was not a relevant consideration when determining legal control. In the present case, Sinclair J did not find the existence of the LM Trust to be a matter to be taken into account under subparagraph (iii). Her Honour went on to find that the phrase "by any other means whatsoever" suggested that subparagraph 2A(1)(a)(iii) had a broad effect and operated as a "catch all" provision, covering the association of companies by control not specifically covered by the tests under subparagraphs 2A(1)(a)(i) and (ii).

The disputant argued that the word "other" in the phrase "by any other means whatsoever" suggested that control must be by means other than those identified in subparagraphs 2A(1)(a)(i) and (ii). Her Honour held that the word "other" did not restrict the ability to consider voting interests under subparagraph 2A(1)(a)(iii) where the test set out in subparagraph 2A(1)(a)(i) did not apply. Sinclair J held that control via a corporate trustee comes within subparagraph 2A(1)(a)(iii) as it must be "by other means".

Sinclair J accepted the Commissioner's submission that there was no policy reason to exclude control by voting interests under subparagraph 2A(1)(a)(iii) and stated that it would be against the intention of the legislature to adopt the disputant's interpretation of section 2A(1)(a)(iii), because to do so would have the effect of limiting the application of subparagraph 2A(1)(a)(iii). Sinclair J rejected the disputant's argument that the use of the word "each" in section 2A(1)(a)(iii) suggested that the same means of control had to apply to each company. Her Honour disagreed and held the phrase "by any other means whatsoever" had a wide effect and included more than one or different means.

In addition, the Commissioner, relying upon the decision of *RWR v AJR [Trusts] [2010]* NZFLR 82 (HC), found that Mr A had control of Company O because he had control over the LM Trust. In opposition, the disputant submitted that the fact that Mr A had power of appointment did not mean that he had control of the corporate trustee. Sinclair J did not find it necessary to consider this point as she already

found that Mr A had legal control of Company O and the issues in *RWR v AJR [Trusts]* were not relevant.

Accordingly, the TRA confirmed the Commissioner's assessment and ruled that the disputant company was only entitled to an input tax deduction of $94,111.12, being the GST component of the purchase price Company O originally paid for the Property.

COMMISSIONER'S STATUTORY DEMANDS UPHELD

Case	Accent Management Limited and Lexington Resources Limited v Commissioner of Inland Revenue
Decision date	2 December 2013
Act(s)	Companies Act 1993, Tax Administration Act 1994, Goods and Services Tax Act 1985
Keywords	Statutory demand, substantial dispute, abuse of process, liquidation

Summary

The companies challenged the statutory demands issued by the Commissioner of Inland Revenue ("the Commissioner") on the grounds that there was a substantial dispute whether or not the debts were owing or due and that the demands ought to have been set aside as an abuse of process. The Court upheld the statutory demand and ordered that the companies pay the amount demanded within 10 working days.

Impact of decision

If Accent Management Limited ("Accent") and Lexington Resources Limited ("Lexington") fail to pay the amount demanded within 10 working days of the judgment the Commissioner may apply to liquidate both companies.

Facts

Accent and Lexington were both issued with statutory demands on 18 April 2013 by the Commissioner. Accent and Lexington are both parties associated with the Trinity scheme and had their tax liability confirmed by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 ("*Ben Nevis*").

In the statutory demands, the Commissioner demanded payment of $3,250,265.74 from Accent for amounts owing under the 1998 tax year and $2,115,309.48 from Lexington for amounts owing under the 1997 tax year.

Both Accent and Lexington applied to set aside the statutory demands on the grounds that:

- there was a substantial dispute whether or not the debts were owing or due relying on section 290(4)(a) of the Companies Act 1993 ("Companies Act"); and
- the demands ought to have been set aside on other grounds, in that in the circumstances of the case, serving the statutory demands was an abuse of process (this ground relied on section 290(4)(c) of the Companies Act).

The applicants sought orders declaring that the document purporting to be a statutory demand was not a statutory demand or, in the alternative, setting aside the statutory demand.

Decision

The Court ordered that Accent and Lexington pay the amount demanded within 10 working days of the judgment and, should a default in payment be made, the defendant may make an application to put Accent and Lexington into liquidation.

