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TAX INFORMATION Bulletin

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YOUR OPPORTUNITY TO COMMENT

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

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.taxtechnical.ird.govt.nz** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

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

You can also subscribe at **www.taxtechnical.ird.govt.nz/subscribe** to receive regular email updates when we publish new draft items for comment.

IN SUMMARY

COMMISSIONER'S STATEMENT

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular matter. A Commissioner's Statement is not a consultative document.

CS 20/05: GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package

All legislative references are to the Goods and Services Tax Act 1985.

Summary

This Statement sets out the Commissioner's position in relation to payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment (MBIE) under the Leaky Homes Financial Assistance Package (FAP) scheme.

The Commissioner considers that a payment under the FAP scheme from MBIE to a body corporate is not a payment in respect of any actual supply of goods and services made by the body corporate in return for that payment.

However, the Commissioner considers that these payments are in the nature of a grant or subsidy from the Crown under section 5(6D) of the Act, and therefore are deemed to be in response to a supply from the body corporate.

As a result these payments are subject to GST.

A GST registered body corporate which receives such payments is therefore obliged to include the GST component in its GST return and to pay for any net GST output tax.

A body corporate which is not registered (and not liable to be registered) for GST will not be obliged to account for GST.

Background

Under the FAP scheme, MBIE makes payments to eligible claimants as a contribution towards the repair of their leaky property.

MBIE is not responsible for repairing leaky buildings. Any repairs required, as with all building maintenance, are the responsibility of the body corporate. As a result, when MBIE makes payment to a body corporate under the FAP scheme MBIE is not paying the body corporate for any services completed on MBIE's behalf or for any supplies made to MBIE.

Instead, the FAP payments are made by MBIE to ensure properties are repaired and to provide resolution for eligible claimants faster than what was being achieved through mediation or litigation under previously available processes. Eligible claimants have not supplied anything to MBIE in return for the payments, instead the payments are connected to the property having suffered damage as a result of water ingress (for which MBIE is not liable).

For GST purposes, these payments will be subject to GST because they are consideration for a "supply" as defined under section 5.

A body corporate does not supply anything to MBIE in exchange for the payments under the FAP scheme. Nevertheless, as this Statement sets out, a payment from MBIE to a body corporate is still subject to GST if that payment is deemed to be consideration for a supply under section 5(6D) of the Act.

Explanation

Section 5(6D) of the Act provides:

> For the purposes of this Act, where any payment in the nature of a grant or subsidy is made on behalf of the Crown or by any public authority to—
>
> (a) any person (not being a public authority) in relation to or in respect of that person's taxable activity; or
>
> (b) any person for the benefit and on behalf of another person in relation to or in respect of that other person's taxable activity,—
>
> that payment shall be deemed to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made in the course or furtherance of that person's taxable activity.

The key requirements of section 5(6D) are that the payment is:

- in the nature of a grant or subsidy;
- made on behalf of the Crown or by any public authority; and
- made to a person in relation to or in respect of that person's taxable activity.

The Commissioner considers that FAP payments from MBIE to a GST registered body corporate meets each of these requirements.

First, the payments are in the nature of a grant or subsidy – MBIE makes payments under the FAP scheme as it is in the public interest to ensure that affected properties are repaired to a satisfactory standard to remain habitable by current and future homeowners.

The payments are not made under any obligation by MBIE to compensate homeowners, as MBIE is not under any legal obligation to do so.

As a result of being made in the public interest and not in response to any obligation, the Commissioner considers that the payments are in the nature of a grant or subsidy.

Second, the FAP payments are made by the Crown– MBIE makes FAP payments on behalf of the Crown.

Finally, the FAP payments are made in relation to or in respect of the GST registered claimant's taxable activity. A key part of a GST registered body corporate's taxable activity is the maintenance of the unit title development. In the context of leaky buildings this will include repair and remediation of the affected building. Therefore, a FAP payment from MBIE to a body corporate is made in relation to that body corporate's taxable activity.

Application

This Statement sets out the Commissioner's position on all payments from MBIE under the FAP scheme to a GST registered body corporate, including payments made before the release of this Statement.

The Commissioner will continue to apply this position to all cases.

If you have any concerns about your compliance with the tax obligations outlined in this Statement, you should discuss this matter with a tax professional or contact Inland Revenue to make a voluntary disclosure.

Tony Munt
National Advisor
Technical Standards, Legal Services

Date of issue: 21 September 2020

LEGAL DECISIONS – CASE SUMMARIES

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, 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.

