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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

You can also subscribe to receive regular email updates when we publish new draft items for comment.

Correction – *Tax Information Bulletin* Vol 26, No 4 May 2014

The second reference to "Brian's assessable period" on page 20, Example 6, incorrectly states the relevant period as being "... from 1 October 2016 until 5 February 2029 ...".

The relevant period should read "... from 1 October 20**15** until 5 February 2029 ..." [emphasis added to show the correction].

IN SUMMARY

Binding rulings

This re-issued public ruling addresses the GST treatment of payments made by the parents or guardians of students (other than international students) who are enrolled at state and integrated schools to the Boards of Trustees of such schools.

The ruling does not reflect any material change in the Commissioner's position on the GST treatment of payments made by parents to state and integrated schools. However, aspects of the ruling have been updated with assistance from the Ministry of Education to reflect their advice to school communities in revised Education circular 2013/06 "Payments by parents of students in state and state-integrated schools" issued on 13 June 2013.

This ruling applies to the engagement of supervisors by PMP Distribution Ltd to provide supervisory services for the delivery of unaddressed newspapers, circulars, leaflets, brochures, catalogues, advertising material, samples and other such items to households and other premises.

This product ruling applies to the New Zealand Māori Arts and Crafts Institute's payment of a scholarship by the Institute to students enrolled in the wood carving school known as Te Wananga Whakairo Rakau o Aotearoa (the National Wood Carving School).

New legislation

FBT rate for low-interest loans increases

The prescribed rate of interest used to calculate fringe benefit tax on low-interest, employment-related loans is 6.70%, up from the previous rate of 6.13% which applied from the quarter beginning 1 July 2014.

Questions we've been asked

This item considers the meaning of excessive remuneration and excessive profits or losses when they are paid or allocated to relatives, partners, shareholders or directors. This item arose out of the recent PIB/TIB review and updates and replaces a number of previous items that were out of date. It concludes that the payment of remuneration must be reasonable based on the services provided by the relative. The allocation of a partnership's profits or losses must be reasonable based on the contributions of the partners.

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Application to stay liquidation proceedings

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The Court dismissed the defendant's application to stay liquidation proceedings brought by the Commissioner of Inland Revenue ("the Commissioner"), finding the Commissioner was a creditor for the purposes of recovering tax and further that the application to appoint liquidators was not an abuse of process.

Application by Trinity investors to stay liquidation proceedings

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The Court dismissed the defendant's application to stay liquidation proceedings brought by the Commissioner of Inland Revenue ("the Commissioner"), finding the Commissioner was a creditor for the purposes of recovering tax and appointing the liquidator did not perpetuate an unlawful order.

Cases involving alleged tax avoidance transferred to High Court and consolidated

34

The Commissioner of Inland Revenue ("the Commissioner") was successful in having two related cases transferred from the Taxation Review Authority to the High Court. These cases were also consolidated.

High Court grants interim relief under section 8 of the Judicature Amendment Act 1972

35

The applicant, Mr John George Russell filed a judicial review application against the Commissioner of Inland Revenue ("the Commissioner") in relation to her decision not to accept his proposed offers of settlement. The Commissioner obtained summary judgment against Mr Russell for approximately $367 million. Mr Russell sought interim relief under section 8 of the Judicature Amendment Act 1972. The Court granted interim relief to Mr Russell making an order prohibiting the Commissioner from commencing bankruptcy proceedings until the Commissioner's application to strike out the judicial review proceeding is determined.

Appeal against High Court decision awarding indemnity costs to the Commissioner

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The Court allowed the appeal overturning Brewer J's cost judgment in *Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2013] NZHC 3411 and replaced the indemnity costs awarded in favour of the Commissioner of Inland Revenue with scale costs.

Appeal by Trinity investors to set aside a High Court decision

38

The Court of Appeal dismissed the appellants' appeal from the High Court judgment of Priestly J (*Accent Management Ltd v Attorney-General* [2013] NZHC 1447, (2013) 26 NZTC 21,020) where he upheld a protest to jurisdiction by the Commissioner of Inland Revenue and the Attorney-General. The original judgment addressed an attempt by the appellants to set aside *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027 (HC) on the basis that Venning J, the first instance judge, failed to apply a purportedly mandatory provision of the Income Tax Act 1994 being subpart EH.

Unsuccessful appeal by Trinity investors in respect of statutory demands issued by the Commissioner

39

This matter involved three appeals against High Court decisions dismissing the appellants' applications to set aside statutory demands issued by the Commissioner of Inland Revenue ("the Commissioner"). The Court of Appeal found that the Commissioner was able to issue statutory demands and dismissed the appeals.

Appeal by Trinity investors to set aside a High Court decision and indemnity costs award

40

The Court of Appeal dismissed the appellants' application to set aside a High Court judgment of Katz J (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2013] NZHC 2361, (2013) 26 NZTC 21-032) and upheld the High Court's award of indemnity costs to the Commissioner of Inland Revenue. The original judgment addressed an application by the appellants to set aside *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027 (HC) on the basis that Venning J, the first instance judge, was biased. That application was dismissed for want of jurisdiction as the matter had subsequently been considered on appeal.

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**

PUBLIC RULING BR PUB 14/06: PAYMENTS MADE BY PARENTS OR GUARDIANS OF STUDENTS TO STATE SCHOOLS – GST TREATMENT

This is a reissue of BR Pub 09/01. For more information about earlier publications of this Public Ruling see the Commentary to this Ruling.

Taxation Laws

This Ruling applies in respect of ss 8 and 10(2) and the definition of "consideration" in s 2 of the Goods and Services Tax Act 1985.

The Arrangement to which this Ruling applies

The Arrangement is the payment of amounts (whether described as "school fees", "voluntary contributions", "activity fees" or otherwise) by parents or guardians of pupils who are enrolled at a State school (including schools integrated within the state system of education under the Private Schools Conditional Integration Act 1975) and who are not international students under the Education Act 1989 to the Board of Trustees of such a school.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Payments made by parents or guardians of children, who are enrolled at a State school and who are not international students under the Education Act 1989, to the Board of Trustees of such a school for the purpose of a general fund to assist with meeting school costs, are not consideration for the supply of education to which there is a statutory entitlement and that the Board has a statutory obligation to provide free of charge. Therefore, GST is not payable on such amounts.
- If other services, not integral to the supply of education services to which there is a statutory entitlement, are supplied on the basis that the supply is conditional on payment being made for such services, the payment is consideration for that supply. GST is chargeable on payments made in those circumstances.

The period or tax year for which this Ruling applies

This Ruling will apply for the period 21 June 2013 to 20 June 2018.

This Ruling is signed by me on the 28th day of August 2014.

Susan Price

Director, Public Rulings

COMMENTARY ON PUBLIC RULING BR PUB 14/06

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 14/06 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in Public Ruling BR Pub 09/01 (*Tax Information Bulletin* Vol 21, No 3 (May 2009)) and before that in Public Ruling BR Pub 03/04 (*Tax Information Bulletin* Vol 15, No 7 (July 2003)). The Ruling applies for the period from 21 June 2013 to 20 June 2018.

Legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Background

1. The Ministry of Education issued an updated circular (Education circular 2013/06) on 13 June 2013 that provides advice on the rights of Boards of Trustees, proprietors, parents and students in respect of requests for donations and other forms of payments in schools. The Education circular explains the types of payments that Boards of Trustees and proprietors can seek from parents and students at state and integrated schools. The circular states that no payments sought from parents are compulsory except for the attendance dues payable to the proprietors

of integrated schools and charges by schools for voluntary purchases of goods and services. There should be no charges associated with the delivery of the curriculum and there are no school "fees" or "levies" in state or integrated schools.

2. According to the circular, schools may ask parents for contributions for general or specific purposes. In addition, on occasion schools may offer for sale consumables, stationery, clothing and activities that enhance, but are not part of, the delivery of the curriculum. These things can be charged for by the school, but students are not obliged to buy them.

3. This Ruling addresses whether payments (however described) made by parents to state and integrated schools are subject to GST.

Statutory framework

4. Under s 93 of the Education Act 1989 ("Education Act"), every state school must have a Board of Trustees. State primary and secondary schools are controlled and managed by their Boards of Trustees. A school's Board must perform its functions and exercise its powers so every student at the school can attain their highest possible standard in educational achievement: s 75(1) of the Education Act. Under s 75(2), except to the extent that any enactment or the general law of New Zealand provides otherwise, a school's Board has complete discretion to control the management of the school as it thinks fit. Grants are paid out of public money to Boards for the purpose of administering their schools: s 79 of the Education Act.

5. The Private Schools Conditional Integration Act 1975 ("PSCI Act") enables private schools originally established to provide education with a special character to become part of the state system of education as an integrated school. As with other state schools, an integrated school's controlling authority is its Board of Trustees: s 25(5) of the PSCI Act.

6. Every Board must have a written charter. The purpose of the charter is to establish the missions, aims, objectives, directions and targets of the school Board that will give effect to the Government's national education guidelines and the Board's priorities: s 61 of the Education Act.

7. The effect of a school charter is that it is an undertaking by the Board to the Minister of Education to take all reasonable steps to ensure the school is managed, organised and administered for the purposes set out in the school charter and the school, its students and community achieve the aims and objectives set out in the school charter: s 63 of the Education Act. A school charter will not take effect if the Secretary for Education determines it is inconsistent with the Education Act or the national administration guidelines: s 63A of the Education Act.

8. The national education guidelines are defined in s 60 of the Education Act as being:

> all the national education goals, foundation curriculum policy statements, national curriculum statements, national standards, and national administration guidelines, for the time being in force under section 60A

9. Section 60A(1)(c) of the Education Act sets out the national administration guidelines, which the Minister may publish from time to time:

> (c) National administration guidelines, which are guidelines relating to school administration and which may (without limitation)—
>
> (i) set out statements of desirable codes or principles of conduct or administration for specified kinds or descriptions of person or body, including guidelines for the purpose of section 61:
>
> (ii) set out requirements relating to planning and reporting including—
>
> (A) scope and content areas, where appropriate:
>
> (B) the timeframe for the annual update of the school charter:
>
> (C) broad requirements relating to schools' consultation with parents, staff, school proprietors (in the case of integrated schools) and school communities, and the broad requirements to ensure that boards take all reasonable steps to discover and consider the views and concerns of Maori communities living in the geographical area the school serves, in the development of a school charter:
>
> (D) variations from the framework for school planning and reporting for certain schools or classes of schools, based on school performance:
>
> (iii) communicate the Government's policy objectives:
>
> (iv) set out transitional provisions for the purposes of national administration guidelines.

10. Under s 3 of the Education Act, everyone who is not an international student (that is, generally, a New Zealand citizen or resident) is entitled to free enrolment and free education at any state school during the period beginning on their 5th birthday and ending on the 1st of January after their 19th birthday.

11. Students enrolled at an integrated school are entitled to free education on the same terms and conditions as

students enrolled at other state schools: s 35(1) of the PSCI Act. However, the proprietors of an integrated school may require payment of attendance dues as a condition of enrolment and attendance: s 36 of the PSCI Act. The money received from attendance dues can be used only for improvements to the school buildings and associated facilities as may be required by any integration agreement, for capital works required by the Minister of Education under s 40(2)(d) of the PSCI Act and for meeting debts, mortgages, liens or other charges relating to the school premises: s 36(3) of the PSCI Act. Attendance dues paid to the proprietors of integrated schools are subject to GST, being payments to secure the enrolment of a pupil in a school for which the proprietors provide the buildings and ensure the special character: *Turakina Māori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA).

12. Each year, parents or guardians of students enrolled at state schools may be asked by school Boards to pay a nominated amount to assist with meeting school costs. Schools may refer to these payments as "donations", "voluntary contributions", "fees" or the like. In the case of integrated schools, such payments are in addition to attendance dues payable to, and contributions sought by, the proprietors.

Application of the legislation

Scheme of the Goods and Services Tax Act 1985

13. Under s 8(1) of the GST Act, GST is chargeable on the supply of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person by reference to the value of the supply. The value of the supply is the consideration provided for the supply (including both monetary and non-monetary consideration): s 10(2) of the GST Act.

14. GST is chargeable on payments made to the Board of Trustees of a state school that is a registered person if such payments are "consideration", as defined in the GST Act. Generally, the Board of Trustees of a state school will be a registered person, as the activities of a school Board are a taxable activity for GST purposes. This is on the basis that every Board of Trustees of a state school is a Crown entity for the purposes of the Crown Entities Act 2004: s 7(1)(d). Under s 2 of the GST Act, a Crown entity is a "public authority" and, pursuant to s 6(1)(b), the term "taxable activity" includes the activities of any public authority. Section 5(6) of the GST Act deems that a school Board (as a public authority) is supplying goods and services where it brings to charge revenue received from the Crown for the supply of outputs (in this case, the supply of education services). For example, the operational funding received by school Boards from the Crown is "revenue from the Crown" and is the consideration for the supply of those services.

15. Any other amounts received by a school Board will also be subject to GST where the amount is "consideration" for GST purposes.

16. As discussed later in this commentary, a payment from a parent for services that a school Board has a statutory obligation to provide free of charge is not consideration. However, a payment from a parent for other services, not integral to the supply of education services, is consideration. To make this distinction it is necessary to understand what is "consideration" and what education services a school Board has a statutory obligation to provide free of charge.

Consideration

17. The statutory definition of "consideration" is wider than the contract law meaning of the term. In *The Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076 (HC), Chisholm J commented in respect of the definition of "consideration" at 13,085:

> In the context of this matter I am not persuaded that it is helpful or appropriate to reflect upon the ordinary meaning of the word. The statutory definition extends the ordinary meaning and it is the scope of the extended statutory definition which needs to be determined.

18. The following principles can be drawn from the cases on the statutory definition of "consideration".

- Under the first part of the definition of "consideration", it is irrelevant whether the payment is voluntary. No contract between the person making the supply and the person providing the consideration is necessary. The supply need not be made to the person who makes the payment: *Turakina*. In *Turakina*, McKay J, referring to the definition, said at 10,036:

  > It is clear from this definition that the supply of any service for consideration is part of a "taxable activity" under sec 6, even though it is to a person other than the person who provides the consideration. Likewise, the value of the supply is to be measured by the consideration, whether or not the consideration is provided by the person to whom the service is supplied. It is not necessary that there should be a contract between the supplier and the person providing the consideration, so long as the consideration is "in respect of, in response to or for the inducement of the supply".

- The supply also need not be made by the person who receives the payment. In the *Trustee, Executors* case, Chisholm J said at 13,086:

> ... in my opinion the crucial factor is the strength of the connection between the payment and the supply. If there is sufficient proximity between the supply and payment to satisfy the requirement that the payment is "in respect of" (or "in response to, or for the inducement of") the supply of goods then the payment qualifies as "consideration" notwithstanding that the payment is made to a third party.

- Although the statutory definition of "consideration" is wider than the contract law meaning, not every payment a registered person receives is "consideration" for GST purposes. A distinction is drawn between a payment in respect of the payee's taxable activity and a payment that is consideration for a supply of goods and services: *The Director-General of Social Welfare v De Morgan* (1996) 17 NZTC 12,636 (CA).
- For a payment to be "consideration" within the first part of the definition there must be a sufficient relationship between the making of the payment and the supply of goods or services. See *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA); *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA); *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 (HC); *Trustee, Executors; Rotorua Regional Airport Limited v CIR* (2010) 24 NZTC 23,979 (HC).
- In *NZ Refining*, Blanchard J said at 13,193:

  > It is fundamental to the GST Act that the tax is levied on or in respect of supplies. It is not a tax on receipts or on turnover; it is a tax on transactions: *CIR v Databank Systems Ltd*. It is therefore necessary, as Mr Green submitted, to distinguish between supplies and the taxable activity (as defined in s 6) in the course of which they are made. The definition in s 6 itself requires a nexus between a supply and consideration, as does s 10.
  >
  > The tax itself is levied by s 8 on a supply in the course or furtherance of a taxable activity and is "by reference to the value of that supply". Section 10 provides that the value of a supply is "to the extent of the consideration for the supply" the amount of the money involved or the non-monetary open market value of the consideration. Already, before turning to the definition of "consideration", it can be seen that, again, a linkage between supply and consideration is requisite to the imposition of the tax.
  >
  > **The definition of "consideration", though broad, cannot and does not dispense with that requirement. To constitute consideration for supply a payment must be made for that supply, though it need not be made to the supplier nor does the supply have to be made to the payer.**
  >
  > **There is a practical necessity for a sufficient connection between the payment and the supply. The mechanics of the legislation will otherwise make it impossible to collect the GST.**
  >
  > [Emphasis added]

- An expectation that the payee will supply goods and services is not enough. It is not sufficient that the person who receives the payment carries out some activity that has the effect of benefiting either the person making the payment or some other person. It is also not sufficient that the payment enables the payee to carry on its activity. Hence, a payment by the Crown to a charitable trust the Crown had established to promote the economic development and well-being of the Chatham Islands' inhabitants and the provision of services in the interests of the community was not consideration for GST purposes. The trustees were fulfilling their fiduciary duties under the trust, and the payment was not an inducement for the performance of services by the trustees: *Chatham Islands*.
- The expression "in respect of, in response to, or for the inducement of" in the definition of "consideration" involves an element of reciprocity: *Taupo Ika Nui; Chatham Islands; Rotorua Regional Airport*.
- It is necessary to consider the legal arrangements between the parties to determine whether a payment is consideration. In the *Chatham Islands* case, Blanchard J commented at [17]:

  > Although the linkage or nexus between a payment and the activity to which it gives rise may be very broad, it is still necessary to have regard to the legal form which is being employed:
  >
  > > ... in taxation disputes the Court is concerned with the legal arrangements actually entered into ... not with the economic or other consequences of the arrangements.
  >
  > (*C of IR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 at p 13,192 citing *Marac Life Assurance Ltd v C of IR* [1986] 1 NZLR 694 at p 706 [also reported as *Marac Life Assurance Ltd v C of IR*; *C of IR v Marac Life Assurance Ltd* (1986) 8 NZTC 5,086 at pp 5,097, 5,098]. The tax being one on transactions, it is necessary to pay close attention to the legal nature of what has been done.

