IN THE COURT OF APPEAL OF NEW ZEALAND

CA36/2013
[2013] NZCA 655

BETWEEN	VINELIGHT NOMINEES LIMITED First Appellant
	WEYAND INVESTMENTS LIMITED Second Appellant
AND	THE COMMISSIONER OF INLAND REVENUE Respondent

Hearing:	16 and 17 October 2013 (further submissions received 14 November 2013)
Court:	Randerson, French and Miller JJ
Counsel:	M T Lennard for Appellants J H Coleman and N S Delamore for Respondent
Judgment:	16 December 2013 at 2.00 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants must pay the Commissioner costs for a standard appeal on a band B basis with usual disbursements. We certify for two counsel.

REASONS OF THE COURT

(Given by Miller J)

Introduction

[1] The Chin family carried on business in New Zealand through Vinelight Investments Ltd (**VIL**), which through several subsidiaries invested in real property and shares, and engaged in various forms of moneylending. VIL and the family elders, Rodney and Sandra Chin, were at all material times New Zealand tax residents.

[2] The family also owned Weyand Investments Ltd (**Weyand**), an investment company which was the repository of much of their wealth. It financed VIL's business activities through interest-free loans which by 1996 amounted to more than $3m. Weyand was registered in Hong Kong, where the family has strong ties, and Ross, Paul and Joanna Chin, the three children of Rodney and Sandra, evidently resided there at relevant times. In Hong Kong Weyand was not required to pay income tax or was somehow able to escape liability for it.

[3] The family's affairs were reorganised in 1998, on the advice of the accounting firm Ernst & Young, for what the Taxation Review Authority has found was the dominant purpose of having Weyand realise VIL's profits in Hong Kong without paying, initially, income and resident withholding tax and, later, non-resident withholding tax. There is now very little dispute about the facts, and for our purposes a summary of what was done will suffice:[1]

(a) A trust, the Vinelight Trust, and its corporate trustee, Vinelight Nominees Ltd (**VNL**) were created. Weyand was a beneficiary of the trust.

(b) VIL assumed an obligation to pay management fees to VNL. These were set at $12,500 per month, a sum chosen on accounting advice to offset VIL's taxable income.

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[1] A fuller account, which the appellants accept, is found at [13]–[38] of the High Court judgment: *Vinelight Nominees Ltd v The Commissioner of Inland Revenue* [2012] NZHC 3306, (2012) 25 NZTC 20-155 [High Court judgment].

(c) VNL assumed by novation liability for the debt then owed by VIL to Weyand, and for the first time interest became payable. The rate was 16.5 per cent per annum, a level chosen not for commercial reasons but to ensure that the interest offset the taxable income, in the form of management fees, that VNL received from VIL.

(d) On 2 May 1997, Rodney and Sandra Chin transferred their shares in Weyand to the three children, who joined them as directors of that company.

(e) VNL secured registration on 5 March 1999 as an approved issuer for purposes of the approved issuer levy (**AIL**) regime under the Stamp and Cheque Duties Act 1971, and had its loan from Weyand registered as a security owed to a non-resident. The AIL regime facilitated offshore borrowing by allowing qualifying borrowers to deduct the levy, at 2 per cent on interest payments, in lieu of non-resident withholding tax (**NRWT**) which would otherwise be imposed at the rate of 15 per cent.

The object of this arrangement was, as Ernst & Young succinctly put it in an internal memorandum of 8 October 1998, "... to mitigate the NZ tax group's tax by shifting all profit up to the [Vinelight Trust] and paying it out by way of interest subject to AIL".

[4] Putting the issue of tax avoidance to one side for the moment, the arrangement's viability in tax law depended critically on Weyand being non-resident for New Zealand tax purposes. If it were resident, VNL must deduct resident withholding tax (**RWT**) at the rate of 30 per cent on the interest paid to Weyand, and Weyand must pay income tax in New Zealand. A foreign-registered corporate taxpayer is resident where its centre of management is in New Zealand or its directors, acting in that capacity, exercise control of the company here.[2] The Taxation Review Authority found, and the High Court agreed, that until 2003, when

2 Income Tax Act 1994, s OE 2 (s YD 2). For reference purposes, in this judgment the equivalent provision of the Income Tax Act 2007 follows, in parenthesis, the Income Tax Act 1994 provision.

there was a second restructuring, Weyand was New Zealand tax-resident because Rodney Chin managed Weyand (and VNL) and Sandra Chin attended to administration under his direction, almost all of this work being done from New Zealand.

[5] The structure's viability also depended, to a lesser extent, on VNL and Weyand not being associated persons for purposes of the New Zealand NRWT regime, which would require that VNL deduct NRWT if Weyand were non-resident but associated. The NRWT regime imposed but zero-rated the tax where non-resident withholding income consisted of interest paid by an approved issuer, in this case VNL, in respect of a registered security to a person, in this case Weyand, who was not an associated person of the issuer.[3] Non-association was achieved here by including a trust, the Vinelight Trust, in the structure.[4]

[6] During the 1998 to 2005 tax years returns were filed in accordance with this arrangement. In particular, VNL filed AIL returns in which it accurately disclosed the interest paid and accounted for the AIL at the rate of 2 per cent. The AIL returns were filed in the form, IR67A, that the Commissioner has prescribed for such returns.

[7] In 2002 the interest rate on the loan from Weyand was reduced to 10 per cent per annum, Rodney Chin explaining to the children that this was necessary to avoid scrutiny from Inland Revenue. It appears that Mr Chin had become concerned after advice that the Commissioner might deny a deduction for the interest to the extent that the rate exceeded market rates.

[8] The arrangement was altered in 2003 after it occurred to someone, possibly a new staff member at Ernst & Young, that Weyand might be New Zealand-resident. Rodney Chin also told the firm that some of the children might wish to return to New Zealand to live. Advice on residency was taken from Ernst & Young, for what the Authority has found was the first time. The firm explained the test for corporate residency, and in an opinion dated 25 June 2003 they opined that Weyand was not

3 Income Tax Act, s NG 2 (s RF 12).
4 Income Tax Act, s OD 7 (subpart YB).

resident, relying on the factual premise that "[n]one of the directors have, to date, performed any directorial or management function in relation to Weyand while physically present in New Zealand". But Ernst & Young also recommended changes to put the issue beyond doubt. The changes, which were adopted by March 2004, included the resignations of the two New Zealand-resident directors, Rodney and Sandra Chin, the resignations of the children as directors in anticipation of their return to New Zealand, and the holding of directors' meetings in Hong Kong. Ernst & Young also advised that the directors must make decisions at those meetings, and must not "rubber stamp" decisions made by anyone else.