Grounds for setting aside statutory demands

Under section 290(4)(a) of the Companies Act, the High Court may set aside a statutory demand if there is substantial dispute whether or not the debt is owing or due. Faire AJ stated that for the Court to determine this, the applicant must show a fairly arguable basis upon which it is not liable for the amount claimed (as approved in *United Homes (1998) Ltd v Workman* [2001] 3 NZLR 447 (CA), at 451–452).

The Court may also set aside a statutory demand if it is satisfied that the demand ought to be set aside on other grounds (Companies Act, section 290(4)(c)). To do this, the Court must determine whether the creditor's prima facie entitlement is outweighed by some factor or factors making it plainly unjust for liquidation to ensue (*Commissioner of Inland Revenue v Chester Trustee Services Limited* [2003] 1 NZLR (CA) 395, at [3]). A company may not allege solvency as a ground for setting aside a statutory demand. A company cannot avoid paying a debt, merely by proving that it is able to pay the debt (*AMC Construction Ltd v Frews Contracting Ltd* [2008] NZCA 389, (2008) 19 PRNZ 13, at [7]).

Commissioner's authority to issue statutory demands

Faire AJ rejected the plaintiffs' submission that the Commissioner was not authorised to issue a statutory demand on behalf of the Crown. His honour found that the Commissioner is the creditor in respect of a taxpayer who has not paid his or her tax. In the matter of taxes, the Commissioner is the statutory agent of the Crown (*Cates v Commissioner of Inland Revenue* [1982] 1 NZLR 530 (CA), (1982) 5 NZTC 61,237).

Further, the issuing of a statutory demand is one of the steps necessary to bring a suit against a company and within the Commissioner's authority (Tax Administration Act 1994, section 156).

Substantial dispute

Faire AJ found that there is no longer any substantial dispute in respect of the tax assessments because the assessments were upheld by the Supreme Court in *Ben Nevis*. Further, an additional part of the debt related to a sealed cost order which cannot be disputed.

The plaintiffs asserted that an active appeal against a decision of Priestley J, dismissing their claim that the original High Court *Ben Nevis* decision was a "nullity" (*Accent Management Ltd v Attorney-General* [2013] NZHC 1447, (20113) 26 NZTC 21-020), meant there was still a substantial dispute in respect of the tax assessments. This argument was rejected by Faire AJ who found that Priestley J's decision stands until it is successfully appealed.

A question was raised on the issue of the quantum of the statutory demand. The Court was asked to determine whether or not a GST credit available to Accent could be off-set against Accent's income, in reliance on the Goods and Services Tax Act 1985, section 46(6). In an affidavit for the Commissioner it was asserted that the credits could be transferred to the 1994 year, where there is a substantial debt for unpaid taxes owing. This was accepted by AJ Faire.

INDEMNITY COSTS AWARDED TO THE COMMISSIONER

Case	Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue
Decision date	17 December 2013
Act(s)	High Court Rules
Keywords	Indemnity costs

Summary

The Commissioner of Inland Revenue ("the Commissioner") applied to the Court for indemnity costs in relation to *Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2011] 1 NZLR 336 (HC) ("*Redcliffe*") which was heard in the High Court in 2011 where the plaintiffs alleged that the original Trinity judgment of the High Court (which led to the Supreme Court decision in *Ben Nevis Venture Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 ("*Ben Nevis*")) should be set aside on the basis that the defendant "presented a false case". The Commissioner sought indemnity costs, increased costs or costs on a 2C basis on the grounds that the plaintiffs' case was vexatious, frivolous or otherwise an abuse of process. The Court determined that the plaintiffs' case was hopeless from the outset and amounted to a collateral attack on the Supreme Court's judgment in *Ben Nevis* and was unnecessary and improper.

Impact of decision

The decision confirms that the Court may award indemnity costs where a proceeding is unnecessary.

Facts

The case concerns a costs judgment made in regard to *Redcliffe* which was heard in the High Court in 2011. In *Redcliffe* the plaintiffs alleged that the original Trinity judgment of the High Court which led to the Supreme Court decision in *Ben Nevis* should be set aside on the basis that the defendant "presented a false case".