Statutory arrangement relating to provision of education in state schools

Role and accountability of school Boards

19. In *Maddever v Umawera School Board* [1993] 2 NZLR 478 (HC), Williams J discussed the role of school Boards at 505:

> The [Education Act 1989] was based on *Administering for Excellence: The Report of the Task Force to Review Education Administration* (the Picot report (1988)) which found that the existing administrative structure of the Education Act 1964 was over-centralised and overly complex. Its recommendations for change were largely implemented in the Education Act 1989, the title of which states that it is "An Act to reform the administration of education". The statute brought about a marked devolution of decision making away from the Minister of Education and the Department of Education so that schools became the basic unit of education administration. The primary mechanisms in the statute to achieve the legislative objectives were the novel concept of Boards of Trustees who were given by s 75 broad powers to manage schools and the idea of the school charter.

20. Williams J then referred to the requirements relating to charters in s 61 of the Education Act and went on to say at 505:

> It is thus clear that the [Education Act 1989] contemplates that the board, in consultation with the Minister, should have a significant role in determining the school's educational goals and a degree of independence in deciding how those goals should be achieved. While the Ministry of Education influences a school's broad objectives through the application of the national educational guidelines established under s 60A ... and the Minister also has a power of approval of school charters, the guidance thus provided is in rather general terms. It is for the parents, staff and other persons to largely determine the distinctive character of the charter for a particular school.

21. Williams J noted that the accountability of school Boards was achieved in several ways, including the requirement that Boards must adhere to their charters.

22. The policy of the Education Act, therefore, is to decentralise the administration of education so that Boards of Trustees are responsible for the control and management of the schools. Although school Boards have considerable power to manage schools, such powers are subject to any enactment and the law of New Zealand: sections 72 and 75(2) of the Education Act. The Education Act provides for several ways to achieve accountability by Boards, including the obligation for Boards to adhere to their school charters (which must incorporate guidelines specified by the Minister of Education for the education services to be provided).

What are education services?

23. The term "education" is defined in the *Concise Oxford Dictionary* (12th ed, 2011) as:

> the process of educating or being educated. ▶ the theory and practice of teaching. ▶ information about or training in a particular subject.

24. It is possible to define the limits of the obligation of school Boards to provide education services (and, therefore, the scope of the entitlement to free education). The national education guidelines issued by the Minister of Education specify:
    - the outcomes desired from the school system;
    - the policy concerning teaching, learning, and assessment for the purposes of underpinning and giving direction to how curriculum and assessment responsibilities are to be managed;
    - the subjects in which education is to be provided (including areas and levels of knowledge).

25. The Minister of Education specifies through national education guidelines or by regulation, in broad terms, the type, level, and standard of instruction or education to be provided in state schools.

26. Every school must have a school charter. The purpose of the charter is to establish the missions, aims, objectives, directions and targets of the school Board that will give effect to the Government's national education guidelines and the Board's priorities: s 61 of the Education Act. Although the Board has a significant role (through the preparation of the school's charter) in determining the school's aims and objectives and how these are to be achieved, the charter does not take effect if the Secretary for Education determines that it is inconsistent with the Education Act or the national administration guidelines: s 63A of the Education Act. The effect of a school charter is that it is an undertaking by the Board to the Minister of Education to take all reasonable steps to ensure the school is managed, organised and administered for the purposes set out in the school charter and the school, its students and community achieve the aims and objectives set out in the school charter: s 63 of the Education Act.

27. Therefore, school Boards have an obligation to provide education that complies with the requirements of the national education guidelines. New Zealand citizens and residents (or children who are otherwise domestic students and not international students under the Education Act 1989) have a statutory right to free enrolment and free education at any state school: s 3 of the Education Act 1989. The provision of free education in state schools is supported by a grant by the Crown: s 79 of the Education Act.

Ministry of Education circular

28. The Ministry of Education (which is responsible for developing the national education guidelines and reviewing school charters) issued on 13 June 2013

a circular (Education circular 2013/06) to Boards of Trustees and principals of state and integrated schools and the proprietors of integrated schools on the rights of Boards, proprietors, parents, and students in respect of requests for donations and other forms of payments in schools. The Ministry's views are as follows.

- No payments sought from parents are compulsory except for the attendance dues payable to the proprietors of integrated schools and charges by schools for voluntary purchases of goods and services. When communicating with parents, Boards of Trustees must clearly distinguish between requests for donations and charges. The Ministry of Education stated in Education circular 2013/06 that:

  > Requests for payment must make a clear distinction between attendance dues, charges, and donations – and between Board of Trustees' and Proprietors' items.
  >
  > Ideally, invoices should specify attendance dues (for state-integrated schools) and charges for agreed optional goods or services only. Strictly speaking, Boards of Trustees and Proprietors cannot "invoice" donations as non-payment of donations does not give rise to a debt that is owed. On the other hand, it can make practical sense to list all requests for payments in a single document. In such cases, it must be made very clear which payments are voluntary and which are not. It is misleading to include a donation within a total which is described as "owed" by a family.

- No charge may be imposed for materials used in delivering the curriculum, such as photocopying charges, charges for using musical instruments or computer facilities. The most a school Board could do is ask for a donation in the same way as it does for a general donation. This is because the statutory right to free education implies that there should be no charge for materials or equipment used in the delivery of the curriculum. However, students may be charged for the hire of musical instruments owned by the school and used outside the delivery of the music curriculum. A charge may be made for costs involved in project work (such as the production of a T-shirt in a design class) but only if the student agrees to take ownership of the finished product. Schools cannot insist that the students take the finished product home.

- No charge may be imposed for a student's attendance at a school camp that is part of the school's curriculum, including part of the content of a particular course at the school. The Ministry of Education considers it is reasonable for parents to be asked to contribute towards the cost of food and towards the costs that are involved in travel to and from the camp. Such a request is a request for a donation. Students may not be excluded from attending a camp that is part of curriculum delivery. If students are given the choice of participating in a school camp that does not form part of the delivery of the curriculum, a charge may be imposed by the school.

- Students should not be excluded from activities organised away from school as part of the curriculum (for example, field work in geography, biology and outdoor education programmes) because of an inability or unwillingness to pay. The Ministry of Education stated in Education circular 2013/06 that:

  > It is reasonable to request parents to pay a donation towards the travel costs which are connected with such activities as geography and biology and outdoor education programmes, provided that staff have made every effort to minimise costs by ensuring that the activities are held as close to the school as possible.
  >
  > Students may not be excluded from entry into a subject or participation in trips that are part of the curriculum delivery because of an inability or unwillingness to pay.

- Boards cannot require a student to purchase a workbook that accompanies a course and in which answers are written. Boards of Trustees may sell workbooks, but purchase cannot be compelled. Once a parent has opted to purchase, the cost becomes an enforceable charge. The Ministry of Education states in Education circular 2013/06 that if a workbook is made compulsory then a Board of Trustees may only ask for a donation towards the costs.

- No charge may be imposed for programmes such as Reading Recovery, English for Speakers of Other Languages, special education services (speech therapy, behaviour or learning difficulties), or music tuition from Itinerant Teachers of Music. In Education circular 2013/06, the Ministry of Education notes that additional resourcing is provided to schools for these programmes as part of the conventional curriculum or through the Ongoing Resourcing Scheme, Specialist Education Services, or Special Education Grant.

- No charge may be imposed where secondary schools purchase tertiary level courses that they offer to senior students as part of the school programme. However, where the school merely facilitates a student's enrolment in a tertiary course, meaning the student would be enrolled only part time at the school, the student would be required to pay the fees associated with the tertiary course.

- A charge may be imposed for in-school activities at which attendance is voluntary and conditional on payment being made, such as performances by visiting drama groups, lunchtime sport or education outside the classroom (EOTC) opportunities.
- Under the national education guidelines Boards are required to report on student progress and Boards are subject to the Official Information Act 1982 and Privacy Act 1993. Therefore, Boards are not entitled to withhold items such as students' reports or leaving certificates to encourage parents to pay school donations or resolve unpaid debts for goods or services the school has provided.

29. The Commissioner accepts the Ministry of Education's views, as expressed in Education circular 2013/06. The supply of services that are necessary to the supply of education services (in which a school Board has an obligation under its charter to provide instruction and in which participation by students is compulsory) are within the scope of education services to which there is a statutory entitlement to receive free of charge. Services that are necessary to the supply of education services include:
    - the use of materials or goods necessary for delivering the curriculum (for example, the use of computers, photocopying charges for materials used in delivering the curriculum, and materials for practical subjects (such as woodwork));
    - the right to participate in activities that are a compulsory part of the curriculum (for example, camps that are part of the curriculum or fieldwork in geography or biology); and
    - the provision of programmes such as Reading Recovery, English for Speakers of Other Languages, and special education services (for speech therapy or behavioural or learning difficulties).
30. There is a distinction between the supplies described above and supplies made in circumstances where the supply made is not necessary to the supply of education services and students have a choice as to whether to receive the supply. Examples of such supplies include:
    - Goods supplied where there is a very clear take-home component, such as stationery or materials, where a student is entitled to ownership of a finished product from practical classes, such as woodwork. In such circumstances a school may not insist that the student take ownership of such goods.
    - Attendance at, or participation in, activities that are voluntary.

Whether sufficient relationship between payment and a supply

31. Pursuant to s 5(6) of the GST Act, where a school Board brings to charge as revenue amounts received from the Crown, such as operational grants for the supply of education services, that supply is deemed to be a supply for GST purposes. The amounts paid by the Crown are consideration, being a payment made in respect of the supply of services.
32. The grant the Crown provides for the supply of education services in terms of the undertaking given to the Minister of Education may be taxed only once, but GST is chargeable on any separate supply the Board makes to parents: *Case R34* (1994) 16 NZTC 6,190; *Suzuki NZ Ltd v CIR* (2001) 20 NZTC 17,096 (CA).
33. In *Suzuki*, the taxpayer had an obligation to repair defective vehicles under a warranty the taxpayer gave to its customers. In turn, the taxpayer had a warranty from its parent company (from which the taxpayer had purchased the vehicles) and had received payments from the parent company for carrying out the obligations of the parent company under the parent company's warranty. There were two separate supplies: the supply of repair services under the warranty to customers and the supply of repair services to satisfy the obligations of the parent company under its warranty. As two separate supplies were made, the Court of Appeal did not accept that the Commissioner had sought to impose tax on the same supply (at [24]).
34. The Court of Appeal said at [23]:

    > This is simply an instance of the common enough situation in which performance obligations under two separate contracts with different counter-parties overlap, so that performance of an obligation under one contract also happens to perform an obligation under another. In such case a supply can simultaneously occur for GST purposes under both contracts. There is a nexus in both cases between the performance and the consideration given by the other party.

35. In some circumstances an existing statutory obligation may mean that there is an insufficient relationship between the payment and a supply. Two GST cases have related to a situation where the parties had statutory rights or obligations outside any contractual relationship there might have been between the parties: *Television NZ Ltd v CIR* (1994) 16 NZTC 11,295 (HC); *Case U1* (1999) 19 NZTC 9,001.
36. The *Television NZ* case concerned payments the Department of Māori Affairs made to the Broadcasting Council (whose assets and liabilities were later

vested in Television New Zealand) for the purpose of a training scheme operated by the Broadcasting Council (and later Television New Zealand) for Māori trainees. The taxpayer's argument was that a supply had not been made for the payment because, in collaborating with the Department of Māori Affairs, the Broadcasting Council was merely discharging a statutory obligation to be a good employer (which included operating a personnel policy that complied with the principle of being a good employer, including recognition of the aims and aspirations of Māori, the employment requirements of Māori, and the need for greater involvement of Māori as employees of the Broadcasting Council).

37. Tompkins J held that the Broadcasting Council had made a supply of services, being the provision of the training programme. There was a contractual obligation to provide the services, and the fact the supply was in accordance with the statutory obligations of the Broadcasting Council did not affect the conclusion that a supply was made under the contract.

38. Under contract law, the performance of a statutory duty is not consideration, although the undertaking of something more than the bare discharge of the duty can be good consideration: *Ward v Byham* [1956] 2 All ER 318 (CA); *Williams v Williams* [1957] 1 All ER 305 (CA). The *Television NZ* case is consistent with that principle. There was reciprocity between the Broadcasting Council and Department of Māori Affairs. Payment would not have been made if the services had not been provided. The Broadcasting Council had discretion about how it would carry out its statutory obligation to be a good employer. The provision of training services under the agreement with the Department of Māori Affairs was in accordance with the Broadcasting Council's statutory obligations, but there was no direct and specific statutory obligation to provide the training.

39. In *Case U1*, the taxpayer had granted a lease under which the tenant had an obligation to pay rates (in addition to rental). The tenant was an "occupier" under the Rating Powers Act 1988 (being the lessee of a property under a lease for a term of not less than 12 months). Under that Act the occupier had primary liability to pay rates. The issue in *Case U1* was whether the payment of rates formed part of the consideration for the lease. (Hence, the issue considered in *Case U1* is slightly different from that considered in the *Television NZ* case.) Judge Barber considered and rejected the argument that the payment of rates was consideration (as the obligation contained in the lease to pay rates was "in respect of" the lease). He also rejected the argument that the payment of rates by the lessee was part of the inducement to persuade the landlord to lease the farm at the rental figure agreed on and was also part of the lessee's response to the granting of the lease. Judge Barber considered that the lease merely recorded the legal position and was not consideration, as the payment of rates by the lessee satisfied the lessee's own statutory obligation rather than an obligation of the lessor. (However, the payment of rates by a lessee under a lease would be part of the consideration for the lease if the lessor was primarily liable for the payment of rates and the lessee had accepted an obligation under the lease to meet the lessor's liability.)

40. In the *Television NZ* case, the statutory obligation was expressed in general terms. However, in *Case U1*, the lessee had a specific statutory obligation to pay rates.

41. Payments made by parents or guardians may supplement the Crown grant to the school. School Boards have a considerable degree of autonomy as to how their funds are used. How the amounts paid are used is not the test of whether a supply is made for the payment: *Chatham Islands*. *Turakina* also confirms that how payments are used does not determine the nature of the supply for the payments. In *Turakina*, the court (at 10,037) rejected the taxpayers' argument that because attendance dues were applied to meet mortgage obligations of the proprietors of the schools, the attendance dues were paid for exempt supplies (being the payment or collection of any amount of interest, principal, or any other amount in respect of a debt security in terms of ss 14(1)(a) (previously s 14(a)) and 3(1)(ka) of the GST Act).

42. There is an expectation that amounts paid by parents will be used for the purposes of the school. However, the Commissioner considers that, as the supply of education services is not conditional on payment being made by parents and as students have a statutory right to receive education services in a state school free of charge if they are domestic students, there is an insufficient relationship between the payments and the supply of education services to which there is a statutory entitlement. In addition, the Commissioner considers that when the payments made by parents are not made for any particular purpose and the school Boards do not undertake any obligations in return for payment, this supports the conclusion that there is not a sufficient relationship between the payment and any other supply: *Chatham Islands*.

43. Some school Boards may attempt to collect amounts unpaid by withholding items (for example, reports, leaving certificates or school magazines) until payment is made. It is possible to argue that, although school Boards have an obligation to the Minister of Education to supply education services, if there is a threat to withhold education services unless payment is made, there is a separate obligation to parents to supply education services under a separate transaction with the parents. On that basis it could be argued that the payments are consideration, being a payment for the inducement of the supply of education services.