[9] The significance of these developments is two-fold. First, the Commissioner says that they show no reasonable inquiries were made before 2003 into Weyand's residency, so that VNL cannot excuse its failure to deduct RWT before 2003 by invoking s NF 5 of the Income Tax Act 1994, which excused a taxpayer who, among other things, concluded on reasonable grounds after making reasonable inquiries that it was not obliged to deduct RWT; further, the failure to make reasonable inquiries is evidence, for purposes of penalty, that the taxpayer took an unacceptable tax position.

[10] Second, the Commissioner has given Weyand the benefit of the doubt by accepting that it ceased to be resident from 31 March 2004; that is, after the changes recommended by Ernst & Young were made. Thereafter VNL continued to account for interest and AIL on the interest. The Commissioner's stance is that it ought to have accounted for NRWT.

[11] In the result, the Commissioner has assessed:

(a) VNL:

(i) For RWT (at 30 per cent) for the periods ended 31 March 1999, 31 October 2000, 31 December 2001, 31 October 2002 and 31 December 2002.

(ii) for NRWT (at 15 per cent) for the periods ended 31 October 2003, 31 January 2005 and 28 February 2005.

(b) Weyand for income tax (at 30 per cent) for the years ended 31 March 1999 to 31 March 2003.

Each of these assessments is in dispute, for a variety of reasons.

The issues

[12] The parties contest five distinct issues, several of which present subsidiary issues.

[13] The first issue is Weyand's tax residency until 2004. As noted, if resident it was required to account for income tax and VNL was prima facie required to account for RWT.

[14] The second issue is whether, assuming Weyand's residency, VNL was required to account for RWT, or must do so after all this time. There are several sub-issues:

(a) Whether the statutory prohibition on raising new issues in challenge proceedings, s 138G of the Tax Administration Act 1994, precludes VNL from arguing that under s NF 2(4)(b)(ii) of the Income Tax Act it was not required to deduct RWT.

(b) If VNL can raise that argument, whether it need not deduct RWT because the interest payments were not made as part of its taxable activities for purposes of s NF 2(4)(b)(ii).

(c) Whether VNL can invoke s NF 5 of the Income Tax Act so as to excuse itself from liability to deduct RWT. As noted above, s NF 5(1)(a) excused a taxpayer who concluded on reasonable grounds after making reasonable inquiries that it need not deduct RWT. There is a minor subsidiary question in relation to the first payment of interest made under the AIL regime, on 1 March 1999, arising from the fact that the security was not registered under the AIL regime until 5 March 1999; the Commissioner says that under s NF 5(1)(b) VNL was not excused liability to pay RWT until this prerequisite had been met.

(d) Whether the Commissioner is time-barred from making RWT assessments for the 1999 to 2001 income years. The taxpayers say that the four-year time bar in s 108 of the Tax Administration Act applies; the Commissioner denies it on the ground that it applies only when RWT returns have been filed. As noted above, those filed by VNL were not RWT returns; rather, they were in the form prescribed for AIL returns.[5]

[15] The third issue is whether an arrangement to which the taxpayers were party amounted to a tax avoidance arrangement for purposes of s BG 1 of the Income Tax Act. The Commissioner says that the overall arrangement in [3] above had that character and retained it throughout notwithstanding the changes made in 2003. We observe that the Commissioner's case for the 2004 and 2005 tax years rests on tax avoidance, while her case for the earlier years rests initially on Weyand's residency and subsequently on tax avoidance. (This is so because, as noted above, s NG 2 zero-rated liability to deduct NRWT where the recipient was a non-associated overseas person, and the Commissioner accepts that such was Weyand's status after 2003.)

[16] The Income Tax Act provided in s GB 1 that the Commissioner might reconstruct a tax avoidance arrangement to counter the tax advantage that it conferred upon the taxpayers. The fourth issue is whether her power of reconstruction is available in law and was exercised in fact. There are two sub-issues:

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5 The argument before us proceeded on the basis that VNL filed no RWT returns after the structure was set up in 1999. That was VNL's position in its statement of position. The record indicates that it did file RWT-related documents, including reconciliation statements, after 1999, but we accept, following memoranda filed by the parties dated 19 November 2013, that they were either for unrelated payments or in respect of nil returns.

(a) Whether s 138G of the Tax Administration Act prevents the taxpayers from challenging her assessments as an impermissible reconstruction.

(b) If the argument is available to the taxpayers, whether reconstruction is possible in law. The taxpayers say that as a matter of strict construction of s GB 1, the Commissioner may reconstruct only by adjusting certain specified things, such as the taxpayers' income; she cannot reconstruct by altering the rate at which tax is payable. The Commissioner says that she can do whatever is necessary to eliminate an unlawful tax advantage, and did; alternatively she did not reconstruct anything, for an increased tax liability followed in law once she avoided the arrangement.

[17] The fifth and final issue concerns penalties. The Commissioner has imposed penalties under ss 141B and 141D of the Tax Administration Act, having decided that the taxpayers took an "unacceptable interpretation"[6] in a transaction having the dominant purpose of tax avoidance. The issue is whether these penalties should have been imposed.

Weyand's tax residency until 2004

[18] The test for residency has been summarised at [4] above. After thoroughly reviewing the evidence, the Authority concluded that Weyand was a New Zealand tax resident at all material times until October 2003:[7]

> [235] Having stood back and absorbed the detailed submissions for each side, I find that, at all material times, the disputants were managed by [Rodney Chin] from New Zealand. It is clear to me that the centre of management was in New Zealand. Also [Sandra Chin] attended to much routine administration under [Rodney Chin's] direction without needing to understand matters. It is arguable whether [Rodney Chin] also controlled the directorate of [Weyand] and its decisions. To a large degree, he was the controlling mind of the disputants. There was not a great deal needing to be done at material times and, apart from giving instructions to the accountants and heeding and implementing their rather aggressive tax advice, nothing

6 The legislation now uses the term "unacceptable tax position" but nothing turns on the difference.

7 *Case 11/2011* [2011] NZTRA 07, (2011) 25 NZTC 1-011 [Authority decision]. Nothing turns for present purposes on this date; for convenience we have proceeded, like counsel, on the basis that Weyand's tax residency changed at the end of the tax year, on 31 March 2004.