CIR v Tower City Holdings Ltd

Case	The Commissioner of Inland Revenue v Tower City Holdings Limited [2020] NZHC 2239
Decision date	31 August 2020 CSUM 20/10
Legislative References	Companies Act 1993, ss 241(2), 241(4), 194, 131, 135, 137, 246 Tax Administration Act 1994, parts 4A and 8A High Court Rules 2014, r 5.61
Legal terms	liquidation, winding-up, interim liquidation, GST, income tax

Summary

The Commissioner applied for an order under s 241(4) of the Companies Act ("CA1993") placing the defendant company ("Tower") into liquidation on a number of grounds, including the company's inability to pay its debts, its failure to keep proper accounting records and breaches of various directors' duties. The defendant company unsuccessfully argued that the order should not be made.

Impact

The result indicates that the Court will at least sometimes be willing to grant a liquidation order where some of the debt is subject to dispute, so long as the Commissioner can establish she has standing as a creditor and can make out one or more of the grounds for liquidation in s 241(4) of the CA 1993. What is still unclear is whether the Commissioner would have been (or will be in future cases) successful in establishing standing to bring the claim when all of the debt in question is the subject of dispute.

Facts

Background – Tower's tax debt

The Commissioner commenced an audit of Tower (a property development company) in 2015, and in May 2017 made default assessments in respect of income tax for the tax years ended 31 March 2014 to 31 March 2016. Only the assessment for the 2016 year resulted in a liability to pay tax. The assessed income tax of $4,084,478.22 related to the sale of three properties in Auckland. The Commissioner also assessed Tower for an evasion shortfall penalty of $3,063,358.70.

A default assessment was also made in May 2017 in respect of GST for the period ended 31 July 2016, resulting in GST to pay of $273,913.04, relating to the sale of another Auckland property. An evasion shortfall penalty of $205,434.78 was assessed for failing to declare the sale for GST purposes.

The total amount of the assessments came to $7,627,184.74.

Tower issued NOPAs in respect of the assessments, and the Commissioner issued NORs. The dispute reached conference stage and then stalled during the process of organising a date for a facilitated conference.

In March 2019, Tower filed two income tax returns for the tax years ending 31 March 2017 and 31 March 2018. The 2017 return declared $46,331 to pay, which was due to be paid by 7 February 2018 but was not paid. Tower also filed GST returns in March 2019, covering five GST periods. One return, for the period ended 31 December 2017, assessed GST to pay of $286,885.27, which was due to be paid by 28 February 2019, but was not paid.

After the audit began, Tower transferred a number of properties out of its ownership, without applying any of the proceeds to its tax debts. The Commissioner was particularly concerned about the nature of some of the property transactions, which did not appear to be arms-length commercial transactions between bona fide third parties, and with the dissipation of the proceeds to Tower's director and to two other individuals involved with the management and control of the company (both had at times also been directors). For this reason, the Commissioner made the application for the appointment of interim liquidators as well as the liquidation application.

Liquidation application and the application for the appointment of interim liquidators

The Commissioner filed an application to place Tower into liquidation in July 2019. At the same time, she filed a without application for an order under s 246 of the CA 1993 appointing interim liquidators to Tower, which was granted. (*Commissioner of Inland Revenue v Tower City Holdings Ltd* [2019] NZHC1577)

In granting the application for the appointment of interim liquidators, Associate Judge Andrews concluded that the Commissioner's application would in all probability succeed. The Court agreed with the Commissioner's submission that the dispute raised by Tower was not genuine, but rather a delaying tactic. There was also a portion of the tax that was self-assessed and not subject to any dispute. Further, there was no prejudice to Tower's ability to pursue its dispute, as the Commissioner's application expressly sought to preserve Tower's dispute and/or challenge rights under Parts 4A and 8A of the Tax Administration Act 1994 ("**TAA**").

The grounds under s 241(4) of the CA 1993 upon which the Commissioner based her liquidation claim were:

> Tower was unable to pay its debts, not only because it was insolvent, but because the wilful actions and conduct of those with control and management of Tower were preventing it from paying its debts (s 241(4)(a)); *Commissioner of Inland Revenue v Tower City Holdings* Limited [2020] NZHC 2239.
>
> Tower had persistently or seriously failed to keep proper accounting records (s 241(4)(b));
>
> Tower's directors had in a serious or persistent way failed to comply with duties relating to Tower under the CA 1993, specifically their duties under s 131, 135 and 137 (s 241(4)(bb)); and
>
> It was just and equitable that Tower be placed into liquidation by the Court.