44. The relationship between the pupils and the school Board is based at least partly on the Education Act: *Grant v Victoria University of Wellington* [2003] NZAR 185 (HC); *A-G v Daniels* [2003] 2 NZLR 742 (CA). There is a statutory right to free education. School Boards have a corresponding statutory obligation to provide education in state schools free of charge. Although Boards may represent that education services would not be supplied if payment is not made, the true legal nature of the transaction is that the Board cannot require payment for the supply of education services as students have a statutory entitlement to receive education free of charge. In the *Chatham Islands* case, Tipping J commented at [25]:

> GST is payable on transactions. When deciding whether a particular transaction is of a kind which attracts GST, it is important to analyse carefully its legal characteristics.

45. A person may waive a statutory benefit conferred on that person under a statute if the waiver does not infringe some public right or public policy: *Bowmaker Ltd v Tabor* [1941] 2 All ER 72 (CA); *Reckitt & Colman (NZ) Ltd v Taxation Board of Review* [1966] NZLR 1032 (CA). To determine whether a statutory right to free education can be waived, it is appropriate to consider whether the purpose of the legislation under which the right is conferred would be infringed by the waiver or contracting out: *Johnson v Moreton* [1978] 3 All ER 37 (HL); *Lieberman v Morris* (1944) 69 CLR 69 (HCA).

46. Sections 20 and 25 of the Education Act require all New Zealand citizens and residents between the ages of 6 and 16 to be enrolled at a state-registered school and to attend the school. Private schools must satisfy requirements as to the suitability of premises, staffing, equipment, and curriculum and, in order to be registered, must give students tuition no lower in standard than that of tuition given to students enrolled at state schools: s 35A of the Education Act. The purpose of the PSCI Act was to enable private schools, originally established to provide education of a special character, to be brought within the state system of education as integrated schools. As with other schools in the state system, the Board of an integrated school is responsible for providing education free of charge to its pupils.

47. Parents can choose to have their children educated at non-state schools. It could be argued that in that sense the statutory entitlement to free education can be waived. However, the public policy objective expressed in the Education Act is that all children are to receive education of a minimum standard. The provision of public funding for education and the entitlement to free education are intended to ensure that cost is not a barrier to access to education. That free education is provided for a public purpose is confirmed by the 1993 statement of national education goals (*New Zealand Gazette* No 58, 29 April 1993), which states:

> **Education is at the core of our nation's efforts to achieve economic and social progress. In recognition of the fundamental importance of education, the Government sets the following goals for the education system of New Zealand.**
>
> 1. The highest standards of achievement, through programmes which enable all students to realise their full potential as individuals, and to develop the values needed to become full members of New Zealand's society.
> 2. **Equality of educational opportunity for all New Zealanders, by identifying and removing barriers to achievement ...**
>
> ...
>
> 6. Excellence achieved through the establishment of clear learning objectives, monitoring student performance against those objectives, and programmes to meet individual need.
>
> [Emphasis added]

48. Therefore, it can be argued that the right to free education is not solely a private right. If Boards were able to impose a requirement for the payment of "fees" and individual parents were able to waive the right to free education, the purpose of the legislation would be infringed.

49. Although school Boards have wide discretion to manage and control schools, such powers cannot be exercised in a manner inconsistent with a statutory provision: s 72 and 75(2) of the Education Act. The Commissioner's view is that school Boards do not have the power to require payment as a condition of the provision of education or any other services or

items that are properly regarded as being integral to the supply of education to which there is a statutory entitlement. The Commissioner acknowledges that, given that an illegal activity can be a taxable activity and given that the definition of "consideration" does not require a contract to exist between the supplier and recipient for a payment to be consideration, payment need not be enforceable for the payment to be consideration. Therefore, the fact the transaction is invalid because the parties do not have the power to enter into a transaction, does not mean the transaction would not be recognised for GST purposes: *C & E Commrs v Oliver* [1980] 1 All ER 353 (QBD). However, the statutory entitlement to education cannot be altered by a representation that education services are conditional on the payment of "fees".

50. Therefore, contributions paid to the Board of Trustees of a state school, whether for general or specific purposes, are not consideration for the supply of education services, even if there were a representation that reports or other information relating to the assessment of students would be withheld unless payment was made (albeit contrary to the legal position). However, if school Boards supplied other goods or services beyond the supply of education services on the basis that the supply was conditional on payment being made, the payment would be consideration for that supply. If a contribution made includes a charge for an item that is beyond the supply of education services, such as a school magazine, there will be a case for apportionment of the payment. Section 10(18) of the GST Act states:

> Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

Conclusion

51. Amounts paid by parents are not consideration for the supply of education services to which there is a statutory entitlement. This is for the following reasons:

- The definition of consideration under the GST Act is not the same as the contract law definition. A contract is not required between parents and school Boards for the payments to be consideration for GST purposes: *Turakina*. However, for the payments to be consideration for a supply, there must be a sufficient relationship between payments and a supply: *NZ Refining; Chatham Islands*; *Suzuki*; *Trustee, Executors*.
- As there is a statutory right to free education, in circumstances where an amount is not paid for any particular purpose or for the undertaking of any specific obligation there will not be a sufficient connection between the payments and a supply. This is so even though there is an expectation that the payments would be used for the taxable activity: *Chatham Islands*; *NZ Refining*. The fact the amounts paid by parents to Boards may be used to meet the cost of things not covered by the Crown grant does not establish the necessary connection that the amounts are paid for services of a particular nature: *Turakina*; *Chatham Islands*.
- GST consequences are determined on the basis of the legal character of the transaction: *Chatham Islands*. The relationship between parents and school Boards is based on the Education Act, which requires Boards of state schools to provide education and entitles students to free enrolment and education at state schools, and the PSCI Act, which entitles students enrolled at integrated schools to free education on the same terms and conditions as in state schools. The true legal nature of the arrangement between parents and the school Board is that school Boards have a statutory obligation to provide free education and students have a right to free education. The supply of education services is not conditional on the payment being made, and payment is not required for the supply of education services.
- It is possible to argue that where a representation is made that education services would be withheld if payment is not made, the payments would be made "in respect of, in response to or for the inducement of" the supply of education services. However, as there is a statutory entitlement to free education in state schools, the true legal position is that education services would be provided whether or not payment was made. Therefore, there would not be a sufficient connection between the payment of general or specific "fees" and the supply of education services to which there is a statutory entitlement.
- A statutory right conferred on a person may be waived only if the waiver does not infringe the purpose of the legislation: *Bowmaker Ltd v Tabor; Reckitt & Colman (NZ) Ltd v Taxation Board of Review; Johnson v Moreton; Lieberman v Morris*. The purpose of the Education Act is that all children should receive education of a minimum standard, and there should be no barriers to access to such education. That purpose would be infringed by a waiver of the right to free education and an ability of school Boards to require the payment of "fees" for education.

- The scope of the obligation to provide education services is defined by the national education guidelines and by the school's charter (into which the guidelines are incorporated). The supply of reports and other information relating to the assessment of students is integral to the supply of education services, and such information must be supplied free. The amounts would not be consideration, even if there were a representation that the supply of such information would be withheld unless payment was made (albeit contrary to the legal position).

52. Therefore, GST is not payable on amounts paid for the purpose of a general fund to assist the school with meeting costs or for activities that are an integral part of the curriculum that the school has an obligation to provide and in which participation by pupils is compulsory. However, if other services not integral to the supply of education services are supplied on the basis that the supply is conditional on payment being made, the payment will be consideration for that supply. If a separate charge is not made for such an item, apportionment may apply: s 10(18) of the GST Act.

53. For payments made by parents or guardians to schools to be consideration, it must be possible to identify a supply of goods or services other than the supply of education services that the schools must supply in terms of their charters. The issues that need to be considered are:

- whether what is provided to students is within the scope of the statutory entitlement to education services; and
- if the supply made is outside the scope of the statutory entitlement, whether there is a sufficient relationship between the supply and the payment.

Examples

54. The following examples are included to assist in explaining the application of the law. It is assumed for the purposes of the following examples that the students are not international students.

Example 1 – General donation

55. Each year the Board of Trustees of a state school asks parents or guardians of students enrolled at the school to make a contribution to assist with meeting school costs. The Board is not required to use the contribution for any particular purpose. The contribution is paid for the general purposes of the school, such as the school library, swimming pool, and shared computer facilities, all of which are facilities available to any student.

56. The payment is not consideration for the supply of education services as there is a statutory entitlement for students to receive education free of charge. As the payment is received for the general purposes of the school and the Board of Trustees does not undertake any obligation to supply any goods or services, such payments are not consideration for a supply of a different nature by the Board. Therefore, GST is not chargeable on the payments.

Example 2 – Payment for materials

57. Students at a state school are asked to pay an amount for materials used in a clothing class. The students are not required to take ownership of the completed item but will not be entitled to ownership unless payment is made.

58. A charge cannot be made for the use of materials necessary for the delivery of education services to which there is a statutory entitlement. However, a charge can be made for the right to ownership of an item completed using such materials. The payment is not consideration for the use of the materials, as the use of such materials is necessary for the provision of instruction in the subject. However, if a student elects to take ownership of the completed item, the payment is consideration for the right to ownership of the item and the Board is liable to account for GST in respect of the payment.

Example 3 – Photocopying

59. In addition to the general school donation, parents of students at a state school are asked to pay photocopying charges for materials (such as articles, extracts from textbooks, or homework exercises) used in teaching, even though such materials should be provided free of charge.

60. The payment is not consideration. It is implicit in the right to free education that there should be no charge for the cost of materials used in the delivery of the curriculum. The provision of photocopied materials necessary for teaching is integral to the supply of education services. GST is not chargeable on the payment.

61. However, if a student chooses to purchase a photocopied school magazine produced by students, the payment made would be consideration for the supply of that item and GST would be chargeable on the payment.

Example 4 – School camp

62. Students at a state school are asked for a donation towards the costs of a school camp (such as a Year 12 Outdoor Education camp, or beginning-of-year camps for the whole of Year 9). Attendance at the camp is a compulsory part of the school's curriculum. The donation amount is not subject to GST. This is because the payment is not consideration for the supply of education services as there is a statutory entitlement for students to receive education free of charge. The camp forms part of the supply of education services by the school. The student will have been entitled to attend the camp regardless of whether payment was made. Therefore the payment does not have the requisite nexus to the supply for it to be consideration.

Example 5 – Stationery and work books

63. A state school charges students for stationery packs and optional workbooks that students are entitled to keep. The payment is made for the supply of the stationery and the work book and is consideration. Therefore, GST is chargeable on the payment.

64. (The school may occasionally waive a payment for stationery by some students but this does not mean that the payments for stationery made by other students are not made for the supply of stationery.)

Example 6 – Visiting drama group

65. A drama group puts on a performance at a state school. Attendance by students is optional but if students do wish to attend a charge is payable. The payment is consideration for the right to attend the performance and GST is chargeable on the payment.

66. Note, however, that when students are *required* to attend a drama performance as part of the curriculum, there is no obligation on parents to pay. Any payment by parents towards the cost of their child attending such a compulsory performance will not be subject to GST.

Example 7 – Advance payment of charges

67. The Board of Trustees of a state school asks parents or guardians of students enrolled at the school to make a single payment in advance, in return for future items to be supplied by the school such as stationery and visiting drama groups and which the family has agreed to receive. Advance payment can also include an amount for a take-home item (such as a letterbox to be made in workshop technology) where the student has chosen to take that item home.

68. These goods and activities are not integral to the supply of education that the school has a statutory obligation to provide. The payment is made for the right to participate in the activities to which the payment relates or for the right to ownership of an item. The entitlement of students to these rights is conditional on payment being made and GST is chargeable on the payment.

References

Expired Ruling(s)
BR Pub 03/04
BR Pub 09/01
Subject references
Education; GST; State integrated schools; State schools
Legislative references
Crown Entities Act 2004 – 7(1)(d)
Education Act 1989 – 3, 20, 25, 60, 60A, 61, 63, 63A, 72, 75, 79, 93
Goods and Services Tax Act 1985 – 5(6), 6(1)(b), 8(1), 10(2), 10(18) and the definitions of "consideration" and "public authority" in s2
Private Schools Conditional Integration Act 1975 – 25(5), 35(1), 36
Case references
A-G v Daniels [2003] 2 NZLR 742 (CA)
Bowmaker Ltd v Tabor [1941] 2 All ER 72 (CA)
Case R34 (1994) 16 NZTC 6,190
Case U1 (1999) 19 NZTC 9,001
C & E Commrs v Oliver [1980] 1 All ER 353 (QBD)
Chatham Islands Enterprise Trust v CIR (1999) 19 NZTC 15,075 (CA)
CIR v NZ Refining Co Ltd (1997) 18 NZTC 13,187 (CA)
The Director-General of Social Welfare v De Morgan (1996) 17 NZTC 12,636 (CA)
Grant v Victoria University of Wellington [2003] NZAR 185 (HC)
Johnson v Moreton [1978] 3 All ER 37 (HL)
Lieberman v Morris (1944) 69 CLR 69 (HCA)
Maddever v Umawera School Board [1993] 2 NZLR 478 (HC)
Reckitt & Colman (NZ) Ltd v Taxation Board of Review [1966] NZLR 1032 (CA)
Rotorua Regional Airport Limited v CIR (2010) 24 NZTC 23,979 (HC)
Suzuki NZ Ltd v CIR (2001) 20 NZTC 17,096 (CA)

Taupo Ika Nui Body Corporate v CIR (1997) 18 NZTC 13,147 (HC)
Television NZ Ltd v CIR (1994) 16 NZTC 11,295 (HC)
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Turakina Maori Girls College Board of Trustees v CIR (1993) 15 NZTC 10,032 (CA)
Ward v Byham [1956] 2 All ER 318 (CA)
Williams v Williams [1957] 1 All ER 305 (CA)
Other references
Education circular 2013/06
New Zealand Gazette No 58, 29 April 1993

APPENDIX – LEGISLATION

Goods and Services Tax Act 1985

1. Section 8(1) provides:

> **8 Imposition of goods and services tax on supply**
>
> (1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

2. The value of the supply is determined under s 10(2), which states:

> (2) Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,—
>
> (a) to the extent that the consideration for the supply is consideration in money, the amount of the money:
>
> (b) to the extent that the consideration for the supply is not consideration in money,—
>
> (i) the open market value of that consideration, if subparagraph (ii) does not apply; or
>
> (ii) the value of the consideration agreed by the supplier and the recipient, if subsection (2B) applies.

3. The definition of "consideration" in s 2 provides:

> **consideration**, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body:

PRODUCT RULING BR PRD 14/06: ENGAGEMENT OF SUPERVISORS BY PMP DISTRIBUTION

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of the Person who applied for the Ruling

This Ruling has been applied for by PMP Distribution Limited (PMP Distribution).

Taxation Law

All legislative references are to the Income Tax Act 2007 (Income Tax Act) unless otherwise stated.

This Ruling applies in respect of:

- the definitions of "extra pay", "income from employment", "PAYE rules", "salary or wages" and "schedular payment" in the Income Tax Act;
- section DA 2(4) of the Income Tax Act; and
- section 6(3)(b) of the Goods and Services Tax Act 1985 (GST Act).

The Arrangement to which this Ruling applies

The Arrangement is the engagement of persons ("Supervisors") by PMP Distribution pursuant to the Independent Contractor Agreement ("the Contract") to provide certain supervisory services in metropolitan and rural areas in relation to the delivery of unaddressed newspapers, circulars, leaflets, brochures, catalogues, advertising material, samples and other such items to households and other premises throughout New Zealand.

Further details of the Arrangement are set out in the paragraphs below.

Parties to the Arrangement

1. The parties to the Arrangement are:
   - PMP Distribution, a wholly owned subsidiary of PMP (NZ) Limited, which operates in the print media industry; and
   - Supervisors, who are people who are or are to be contracted by PMP Distribution to provide certain supervisory services throughout New Zealand in relation to the delivery of unaddressed mail.
2. PMP Distribution also contracts with Deliverers, although they are not technically parties to the Arrangement. Deliverers are people who physically deliver the unaddressed mail from drop-off locations to households and other premises throughout New Zealand.

Delivery of circulars

3. The circular deliveries that are supervised by the Supervisors under the Contract are not items the carriage of which requires PMP Distribution to be registered as a postal operator under the Postal Services Act 1998, and PMP Distribution will not register as such.

Meaning of terms in the contract

4. The Supervisors are engaged under the Contract between PMP Distribution and the Supervisors.
5. Within the Contract, defined terms and their meanings are:
   - "Contractor", which means the same as "Supervisor";
   - "Distributor", which means the deliverer of circulars and is equivalent to and interchangeable with the term "Deliverer";
   - the "Manual", which means the Supervisors' instructions published by PMP Distribution; and
   - the "Company", which means PMP Distribution.
6. The Manual does not replace or override any of the material terms of the Contract and it does not affect the nature of the contractual relationship between PMP Distribution and the Supervisors.