> controversial to the family was undertaken. The adult children were busy professionals who respected their parents and their acumen and so were content to implement [Rodney Chin's] suggestions. However, they are all intelligent and sensible and could not be regarded as controlled by [Rodney Chin] except, perhaps, to some degree by default. They left it to [Rodney Chin] to obtain and implement specialist tax advice.

[19] The evidence established that Weyand had formerly owned a building in Hong Kong, but the building was sold in 1989 and thereafter Weyand undertook what the Authority described as "minimal activity".[8] In this Court, as in the High Court, Mr Lennard argued that Weyand was essentially dormant and in such a case the centre of management test is not especially useful; further, when applying that test courts must discount mere "administrative" acts. He argued that the only true acts of central or superior management happened in Hong Kong; they comprised a resolution to pay a dividend, the reduction in interest rate, and a loan by Weyand to another entity.

[20] As Peters J observed,[9] these three things were not the only acts of management that the Authority relied upon. Mr Lennard contended that most such acts could not qualify as "centre of management" considerations, for they were routine administrative tasks of the sort often assigned to employees or accountants. Peters J disagreed. She observed that the question is one of fact, depending on the nature of the company's business and activities.[10] She reviewed the evidence, finding that Weyand had its centre of management in New Zealand even if the test focused on the acts of "superior management".[11] She emphasised,[12] as had the Authority, that Rodney Chin alone decided to consult Ernst & Young about the structure and its implementation, in which he was closely involved; he demanded interest on the debt from Weyand, addressing the demand to his own residential address in Auckland; he decided that the interest rate ought to be reduced; and he and Sandra Chin attended to the preparation of financial statements in New Zealand.

[21] These conclusions of fact were not disputed before us. We add that Weyand's New Zealand and Hong Kong bank accounts were managed from New Zealand by

8 At [149].
9 High Court judgment, above n 1, at [47].
10 At [55].
11 At [53].
12 At [56]–[69].

Mr and Mrs Chin, and Mr Chin managed its dealings with the Commissioner in New Zealand, and with revenue authorities in Hong Kong. The company may have been otherwise dormant, as counsel put it, but that merely confirms the absence of any activity that anyone might be said to manage elsewhere.

[22] Mr Lennard urged us to distinguish between acts of “superior” and “administrative” management, but we do not find these adjectives useful. On the contrary, counsel’s approach would have hearing authorities treat some dimensions of management as wholly irrelevant, while conflating the “centre of management” test in s OE 2(1)(c) of the Income Tax Act with the alternative “acts of directors” test in s OE 2(1)(d). For purposes of the former test, a company resides where the centre of management “actually abides” and that question is one of fact and substance.[13] We agree with Peters J and the Authority that at all material times until its affairs were restructured as noted at [8] above, Weyand’s centre of management lay with Rodney and Sandra Chin in New Zealand.

[23] It follows that until March 2003 Weyand was tax resident under s OE 2(1)(c) of the Income Tax Act. This ground of appeal fails. The Commissioner was right to assess Weyand for income tax as noted at [11](b) above.

[24] The next question is whether VNL must account for RWT while Weyand was resident.

Must VNL account for RWT?

[25] As noted at [14] above, this question raises several sub-issues. The first is whether VNL may argue that it did not make the interest payments as part of its taxable activities so as to attract liability to deduct RWT in the first place.

Does s 138G of the Tax Administration Act preclude VNL from claiming that the interest payments were not made as part of its taxable activities?

[26] The disputes regime in the Tax Administration Act adopts the philosophy that so far as possible tax disputes should be resolved in dialogue between taxpayer and

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13 *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455 (HL) at 458.

Commissioner, not in litigation. It establishes a formal process under which the parties must make full disclosure before challenge proceedings begin. This objective is ultimately achieved by insisting in s 138G(1) that the parties must make full disclosure in their respective statements of position, which are exchanged before challenge proceedings are filed, and prescribing that they may not raise new matters before the hearing authority. At the relevant time[14] the section provided specifically that in challenge proceedings the parties might raise only the "facts and evidence, and the issues arising from them", and the "propositions of law" that they had disclosed in their statements of position:

> (1) Unless subsection (2) applies, if the Commissioner issues a disclosure notice to a disputant, and the disputant challenges the disputable decision, the Commissioner and the disputant may raise in the challenge only–
>
> (a) The facts and evidence, and the issues arising from them; and
>
> (b) The propositions of law,–
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> that are disclosed in the Commissioner's statement of position and in the disputant's statement of position.

The Authority has a closely circumscribed power to admit new matters,[15] but it was not invoked here.

[27] Before the Authority, and in the High Court, VNL contended that it was never liable to deduct RWT, for the interest was not paid to Weyand "wholly or partly in the course of or furtherance of a taxable activity" as required by s NF 2(4)(b)(ii) of the Income Tax Act. The Authority and the High Court agreed that this claim was raised for the first time in the challenge proceeding; indeed, it was not pleaded even then. It first surfaced when counsel opened his case.[16] So s 138G stood squarely in VNL's way. The Authority nonetheless went on to deal with the argument on the merits;[17] the High Court Judge did not find it necessary to do so.[18]

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14 Section 138G of the Tax Administration Act 1994 was amended by the Taxation (Tax Administration and Remedial Matters) Act 2011. The disclosure notices in this case were issued on 22 February 2007 so the former section applies.

15 Tax Administration Act, s 138P.

16 Authority decision, above n 7, at [238].

17 At [303]–[305].

18 At [82].

[28] VNL's statement of position made no reference to the "taxable activity" issue. VNL relies rather on the Commissioner's statement of position, which included s NF 2 in a list of provisions relied upon. It follows, Mr Lennard contended, that the issue is not "entirely new",[19] so not proscribed under s 138G.[20]

[29] A hearing authority which confronts an objection under s 138G must make a decision about the scope of the challenge proceeding. It does so not to ensure the integrity of its own processes, but rather to enforce the parties' obligation to disclose relevant facts, issues and propositions of law during a closely structured pre-litigation dialogue.[21] Section 89M, which establishes the relevant disclosure obligation, required at the time that each party's statement of position outline the facts, evidence, issues and propositions of law on which it meant to rely, in sufficient detail to fairly inform the other party.