Issues

Preliminary question – Did the Commissioner have standing to claim as a "creditor" of Tower?

Was the liquidation proceeding vexatious, and/or an abuse of process?

Had the Commissioner shown that Tower had persistently or seriously failed to comply with s 194 of the CA 1993 ?

Had the Commissioner shown that Tower was unable to pay its debts?

Did Tower have a genuine and substantial argument that there were GST set-offs which did or may exceed any amount owing to the Commissioner?

Had the Commissioner shown that Tower's directors had, in a persistent and/or serious way, failed to comply with duties relating to Tower under ss 131, 135, and/or 137 of the CA 1993?

Had the Commissioner shown that it would be just and equitable to put Tower into liquidation?

Decision

Did the Commissioner have standing to claim as a "creditor" of Tower?

The Court held that the Commissioner was a creditor of Tower, based on Tower's two self-assessed returns showing an indebtedness of $333,216.27, and did not require leave (as a prospective or contingent creditor would have done) to bring the claim.

Was the liquidation proceeding vexatious, and/or an abuse of process?

This became an issue because counsel for Tower submitted that the claim had been brought for vexatious or ulterior motives, namely:

- so that the Commissioner could avoid determining Tower's GST returns and/or making refunds to Tower;
- to obtain information about third parties,
- to deny Tower its rights to dispute and/or challenge the Commissioner's application under the TAA.

The Court found that there was no basis for any of the allegations of abuse of process.

Had the Commissioner shown that Tower had persistently or seriously failed to comply with s 194 of the CA 1993?

The Court found that there was "no doubt" that the Commissioner had shown that Tower had seriously and persistently failed to comply with its obligations under s 194 of the CA 1993 (being the obligation to keep proper accounting records).

The Court concluded that satisfying this ground was sufficient for the Commissioner to be entitled to a liquidation order, and that there was no sound basis on which it should exercise its discretion against making an order. The liquidation order was therefore made on the basis of this ground having been established.

Had the Commissioner shown that Tower was unable to pay its debts?

Having determined that a liquidation order would be granted on the previous issue, the Court considered that there was strictly no need to address this issue, but recorded that, if necessary, it would have found for the Commissioner on this issue.

Did Tower have a genuine and substantial argument that there were GST set-offs which did or may exceed any amount owing to the Commissioner?

Again, an answer was not strictly required, but had an answer been necessary, the Court's answer would have been "no". It was not disputed that Tower owed the self-assessed amounts of tax, and r 5.61 of the High Court Rules 2016 precludes any set-off against that debt.

Had the Commissioner shown that Tower's directors had, in a persistent and/or serious way, failed to comply with duties relating to Tower under ss 131, 135, and/or 137 of the CA 1993?

Again, no answer was required, and with respect to this issue the Court considered it "neither necessary nor appropriate to embark on an analysis of the performance of the directors, in a number of complex transactions, in order to make findings on whether they discharged their respective duties under ss 131, 135, and 137 of the Act (and to the extent that they did not, whether their defaults can be characterised as "persistent" or "serious", so as to justify the making of a liquidation order)."

Had the Commissioner shown that it would be just and equitable to put Tower into liquidation?

Again, the Court considered there was no need to address this issue, as the need for a liquidation was clear on the issue of serious and persistent breach of s 194 of the Act, and "nothing useful would be added by making findings on the question of whether the circumstances are also caught by the broad "just and equitable" jurisdiction in s 241(4)(d) of the Act."

About this document

These are brief case summaries, prepared by Inland Revenue, of decisions made by the Taxation Review Authority, the District Court, the High Court, the Court of Appeal or the Supreme Court in matters involving the Revenue Acts. For Taxation Review Authority matters, names have been anonymized. The findings of the court described in a case summary will no longer represent current law where the matter has been successfully appealed or subsequent amended legislation has been enacted.

Court of Appeal finds tax avoidance, but no shortfall penalties for taking an unacceptable tax position

Case	Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited [2020] NZCA 383.
Decision date	3 September 2020 CSUM 20/11
Legislative References	Income Tax Act 2004, ss BG 1, DB 7, EH 48(3)(a), subpart EW, GB 1, OB 1, OB 6. Tax Administration Act 1994, ss 108, 141B, 141D, 141FB.
Legal terms	Tax avoidance, tax advantage, shortfall penalties, unacceptable tax position.