Terms of the contract

7. The terms of the Contract under various headings are as follows.

Services

8. Under the heading Services, the Contract requires the Supervisors to:
   - ensure all circulars are delivered to households in accordance with the PMP Distribution instructions;
   - be aware that PMP Distribution may vary the volume of deliveries or make changes in areas serviced by Supervisors;
   - be responsible for the appointment of Deliverers;
   - oversee the delivery of material by contracted Deliverers in a defined area and to complete related tasks;
   - not pay Deliverers directly; and
   - familiarise themselves with, and fully comply with, the Manual (and any amendments) and any applicable legislation, including that related to tax and health and safety.

Payment

9. Under the heading Payment, the Contract provides that PMP Distribution will pay Supervisors monthly in arrears. The basis for the calculation of the payment to Supervisors is the quantity of each job, as shown on the Supervisor worksheet for the distribution supervised by the Supervisor. Schedule 2 specifies the fees PMP Distribution is to pay the Supervisors.

10. All payments the Supervisor receives are gross payments, and the Supervisor is solely responsible for its own accident compensation levies, income tax liabilities, and GST liability under the Income Tax Act, the GST Act and the Accident Compensation Act 2001.

11. PMP Distribution may be required to withhold statutory deductions from the payments; if so, the payment made will be reduced to the extent that the payment is withheld.

Liability and claims

12. Under the heading Liability and Claims, the Contract states that the Supervisor will be responsible for all errors, omissions, loss or damage that are its responsibility having regard to standards of service and compliance with the Manual as required by PMP Distribution. This means PMP Distribution will not be liable to the Supervisor (or any other person) for any loss resulting from the Supervisor's deliberate actions or negligence or where there is a breach of any term of this contract or the Manual.

13. The Supervisor must take out insurance to indemnify PMP Distribution against any damage or loss arising from the Supervisor's actions or relating to the services that the Supervisor will provide.

Motor vehicle, telephone, office and storage facilities

14. Under the heading Motor Vehicle, Telephone, Office and Storage Facilities, the Contract states that the Supervisors are responsible for providing their own equipment (such as personal office supplies, a telephone, a vehicle and wet weather gear) at their own expense. The Supervisors are also responsible for ensuring that such equipment is well maintained, safe and fit for purpose. The Supervisor will be responsible for all costs and services incurred in providing the services.

Relief Supervisor

15. Under the heading Relief Supervisor, the Contract provides that the Supervisor shall appoint a Relief Supervisor to temporarily undertake the obligations of the Contractor if the Supervisor is unable to work. An appointment of a Relief Supervisor by the Supervisor must be approved in writing by PMP Distribution. The Supervisor is solely responsible for payment and all other obligations to others who help them in this way.

Termination

16. Under the heading Termination, the Contract states that PMP Distribution or the Supervisor may terminate the Contract for any reasons whatsoever by giving four weeks' notice in writing. However, if PMP Distribution believes a serious breach of the Contract has occurred, then PMP Distribution may terminate the Contract immediately by written notice.

Term

17. Under the heading Term, the Contract provides that the Agreement shall commence from the commencement date until terminated in accordance with the conditions in the termination section of the Contract.

Relationship

18. Under the heading Relationship, the Contract defines the contractor's status as follows:

- The Supervisor is an independent contracting party and not an agent or employee of PMP Distribution.
- The terms of the Contract or its operation do not create an employment relationship between the Supervisor and PMP Distribution.

Conflict of Interest

19. Under the heading Conflict of Interest, a Supervisor may accept other engagements or work while engaged by PMP Distribution unless there is a conflict of interest.

General

20. Under the heading General, the Contract provides a process of resolving any dispute or conflict that arises.

Three schedules

21. Schedule 1 contains the personal information of Supervisors contracted by PMP Distribution.

22. Schedule 2 specifies Supervisors' rates of payment based on quantities and weights of circulars.

23. Schedule 3 provides a template for a GST letter to be used by Supervisors who are GST registered.

Conditions stipulated by the Commissioner

This Ruling is made subject to the following conditions:

a) The Contract entered into between PMP Distribution and the Supervisors is the same as that provided to the Inland Revenue Department in the Ruling Application dated 16 December 2013, except in relation to immaterial details such as fees, rates, frequency of invoices, defined areas, names and addresses that

are in the operational Manual or specific delivery instructions.

b) The relationship between PMP Distribution and any of the Supervisors is, and during the period of this Ruling will apply, in accordance with all of the material terms of the Contract.

How the Taxation Laws apply to the Arrangement

Subject in all respects to any of the conditions stated above, the Taxation Laws apply to the Arrangement as follows:

a) For the purposes of the PAYE rules, any payment made to a Supervisor by PMP Distribution under the Contract will not be "salary or wages" or "extra pay" or a "schedular payment" within the meaning of those terms as defined in ss RD 5, RD 7 and RD 8 respectively.

b) For the purpose of s DA 2(4), any payment made to a Supervisor by PMP Distribution under the Contract will not be "income from employment".

c) For the purposes of the GST Act, the provision of services by any Supervisor under the Contract will not be excluded from the definition of "taxable activity" (as defined in s 6 of the GST Act) by s 6(3)(b) of the GST Act.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 December 2013 and ending on 30 November 2017.

This Ruling is signed by me on the 23rd of June 2014.

James Mulcahy

Investigations Manager, Investigations and Advice

PRODUCT RULING BR PRD 14/07: NEW ZEALAND MĀORI ARTS AND CRAFTS INSTITUTE SCHOLARSHIP

This is a product ruling made under section 91F of the Tax Administration Act 1994.

Name of the person who applied for the Ruling

This Ruling has been applied for by the New Zealand Māori Arts and Crafts Institute ("the Institute").

Taxation Law

All Legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Ruling applies in respect of section CW 36.

The Arrangement to which this Ruling applies

The Arrangement is the payment of a scholarship by the Institute to students enrolled in the carving school known as Te Wananga Whakairo Rakau o Aotearoa ("Te Wananga Whakairo") which runs a three-year Diploma in Traditional Whakairo course. Further details of the arrangement are set out in the paragraphs below:

1. The Institute was established by the New Zealand Māori Arts and Crafts Institute Act 1963. Under that Act, the purpose of the Institute is to operate as a showcase for Māoritanga with an emphasis on displaying aspects of Māori culture to tourists. It is also charged under the Act with furthering the development of carving in a traditional manner.
2. In 1994 a "needs analysis" of the Institute was undertaken. It was decided to focus activities on training and educating Māori. To this end, the Institute awards a Diploma in Traditional Whakairo.
3. To be awarded the Diploma, students must complete 14 modules. The modules are:
   - Module 1 Introduction to Māori Art
   - Module 2 Tool Technology
   - Module 3 Tool care and maintenance
   - Module 4 Manufacture Patuki
   - Module 5 Manufacture Tekoteko
   - Module 6 Introduction to Māori Design
   - Module 7 Tribal Styles
   - Module 8 Nga patu o te Riri (combat clubs)
   - Module 9 Nga Rakau o te Riri (combat staffs)
   - Module 10 Nga waka mauri
   - Module 11 Taonga Whakatautau
   - Module 12 Taonga Puoro (musical instruments)
   - Module 13 Hanga Whare
   - Module 14 Hanga waka.
4. The Institute has trained student carvers since 1967. Initially, between four to eight carvers were taken on but since 1983 the intake has been limited to three to five students per year.

The Scholarship Agreement ("the Agreement")

5. The Institute offers a limited number of scholarships to assist students ("Tauira") while they are undertaking their studies. The Scholarship agreement entered into between the Institute and its Tauira has the following features:
   - Each scholarship will be awarded to a successful applicant for the duration of the student's course at the amount of $18,200.00 per annum. The amount of the annual scholarship payments may be adjusted from time to time to reflect changes in the Consumer Price Index.
   - The Agreement sets out the hours of class attendance required by the Tauira. Terms and study periods are also specified.
   - The Agreement states that the Institute will provide uniforms and tools for the Tauira.
   - Any carvings or other items produced by the Tauira in the course of their studies are the property of the Institute.
6. The Scholarship payments aim to help cover the living costs of Tauira. Tauira have generally moved from their tribal area, are young and have very few assets. All costs of training, protective clothing, tools, equipment and raw materials are covered by the Institute.
7. The Institute also has a scholarship policy which is set out below:

   Scholarship Policy

   The Māori Arts and Crafts Institute now offers student scholarships to successful applicants to **Te Wananga Whakairo**.

   Scholarships will be offered annually to successful applications to **Te Wananga Whakairo** and the number of students will be determined or negotiated between the Institute and Te Wananga.

   Scholarships will be awarded to a successful applicant for the duration of the student's course upon recommendation of the interview panel.

   The duration of the course is three years.

   A review of year one will be undertaken encompassing the student's achievements and compliance with Te Wananga and New Zealand Māori Arts and Crafts Institute Policies.

Scholarships will be awarded for the duration of the student's course.

The Scholarship awarded is $18,200.00 per annum.

Award payments will be made weekly in an effort to assist students budget adequately for the year.

Award payments will be direct credited to student bank accounts and record of payments identified through student bank statements.

Te Wananga reserve the right to terminate a student's scholarship with one weeks' notice of such termination for serious breaches of Wananga/Institute policies and dismissal through misconduct.

Students will, for the first three months of their first year with Te Wananga, move through a probation period. During this time Te Wananga staff and student will determine suitability/ability to cope with the course challenges.

Termination of a student's scholarship may also be the result of the students' inability to fully complete Module assignments or practice tasks prescribed within the Wananga's curriculum to prescribed standards and within given time frames.

Students who wish to terminate their scholarships may do so either during the probation period or by giving one week's notice of such termination.

8. Fourteen students are now enrolled in carving courses.

How the Taxation law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Scholarship payments made by the Institute to a student pursuant to the Arrangement will be exempt income of the student under section CW 36.

The period for which this Ruling applies

This Ruling will apply from the period 1 April 2014 to 31 March 2018.

This Ruling is signed by me on the 9th day of July 2014.

James Mulcahy

Investigations Manager, Investigations and Advice

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

FBT RATE FOR LOW-INTEREST LOANS INCREASES

The prescribed rate of interest used to calculate fringe benefit tax on low-interest, employment-related loans is 6.70%, up from the previous rate of 6.13% which applied from the quarter beginning 1 July 2014.

The new rate applies for the quarter beginning 1 October 2014.

The rate is reviewed regularly to align it with the results of the Reserve Bank's survey of variable first mortgage housing rates.

The new rate was set by Order in Council on 18 August 2014.

Income Tax (Fringe Benefit Tax, Interest on Loans) Amendment Regulations (No 2) 2014 (LI 2014/284)

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 14/09: INCOME TAX – MEANING OF "EXCESSIVE REMUNERATION" AND "EXCESSIVE PROFITS OR LOSSES" PAID OR ALLOCATED TO RELATIVES, PARTNERS, SHAREHOLDERS OR DIRECTORS

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

This Question We've Been Asked (QWBA) is about ss GB 23, GB 24, GB 25 and GB 25B. It explains the meaning of "excessive remuneration", "excessive profits or losses" and "excessive amount arising from the application of the look-through company rules" when they are used in those four sections.

During a review of the *Public Information Bulletin* and *Tax Information Bulletin* series published before 1996, four items were identified that deal with the issue of "excessive remuneration". This QWBA updates and replaces:

- "Wages paid to son during holidays" *Public Information Bulletin* No 29 (February 1966)
- "Excessive remuneration paid to shareholders or relatives of shareholders" *Public Information Bulletin* No 115 (November 1981)
- "TRA decisions – *Case J53* (1987) 9 NZTC 297 or *Case 94* (1987) 10 TRNZ 709 – Directors' fees" *Public Information Bulletin* No 164 (August 1987)
- "Family partnerships: Commissioner's ability to reallocate profits and losses" *Tax Information Bulletin* Vol 7, No 2 (August 1995).

The Public Information Bulletin review has now been completed, see "Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013).

Question

1. When is the payment of remuneration or allocation of profits or losses considered to be excessive for the purposes of ss GB 23 to GB 25B?

Answer

2. Any remuneration, profits or losses will be considered excessive where:
   - the amount paid is more than a reasonable reward for the services provided by a relative;
   - the share of partnership profits or losses exceeds the value of the contributions made by the partner;
   - the amount paid by a close company exceeds a reasonable reward for the services provided by a shareholder or director, or was influenced by the person's relationship with a shareholder or director; and
   - the amount allocated under the LTC rules to a relative (aged under 20) who owns an effective look-through interest in an LTC exceeds a reasonable amount having regard to the value of their contributions by way of services, capital and any other relevant matters.
3. Generally, remuneration such as salary or wages incurred in deriving income is deductible. However, ss GB 23 to GB 25B are specific anti-avoidance provisions that the Commissioner can invoke where she considers that:
   - excessive remuneration or income has been paid to a relative (s GB 23);
   - a partner's share of partnership profits or losses is excessive (s GB 23);
   - excessive remuneration has been paid by a close company to a shareholder or director, or a relative of a shareholder or director (s GB 25); and
   - excessive income is allocated under the LTC rules to a person (aged under 20) who owns an effective look-through interest in an LTC where a relative of the person also owns an effective look-through interest in the LTC (s GB 25B).
4. The purposes of these provisions are to prevent taxpayers reducing their income tax liability by allocating excessive payments to relatives and others, and to prevent the streaming of excessive losses to relatives to reduce their income tax liability. The amount considered excessive is either not deductible or reallocated.
5. Where excessive remuneration or income is paid to a relative, shareholder or director, or a partner's share of partnership profits or losses is excessive, ss GB 23, GB 25 and GB 25B allow the Commissioner

to reallocate the income or losses based on what is considered reasonable.

6. However, there are exemptions to ss GB 23 and GB 25. Section GB 23 does not apply if a genuine contract of employment or partnership satisfies the conditions set out in s GB 24. Similarly, s GB 25 does not apply if the conditions in s GB 25(3) are met.

Explanation

7. Generally, remuneration such as salary or wages incurred for the purpose of deriving income is deductible. However, when excessive remuneration has been paid to a relative, shareholder or director, ss GB 23 to GB 25 allow the Commissioner to reallocate the excessive amount based on what is reasonable. Section GB 23(3) similarly allows the Commissioner to reallocate a partner's share of partnership profits or losses when they are excessive. Section GB 25B allows the Commissioner to reallocate an excessive amount allocated to a relative who is aged under 20 under the look-through company (LTC) rules.

8. Broadly, the purpose of these provisions is to prevent taxpayers from reducing their income tax liability by allocating excessive remuneration, payments, profits or losses to relatives and others.

9. This QWBA is about the specific anti-avoidance provisions dealing with excessive remuneration and allocations of profits and losses in ss GB 23 to GB 25B.

Meanings of key terms

10. Sections GB 23 to GB 25B refer to "excessive" in the context of excessive "income", "remuneration" and "losses". These sections also refer to the Commissioner's ability to reallocate income or losses based on whether these amounts are "reasonable". Section YA 1 defines the terms "income" and "loss". The Act does not define the terms "excessive", "remuneration" and "reasonable".

Ordinary meanings of "excessive", "remuneration" and "reasonable"

11. The *Concise Oxford English Dictionary* (12th edition, Oxford University Press, 2011) provides the following ordinary meanings of the words "excessive" "remunerate" and "reasonable":

> **excessive ▶ adj.** more than is necessary, normal, or desirable.
>
> **remunerate ▶ v.** pay for services rendered or work done.
>
> **reasonable ▶ adj.** 1 fair and sensible. … **3** as much is appropriate or fair; moderate.

12. Based on the dictionary meanings, the ordinary meaning of "excessive remuneration" is "more than is necessary or normal for the services rendered or work done". The meaning of "reasonable" is "fair and sensible" or "as much as is appropriate or fair". The Commissioner can reallocate "excessive remuneration" based on what is "reasonable". The Commissioner considers an amount of remuneration "reasonable" if it is appropriate or fair for the services provided.

13. This QWBA explains the Commissioner's ability to reallocate excessive remuneration, profits or losses under ss GB 23 to GB 25B. This QWBA discusses the legislation and case law and provides examples to help readers understand the application of the law. The examples cover:

- Paying excessive income or remuneration to a relative—s GB 23(1) and (2);
- Allocating excessive profits or losses to a partner in a partnership—s GB 23(3);
- Paying excessive remuneration to a shareholder or director (including a relative of a shareholder or director)—s GB 25; and
- Allocating excessive income from an LTC to a relative aged under 20 under the LTC rules—s GB 25B.

Who is a "relative"?