[30] The hearing authority may not find it easy to decide whether a new issue is being identified or a new proposition of law invoked. The difficulty may be encountered not when interpreting a party's pleading but, as this case illustrates, when deciding whether a pleaded issue was disclosed in the statements of position. The parties may have advanced their positions in deliberately broad terms to preserve freedom of movement in challenge proceedings,[22] without actually joining issue on some of the matters recited. Two features of the legislation may further complicate the authority's task. First, the pre-litigation process contemplates that the parties' positions may evolve after disclosure,[23] but it grants the taxpayer no right of reply to the Commissioner's statement of position.[24] Second, while s 89F requires that each party disclose during the pre-litigation phase those things upon which it

[19] In *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [155] [*Ben Nevis*] the Supreme Court refused the taxpayer leave to introduce an issue which was, on the facts, "wholly new".

[20] *Commissioner of Inland Revenue v V H Farnsworth Ltd* [1984] 1 NZLR 428 (CA) at 430 [*Farnsworth*].

[21] The processes were summarised in *Ben Nevis* at [153].

[22] *BASF New Zealand Ltd v Commissioner of Inland Revenue* (1997) 18 NZTC 13,322 (CA) at 13,327–13,328.

[23] *Commissioner of Inland Revenue v Delphi Fishing Co Ltd* (2004) 21 NZTC 18,525 (HC) at [52].

[24] Tax Administration Act, s 89M(8). Further material may be added by agreement or by the taxpayer in the Commissioner's discretion. Such material is deemed to be part of the provider's statement of position.

intends to rely, s 138G allows them to rely in the challenge proceeding on what was said in the other party's statement of position too.

[31] Whether a given point was sufficiently disclosed is a question of judgement, to be exercised against the objectives of the disclosure provisions.[25] Those provisions anticipate that before litigation begins the parties will identify, and so may discuss, all issues whose resolution might affect the positions that, absent agreement, they will bring to litigation. This objective requires that any given issue be identified in a statement of position with sufficient clarity to cause a reasonable party to recognise it as such.

[32] In this case neither party's statement of position identified the taxable activity issue at all. When dealing with the time bar, which VNL did raise, the Commissioner listed numerous provisions of the tax laws in support of an unrelated proposition that she[26] need not re-open the taxpayers' returns. She listed s NF 2 only because it is the charging provision for RWT. Nothing more was said about it. Mr Lennard argued that by invoking the section in this belt and braces fashion, the Commissioner put in issue all of its requirements, so allowing VNL to claim in later proceedings that any one of them had not been satisfied. We do not agree. A reasonable person would not think the Commissioner had made an issue of taxable activity merely by listing s NF 2 for what was plainly a different and wholly uncontroversial purpose. Further, VNL knew all along that the Commissioner relied upon s NF 2; she had issued RWT assessments. If it wished to deny liability for RWT on other distinct grounds, such as taxable activity, then it could have said so in its own statement of position.

[33] It follows that we agree with Peters J that s 138G precludes VNL from raising the taxable activity issue, and for essentially the same reasons. We too decline to address the merits. We do record, for the sake of completeness, that the Authority reached the apparently unremarkable conclusion that the interest was paid in the course of VNL's taxable activities, which we have summarised at [1] and [2] above.

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25 *Farnsworth* at 436; *Ben Nevis* at [152]–[153].

26 The Commissioner at the time was male but the present Commissioner is female, and we use the female personal pronoun throughout.

Did VNL make reasonable inquiries and have reasonable grounds for concluding that it need not deduct RWT?

[34] The Income Tax Act provided in s NF 5 that a person was not liable to deduct and pay any amount to the Commissioner under the RWT rules where, in relation to any given payment, "that person":

> (a) On reasonable grounds and having made all reasonable inquiries, concluded that that payment or receipt constituted non-resident withholding income as being an amount derived by a person not resident in New Zealand and was for that reason not resident withholding income; and
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> (b) Complied with all the obligations on the part of that person which would have been applicable under this Act or the Tax Administration Act 1994 had that payment or receipt constituted non-resident withholding income.

Where the taxpayer had complied with these obligations, the payment was deemed to be made to a non-resident, so the taxpayer could deduct NRWT at 15 per cent, rather than RWT at 30 per cent. It could go further and have NRWT zero-rated, as VNL did, by securing approved issuer status. It would then pay only the AIL. The objective of this regime, which remains in force, is that of encouraging investment in New Zealand by reducing the cost to taxpayers of borrowing offshore.[27] Consistent with that objective, AIL is available only where lender and borrower are not associated persons as defined.

[35] Several points may be made about s NF 5. First, it permits access to a preferential taxation regime for a taxpayer which pays interest to a third party lender that is resident offshore.[28] It contemplates that the taxpayer may not know much about the lender. For that reason, it permits the taxpayer to escape liability for RWT by showing that it was wrong on reasonable grounds about the lender's residency status.

[36] Second, a taxpayer may invoke s NF 5 only if it has concluded that the lender is not resident in New Zealand. So a taxpayer who wants access to the NRWT regime must consider and answer that question.

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27 Ruth Richardson and Wyatt Creech *Business Tax Policy 1991* (30 July 1991) at 20–21.
28 Section NF 5 also covers certain other payments, notably dividends.

[37] Third, the taxpayer must answer the question after making "all reasonable inquiries". Mr Lennard argued that this limb of the section is confined to inquiries into facts. Peters J appears to have accepted this argument.[29] The natural meaning of the language is not so restricted, and we see no reason to confine it in that way. In this setting, it may well be reasonable to expect some taxpayers to make inquiries of a relevantly qualified professional adviser, such as an accounting firm. We observe too that the reasonableness requirement extends to the content of the taxpayer's inquiries. The taxpayer may not know the residency criteria when it first approaches the adviser, but the initial inquiry should soon elicit that information, resulting in the taxpayer supplying the adviser with all relevant facts that it knows or can reasonably ascertain.

[38] Lastly, the taxpayer must also have reasonable grounds for concluding that the lender is non-resident. We accept that advice from a qualified adviser may supply reasonable grounds, provided the taxpayer has made reasonable inquiry of the adviser about its eligibility for NRWT and the taxpayer as taken reasonable steps to satisfy itself that, as a matter of fact, it meets all relevant eligibility requirements.