The Commissioner succeeded in the substantive case in the High Court and the Supreme Court. The Supreme Court overturned a decision made by the Court of Appeal in favour of the plaintiffs on the procedural ground that the Commissioner should have applied to strike out the statement of claim rather than protest jurisdiction.

The Commissioner sought indemnity costs, increased costs or costs on a 2C basis on the grounds that the plaintiffs' case was vexatious, frivolous or otherwise an abuse of process.

Decision

The Court awarded indemnity costs to the Commissioner.

A Judge has the discretion to award indemnity costs under rule 14.6 of the High Court Rules if the party has acted vexatiously, frivolously, improperly, or unnecessarily in commencing a proceeding.

Rule 14.6(3) states that the Court may award increased costs if the party opposing increased costs has contributed unnecessarily to the time or expense of the proceeding by pursuing an argument that lacks merit.

The Court determined that the plaintiffs' case was hopeless from the outset and amounted to a collateral attack on the Supreme Court's judgment in *Ben Nevis*.

Justice Brewer found that the proceeding was unnecessary and improper. The proceeding was unnecessary because the Supreme Court had already determined the issues at hand. Further, making a collateral attack on the Supreme Court was improper. However, His Honour could not find an evidential basis for saying that the case was frivolous or vexatious.

His Honour dismissed the plaintiff's argument that indemnity costs could not be awarded because no substantive findings were made in the High Court

judgment. His Honour found that if a claim was brought to the Court, the Court had no jurisdiction to hear it, and the circumstances behind the making of the claim led to the conclusion that it was unnecessary and improper, then indemnity costs could be awarded.

INDEMNITY COSTS AWARDED TO THE COMMISSIONER

Case	Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue
Decision date	18 December 2013
Act(s)	High Court Rules
Keywords	Indemnity costs

Summary

This was a costs decision in relation to an application by Redcliffe Forestry Venture Limited ("Redcliffe") to set aside a statutory demand made by the Commissioner of Inland Revenue ("the Commissioner"). The Commissioner requested costs on a 2B basis up until 12 September 2013 and thereafter either indemnity or increased costs. Associate Judge Faire accepted the Commissioner's submission that the arguments advanced on Redcliffe's behalf were groundless and unsupported.

Impact of decision

The decision confirms that in exercising the discretion to award indemnity costs, the grounds that may be considered are not closed. Factors such as the history of the case (ie, unsuccessful in all previous attempts, groundless and unsupported arguments) may be taken into account.

Facts

On 25 October 2013, Associate Judge Faire dismissed Redcliffe's application to set aside a statutory demand made by the Commissioner for tax avoided under the Trinity scheme. Faire AJ reserved the issue of costs and asked for the parties to agree to costs or, failing that, file memoranda addressing costs.

The Commissioner and Redcliffe were unable to agree as to the quantum of costs. Redcliffe asked for costs on a 2B basis. The Commissioner requested costs on a 2B basis up until 12 September 2013 and thereafter either indemnity or increased costs.

Decision

The Court awarded indemnity costs to the Commissioner.

A Judge has the discretion to award costs under rule 14.1 of the High Court Rules in relation to a step taken in a proceeding. This discretion is generally exercised in accordance with the specific High Court Rules contained in rules 14.2–14.10.

Rule 14.6 states that the Court may award indemnity costs if the party has acted vexatiously, frivolously, improperly or unnecessarily in commencing a proceeding.

Existing case law indicates that indemnity costs should only be awarded in truly exceptional circumstances (*Hedley & Ors v Kiwi Co-operative Dairies Ltd* (2002 16 PRNZ 694 (HC)). This includes allegations that ought to have never been made, or unduly prolonging a case by groundless contentions (*Bradbury v Westpac Banking Corporation* [2009]3 NZLR 400, (2009) 19 PRNZ 385 (CA)).

Associate Judge Faire accepted the Commissioner's submission that the arguments advanced on the plaintiff's behalf were groundless and unsupported. This was supported by the background evidence of "challenge after challenge" taken as part of the Trinity litigation including a recent decision on virtually identical facts in relation to two of the other Trinity disputants (*Bristol Forestry Venture Ltd v Commissioner of Inland Revenue* [2013] NZHC 2819).