14. "Relative" is defined in s YA 1. In summary, a "relative" is someone who is connected with another person by:

- coming within the second degree of a blood relationship (eg, a sister and brother are within the second degree of a blood relationship; a parent and child are within the first degree);
- being married (or in a civil union or de facto relationship) and including when one person is married to a person who comes within the second degree of a blood relationship with the other person (eg, a brother and his sister's de facto partner; a daughter and her mother-in-law);
- being adopted as a child by that person, or being adopted as a child by someone who comes within the first degree of relationship with that person (eg, a parent and their adopted child, or an adopted child and the son of the adopting parent);
- being the trustee of a trust that a relative has benefited under or is eligible to benefit under.

15. In the definition of LTC, "relative" means a person connected with another person in a manner described in any of the first three bullet points above.

Excessive income or remuneration paid to a relative – section GB 23(1) and (2)

16. Section GB 23(1) applies when a person who carries on a business or undertaking employs or engages a relative and the Commissioner considers that the remuneration paid to the relative is excessive for the services they provide. This provision also applies when the person who employs or engages is a company (other than a close company—see s GB 25(1)) and the person receiving the excessive remuneration is a relative of a director or shareholder in the company.

17. Section GB 23(2) similarly applies to a person (person A) who carries on a business in partnership and the partnership employs or engages a relative of person A to perform services for this business. If person A is a company, s GB 23(2) applies if the person employed or engaged is a relative of a director or shareholder of that company and the Commissioner considers that the remuneration paid to the relative is excessive. This provision also potentially applies to a person who owns an effective look-through interest for an LTC, if the LTC employs a relative of that person.

18. In summary, the focus of these provisions is on excessive remuneration paid to relatives for services rendered. Sections GB 23(1) and (2) cover situations where the person carrying on the business or undertaking is a:
    - natural person;
    - company (but not a close company);
    - partnership; or
    - LTC.

19. If excessive remuneration is paid to a relative, s GB 23(4) allows the Commissioner to reallocate the income among the parties "as the Commissioner considers reasonable". In applying s GB 23(4) and (6), the Commissioner may take into account the nature and extent of the services the relative provides, the value of contributions made by the respective partners, and any other relevant matters.

20. However, s GB 23(1) and (2) does not apply if the contract is a "genuine contract" under s GB 24. Section GB 24(2) provides an exemption if there is a genuine contract of employment, engagement or partnership (see para [36] for discussion of s GB 24 as it applies to partnerships). For a contract of employment or engagement to be treated as a genuine contract under s GB 24(2), the following conditions must all be satisfied:
    - the contract is in writing and signed by all parties;
    - the person employed or engaged was aged 20 years or over when the contract was signed;
    - the contract is binding for at least three years;
    - the person employed or engaged has control over their income under the contract; and
    - no part of the income or share of profits derived by the relative or company (of which the relative is a shareholder or director) is a disposition for inadequate consideration.

21. The Court of Appeal considered a corresponding provision to s GB 24(2) (s 106(6) of the Land and Income Tax Act 1954) in *CIR v Lilburn* [1960] NZLR 1,169. The court determined that for an employment contract to be a genuine contract of employment, it must satisfy all of the conditions stated in s GB 24(2). If the contract did not satisfy all the conditions, then it did not come within the s GB 24 exemption for a genuine contract—notwithstanding that it might be genuine in every other way. In *Lilburn* there was no genuine contract of employment because the contract was not binding for at least three years.

22. The following cases provide further guidance on when remuneration paid to a relative is excessive. Judge Barber considered the issue of excessive wages paid to a relative in *Case L64* (1989) 11 NZTC 1,374. His Honour applied the equivalent to s GB 23 and refused to allow the taxpayer to deduct $100 wages paid to his five-year-old son for two weeks' work on a building site. His Honour said that it was unreal to regard a five-year-old as providing services sufficient to justify any sort of payment.

23. In *Case J24* (1987) 9 NZTC 1,140 one of the issues Judge Bathgate considered was the deductibility of wages paid to the taxpayer's children and whether they were excessive. His Honour stated (at 1,147) that the key issue was "the nature and extent of the work done, rather than the identity of the person who does that work". In *Case J24* the amounts paid by the objector to his children would have been reasonable, if they "equated to an amount the objector would have to pay for an adult to do that same work, or to what it would have cost him, had he been paid wages for his work in his business" (at 1,148). Judge Bathgate regarded this as a commercially sound and practical method for calculating the appropriate wages. However, the taxpayer was unsuccessful in obtaining a deduction for reasons other than the wages being excessive.

24. In *Case F108* (1984) 6 NZTC 60,072 one of the issues Judge Barber considered was whether the Commissioner was correct in disallowing a substantial amount of a taxpayer's claim for a deduction for wages. The wages were paid to the 17-year-old daughter of the two principal shareholders and directors of the

taxpayer company. Based on the hours worked and wages received, his Honour concluded that the $2.48 an hour the daughter was paid was a reasonable rate of pay based on the daughter's age and the type of work she carried out.

Summary of cases on excessive remuneration paid to a relative

25. The key focus is on the nature and extent of the work the relative carries out. Any remuneration paid should be based on the nature and extent of the work undertaken by the relative. Whether remuneration is reasonable may depend on the relative's age and the type of work carried out (*Case F108*). The appropriate remuneration may be determined using an industry standard for doing the same type of work or calculated using a commercially acceptable method (*Case J24*; *Case F108*). It is unrealistic to claim a deduction for payments made to very young children because they are unlikely to be able to perform any useful work (*Case L64*). Where there is a genuine contract of employment or engagement under s GB 24(2), the Commissioner cannot reallocate any remuneration paid to the relative (*Lilburn*).

26. Based on these cases, the Commissioner reiterates the criteria she will consider for determining a reasonable payment for services rendered as set out in *Tax Information Bulletin* Vol 7, No 7 (January 1996):

- The nature of the services and the circumstances in which they will be or are performed.
- The knowledge and skills required to carry out the services, including any particular qualifications.
- The amount of payment that the person carrying out the duties would be paid by another independent employer for like services.
- The locality where the duties are being performed.
- The amount the taxpayer would be prepared to pay an arm's length employee undertaking similar duties.

Example 1 – Wages paid to daughter and son working in family business

27. Mary and Bob operate a dairy as a family business. At the end of the 2013 income year, Mary and Bob claim a deduction for $20,000 wages paid to their children, Caroline aged 17 and David aged 5, for working in the dairy.

Are the wages paid to Caroline and David deductible?

28. The Commissioner will allow a deduction for wages Mary and Bob paid to Caroline provided the wages are reasonable based on the nature and extent of the work she carried out. For example, if Caroline's wages are consistent with the industry standard for similar work performed in a dairy, the Commissioner is likely to allow a deduction. However, the Commissioner is likely to disallow any additional amount paid on the basis that the remuneration is excessive. It is up to Mary and Bob to be able to show the Commissioner that the wages paid to Caroline are reasonable for the work that she performs. Evidence showing how the amount of Caroline's wage was set may be useful.

29. The Commissioner will not allow a deduction for wages paid to David. The Commissioner's view is that children as young as five are unlikely to be able to perform any useful work.

Example 2 – Wages paid to daughter working in family business

30. Ted runs an accountancy business from an office in his home. He employs his 13 year-old daughter Lucy to clean his office (but not the rest of the house) and do filing every Saturday. This generally takes Lucy around four hours and she is paid $18 per hour. Ted seeks to deduct Lucy's wages from his income.

Are the wages paid to Lucy deductible?

31. In this case, Lucy is relatively young. Also, some of the work she is being paid to undertake (cleaning) and the location of the work (home) mean the work might be seen as a normal household chore. When these factors are present, the Commissioner is likely to consider the arrangement more carefully.

32. The onus is on Ted to show the Commissioner that the wages paid to Lucy are reasonable for the work she carries out. If Ted can show that $18 per hour is a reasonable amount to pay an arm's length employee with Lucy's knowledge and skills to undertake cleaning and filing, then he will be entitled to a deduction. Evidence showing that Lucy would be paid a similar amount for providing the same services to a third party would assist with this. As would evidence showing that Ted would have to pay a similar amount for someone else to perform the services to the same standard.

Excessive profit or losses allocated to a partner in a partnership – section GB 23(3)

33. Section GB 23(3) applies when two relatives carry on business in partnership and the Commissioner considers that a partner's share of partnership profit or losses is excessive. Section GB 23(3) also applies if one

partner is a company and another partner is a relative of a director or shareholder in that company.

34. Under s GB 23(4), where the Commissioner considers that a partner's share of partnership profits or losses is excessive, the Commissioner may allocate the profits or losses among the partners based on what the Commissioner considers reasonable.

35. Section GB 23(6) sets out the matters the Commissioner may take into account when applying s GB 23(3) to a partnership. These are the value of the contributions made by the respective partners, by way of services, capital or otherwise and any other relevant matters.

36. As noted above at para [20], s GB 24 provides an exemption to s GB 23(3) where a contract of partnership is genuine. Under s GB 24(2), a contract of partnership is treated as a genuine contract if:

- the contract is in writing and signed by all partners;
- all partners were aged 20 years or over when the contract was signed;
- the contract is binding for at least three years (the contract may be dissolved for the reasons set out in ss 36 and 38 of the Partnership Act 1908, which provide for the dissolution of a partnership for reasons such as death, bankruptcy or dissolution by the court); and
- each partner has control over their share of profits and real liability for their share of losses.

37. The courts have considered the reallocation of partnership profits or losses between partners. In *Case B45* (1976) 2 NZTC 60,394, the Chairman, Lloyd Martin, considered whether the Commissioner was correct in reallocating income between partners in a farming partnership. In this case, no written contract of partnership existed. The partners were a farmer and the trustees of a family trust that farmed land in partnership. The partners owned the land as tenants-in-common in equal shares. The farmer bailed livestock to the partnership. He also worked for the partnership and received a management fee. After the management fee was deducted from the partnership's income the profits from the partnership were allocated equally between the partners. However, the Commissioner considered that the amount allocated to the trustees was excessive.

38. In considering the allocation of partnership profits, the Chairman took into account the contributions by the partners, which included the value of land provided by the trustees, livestock bailed by the farmer, and the value of the services the farmer provided. These services were as a working partner who was responsible for the farming operation. The Chairman also noted that the farmer did not receive any payment for the bailed livestock for the first 12 months of the agreement. The Chairman disagreed with the Commissioner and concluded that after deducting a reasonable management fee for the farmer's services and subtracting allowable deductions, it was reasonable for the balance of profits to be divided equally among the partners. This was consistent with the contributions of the partners, the partnership accounts and was in accordance with "ordinary commercial practice in the case of a partnership" (at 60,405).

39. In *Case M65* (1990) 12 NZTC 2,368 the taxpayer and his wife were insurance consultants for a life assurance company. They carried on their consultancy business in a formal partnership. Relevantly, the husband declared two-thirds of the partnership commission income in his income tax return and the wife declared one-third. This was consistent with what the court concluded that the partnership agreement had intended.

40. Judge Bathgate also noted that the two-thirds and one-third allocation of profits between the husband and wife partners correctly reflected the contributions by the partners by way of services and capital. In other words, the contract of partnership was not a sham and could not be challenged in any other way as not being a genuine partnership contract. As a result, the Commissioner could not reallocate the taxpayers' income.

41. In *Case S2* (1995) 17 NZTC 7,012 there was no partnership agreement. The taxpayer and his wife were joint owners and partners in a rental property. From 1989 to 1992, all rental losses were allocated to the husband. However, the Commissioner reallocated the losses equally between the husband and wife.

42. The taxpayer's accountant put forward three arguments why the husband should be able to use all of the losses. First, the husband and wife were joint owners of the rental property and they could choose how to divide the profits or losses. Secondly, on the basis that the husband and wife were partners there was no reason why they could not allocate all of the profits or losses to the husband. Finally, as an alternative, the rental losses could be allocated by using the original property investment contributions, which were 80% by the husband and 20% by the wife.

43. Judge Barber acknowledged that there was a partnership in existence in terms of s 5 of the Partnership Act 1908, which sets out rules for determining whether a partnership exists. Further, he noted that under s 27(a) of the Partnership Act 1908 there is a presumption that, in the absence of a partnership agreement, the partners are entitled to share equally.

44. However, his Honour also stated that the Income Tax Act 1976 set out the criteria for the Commissioner to consider (the equivalent to s GB 23(6)) and concluded (at 7,016):

> The husband and wife "could not allocate profits or losses each year solely to their best tax advantage." Although the wife may have initially contributed 20% of the money used to fund their property investments, this was not determinative. Other factors such as a joint liability under the mortgage and subsequent contributions from the wife indicated that the **husband and wife were equal owners and partners**.
>
> [Emphasis added]

45. Because the husband and wife were equal owners and partners, it was appropriate to share the losses equally between them.

Summary of partnership cases

46. Where there is no partnership agreement, partnership profits and losses should be divided equally between the partners following the presumption under s 27(a) of the Partnership Act 1908 (*Case S2*).

47. When considering whether a partner's share of profits or losses is excessive, the Commissioner may also take into account the capital contributions of the partners as shown in any agreement, including when a partner has made assets available to the partnership. This may include taking into account any payments received for the use of these assets. The Commissioner may also consider services provided by each partner, including responsibilities undertaken, special skills or expertise, work done, and time spent on partnership business (*Case B45*). Where there is a genuine contract of partnership under s GB 24(2), the Commissioner cannot reallocate any amounts attributed to the partners (*Case M65*).

Example 3 – Excessive profits or losses allocated to partner

48. June and her husband Jim are partners in a partnership that owns several rental properties that have been operating at a loss. An agent manages the rental properties because June has a full-time job and Jim is retired. They do not have a partnership agreement. In June and Jim's partnership return for the 2013 income year, the losses are allocated on the basis of 75% to June and 25% to Jim. This allows June to offset a greater proportion of the losses against her employment income, which is higher than Jim's pension.

Can the Commissioner apply section GB 23 to reallocate the losses?

49. Yes—the Commissioner can apply s GB 23 to reallocate the losses. Under s 27(a) of the Partnership Act 1908, there is a presumption that partners share profits and losses equally. Any different allocation between June and Jim would need to be justified based on the criteria in s GB 23(6) and the principles developed by the courts. Partners in a partnership cannot allocate profits or losses to obtain a tax advantage. As a result, the Commissioner would reallocate the losses on a 50-50 basis.

50. However, if June and Jim had a genuine contract of partnership that satisfied the conditions in s GB 24(2), the partnership's profits and losses could be allocated in terms of that contract.

Excessive remuneration paid to a shareholder or director (including a relative of a shareholder or director) – section GB 25

51. Section GB 25 applies when the Commissioner considers that a close company has paid excessive remuneration for services to a person who is a shareholder or director of the company. This provision also applies to excessive remuneration paid to a relative of a shareholder or director of the company. Where a close company pays excessive remuneration, s GB 25(2) treats the excess as a dividend paid by the company and derived by the shareholder or director.

52. However, an exemption to s GB 25 applies if the criteria in s GB 25(3) are met:

- the service provider is an adult employed substantially full-time in the business of the company and who manages or administers the company;
- the amount provided to the service provider is not influenced by their relationship with a shareholder or director; and
- the service provider is resident in New Zealand.

53. In *Case J53* (1987) 9 NZTC 1,297 (at 1,297) Judge Barber considered that determining whether remuneration was excessive required a focus on the nature and

extent of the services the directors provided to the company:

> The directors attended to all their statutory duties as prescribed under the Companies Act.
>
> From time to time they executed company documents and prepared reports for the Statistics Department. In line with their responsibilities they met with their professional advisors at least three times a year. The husband made capital improvements to the farm, thereby increasing the company's assets. The wife kept the day-to-day company accounts. Some of the work performed by the husband could be considered work as a lessee while other work was as a director.

54. Judge Barber's view was that the remuneration paid to the directors was not excessive given the nature of the services they provided and responsibilities they undertook on behalf of the company. His Honour said they were entitled to be "remunerated in a fair manner" (at 1,301).

55. In *Case J99* (1987) 9 NZTC 1,560, Judge Barber considered whether the Commissioner was correct in reallocating income that was paid to the wife of a shareholder-director. Both the husband and wife were shareholders, directors and employees of the taxpayer construction company.

56. In the year in question, the company allocated its net profit as shareholder salaries paying both the husband and wife a salary of $37,109 each. The Commissioner considered that the amount paid to the wife exceeded a reasonable amount for the services she provided.

57. Judge Barber agreed that the wife's salary was influenced by her relationship with her shareholder-director husband and related to the profits of the company. In deciding on a reasonable salary for the wife, his Honour focused on the true worth of her services. This included comparing the husband's and wife's services provided to the company. The wife's salary was reduced to $28,000 with the excess being treated as a dividend paid by the company to her.