[39] The facts of this case are initially inauspicious for the taxpayer, VNL. It must demonstrate both that it made all reasonable inquiries about Weyand's residency, and that it then concluded on reasonable grounds that Weyand was non-resident. Although technically not an associate of Weyand, VNL could scarcely have been more closely related. Both were Chin family entities, and they shared the same management. VNL must be taken to know everything about Weyand's residency that Weyand itself knew.

[40] Mr Lennard accordingly sought to make a virtue of VNL's knowledge, contending that because of its relationship to Weyand it need not make inquiries of fact at all. He argued further that because the taxpayers collectively relied on Ernst & Young VNL had reasonable grounds for concluding that Weyand was non-resident. He dealt with the difficulty that not until 2003 did Ernst & Young give advice by arguing that the firm must be taken to have reassured them about Weyand's residency by advising them to use the AIL regime. In other words, advice

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29 At [96].

that Weyand was not resident was implicit in Ernst & Young's 1998 work on the structure set up to access the AIL regime.

[41] However, it does not appear that VNL actually concluded that Weyand was non-resident. We were not pointed to any evidence that, presumably through Mr Chin, the taxpayers ever turned their minds to the question, as VNL must have done to invoke s NF 5. Mr Chin did depose to being told that the company must be controlled from Hong Kong, but not that he was ever advised about Weyand's residency in fact. The Authority found on the facts that Weyand's residency was not raised until 2003. We note the Authority's finding that the structure was designed on the assumption that a British Virgin Islands company would be used and only at the last moment was Weyand substituted:

> [284] The documentary references set out for the disputants demonstrate by their silence that no advice was given by the accountants concerning the tax residency of [Weyand]. Further, they provide the likely explanation as to why this was the case – namely that right up to and past the point at which the accountants registered VT[30] for approved issuer status it was intended to liquidate [Weyand] and establish a [British Virgin Islands] company. There would be no logical reason to provide tax residency advice concerning [Weyand] when it was to be liquidated and not used in the scheme.

[42] As Peters J put it,[31] it seems VNL did no more than follow a course of action that Ernst & Young devised, assuming that it would work.

[43] Before us, Mr Lennard pointed to a letter in which Ernst & Young applied for approved issuer status and a fax to VNL's bookkeeper giving instructions about the payment of the AIL. These examples fall well short of showing that VNL thought about Weyand's status, and they cast no doubt on the Authority's thorough fact-finding.

[44] Nor can VNL show that because it took advice from Ernst & Young it made reasonable inquiries or, following favourable advice, had reasonable grounds to think Weyand was resident. The Authority found that Ernst & Young did not give advice on residency until 2003.[32] We are not prepared to accept that residency advice was

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30 VT is the Vinelight Trust.
31 At [97].
32 At [289].

necessarily implicit in Ernst & Young's work on the AIL structure. At best, the firm appears to have assumed that Weyand was non-resident, but that is not the same thing. As we have noted at [8], when the firm eventually did give advice it assumed, presumably having discussed the matter with Mr Chin, that Weyand was not managed from New Zealand. That assumption was wrong, for reasons already discussed. The point is that there is no reason to suppose that Ernst & Young knew any different in 1998.

[45] It follows that the statutory criteria were not satisfied: VNL did not make all reasonable inquiries, it did not reach a conclusion about Weyand's status, and it did not have reasonable grounds for concluding that Weyand was non-resident. For these reasons, which are consistent with those of the Authority[33] but somewhat different from those of Peters J, VNL's claim that because it relied on professional advice it had reasonable grounds cannot succeed.

[46] As noted at [14](c), there is a sub-issue about the first payment of interest, made on 1 March 1999. The Authority held that because the debt security had not been registered for AIL purposes when the payment was made, VNL could not satisfy the requirements of s NF 5(1)(b).[34] Peters J did not find it necessary to deal with the issue, since she had held that VNL could not obtain relief under s NF 5(1)(a).[35] We take the same approach.

Does a time bar preclude the Commissioner from assessing VNL for RWT for the 1999 to 2001 years?

[47] VNL has invoked the four-year time bar in s 108 of the Tax Administration Act, seeking to deny the Commissioner the right to issue RWT assessments for the years 1999 to 2001.[36]

[48] More than four years passed between VNL accounting to the Commissioner for the interest it paid Weyand in those years and being assessed for AIL, and the Commissioner re-assessing VNL for RWT. There is no dispute about that. But VNL

33 At [289].
34 At [281].
35 At [89].
36 The section was amended in 2001, but not materially so.

accounted for the interest in AIL returns, which it filed in the form, IR67A, prescribed for such returns.[37] The Commissioner says the time bar applies only when a return was filed in the form, IR15P, that she has prescribed for returns filed under the RWT rules.

[49] The legislature has established a time bar for income tax purposes in s 108, and extended it to RWT in s 99 of the same Act. At the material time s 108 provided:

> **108 Time bar for amendment of assessment of tax under Income Tax Act 1994**
>
> (1) Except as specified in this section or in section 108B, if–
>
> (a) A taxpayer provides a tax return and is assessed for the taxable income of the taxpayer and the income tax liability of the taxpayer and the tax payable by the taxpayer; and
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> (b) 4 years have passed from the end of the income year in which the taxpayer provides the tax return,–
>
> the Commissioner may not alter the assessment so as to increase the amount assessed.
>
> (1A) Unless subsection (2) or section 108B applies, the Commissioner must not issue an income statement under Part 3A if 4 years have passed since the end of the income year that follows the income year to which the income statement would apply.
>
> (1B) The Commissioner must not amend a non-filing taxpayer's assessment if 4 years have passed from the end of the income year in which the terminal tax date for the assessment falls.
>
> (2) If the Commissioner is of the opinion that a tax return provided by a taxpayer–
>
> (a) Is fraudulent or wilfully misleading; or
>
> (b) Does not mention gross income which is of a particular nature or was derived from a particular source, and in respect of which a tax return is required to be provided,–
>
> the Commissioner may alter the assessment at any time so as to increase its amount.
>
> (3) This section overrides every other provision of this Act, and any other rule or law, that limits the Commissioner's right to amend assessments.

[37] As noted at footnote 5, the argument before us on this issue proceeded on the basis that no relevant RWT returns were filed in any of the years in issue.

> (4) Subsection (1) applies to all returns filed on or after 1 April 1997.