His Honour concluded that this was a proper case for indemnity costs.

TAXPAYER UNSUCCESSFUL IN APPLICATION FOR ORDER ALLOWING PURPORTED OBJECTIONS

Case	TRA 011/13; [2014] NZTRA 01
Decision date	8 January 2014
Act(s)	Tax Administration Act 1994, Taxation Review Authority Regulations 1994
Keywords	Notice of determination of loss, objection, points of objection notice, case stated, validity

Summary

The applicant sought an order from the Taxation Review Authority ("TRA") directing the Commissioner of Inland Revenue ("the Commissioner") to allow purported late objections. The TRA held that the objections were not made in accordance with the Tax Administration Act 1994 ("TAA") and declined to make the order sought. The TRA also held that the administrative law arguments raised by the applicant did not alter this conclusion.

Impact of decision

The case relates to the old objection procedure.

Facts

The applicant (a car dealer operator until 1993), having ceased trading and having no funds to pay outstanding pay as you earn ("PAYE"), was put into liquidation in September 1994 and the Official Assignee was appointed liquidator.

Having conducted an investigation of the applicant's tax affairs and ascertained discrepancies, the Commissioner wrote to the Official Assignee on 14 August 1995 enclosing a notice of determination of loss ("NODL") for the 1991 to 1994 tax years. Each NODL was addressed to the Official Assignee and included the applicant's IRD number. It was also made clear that any objection was to be made within two months.

On 26 October 1995, the Commissioner wrote another letter (with the applicant's name and IRD number recorded) to the Official Assignee with an NODL for the 1995 tax year attached to it. The time by which any objection was to be filed was not specified on the NODL as the form read "Any objection ... must ... be delivered ... within [gap] month from the date of this notice".

The Official Assignee did not give any notice of objection to the Commissioner in accordance with section 126 of the TAA in relation to the NODLs issued for the 1991 to 1995 income tax years.

The applicant's tax returns for the 1991 to 1995 years had been filed by Mr X. In August 1996 the Commissioner wrote informing Mr X that he was not recognised as the applicant's tax agent.

The applicant was struck off in May 1996 and re-registered in July 1997.

On 19 December 1997, the Commissioner sent copies of the NODLs for the 1991 to 1995 years to Mr X as he requested. Having received the copies, Mr X wrote two letters to the Commissioner, one raising concerns over the validity (the validity letter) of the NODLs and the other purporting to give notice of objection to the NODLs (the fresh objection letter). The Commissioner, on 14 January 1998, wrote to Mr X acknowledging receipt of the validity letter and stating that the points raised were not accepted.

On 6 March 1998, Mr X wrote to the Commissioner asking her to clarify her position in respect of the "alleged invalid NODLs". The Commissioner replied on 18 March 1998 stating that the late objection letter would not be considered until a determination was made as to whether Mr X was authorised to file a late objection.

In April 1998, a Points of Objection Notice was served on the Commissioner in relation to the 1991 to 1994 years. The Commissioner did not respond to this Points of Objection Notice and did not state a case to the TRA. No Points of Objection Notice was received in respect of the 1995 year.

The applicant was again put into liquidation in June 1998, and remained in liquidation until it was struck off in May 2005. Mr X was purportedly appointed as receiver of the applicant in May 2005, but as the applicant was struck off, the notice of appointment was returned to Mr X. The applicant was subsequently re-registered in October 2010, and the notice of appointment of receiver was filed shortly afterwards.

In 2010 the Commissioner began an investigation into the applicant's tax affairs. Having been advised by the Commissioner in 2013 that the assessments for the 1991 to 1995 years were final, the applicant filed an application pursuant to regulation 6(4) of the Taxation Review Authority Regulations 1994 ("Regulations") for an order directing the Commissioner to allow the purported objections.

Decision

Validity of NODLs

In determining the validity of the NODLs, the TRA considered a number of arguments raised by the applicant, such as the applicant's name not being on the NODLs, the NODLs being sent to the Official Assignee, and issues regarding the date for lodgement of the objections.