Summary

The Commissioner of Inland Revenue ("Commissioner") sought to disallow interest deductions claimed by Frucor Suntory New Zealand Limited ("Frucor") in respect of a tax-driven structured finance transaction it entered in to in March 2003 with the Deutsche Bank. The Commissioner contended that the funding arrangement was a tax avoidance arrangement in terms of s BG 1 of the (now repealed) Income Tax Act 2004 and denied a portion of Frucor's claims for deductions in the 2006 and 2007 income tax years. She also contended that Frucor took an unacceptable tax position and shortfall penalties should be imposed.

Frucor had been successful in the High Court, with that Court holding that the funding arrangement was not a tax avoidance arrangement; the Commissioner's assessments for 2006 and 2007 were incorrect and were thereby cancelled; and Frucor did not take an unacceptable tax position (and so the Court would have set aside the shortfall penalties imposed of $1,786,555 and $1,924,779 even if it had been wrong on its principal conclusion).

The Commissioner appealed and the Court of Appeal allowed the appeal, set aside the orders of the High Court, reinstated the Commissioner's assessments with regards to the disallowed deductions and held that shortfall penalties did not apply.

Impact

The decision confirmed that the prohibition on identification of an economically equivalent arrangement that would not have constituted tax avoidance does not preclude consideration of the economic and commercial effect of the transaction under scrutiny. Such consideration, focusing entirely on the funding arrangement in question, was central to the second stage of the *Ben Nevis* analysis. The artificial and contrived features of the funding arrangement revealed the purpose of the arrangement was to dress up a subscription for equity as an interest only loan to achieve a tax advantage.

The decision also confirmed that where an arrangement is deemed void in accordance with s BG1 of the Tax Administration Act 1994, the taxpayer's deductions and assessable income may be adjusted by the Commissioner by application of s GB 1, as she thinks appropriate to counteract any tax advantage obtained by the taxpayer from or under the arrangement. The tax advantage with which the section is concerned is the New Zealand tax advantage achieved by the New Zealand taxpayer and the Commissioner is not required to consider other arrangements the taxpayer might have entered into had it not chosen to proceed with the tax avoidance arrangement under review. Thus, the Commissioner may reconstruct by allowing a portion of a deduction and disallowing the balance.

The Court of Appeal accepted the High Court's expression of the test for whether a taxpayer takes "an unacceptable tax position" under s 141B, as "whether there is substantial merit in the taxpayer's arguments." Although it came to different conclusion on the core tax avoidance issue, it was not persuaded that Frucor's arguments could be dismissed as lacking substantial merit, and this was particularly so where a lower court Judge explained in a careful, closely reasoned and comprehensive judgment why he was persuaded those arguments were factually and legally correct.

Facts

Frucor entered into a funding arrangement, whereby Deutsche Bank advanced $204m to Frucor in exchange for a fee of $1.8 million and a convertible note redeemable at maturity in five years' time by the issue of 1,025 non-voting shares in Frucor ("the note"). The $204m advance by Deutsche Bank was funded by a contemporaneous payment of $149m from Frucor's parent Danone Asia Pty Ltd ("DAP") for the forward purchase of the shares from Deutsche Bank in five years' time at a pre-agreed price matching the face value of the note (the forward purchase agreement). The balance of $55m was contributed by Deutsche Bank.

Over the life of the note, Frucor paid $66m to Deutsche Bank and claimed the full $66m as interest payments on an interest only basis on $204m. The $66m coupon payments equated to the amount required to pay amortising principal and interest on the $55m introduced into the funding arrangement by Deutsche Bank.

Issues

The issues for consideration by the Court of Appeal were:

- Did the High Court err in finding the funding arrangement was not a tax avoidance arrangement under s BG 1 of the Income Tax Act 2004 ("the Act")?
- Did the Commissioner correctly counteract the tax advantage under s GB 1 of the Act? (Frucor argued there was no tax advantage even if this was a tax avoidance arrangement. Muir J in the High Court did not need to deal with this issue because of his principal finding. Frucor gave the Court of Appeal notice it supported the High Court judgment on this additional ground.)
- Did the High Court err in finding that shortfall penalties should not be imposed in any event?

Decision

Tax Avoidance

The Court of Appeal found that it was "reasonably plain" that the funding arrangement had New Zealand tax avoidance as one of its purposes or effects and this was not merely incidental to some other purpose. The primary purpose of the funding arrangement was to provide a tax advantage to Frucor through the interest deductions it claimed. The funding arrangement was in many respects artificial and clearly contrived. The Court of Appeal found that taking the parts of the arrangement together, the purpose of the arrangement was to "dress up a subscription for equity as an interest only loan to achieve a tax advantage."