[50] Section 99 begins by empowering the Commissioner to assess any person for any amount that, in the Commissioner's opinion, that person is liable to pay under the RWT rules. [38] It then imports "so far as may be" the time bar in s 108, along with certain other provisions:

> **99 Assessment of RWT**
>
> ...
>
> (2) Sections 108 to 111, 113, and 114 shall apply, so far as may be, with respect to every assessment made under subsection (1) of this section, as if—
>
> (a) the term income tax for any year in section 108(1) included an amount assessed under subsection (1) of this section and the term income in section 108(2) included an amount of resident passive income; and
>
> (b) the term taxpayer in sections 109, 111, and 113 included a person who is assessed or is liable to be assessed under subsection (1) of this section; and
>
> (c) the term tax already assessed in section 113 included an amount already assessed under subsection (1) of this section.

As Peters J observed, s 99(2) purports to alter the meaning of "income tax for any year" in s 108, but those words are no longer to be found there.[39] Fortunately nothing here turns on this evident drafting error.

[51] It will be seen that time runs from the end of a period in which the taxpayer furnishes a "tax return" upon which an assessment is made, and the bar falls four years from the end of that period. It works by prohibiting the Commissioner from amending an assessment to increase the amount payable. No bar applies if the Commissioner is "of the opinion" that the return is fraudulent or wilfully misleading, or omits gross income which is of a particular nature or derived from a particular source and which ought to have been returned. The authorities establish that the

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[38] Section OB 1 of the Income Tax Act reverts to s OZ 1, which defines "RWT Rules" as those sections of the Income Tax and Tax Administration Acts that concern RWT.

[39] At [100]. They were deleted from 1 October 1996, under the Tax Administration Amendment (No 2) Act 1996.

time bar "is not directed to a failure to characterise the advantage as income but the failure to mention it at all."[40]

[52] The Commissioner does not claim that VNL's AIL returns were dishonest, or that they failed to disclose gross withholding income; Mr Coleman conceded that in its AIL returns VNL disclosed all of the interest paid to Weyand. The Commissioner's position rather is that, as a matter of construction, a "tax return" is a return in the prescribed form; further, unless the prescribed return is filed she cannot be expected to know what sort of tax is to be assessed, since she acts on the limited information found in the return.[41] Counsel added that the authorities under s 108 did not address this problem; in all of them the relevant tax was income tax, and the relevant return an income tax return. For good measure, he submitted that an AIL return is not a return filed under the RWT rules; it is filed under the Stamp and Cheque Duties Act.

[53] For the appellants, Mr Lennard responded by arguing that an AIL return is a return as defined as it returns the interest paid. A return need not be filed in a prescribed form. He also argued that the Commissioner's approach would deny the time bar any application to RWT, by precluding a taxpayer who paid a person whom it wrongly believed to be non-resident from relying on the time bar. That approach, he submitted, would be contrary to the legislature's plain intention.

[54] We begin by examining what the legislation says about "tax returns". Section 3 of the Tax Administration Act defines a tax return as:

> ... a form or document that a taxpayer is required by a tax law –
>
> (a) to complete; and
>
> (b) to provide to the Commissioner, –
>
> whether in electronic or written form and whether provided in respect of a period or not; and also includes a tax form issued by another taxpayer that the taxpayer provides to the Commissioner.

40 *Cross v Commissioner of Inland Revenue* [1987] 1 NZLR 498 (CA) at 508 per Somers J; see also at 503 per Richardson J.

41 *Miller v Commissioner of Inland Revenue* [2001] 3 NZLR 316 (PC), also cited as *O'Neil v Commissioner of Inland Revenue*.

[55] A tax law, namely s NF 4 of the Income Tax Act, required that the taxpayer, in this case VNL, complete and file a RWT return. Section 50 of the Tax Administration Act (which is not itself a tax law as defined) further provides that every person required to pay RWT shall "deliver to the Commissioner a statement in a form authorised by the Commissioner showing such details in relation to the payment of RWT as the Commissioner may prescribe". The Commissioner has prescribed the form IR15P. In the exercise of a parallel power under s 86K of the Stamp and Cheque Duties Act, she has prescribed that the form IR67A must be used for AIL returns.

[56] We accept that s 99 does not insert the words "RWT return" in s 108, but it hardly seems necessary in the face of these perfectly specific provisions. In addition, as Peters J observed, the time bar in s 108 is not applied to every kind of tax, but only on a case by case basis.[42] Notably, s 100 of the Act, dealing with NRWT, does not incorporate the time bar at all.

[57] Mr Lennard argued that this analysis leaves little room for the time bar, effectively confining it to cases where all the interest was disclosed but an error was made when calculating the correct amount of tax. Implicit in that argument was the proposition that the Commissioner must escape the time bar in respect of any interest not disclosed. We are not sure that s 108(2)(b) would necessarily be interpreted in that way in every case. In any event, its meaning is clear. A taxpayer which invokes the time bar against the Commissioner's RWT assessment must point to a return filed in the form prescribed for RWT.

[58] We need not address Mr Lennard's argument that a second prerequisite under s 108, the making of an assessment, was met. He argued that the Commissioner's AIL assessments must be interpreted as a positive decision that no RWT was payable.

[59] We agree with Peters J and the Authority, whose reasons on this issue we have not found it necessary to discuss, that the time bar does not apply, for VNL never filed qualifying returns.

42 At [105].

Were the taxpayers party to a tax avoidance arrangement?

[60] A tax avoidance arrangement is an arrangement – a contract, agreement, plan or understanding – which directly or indirectly has tax avoidance as its more than merely incidental purpose or effect.[43] The legislation contemplates that taxpayers may take advantage of specific tax laws, but not so as to alter the incidence of tax in a manner that Parliament cannot have contemplated.[44] A court begins its analysis by establishing the existence and ambit of any arrangement. It then decides whether that arrangement has the offending purpose or effect.[45] If it does, the arrangement is void as against the Commissioner and susceptible to reconstruction.

[61] Mr Lennard emphasised that taxpayers may structure transactions to best tax advantage, and to that end may employ trusts and companies to take advantage of concessions available under specific provisions,[46] such as the RWT and AIL rules. In this case, he submitted, the taxpayers did just that when novating the VIL debt to Weyand: they employed a trust, as Parliament must have contemplated, to avoid association. Counsel argued that Parliament had available to it several established variants on "associated persons" provisions,[47] but in s OD 7 it chose the least restrictive, so must be taken to have contemplated arrangements such as this one. It follows, he submitted, that common control and ownership cannot be relied upon as evidence of avoidance.