58. In *GS Mathews (Chemist) Ltd; Troon Place Investments Ltd v CIR* (1995) 17 NZTC 12,175, the main issue for the High Court was whether remuneration paid to the shareholders of two close companies (GS Mathews (Chemist) Ltd and Troon Place Investments Ltd) was excessive. One company was a retail chemist and the other a property investment company. A husband and wife owned the shares in both companies.

59. The taxpayer companies paid the husband and wife shareholders substantial remuneration for the 1990 and 1991 income years. However, during this time the husband and wife were on an extended overseas trip and had left the companies in the hands of managers. Although they were overseas, the husband and wife were involved in the management of both companies, at least to some extent, by staying in contact with their managers. The shareholders also investigated other business opportunities while overseas.

60. For GS Matthews (Chemist) Ltd, Tompkins J concluded that nothing limited the court to considering only services rendered by the shareholders during the time they were away. His Honour concluded that the remuneration paid to the shareholders was reasonable based on the results achieved by the pharmacy as a result of the business and entrepreneurial skills of the shareholders during the preceding years as well as their contributions during 1990 and 1991.

61. When considering whether remuneration paid to shareholders is excessive, the services rendered by the shareholders can be considered "in a broad and reasonable way". This may include considering the value of a shareholder's contribution in previous years, if it has provided an on-going benefit to the company. Previous salaries paid to shareholders may be relevant when determining whether a subsequent salary is excessive.

62. Troon Place Investments Ltd was a property investment company whose sole source of income was from rents earned from leasing commercial premises. In the 1990 and 1991 income years, it paid shareholder remuneration of $27,494 and $34,062 respectively. However, the Commissioner considered this remuneration excessive and reassessed these amounts based on an estimate of the number of hours the shareholders worked for Troon Place Investments while they were overseas.

63. Tompkins J agreed with the Commissioner's assessment based on the hours the shareholders worked for the company while overseas. He noted that the property investment company was not in the same category as GS Mathews (Chemist) Ltd. This was because the sole source of income was rents rather than the entrepreneurial and business skills of the shareholders.

Summary of shareholder and director remuneration cases

64. Remuneration paid must be based on the "true worth" of the services provided and not an arbitrary figure based on the company's profits (*Case J99*). The reasonableness of fees must be based on the nature and extent of the services provided by the shareholder or director to the company (*Case J53*).

65. Remuneration must not be based on a relationship with a shareholder or director (*Case J99*). When determining whether remuneration paid to

shareholders is excessive, the services rendered by the shareholders can be considered "in a broad and reasonable way". This may include the value of a shareholder's contribution in previous years if it has provided an on-going benefit to the company (*GS Mathews (Chemist)*).

Example 4 – Excessive remuneration to shareholder or director

66. Sue and her husband Peter are 50-50 shareholders in a close company, ABC Ltd. Sue works full time in the business. Peter stays at home with the couple's children during the week, but works 5 hours cleaning the company offices every Saturday. During the 2013 income year, ABC Ltd paid Sue and Peter a salary of $70,000 each. ABC Ltd has claimed the payment of these salaries as a deduction.

Are these salaries deductible to ABC Ltd?

67. The Commissioner cannot reallocate the salaries if the conditions in s GB 25(3) are met. On the basis that both Sue and Peter are residents, Peter's first difficulty in having the exemption apply to him is that he does not work substantially full-time in the business. In addition, Sue and Peter would need to show that the salaries paid were not influenced by their relationship to each other as shareholders (ie Peter would have to show that his salary was not influenced by his relationship to Sue as a shareholder of ABC Ltd and vice versa). Any salaries paid must be based on the value of the shareholder's contributions to the company. In determining whether the salaries paid are influenced by Sue and Peter's relationship to each other as shareholders the Commissioner will consider the nature and value of the services Sue and Peter provided to the company. In this case, it is likely that Peter's salary has been influenced by his relationship with Sue, as his salary appears to be significantly out of proportion to the services that he is providing to the company. In such a case, the amount of the excess will be treated as a dividend paid by ABC Ltd to Peter.

Excessive allocation of income from a look-through company to a relative aged under 20 – section GB 25B

68. Section GB 25B concerns LTCs. It is an anti-avoidance provision aimed at preventing excessive income from being diverted to owners aged under 20. Section GB 25B applies when two or more people who are relatives own look-through interests in an LTC. This provision applies when excessive income is allocated to a relative aged under 20 under the look through company rules.

69. Section HB 1(4) states that an LTC's activity is treated as being carried on by persons holding "effective look-through interests" in the LTC. This means income and deductions are generally passed on to the LTC's owners in proportion to their ownership interest in the LTC. Section GB 25B applies where the Commissioner considers that the application of the standard methods of calculating a look-through interest in s HB 1 results in excessive income being allocated to a relative aged under 20. Section GB 25B(2) allows the Commissioner to reallocate the owner's effective look-through interests based on what is considered to be reasonable. When applying s GB 25B, s GB 25B(3) provides that the Commissioner may consider:

- the nature and extent of the services rendered by the relative;
- the value of the contributions made by the respective owners, by way of services, capital or otherwise; and
- any other relevant matters.

Example 5 – Excessive allocation of income or deductions from a look-through company to a relative aged under 20

70. May and Adam each own 50% of the shares in an LTC. They both gift 10% of the company's shares to Dan, their five-year-old son, who then owns 20% of the shares. As a result, they allocate 20% of the LTC's income to Dan.

Can the Commissioner reallocate the amount paid to Dan?

71. Section GB 25B(2) allows the Commissioner to reallocate effective look-through interests if income allocated to a relative aged under 20 is considered excessive. Section GB 25B(3) sets out the criteria the Commissioner may take into account when considering whether the income is excessive. These criteria are the nature and extent of the services rendered and the value of the contributions made by May, Adam and Dan by way of services, capital or otherwise. These criteria are similar to those for partnerships in s GB 23(3). The Commissioner's view is that cases that consider partnership income where there is no contract of partnership, such as *Case B45* and *Case S2*, assist when determining the nature and extent of the services rendered by each owner with an effective look-through interest and for valuing the contributions made by the respective owners.

72. Given that it is unlikely that Dan has provided services and he has provided no capital contributions to justify receiving 20% of the LTC's income, the Commissioner will regard this allocation as excessive. The Commissioner can reallocate the amount paid to Dan by treating his look-through interests as being held by May and Adam.

73. For further information, see "Changes to the qualifying company rules and introduction of look-through company rules" *Tax Information Bulletin* Vol 23, No 1 (February 2011).

Relationship between this QWBA and Penny and Hooper *case*

74. The Commissioner notes that there are similarities between the subject matter considered in this QWBA and the Supreme Court decision in *Penny and Hooper v CIR* [2011] NZSC 95. The relationship between the two is explained below.

75. This QWBA is about the specific anti-avoidance provisions dealing with excessive remuneration and allocations of profits and losses in sections GB 23 to GB 25B. *Penny and Hooper* considered the issue of diverting personal services income.

76. The concepts of excessive remuneration and diverting personal services income both involve attempting to shift income from a key individual through whom the business earns income. For excessive remuneration, the focus is on whether the remuneration diverted to other individuals is reasonable given the services rendered by the other individuals. The specific anti-avoidance provisions may apply where the amount paid is excessive compared to the contribution to the business by the relevant individual.

77. In *Penny and Hooper*-type scenarios, the focus is on the income diverted from the key individual to associated entities, and generally through to other related individuals. The Supreme Court addressed the issue of diverting personal services income in *Penny and Hooper* under the general anti-avoidance provisions. For the Commissioner's view of the general anti-avoidance provisions in ss BG 1 and GA 1 see "IS 13/01: Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007" *Tax Information Bulletin* Vol 25, No 7 (August 2013). For information about diverting personal services income, see RA 11/02: "Diverting personal services income by structuring revenue earning activities through an associated entity such as a trading trust or a company – the circumstances when Inland Revenue will consider this arrangement is tax avoidance" *Tax Information Bulletin* Vol 23, No 8 (October 2011). The principles in this QWBA are not intended to be applied to *Penny and Hooper*-type scenarios.

References

Legislative references
Income Tax Act 2007 – ss DA 1, GB 23, GB 24, GB 25, GB 25B, HB 1, YA 1 ("close company", "company", "director", "effective look-through interest", "income", "look-through company", "loss", "partnership", "relative" and "shareholder")
Related rulings or statements
"Update on Public Information Bulletin review" *Tax Information Bulletin* Vol 25, No 10 (November 2013)
"IS 13/01: Tax avoidance and the interpretation of sections BG 1 and GA 1 of the Income Tax Act 2007" *Tax Information Bulletin* Vol 25, No 7 (August 2013)
"Changes to the qualifying company rules and introduction of look-through company rules" *Tax Information Bulletin* Vol 23, No 1 (February 2011)
"RA 11/02: Diverting personal services income by structuring revenue earning activities through an associated entity such as a trading trust or a company – the circumstances when Inland Revenue will consider this arrangement is tax avoidance" *Tax Information Bulletin* Vol 23, No 8 (October 2011)
"Reasonable wages – payments to a spouse" *Tax Information Bulletin* Vol 7, No 7 (January 1996)
Subject references
Deductibility; Excessive allocation of income from a look-through company; Excessive remuneration paid to a relative, shareholder or director or to a relative of a shareholder or director; Excessive share of partnership profits or losses
Case references
Case B45 (1976) 2 NZTC 60,394
Case F108 (1984) 6 NZTC 60,072
Case J24 (1987) 9 NZTC 1,140
Case J53 (1987) 9 NZTC 1,297
Case J99 (1987) 9 NZTC 1,560
Case L64 (1989) 11 NZTC 1,374
Case M65 (1990) 12 NZTC 2,368
Case S2 (1995) 17 NZTC 7,012
CIR v Lilburn [1960] NZLR 1,169
GS Mathews (Chemist) Ltd; Troon Place Investments Ltd v CIR (1995) 17 NZTC 12,175
Penny and Hooper v CIR [2011] NZSC 95

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.

APPLICATION TO STAY LIQUIDATION PROCEEDINGS

Case	Commissioner of Inland Revenue v Redcliffe Forestry Venture Ltd
Decision date	11 August 2014
Act(s)	Companies Act 1993, Tax Administration Act 1994
Keywords	Trinity, liquidation, stay proceedings, creditor

Summary

The Court dismissed the defendant's application to stay liquidation proceedings brought by the Commissioner of Inland Revenue ("the Commissioner"), finding the Commissioner was a creditor for the purposes of recovering tax and further that the application to appoint liquidators was not an abuse of process.

Impact of decision

The Court held that the Commissioner is entitled to bring these proceedings as a creditor.

The judgment reinforces the points made in *Raynel v Commissioner of Inland Revenue* (2004) 21 NZTC 18,583 (HC) ("*Raynel*") and *Commissioner of Inland Revenue v Ben Nevis Forestry Ventures Ltd* [2014] NZHC 1746 regarding the Commissioner's obligation to preserve the integrity of the tax administration system in enforcement/recovery proceedings. In this case, although recovery was unlikely, the integrity of the tax system provided a sound justification for liquidation proceedings.

Facts

Redcliffe Forestry Venture Ltd ("Redcliffe") was a party to a forestry venture (known as the Trinity scheme) which was held to be a tax avoidance scheme by the High Court (*Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC)), Court of Appeal (*Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230; (2007) 23 NZTC 21,323 (CA)) and Supreme Court (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115; [2009] 2 NZLR 289). The Commissioner applied to appoint a liquidator in respect of unpaid tax assessments confirmed by the Supreme Court. This proceeding concerned Redcliffe's application to stay those proceedings.

Decision

Is the Commissioner a creditor?

Courtney J referred to, and relied upon, similar applications brought by Ben Nevis Forestry Ventures Ltd and Bristol Forestry Venture Ltd (*Commissioner of Inland Revenue v Ben Nevis Forestry Ventures Ltd* [2014] NZHC 1746) in which she had to consider the same arguments. Her Honour concluded that section 156 of the Tax Administration Act 1994 ("TAA") conferred creditor status on the Commissioner for the purposes of bringing liquidation proceedings under section 241 of the Companies Act 1993.

Her Honour also noted that the Court of Appeal has rejected a similar argument by Redcliffe (and others) made in appeals against Associate Judge Faire's (as he was then) decision not to set aside statutory demands issued by the Commissioner (*Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2014] NZCA 349).

Are the liquidation proceedings an abuse of process?

Her Honour referred to *Raynel*, where Randerson J considered that section 6A(3) of the TAA prevailed over other provisions in the Inland Revenue Acts, including section 176 of the TAA; and that the obligation to collect the highest net revenue was not an absolute one. The Commissioner was also required to have regard to the available resources, the importance of promoting compliance by all taxpayers and the compliance costs incurred by taxpayers.

Her Honour, agreeing with Randerson J, considered that Redcliffe, not trading and having no assets, had engaged the Commissioner in expensive litigation and held that, as a consequence, there is no abuse by the Commissioner in seeking to have liquidators appointed.

Is there a genuine dispute and should a stay be granted pending the outcome of outstanding appeal?

Her Honour noted that the outstanding appeal against Associate Judge Faire's refusal to set aside a statutory demand, which the applicant was referring to, has now been dismissed.

Referring to Associate Judge Faire's finding that there was no basis on which to find a genuine dispute as the position had been finally determined by the Supreme Court in 2008, her Honour found that tax is due under assessments confirmed by the Supreme Court in 2008 and the application to appoint liquidators is part of that process.

Her Honour also held that the existence of an appeal against the decision not to set aside the statutory demand is not a good reason for staying the proceedings.

Is there prejudice to the Commissioner in granting the stay?

The defendant submitted that there was no prejudice to the Commissioner in granting the stay as Redcliffe is not trading and there are no assets at risk of dissipation. However, her Honour did not find this submission to be persuasive, stating that so long as Redcliffe's status remains undetermined, the Commissioner will continue to incur costs in relation to the litigation pursued by this insolvent company.

The High Court dismissed the defendant's stay application.

APPLICATION BY TRINITY INVESTORS TO STAY LIQUIDATION PROCEEDINGS

Case(s)	Commissioner of Inland Revenue v Accent Management Ltd; Commissioner of Inland Revenue v Lexington Resources Ltd
Decision date	11 August 2014
Act(s)	Companies Act 1993, Tax Administration Act 1994, Income Tax Act 1994
Keywords	Trinity, liquidation, stay proceedings, creditor

Summary

Court dismissed the defendant's application to stay liquidation proceedings brought by the Commissioner of Inland Revenue ("the Commissioner"), finding the Commissioner was a creditor for the purposes of recovering tax and appointing the liquidator did not perpetuate an unlawful order.

Impact of decision

This is a further judgment of Courtney J rejecting applications by Trinity investors to stay liquidation proceedings. As with previous judgments, it confirms the Commissioner's ability to take enforcement/recovery action.

Facts

Accent Management Ltd and Lexington Resources Ltd ("the defendants") were party to a forestry venture (known as the Trinity scheme) which was held to be a tax avoidance scheme by the High Court (*Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC)), Court of Appeal (*Accent Management Ltd v Commissioner of Inland Revenue* [2007] NZCA 230; (2007) 23 NZTC 21,323 (CA)) and Supreme Court (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115; [2009] 2 NZLR 289). The Commissioner applied to appoint a liquidator in respect of unpaid tax assessments confirmed by the Supreme Court. This proceeding concerned an application by the defendants to stay those proceedings.

Decision

Would appointing liquidators perpetuate an unlawful or illegal order?

The defendants argue there was an unlawful/illegal imposition of tax by Venning J at first instance (*Accent Management Ltd v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC)). Acting as a hearing authority under the Tax Administration Act 1994 ("TAA"), his Honour's failure to assess under subpart EH of the Income Tax Act 1994 meant his orders were either of no effect or exceeded the jurisdiction conferred by sections 138B and 138P of the TAA.

This argument was raised in the context of the defendants' further applications to set aside statutory demands issued by the Commissioner. Associate Judge Faire (as he was then) considered the argument had already been determined by an earlier decision of Priestley J (*Accent Management Ltd v Attorney-General* [2013] NZHC 1447, (2013) 26 NZTC 21,020). Associate Judge Faire dismissed those applications and required the defendants to pay the Commissioner the amount of tax being sought (*Accent Management Limited v Commissioner of Inland Revenue* [2013] NZHC 3197).

The defendants argued that Associate Judge Faire's order amounted to the unlawful and illegal imposition of tax and determination of the proceedings would perpetuate an unlawful and illegal order. Further, the Commissioner could not bring proceedings in reliance on that order.

Her Honour pointed out the fact that the subpart EH argument had already been raised by the defendants in the Priestley J proceedings. His Honour had dismissed the proceedings, finding that they were a collateral and impermissible attack on the judgments of the Supreme Court and Venning J.