The TRA did not find the absence of the applicant's name on the NODLs to be an issue affecting their validity, as the NODLs recorded the applicant's IRD number, and were sent under cover of letters recording the name of the applicant and the applicant's IRD number. There was therefore no uncertainty as to the identity of the taxpayer and the subject of each NODL.

The TRA also rejected the applicant's submission that the NODLs ought to have been sent to Mr X, noting that on liquidation the address for service for the applicant became the office of the Official Assignee and that the NODLs were properly given to the Official Assignee. The TRA distinguished the case of *Case U45* (2000) 19 NZTC 9,397 relied on by the applicant, and referred to *Case R15* (1994) 16 NZTC 6,087, where the TRA held that from the date of liquidation it was not competent for any person other than the liquidator to lodge an objection to assessments of taxation liability in years prior to the date of commencement of the liquidation.

The TRA then considered the issue regarding the date for lodgement of objections. The TRA noted that no notice of objection was given for the NODLs for the 1991 to 1994 income tax years within the timeframe specified, being two months from the date of the NODL. The NODLs for these years were held to be valid and enforceable.

As to the NODL for the 1995 tax year, the TRA referred to section 126(1) of the TAA where it is intended that a time period will be specified in the NODL. The TRA stated that there is a need for certainty as to the time frame to ensure that a taxpayer's objection rights are not prejudiced and it is not sufficient for the TRA to simply imply a reasonable time period and then fix what that period should be. In the TRA's view the NODL was not properly completed by the Commissioner, and it was therefore invalid and of no legal effect.

Purported late objections

The TRA considered that the copies of the NODLs sent to Mr X on 19 December 1997 following Mr X's request did not amount to the fresh service of those NODLs and the commencement of a new objection period. The purported late objections were not accepted by the Commissioner as late objections under section 126(2) of the TAA. It was clear from the Commissioner's letter of 18 March 1998 that the fresh objection letter would not be considered as to whether it could be accepted as late objections to the NODLs until the issue of Mr X's authorisation was cleared up.

The TRA concluded that the application could not succeed as the objections were not made in accordance with section 126(1) of the TAA and were not accepted by the Commissioner under section 126(2). However, the TRA went on to address the remaining arguments raised by the applicant.

Case stated

The applicant argued that the purported objections had to be considered relying on section 127(1) of the TAA, which provides "The Commissioner shall consider all such objections …".

The TRA rejected this argument as the word "such" refers back to objections in accordance with section 126 of the TAA.

The TRA also rejected the applicant's argument that the purported objections were considered and disallowed by the Commissioner in accordance with section 127 of the TAA. The applicant referred to the Commissioner's letter of 14 January 1998 in that regard. The TRA agreed with the Commissioner that the letter was not in response to the purported objections. The TRA noted that under section 134 of the TAA, the Commissioner must consider the objection and reach a decision before the case can go before the TRA, and that there is no time limit imposed in consideration of an objection (relying on *FB Duvall Limited v Commissioner of Inland Revenue* (2006) 22 NZTC 19,866 (CA), at [29]).

The TRA found that as there was no objection to be heard, the Points of Objection Notice relating to the 1991 to 1994 years was of no effect and the Commissioner was not required to state a case to the TRA for those years. As the NODL for the 1995 year was invalid and the Points of Objection Notice did not refer to that year, the Commissioner was never required to state a case in relation to that year.

Vendetta, improper motive, section 6 of the TAA and section 27 of the New Zealand Bill of Rights Act 1990 ("BORA")

In relation to the applicant's allegation that the Commissioner's actions were governed by improper motives as part of a vendetta against Mr X, the TRA applied the approach of the Court of Appeal in *Dandelion Investments Limited v Commissioner of Inland Revenue* [2013] 1 NZLR 600 (CA). In that case it was held that the TRA's role was one concerned with the correctness of the assessment, and it did not extend to conducting a broad-based judicial review of the process leading up to assessment and disallowance of the objection and subsequent conduct of the proceeding.

The TRA also rejected the applicant's allegation that the Commissioner was in breach of section 6 of the TAA and section 27 of the BORA. The TRA found that the procedures were followed properly and that natural justice did not require the Commissioner to state a case.

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