[62] Mr Lennard further argued that a taxpayer does not engage in tax avoidance by assigning a debt for valuable consideration to an overseas entity in order to take advantage of the concessionary AIL regime. Counsel emphasised that the tax advantage here was legitimately available to the taxpayers, who might have employed a non-associated company in the British Virgin Islands. Indeed, he observed, that is precisely what had been proposed; the decision to use Weyand was taken for family reasons. It appears to have been accepted before the Authority that the family would have achieved their objective had they used a British Virgin Islands

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43 Income Tax Act, s BG 1 (s BG 1). "Tax avoidance arrangement" is defined in s OB 1 (s YA 1).
44 *Ben Nevis*, above n 19, at [106].
45 *Ben Nevis* at [161] and [182].
46 At [111] and [129].
47 Income Tax Act, ss OD 7, OD 8(1), OD 8(3) and OD 8(4) (subpt YB).

company. Finally, counsel argued that any purpose or effect of avoidance was merely incidental.

[63] It was more or less explicit in Mr Lennard's submissions that the arrangement here comprised the novation of the VIL debt to Weyand. The Authority found otherwise, for reasons we consider compelling. Ultimately counsel could not dispute that there existed a wider arrangement having the component parts summarised at [3] above. He submitted rather that the novation is the only part that matters.

[64] We do not see it in that way. The wider arrangement existed, and it is appropriately assessed as a whole.[48] Each component of it was necessary to achieve the motivating purpose of transferring taxable income from VIL to Weyand in a manner which avoided income tax and subsequently NRWT. We emphasise that the court inquires into the purpose of the arrangement, not the subjective purpose of any individual. As Mr Coleman submitted, the arrangement's purpose was unambiguously set out in the contemporaneous documents. We have mentioned the Ernst & Young memorandum of 8 October 1998. The firm had earlier, on 9 July 1997, summarised the benefits of the arrangement as follows:

> The advance of funds from your children to the Vinelight Trust should result in tax deductions of approximately $300,000 per year. This represents potential annual tax saving of between $50-90,000.
>
> The structure will enable Chin family wealth to be accumulated in the Vinelight Trust and offshore in Weyand BVL.

[65] And in a fax of 5 October 1998 the firm advised that:

> As you can see, after management fees and interest costs VIL is in a tax refund position and KPL[49] in a tax loss position. The majority of the Vinelight Trust's income remaining after distributions to the beneficiaries will be paid to Weyand Investments Ltd ("Weyand") by way of interest subject to approved issuer levy at the rate of 2 [per cent]. Given the interest income is not taxed in Hong Kong this provides tax savings exceeding $NZ40,000 in the current year. This directly benefits your children as shareholders in Weyand.
>
> …

[48] *Ben Nevis* at [105].
[49] KPL is one of the subsidiaries of VIL mentioned at [1] above.

> To achieve our tax planning objectives we recommend VT charge KPL management fees in respect of the management services provided by Rodney. We recommend the management fees be initially set at $NZ12,500 per month for the [period] ended 31 March 1998.

[66] As Mr Coleman submitted, the arrangement was contrived to ensure that all the profits from the New Zealand businesses were transferred to VNL as management fees then accumulated in Weyand, with the only tax collected being the AIL at a rate of 2 per cent. Notably, there was no change of control, yet interest was charged on existing borrowings for the first time, at a non-commercial rate, and management fees were charged for the first time, at a rate fixed to offset VIL's taxable income. We note the Authority's finding that:

> [319] The interest in issue was a device to transfer to [Weyand] profit obtained by VT from VIL and KPL. Accordingly, interest was not to be charged until VIL was owned by VT. Interest was charged as an accrual to provide a deduction to VT in the year to 31 March 1998 even though it was not paid or credited to [Weyand] in that year. No written demand was in fact made to VT for interest by [Weyand] before 18 December 1998.

We observe too that the management services were provided by Mr Chin, yet VNL, which invoiced the fees, paid him nothing for his services.

[67] The Authority characterised the arrangement as tax avoidance in forthright terms; it was a case of the disputants "colluding to siphon profits from New Zealand investment companies into [VT] and remitting those profits to [Weyand] in Hong Kong at a 2 [per cent] tax rate instead of a 30 [per cent] tax rate".[50] Although pejorative, this characterisation was not inaccurate. As we have noted above, Parliament enacted the NRWT and AIL rules to encourage investment in New Zealand. That was not the objective of the arrangement in this case.[51] It is no sufficient answer to say that the arrangement otherwise complied with the letter of the tax laws.[52]

[68] Further, we agree with the Authority and the High Court that tax avoidance was a more than merely incidental purpose of the arrangement. Indeed, it was the

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[50] Authority decision, above n 7, at [342].

[51] *Ben Nevis* at [114].

[52] *Ben Nevis* at [106]; *Penny v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] 1 NZLR 433 at [45]–[46].

dominant purpose. Mr Lennard pointed to the decision to use Weyand instead of a British Virgin Islands company and the decision that the children would return to live in New Zealand, and he argued that the core tax avoided, $417,717.60, was modest relative to the family assets.[53] It remains the case, however, that the objective of the arrangement with which we are concerned, the arrangement summarised at [3] above, was quite plainly that of avoiding tax on the profits of the New Zealand investment companies controlled by VIL. Family objectives did not require that the arrangement take that form.

Can the Commissioner reconstruct, and did she do so by adjusting the tax payable?

[69] The question of reconstruction arises because the Commissioner laid claim to the unpaid tax in a straightforward manner, by assessing VNL for NRWT and applying the AIL in part payment of the resulting debt, but justified herself by asserting that she was exercising her statutory power of reconstruction.

[70] As noted at [16] above, this question raises two sub-issues. The first is whether the taxpayers may argue that by adjusting the rate of tax payable the Commissioner exercised a power of reconstruction that the statute did not confer upon her.

Does s 138G of the Tax Administration Act preclude the taxpayers from challenging the Commissioner's "reconstruction"?

[71] We have already discussed s 138G at [26]–[32] above.