Gilbert J concluded: "[i]t is hard to discern any rational commercial explanation for the artificial and contrived features of the arrangement, other than tax avoidance." *Commissioner of Inland Revenue v Frucor Suntory New Zealand Limited* [2020] NZCA 383.

As a matter of commercial and economic reality, the Court of Appeal found that the payment of $149m by DAP did not carry any interest liability for Frucor or Deutsche Bank. The only amount that did attract interest was the $55m advanced by Deutsche Bank under the note, for which Frucor paid $11m in deductible interest expenditure. Therefore, Frucor used the specific provisions to claim deductions for interest in an artificial and contrived manner that cannot have been within Parliament's contemplation.

The Court of Appeal held it was not relevant that Frucor could have borrowed the $204 million from another Danone entity at an arm's length rate of interest and be entitled to claim the same interest deductions. The focus must be on the arrangement that was entered into, not one that might have been entered in to but was not.

The Court of Appeal concluded that the prohibition on identification of an economically equivalent arrangement does not preclude consideration of the economic and commercial effect of the transaction under scrutiny. Such consideration, focusing entirely on the funding arrangement in question, is central to the second stage of the *Ben Nevis* analysis and it is by no means "almost meaningless" or a "mere checkpoint for the Commissioner to divert around" as the High Court Judge had suggested.

The Court of Appeal held:

> We consider that when the economic and commercial effect of the funding arrangement is examined in its context, it becomes clear that tax avoidance was its principal purpose or effect or, at least, tax avoidance was not merely an incidental purpose or effect of the arrangement. In summary, we accept the Commissioner's submission that by entering into the funding arrangement Frucor achieved a $66 million interest deduction without incurring a corresponding economic cost for which Parliament intended deductions would be available. As a matter of commercial and economic reality, $55 million of the claimed interest represented the repayment of principal borrowed from Deutsche Bank and was not an interest cost. We have therefore concluded that the Commissioner was entitled to invoke s BG 1.

Section GB 1

The Court of Appeal noted that the tax advantage with which s GB 1 is concerned is the New Zealand tax advantage achieved by the New Zealand taxpayer (here Frucor). The funding costs and tax position of other parties to the funding arrangement are irrelevant to the analysis under s GB 1.

The Court of Appeal held the tax advantage gained under the arrangement was not the entire interest deductions, but only those that were principal repayment of $55m. The Commissioner was therefore, entitled to reconstruct by allowing the permissible deductions totalling $11m but disallowing the balance. She was not required to consider other arrangements the taxpayer might have entered in to, had it not chosen this particular funding arrangement.

Shortfall Penalties

The Commissioner sought to impose shortfall penalties under s 141B of the Tax Administration Act for Frucor's taking of "an unacceptable tax position" that when viewed objectively, failed to meet the standard of being "about as likely as not to be correct". The Commissioner contended that Frucor had taken such a position because tax avoidance was the dominant purpose of the arrangement.

Frucor submitted that the question of whether a taxpayer's position was "about as likely as not to be correct" was correctly distilled by the High Court Judge to "whether there is substantial merit in [the taxpayer's] arguments". Expressed another way, Frucor submitted, the question is whether the taxpayer's argument would be seriously considered by a court.

Frucor submitted that the High Court judgment was a complete answer to any question of penalties.

Relying on the decision of Kós J in *Commissioner of Inland Revenue v John Curtis Developments Ltd*, *Commissioner of Inland Revenue v John Curtis Developments Ltd* [2014] NZHC 3034, (2014) 26 NZTC 21-113, Frucor submitted that its position must be regarded as one capable of being reasonably adopted and having substantial merit - given it was found to be correct by the High Court.

The Court of Appeal agreed with Frucor referencing the Supreme Court's stance in *Ben Nevis, Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 that the inclusion of the word "about" in the test shows that a 50 per cent prospect of success is not the standard; rather the question is whether the merits of the arguments supporting the taxpayer's interpretation are substantial.

The Court of Appeal held that although it came to a different conclusion from the High Court on the core tax avoidance issue, it was not persuaded that Frucor's arguments could be dismissed as lacking in substantial merit.

The Court of Appeal regarded the High Court judge, Muir J as an experienced commercial Judge who regarded Frucor's argument as deserving of serious consideration. The High Court judgment explained in a careful, closely reasoned and comprehensive way, the reasons why the Judge was persuaded Frucor's arguments were factually and legally correct.

The appeal was allowed, and the orders made in the High Court were set aside. The Court of Appeal ruled that the interest assessments were to be reinstated but the shortfall penalties the Commissioner had sought, do not apply.

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Legal Services

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