On appeal, the Court of Appeal upheld Priestley J's decision and rejected the argument that the failure to assess the tax under subpart EH led to Venning J levying a tax in breach of section 22(a) of the Constitution Act 1986 as being a tax levied other than by an Act of Parliament (*Accent Management Ltd v Attorney-General* [2014] NZCA 351). The Court of Appeal also rejected the argument that acting as a hearing authority limited the High Court's jurisdiction.

In a separate appeal, the Court of Appeal also upheld the decision of Associate Judge Faire.

Her Honour rejected the defendants' submission that the present proceedings have been brought in reliance on the defendants' failure to comply with Associate Judge Faire's orders, as the validity of those orders would not affect the Commissioner's right to bring the proceedings in the form they were brought. It was clear from the Statement of Claim that the application was not made solely on the orders made by Associate Judge Faire.

Her Honour also rejected the defendants' submission that Associate Judge Faire's order requiring defendants to pay the sum of money demanded by the Commissioner amounted to the imposition of a tax for which the Associate Judge had no authority. The order did not create any new debt, much less a tax, it was merely a step in the enforcement process relating to the tax that was the subject of the statutory demand.

In relation to the defendants' subpart EH argument, her Honour noted that it was rejected by the Court of Appeal, with her Honour noting she agrees with and, in any event, is bound to follow that decision.

Is the Commissioner a creditor?

The defendants argue that, although the Commissioner has the power to sue in her own name under section 156 of the TAA, by virtue of section 14(1) of the Crown Proceedings Act 1950, liquidation proceedings are not an action for recovery of tax within the meaning of section 156.

Her Honour noted that this argument had already been rejected in the applications for stay of liquidation proceedings brought by the other Trinity scheme participants (*Commissioner of Inland Revenue v Ben Nevis Forestry Ventures Ltd* [2014] NZHC 1746 and *Commissioner of Inland Revenue v Redcliffe Forestry Venture Ltd* [2014] NZHC 1877). The definition of "creditor" in section 240 of the Companies Act 1993 encompasses the Commissioner in relation to proceedings brought to recover or pay tax debt. Therefore, the Commissioner is a creditor for the purposes of liquidation proceedings brought under section 241 of the Companies Act 1993.

Are the proceedings an abuse of process?

The defendants submitted that the proceedings were an abuse of process as the Commissioner obtained the orders requiring payment of outstanding tax by deliberately or recklessly misleading the hearing authority. The defendants also relied on Notices of Proposed Adjustment ("NOPAs") served earlier this year, arguing that those notices must be determined before any further steps could be taken.

Her Honour found that the current proceedings were not an abuse of process, noting that those NOPAs are based on the subpart EH argument and this issue had already been determined by the Court of Appeal.

Balance of convenience

Her Honour found that, given the Supreme Court had confirmed the assessments as correct in 2008 and the taxpayers continue to engage in costly litigation even though they cannot meet the debt, there was prejudice to the Commissioner in not having the matter finally disposed of.

Courtney J found in the Commissioner's favour on every issue and dismissed the stay applications.

CASES INVOLVING ALLEGED TAX AVOIDANCE TRANSFERRED TO HIGH COURT AND CONSOLIDATED

Case	Commissioner of Inland Revenue v Bell Road Developments Ltd & Others & Kupuri Investments Ltd & Others
Decision date	7 August 2014
Act(s)	Tax Administration Act 1994, High Court Rules
Keywords	Transfer, consolidation

Summary

The Commissioner of Inland Revenue ("the Commissioner") was successful in having two related cases transferred from the Taxation Review Authority ("TRA") to the High Court. These cases were also consolidated.

Facts

Bell Road Developments Limited, Tararua Street Developments Limited and Messines Developments Limited ("Bell Group") successfully undertook three major property developments. Mr C J Mason, Kupuri Investments Limited, and Trustman Services Limited as trustee of the Columbia Trust ("Mason Group") ultimately received the profit from the property developments. However, the profits were returned by Emborion International Limited ("Emborion") in the 2004–2008 income years on the basis the Bell Group was acting as its agent.

The Commissioner assessed the Bell Group's profit on the basis it entered into a tax avoidance arrangement that was void against the Commissioner. The Mason Group was assessed in the alternative on the basis the profit derived by the Bell Group flowed to the Mason Group (again on the basis the Mason Group entered into a tax avoidance arrangement). The Bell Group and the Mason Group (jointly "the respondents") each commenced separate challenge proceedings in the TRA in August 2013.

In this proceeding, the Commissioner applied to the High Court seeking orders to transfer and consolidate the challenge proceedings filed by the respondents.

Decision

Transfer

The Court was satisfied that there were sufficient factors supporting transfer of the proceedings to the High Court.

In determining whether transfer to the High Court was warranted, the Court referred to the decision in *Commissioner of Inland Revenue v Erris Promotions* [2003] 1 NZLR 506 (CA) as also referred to in the *Commissioner of Inland Revenue v McIlraith* (2003) 21 NZTC 18,112 (HC) decision.

Taxpayer's choice of forum

The Court considered the advantages available to the respondents in these proceedings being commenced and remaining in the TRA, namely; the TRA's specialist jurisdiction, its powers of a Commission of Inquiry, the informality, costs considerations, confidentiality and the fact it is not necessary to instruct a lawyer to conduct the challenge.

The Court determined that the fact the TRA is a specialist tribunal should not be overstated. The Court also held that while the TRA has the powers of a Commission of Inquiry there are existing authorities that support the transfer of proceedings in cases where there are complaints or challenges based on administrative law reasons. The Court agreed that the informality and costs considerations, generally, benefit taxpayers who commence challenge proceedings in the TRA.

The Court found that confidentiality did not appear to be an important feature to the respondents, or those associated with them. Accordingly, the Court found it necessary in this case to consider whether the reasons advanced by the Commissioner for transfer outweighed the factors favouring retention in the TRA.

The Commissioner had relied on the following factors in support of her application for transfer:

1. the complexity of the arrangement;
2. the significance of the litigation;
3. issues of administrative law; and
4. the likelihood of appeal.

Complexity of arrangement

The Court concluded that despite submission from counsel for the respondents, the matter was not straightforward and the fundamental features of the arrangement would have to be considered in a commercial and economically realistic way. The Court also noted that there were disputed facts. In addition, the Court referred to the TRA's minute of 20 November 2013, which recorded that Mr Russell estimated a 20-day hearing would be required and found that this was inconsistent with the respondents' submission that the matter was straightforward. The Court found that the proceedings were at least of moderate complexity.

Significance of the litigation

The Court noted, as a partial answer to the costs advantage of the TRA that due to the amount of tax in dispute (being in excess of $3.5m) and the limited number of parties

affected, the argument that the costs in the High Court count against a transfer did not hold much weight. The Court also noted that tax disputes involving sums of this nature can properly be dealt with before the TRA. The Court concluded that while the use of a company with tax losses to offset tax was not novel, if the arrangement was found to be a tax avoidance arrangement there is potential for broader application. Accordingly, in principle there would be some precedential value in the case.

Issues of administrative law

The Court considered that the respondents' administrative law allegations (impugning the integrity and conduct of the Commissioner's officials, including an allegation of vendetta) supported a transfer to the High Court.

Likelihood of appeal

The Court acknowledged that the prospect of more than one appeal in this matter supported a transfer of proceedings to the High Court. However, the Court emphasised that weight should not be placed too heavily on the number of potential appeals that may arise but on the overall delay in resolution of the proceedings due to those potential appeals.

Consolidation

The Court noted that it has a broad discretion to grant consolidation under High Court Rule 10.12, albeit that it should be exercised in accordance with the interests of justice.

The Court found that the relationships between Emborion and the Bell and Mason Groups were interrelated and interlinked, and therefore consolidation would avoid repetition and conflicting findings of fact. The Court noted that the separate interests of the Bell and Mason Groups could be provided for as they could be separately represented and make their own cases in relation to their respective positions. The Court was ultimately satisfied that the interests of justice favoured consolidation and made orders consolidating the two proceedings.

HIGH COURT GRANTS INTERIM RELIEF UNDER SECTION 8 OF THE JUDICATURE AMENDMENT ACT 1972

Case	Russell v Commissioner of Inland Revenue
Decision date	26 August 2014
Act(s)	Judicature Amendment Act 1972
Keywords	Interim relief, bankruptcy, judicial review, position necessary to preserve

Summary

The applicant, Mr John George Russell ("Mr Russell") filed a judicial review application against the Commissioner of Inland Revenue ("the Commissioner") in relation to her decision not to accept his proposed offers of settlement. The Commissioner obtained summary judgment against Mr Russell for approximately $367 million. Mr Russell sought interim relief under section 8 of the Judicature Amendment Act 1972 ("JAA"). The Court granted interim relief to Mr Russell making an order prohibiting the Commissioner from commencing bankruptcy proceedings until the Commissioner's application to strike out the judicial review proceeding is determined.

Introduction

This decision concerns an application made by Mr Russell for interim relief under section 8 of the JAA. Specifically, Mr Russell sought an interim order to prevent the Commissioner from taking steps to have him adjudicated bankrupt on the grounds that the order is necessary to preserve his position and is in the interest of justice.

Facts

In January 2003, the Commissioner assessed Mr Russell, for taxation in the years 1985 to 2000, having determined that he was a party to, and affected by, arrangements said to constitute tax avoidance. These assessments were confirmed in the Taxation Review Authority and on appeal.

Mr Russell's appeals to the High Court and Court of Appeal were dismissed. On 13 August 2012, the Supreme Court dismissed Mr Russell's application for leave to appeal to that Court.

As Mr Russell has exhausted all avenues of challenge to the assessments, the Commissioner began enforcement action against him. On 10 June 2014, Associate Judge Doogue granted summary judgment against Mr Russell in favour of the Commissioner for unpaid tax, interest, and penalties totalling $367,204,207.41.

Before the application for summary judgment was heard, Mr Russell filed proceedings seeking judicial review that relates to the Commissioner's refusal to accept Mr Russell's offers to settle his tax liability and under which he alleges that the Commissioner's decision to reject his instalment proposals were not made fairly, reasonably, or in accordance with the relevant provisions of the Tax Administration Act 1994.

The Commissioner has applied to strike out the judicial review proceedings. The application has not yet been set down for hearing.

Mr Russell then applied for interim relief under the JAA.

Decision

The Court made an interim order prohibiting the Commissioner from commencing bankruptcy proceedings against Mr Russell, pending further order from the Court. Her Honour held that the order is to last only until the Commissioner's application to strike out the judicial review proceeding is determined. The Court reserved her decision on costs, pending further order of the Court.

Jurisdiction to make interim orders

Andrews J began her analysis by considering the legislation and case law relevant to the application of section 8 of the JAA. Her Honour referred to the approach taken in *Carlton & United Breweries Limited v Minister of Customs* [1986] 1 NZLR 423 (CA) ("Carlton") and noted the differences of approach as to the place for consideration of the merits of the applicant's case for judicial review.

Her Honour mentioned the case of *Safe Water Alternative New Zealand Incorporated v Hamilton City Council* [2014] NZHC 1463 ("*Safe Water*") in which Kos J described the *Carlton* approach as a two-stage enquiry of first determining whether it is necessary to grant interim relief to preserve the applicant's position, then considering whether it is appropriate to grant the relief sought. The Court in *Safe Water* described a three-stage approach, with a new first stage of considering whether there is a "real contest" between the parties.

Then her Honour referred to *International Heliparts NZ Ltd v Director of Civil Aviation* [1997] 1 NZLR 230 (HC) where it was considered that the test is simply whether interim orders are necessary to preserve the applicant's position.

Andrews J preferred not to adopt the three-stage test described in *Safe Water* as her Honour considered that it is not consistent with *Carlton* and appears to require consideration of the merits of the applicant's case twice; first to decide if there is a "real contest", and second to decide whether to exercise the discretion to grant interim relief.

Her Honour also noted the approach taken by Whata J in *Hampton v Canterbury Earthquake Recovery Authority* [2012] NZRMA 139, where the Court first determined whether an order was necessary to preserve the applicant's position and then considered the apparent strengths and weaknesses of the applicant's case.

Is an interim order necessary to preserve the applicant's position?

Andrews J accepted the submission made by Mr Russell's counsel, that the position that the applicant sought to preserve was "the legal status of not being bankrupt". This was in opposition to the submission made on behalf of the Commissioner that the "position" was the ability for Mr Russell to pursue the judicial review application.

Her Honour went on to find that an interim order was reasonably necessary to preserve Mr Russell's position of not being bankrupt, as the Commissioner has a judgment against him and in the absence of an interim order preventing her from doing so, can and will pursue bankruptcy proceedings.

Should an interim order be made?

Andrews J considered that the issue of whether to grant the interim order was far more difficult, and requires consideration, among other things, of the application for judicial review.

In regard to Mr Russell's case for judicial review, her Honour concluded that as the Commissioner's application to strike out Mr Russell's judicial review application had not yet been heard, it was not appropriate to comment in any detail on the strength or weakness of Mr Russell's case. However, her Honour could not conclude that Mr Russell's case is so hopeless that his application for an interim order should be dismissed before the application to strike out, where the strength of the case is focused on and is heard.

Remaining discretionary factors

Andrews J did not accept the counsel for the Commissioner's submission that a factor counting against a stay is that judicial review proceedings could be pursued by the Official Assignee if Mr Russell was bankrupted. Her Honour considered this submission speculative and noted that there was no evidence that the Official Assignee would pursue the proceeding. Her Honour agreed with Mr Russell's counsel that the nature of the judicial review proceeding is such that the Official Assignee would be unlikely to see any benefit in pursuing it. Her Honour considered that the interest in pursuing it lies with Mr Russell, not the administrator of his estate.

In regards to the "delay", Andrews J recognised that Mr Russell's case is a tax dispute with a very long history.

Her Honour accepted that delay cannot be determinative to conclude that a stay should not be granted. Her Honour also accepted that the extremely long time it has already taken to determine tax issues between the Commissioner and Mr Russell is prejudicial to the public interest in maintaining the integrity of the tax system, and to the Commissioner carrying out her duties to administer the tax laws. Accordingly, her Honour noted that if there is further delay as a result of a stay of the bankruptcy proceedings, it should be for as short a time as possible.

APPEAL AGAINST HIGH COURT DECISION AWARDING INDEMNITY COSTS TO THE COMMISSIONER

Case(s)	Ben Nevis Forestry Ventures Limited & Ors v Commissioner of Inland Revenue; Redcliffe Forestry Venture Limited & Others v Commissioner of Inland Revenue
Decision date	5 August 2014
Act(s)	High Court Rules, Court of Appeal (Civil) Rules
Keywords	Indemnity costs, hopeless case, access to justice

Summary

The Court allowed the appeal overturning Brewer J's cost judgment in *Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2013] NZHC 3411 and replaced the indemnity costs awarded in favour of the Commissioner of Inland Revenue ("the Commissioner") with scale costs.

Impact of decision

The Court confirmed the approach in *Bradbury v Westpac Banking Corp* [2009] NZCA 334, [2009] 3 NZLR 400 ("*Bradbury*") in determining whether a case for indemnity costs was made out and held that awarding the costs must be consistent with access to justice. Noting timing is a critical factor, what happens between substantive judgment and the costs decision is not relevant to the consideration of awarding indemnity costs.

Facts

This appeal relates to the Trinity scheme, which was confirmed as tax avoidance by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289.

This decision in particular relates to the High Court judgment delivered by Brewer J which awarded indemnity costs to the Commissioner for a proceeding commenced by the appellants which sought to set aside *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19.027 (HC) ("*Accent 2004*").

In the High Court proceeding, the Commissioner filed a protest to jurisdiction under rule 5.49 of the High Court Rules. This was upheld by Venning J in *Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2011] 1 NZLR 336 (HC) ("*Redcliffe 2010*") but subsequently overturned by the Court of Appeal (*Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2011] NZCA 638, [2012] 2 NZLR 823), on the basis that the rule 5.49 procedure was not the appropriate vehicle for the Commissioner to challenge the application to set aside the Accent 2004 judgment. However, on appeal the Supreme Court reinstated Venning J's judgment (*Commissioner of Inland Revenue v Redcliffe Forestry Venture Ltd* (2012) NZSC 94, [2013] 1 NZLR 804).

Brewer J found that the application to set aside Accent 2004 was hopeless from the outset and amounted to a collateral attack on legal matters that had already been pronounced upon by the Supreme Court. Brewer J relied, amongst other things, on a substantially similar proceeding that was rejected by Keane J in *Accent Management Ltd v Commissioner of Inland Revenue* (2010) 24 NZTC 24,126.

Decision

In addressing the principles governing indemnity costs, the Court first referred to rule 14.6 of the High Court Rules and rule 53E(3) of the Court of Appeal (Civil) Rules 2005, under which a court may award indemnity costs if:

a) the party has acted vexatiously, frivolously, improperly, or unnecessarily in commencing, continuing, or defending a proceeding or a step in a proceeding; or

b) some other reason exists that justifies the court making an order for indemnity costs despite the principle that the determination of costs should be predictable and expeditious.

The Court considered *Bradbury*, the leading case on indemnity costs, where the Court noted that access to justice is a fundamental right, and listed non-exhaustive categories in which indemnity costs have been ordered. These included "making allegations which ought to never have been made or unduly prolonging a case by making groundless contentions, summarised in French J's 'hopeless case' test".

The Court noted that the reference to the "hopeless case" test is an observation made by French J (*J Corp Pty Ltd v Australian Builders Labourers Federation Union of Workers (WA Branch) (No 2)* (1993) 46 IR 301 (FCA)) who relied on an earlier decision of Woodward J (*Fountain Selected Meats (Sales) Pty Ltd v International Produce Merchants Pty Ltd*

(1988) 81 ALR 397 (FCA)) where he found that if a case is truly hopeless, the action must be presumed to have been commenced for some ulterior motive.

The Court, pointing out the long delay (almost four years) between the judgment in *Redcliffe 2010* and Brewer J's decision, considered that what happened after *Redcliffe 2010* was decided could not have a bearing on the appropriate award of costs in *Redcliffe 2010* itself.

The Court also found Keane J's judgment was not relevant to the determination of costs for *Redcliffe 2010* as Keane J's decision was reserved and had not been delivered when the statement of claim for *Redcliffe 2010* was filed.

The Court rejected the appellants' argument that if their case was hopeless, it meant that the Court of Appeal's decision reversing *Redcliffe 2010* was a hopeless decision; pointing out the Court of Appeal only considered the Commissioner's jurisdictional argument, not the merits of the underlying proceeding.

The Court went on to find that while it accepted the existence of serial attacks on the decision of the Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] NZLR 289, indemnity costs could not be awarded in relation to *Redcliffe 2010* which was at the beginning of the series of proceedings. It stated this was a case where a claim failed after due consideration, rather than one which was so hopeless that it should never have been brought in the first place. The Court also noted that awarding indemnity costs would not be consistent with access to justice, a consideration the court identified in *Bradbury*.

The Court held that Brewer J was wrong in taking into account subsequent litigation involving the appellants and others, and allowed the appeal substituting an award of costs on a 2C basis, plus disbursements.

In relation to the costs in this matter, the Court awarded to the appellants collectively one set of scale costs reduced by 50 per cent of the costs payable for a standard appeal in recognition that the appeal was heard on the papers in conjunction with a number of other appeals.

APPEAL BY TRINITY INVESTORS TO SET ASIDE A HIGH COURT DECISION

Case	Accent Management Limited v Attorney General, the Commissioner of Inland Revenue
Decision date	5 August 2014
Act(s)	Tax Administration Act 1994, Income Tax Act 1994
Keywords	Trinity, nullity, indemnity costs, *functus officio*, hearing authority

Summary

The Court of Appeal dismissed the appellants' appeal from the High Court judgment of Priestly J (*Accent Management Ltd v Attorney-General* [2013] NZHC 1447, (2013) 26 NZTC 21,020) where he upheld a protest to jurisdiction by the Commissioner of Inland Revenue ("the Commissioner") and the Attorney-General. The original judgment addressed an attempt by the appellants to set aside *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027 (HC) on the basis that Venning J, the first instance judge, failed to apply a purportedly mandatory provision of the Income Tax Act 1994 ("ITA") being subpart EH.

Impact of decision

The Court of Appeal confirmed that once a decision has been considered on appeal, the lower court is *functus officio* and has no jurisdiction. It further found the fact the High Court is a hearing authority in terms of section 3 of the Tax Administration Act 1994 ("TAA") does not affect the status of the High Court or of the High Court judge hearing the challenge proceeding.

Facts

This judgment relates to an appeal against a High Court judgment of Priestly J (*Accent Management Ltd v Attorney-General* [2013] NZHC 1447, (2013) 26 NZTC 21,020) ("Priestly J judgment") where he upheld a protest to jurisdiction by the Commissioner and the Attorney-General (the respondents will be jointly referred to as "the Commissioner") and dismissed the application made by the appellant to set aside an earlier decision *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027 (HC) (*"Accent 2004"*). His Honour also awarded indemnity costs to the Commissioner.

Accent 2004 ruled that an arrangement to which the appellant and a number of other taxpayers were party was a tax avoidance arrangement. This was 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 2008*").

The appellant was seeking to set aside *Accent 2004* as a nullity on the basis that Venning J, the first instance judge, failed to apply, as claimed by the appellant, a mandatory provision of the ITA—being subpart EH.

The Commissioner submitted the principle of finality applies and the High Court is *functus officio* and therefore has no jurisdiction to consider the appellant's claim because the appellant is essentially re-running the arguments that failed in *Accent Management Ltd v Commissioner of Inland Revenue* (2010) (2010) 24 NZTC 24,126 (HC) ("*Accent 2010*") and in the Supreme Court in the *Redcliffe* proceedings (*Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2011] 1 NZLR 336 (HC); *Redcliffe Forestry Venture Ltd v Commissioner of Inland Revenue* [2011] NZCA 638, [2012] 2 NZLR 823; *Commissioner of Inland Revenue v Redcliffe Forestry Venture Ltd* [2012] NZSC 94, [2013] 1 NZLR 804 ("*Redcliffe SC*").

Decision

The Court of Appeal found for the Commissioner and dismissed the appeal.

The Court of Appeal stated in relation to the issue of jurisdiction that the appellant's arguments were materially the same as those it already considered and by the Supreme Court, and therefore the High Court was *functus officio* and did not have jurisdiction to deal with an application. It stated at [40]:

> We conclude that there is no material distinction between the present case and *Redcliffe SC*. Applying *Redcliffe SC* leads to the inevitable conclusion that the High Court does not have jurisdiction to deal with Accent's claim.

The Court found the issue of whether the High Court being a hearing authority makes it amenable to reviewing its own decisions, a red herring. It stated at [30]:

> There is nothing to suggest that the fact the High Court is a hearing authority in terms of section 3 of the TAA affects the status of the High Court or of the High Court Judge hearing the challenge proceeding. The TAA does not reconstitute the High Court as an inferior tribunal, subject to the jurisdiction of the High Court on judicial review.

The Court went on to uphold the indemnity costs awarded to the Commissioner in the Priestly J judgment and awarded indemnity costs to the Commissioner in this case stating at [45]:

> As we have noted earlier the question of the applicability of section EH(1) has become something of a refrain. There comes a time when the appellant must accept that the decision of the Court went against it in the Supreme Court in *Ben Nevis 2008* and must face up to the consequences of that finding.

UNSUCCESSFUL APPEAL BY TRINITY INVESTORS IN RESPECT OF STATUTORY DEMANDS ISSUED BY THE COMMISSIONER

Case(s)	Redcliffe Forestry Venture Limited v Commissioner of Inland Revenue (CA 791/2013); Bristol Forestry Venture Limited v Commissioner of Inland Revenue (CA 633/2013); Accent Management Limited v Commissioner of Inland Revenue (CA 23/2014), [2014] NZCA 349
Decision date	5 August 2014
Act(s)	Companies Act 1993, Tax Administration Act 1994, Income Tax Act 1994
Keywords	Trinity, statutory demands, creditor, insolvency

Summary

This matter involved three appeals against High Court decisions dismissing the appellants' applications to set aside statutory demands issued by the Commissioner of Inland Revenue ("the Commissioner"). The Court of Appeal found that the Commissioner was able to issue statutory demands and dismissed the appeals.

Impact of decision

The Court of Appeal preferred the characterisation of the Commissioner as an officer of the Crown exercising certain functions on the Crown's behalf rather than as being part of the Crown. In any event the Commissioner is able to recover tax due to the Crown.

The Court of Appeal agreed with the view that the public has an interest in the end of litigation as the public purse sustains litigation to a large degree.

Facts

This appeal relates to the Trinity scheme that was confirmed as tax avoidance by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 ("*Ben Nevis*"). This appeal was one of a number of related matters heard by the Court of Appeal on 18 to 20 March 2014. This proceeding specifically relates to the Commissioner's attempts to enforce assessments confirmed by *Ben Nevis* by issuing statutory demands against the appellants in accordance with section 289 of the Companies Act 1993.

The appellants applied for the demands to be set aside under section 290 of the Companies Act 1993 on the basis

that there is a substantial dispute whether or not the debt is owing (section 290(4)(a)) and the demand ought to be set aside on other grounds (section 290(4)(c)). All appellants relied on the on-going litigation to argue there was no final determination of their challenges to the Commissioner's assessments and so only a contingent not present debt owing. In addition, some of the appellants argued the Commissioner was not authorised to issue a statutory demand on behalf of the Crown, the Commissioner not being a creditor for the purposes of section 289.

These applications were heard as three separate proceedings in the High Court, each of which was dismissed by Associate Judge Faire (as he then was), who also awarded indemnity costs to the Commissioner in two of the matters.

The appellants appealed both the substantive decisions and the costs awards to the Court of Appeal.

Decision

The Court of Appeal found for the Commissioner on all grounds.

The Commissioner as creditor

The Court considered whether the Commissioner was part of the Crown and considered the better view is that the Commissioner, as an officer of the Crown, can exercise certain functions on the Crown's behalf and section 156 of the Tax Administration Act 1994 ("TAA") makes it clear this includes conducting litigation to recover tax.

The Court found that the source of the Commissioner's statutory powers to collect tax and issue a statutory demand came from section 6A read in conjunction with sections 156 and 176.

However, even if the Commissioner lacked the statutory power to issue a statutory demand in her own name, she could do so as an agent or officer of the Crown. In this case, the only defect in the demands issued was the omission of the words "on behalf of the Crown", but that omission was at worst a trivial defect, and the Court thought it not an omission at all.

Whether there was a substantial dispute

The Court dismissed the appellants' arguments that Part 8A challenges had not been finally determined. The Court considered that if the appellants' arguments were accepted, it would mean any defaulting taxpayer could defer payment of tax simply by commencing proceedings attacking the judgment in which his or her challenge failed.

Other grounds

The Court rejected all other reasons for setting aside the statutory demands. With regard to the appellants' claim that there was a public interest in the proceedings by virtue of the Commissioner's questionable motives—in this case to remove challenges to her assessments by liquidating the taxpayers—the Court said there was in fact a public interest in the finality of litigation. This also applied to the appellants' argument that setting aside the statutory demand was in the public interest because there was no other creditor.

In relation to a tangential point as to whether Goods and Services Tax credits could be offset against costs awarded by the High Court, the Court of Appeal agreed with the Commissioner that section 46(6) of the Goods and Services Tax Act 1985 did not provide for this.

Costs

The Court found the appeal points brought were hopeless from the outset and were motivated by an intention to delay the collection of tax. Accordingly, the Court awarded indemnity costs in the Commissioner's favour.

APPEAL BY TRINITY INVESTORS TO SET ASIDE A HIGH COURT DECISION AND INDEMNITY COSTS AWARD

Case	Ben Nevis Forestry Ventures Limited, Bristol Forestry Ventures Limited, Clive Richard Bradbury, Gregory Alan Peebles v Commissioner of Inland Revenue
Decision date	5 August 2014
Act(s)	Tax Administration Act 1994, Income Tax Act 1994
Keywords	Trinity, indemnity costs, setting aside, bias

Summary

The Court of Appeal dismissed the appellants' application to set aside a High Court judgment of Katz J (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2013] NZHC 2361, (2013) 26 NZTC 21-032) and upheld the High Court's award of indemnity costs to the Commissioner of Inland Revenue ("the Commissioner"). The original judgment addressed an application by the appellants to set aside *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027 (HC) on the basis that Venning J, the first instance judge, was biased. That application was dismissed for want of jurisdiction as the matter had subsequently been considered on appeal.

Impact of decision

The Court of Appeal confirmed that once a decision has been considered on appeal, the lower court has no

jurisdiction—even in a case where a judgment is void *ex debito justitiae* (ie, where a judgment is fundamentally flawed (for instance a breach of natural justice) it must still go to the last Court seized of the matter even though the judgment could be voided as of right).

Facts

This appeal relates to the Trinity scheme which was confirmed as tax avoidance by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 ("*Ben Nevis*"). This appeal was one of a number of related matters heard by the Court of Appeal on 18 to 20 March 2014. This proceeding involved an appeal against a High Court judgment of Katz J (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2013] NZHC 2361, (2013) 26 NZTC 21–032). ("Katz J judgment") where her Honour upheld a protest to jurisdiction by the Commissioner and dismissed the application made by the appellants to set aside an earlier decision *Accent Management Ltd v Commissioner of Inland Revenue* (2004) 22 NZTC 19,027 (HC) ("*Accent 2004*"). The appellants in the Katz J judgment were seeking to set aside *Accent 2004* on the basis that Venning J, the first instance judge, was biased as he was said to be beholden to the Commissioner.

Katz J also awarded the Commissioner indemnity costs.

Decision

The Court of Appeal found for the Commissioner.

The Court began by setting out the context of the appellants' appeal at [16]:

> The taxpayers [including the appellants] who contested the Commissioner's assessments in the High Court, and who were unsuccessful in *Accent 2004* (and in the appellate decisions upholding *Accent 2004*) have embarked on a series of challenges to the ruling, all of which have been unsuccessful and most of which have led to awards of indemnity costs against them.

First issue: Jurisdiction to set aside

The Court referring to *R v Smith* [2003] 3 NZLR 617 (CA) agreed with Katz J's judgment, finding that there is jurisdiction to set aside a proceeding *ex debito justitiae* where no appeal has been determined but that this jurisdiction is exercised rarely and only in clear-cut cases.

Second issue: Impact of appeals

The Court found the question of the appropriate venue for dealing with a potentially tainted judgment that has been the subject of successive appeals is not clear from the authorities. The Court considered there was a conflict between:

1. authorities establishing that a decision obtained in breach of the rules of natural justice can be set aside *ex debito justitiae*; and
2. the reality that in a hierarchical court system it would be an oddity if a trial court could set aside its own decision and thereby effectively nullify decisions of appellate courts.

It accepted a court setting aside an earlier decision of its own is a real possibility in the case of a judgment obtained by fraud and this possibility was confirmed in the related decision of the Supreme Court in *Commissioner of Inland Revenue v Redcliffe Forestry Venture Ltd* [2012] NZSC 94, [2013] 1 NZLR 804 ("*Redcliffe*"). However, the Court concluded that *Redcliffe* indicates that a challenge to a concluded judgment that has been the subject of an appellate judgment should not be mounted in the trial court except in the case of a judgment obtained by fraud, which is recognised as a special exception.

In the circumstances of this case, the appropriate Court is the appellate Court and the Commissioner's protest was upheld.

Third issue: Whether indemnity costs should have been awarded to the Commissioner

The Katz J judgment awarded indemnity costs to the Commissioner on the basis it was a hopeless case relying on the indemnity costs principles in *Bradbury v Westpac Banking Corp* [2009] NZCA 234, [2009] 3 NZLR 400 at [29](b)–(e). Katz J found it was not even remotely arguable that the Court had jurisdiction to hear and determine the proceeding and the relief it sought was indisputably beyond the jurisdiction of the High Court.

For this reason, the Court did not consider the Commissioner's other arguments for indemnity costs of:

1. misconduct causing loss of time to the Court and other parties;
2. commencing or continuing proceedings for an ulterior motive; and
3. doing so in wilful disregard of known facts or clearly established law.

The Court accepted the appellants' submission that the jurisdictional issues in the case are ones on which there is no clear precedent and the fact that the appellants ultimately lost in the High Court, and have now lost in the Court of Appeal, does not mean that the jurisdictional argument was hopeless.

However, the Court noted it did think the underlying claim meets a number of the other arguments put forward by the Commissioner and dismissed the appeal against the indemnity costs stating at [58]:

> First, it is a continuation of repeated proceedings alleging bias on the part of Venning J, in circumstances where all scrutiny of the position of Venning J has found the allegations to be unsubstantiated. Second, it is for an ulterior motive of preventing the Commissioner from obtaining the fruits of the judgment of the Supreme Court in Ben Nevis. It is, as we mentioned earlier, part of a series of challenges. These have been repetitious in nature and have reached the point where they are improperly brought. In the circumstances, therefore, we consider that Katz J was right to award indemnity costs and we dismiss the appeal against the costs judgment.

The Court went on to consider costs in this proceeding stating the reasons justifying the award of indemnity costs in the Katz J judgment could equally justify indemnity costs on this appeal. However, because the jurisdiction arguments raised were at least arguable, it awarded the Commissioner costs on a complex appeal on a band B basis plus usual disbursements.

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