[72] Under the heading "Commissioner's power to counteract tax advantage", the Commissioner asserted in her statement of position that she had a wide discretion under s GB 1 to reconstruct the arrangement to impose tax on the taxpayer or any other person who benefitted from or was affected by the arrangement. Specifically, she might reassess both Weyand and VNL. As that assertion suggests, the Commissioner evidently took this point because the taxpayers, specifically VNL as the trustee for the Vinelight Trust, had asserted that any reconstruction must be

53 This appears to be the core tax for VNL only for the years 1999–2003.

confined to depriving a given taxpayer of the benefit that it had gained. In its statement of position VNL had accepted that the reconstruction power was available, to that limited extent. VNL did not dispute the Commissioner's power to reconstruct by adjusting the rate of tax.

[73] Was the issue sufficiently disclosed in the statements of position? The Authority and the High Court Judge thought not. We agree. The Commissioner undoubtedly took the stance that by issuing assessments for NRWT (and giving credit in those assessments for AIL paid) on the disclosed interest she was exercising her power of reconstruction. She discussed the power in some detail, citing authorities which indicated that the power of reconstruction has "a wide generality". But that discussion was directed to a different issue – who might suffer the consequences of reconstruction. The Commissioner could not reasonably have been expected to appreciate that an issue arose about her capacity to reconstruct by issuing assessments which simply applied a different tax rate to income disclosed.

Did the Commissioner reconstruct, and if so, has she the power to do it?

[74] A tax avoidance arrangement is void as against the Commissioner for income tax purposes.[54] The Commissioner is empowered, in accordance with pt G of the Income Tax Act, to counteract a tax advantage obtained by a person from such arrangement.[55] Section GB 1(1) establishes how she may go about it:

> … the amounts of gross income, allowable deductions and available net losses included in calculating the taxable income of any person affected by that arrangement may be adjusted by the Commissioner in the manner the Commissioner thinks appropriate, so as to counteract any tax advantage obtained by that person from or under the arrangement...

The subsection goes on to provide inter alia that, without limiting its generality, the Commissioner may have regard to such amounts of gross income, allowable deductions and available net losses as, in the Commissioner's opinion, that person might be expected to have, had the arrangement not been made. The Commissioner may also, again without limiting the generality of s GB 1, disallow any tax credit that a person has claimed under a tax avoidance arrangement that had relieved the person

54 Income Tax Act, s BG 1.
55 Section BG 1(2).

of a liability to pay income tax.

[75] These provisions obviously deal with income tax, but s NG 17 applies them to NRWT so far as applicable and with any necessary modifications, as if NRWT were income tax.

[76] The Commissioner did not adjust VNL's gross income, allowable deductions or available net losses; she accepts the amounts that VNL disclosed. As noted, she simply assessed VNL for NRWT.

[77] Mr Lennard submitted that the reconstruction power does not extend to adjusting tax rates. He drew on the history of the reconstruction power to emphasise that an express statutory power is required,[56] and argued that the power now conferred by the statute is carefully circumscribed.

[78] Mr Coleman began with the proposition that the Commissioner's reconstruction power extends to doing whatever she thinks necessary to counteract a tax advantage gained under a tax avoidance arrangement, and that power extends to changing the rate of taxation. Alternatively, counsel submitted, the Commissioner did adjust the taxpayer's income, by adjusting "NRWT income" from zero to the full amount of interest paid. In oral argument, Mr Coleman further argued that no reconstruction was necessary; by avoiding the arrangement the Commissioner exposed VNL to a liability to pay NRWT that is imposed by law.

[79] The Commissioner enjoys no power to reconstruct except by statute.[57] Section BG 1(2) creates the power and requires that it be exercised in accordance with pt G, the relevant provision of which is s GB 1. That section specifies that the Commissioner may adjust the amounts of gross income, allowable deductions and available net losses in the manner she thinks appropriate to eliminate an unlawful tax advantage. So she is endowed with flexibility to decide what adjustments are necessary, but she can do it only by adjusting in some manner the amounts of one or more of these three items. The subsection goes on to provide that without limiting

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56 *Commissioner of Inland Revenue v Gerard* [1974] 2 NZLR 279 (CA) and *Wisheart, McNab and Kidd v Commissioner of Inland Revenue* [1972] NZLR 319 (CA).

57 *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591 (PC).

its generality the Commissioner may exercise the power to eliminate a tax advantage that the person "might" have enjoyed, but in doing so it merely confirms that the mechanism necessarily involves adjusting one or more of the three items.

[80] Section NG 17 applies s GB 1 to NRWT, but without enlarging the Commissioner's powers of adjustment, which remain limited to income (in this case, resident withholding income), allowable deductions and available net losses.

[81] As noted, the Commissioner did not in this case adjust the gross resident withholding income, any deductions or available losses, but she had no need of adjustments. NRWT is payable, generally speaking, whenever the taxpayer pays non-resident withholding income to another person, and where the tax is not paid, the sum in default becomes a statutory debt payable to the Commissioner.[58] In circumstances where there was no need to adjust the amount of non-resident withholding income, a straightforward application of the statute fixed the correct amount of tax payable. The Commissioner need only assess VNL for NRWT on its reported non-resident withholding income, and that is what she did.

[82] We conclude that the Commissioner did not exercise her power of reconstruction by issuing new assessments in the circumstances.

Penalties

[83] Shortfall penalties were imposed under ss 141B and 141D of the Tax Administration Act, on the footing that the taxpayers' position was abusive when taken.[59] In such a case shortfall penalties of 100 per cent of the core tax avoided are available to the Commissioner.[60]

[84] Liability under s 141D arises when a taxpayer has taken an "abusive tax position", meaning a tax position that was unacceptable when taken and which,

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58 Section NG 13 (ss RA 10 and RF 6).

59 We note that the litigation spans a period over which the legislation changed, but it did not change in any material way and for convenience we will use s 141D as it now stands.

60 Counsel did not quantify the penalties in argument, but it appears from the record that penalties of $248,453.37 were imposed on VNL and $270,045.94 on Weyand, amounting in each case to 100 per cent of the core tax avoided less 50 per cent deducted under Tax Administration Act, s 141 FB, on the ground that both entities previously had a clean slate.

viewed objectively, was taken regarding an arrangement having a dominant purpose of avoiding tax:

> **141D Abusive tax position**
>
> ...
>
> (7) For the purposes of this Part and section 177C, an abusive tax position means a tax position that,—
>
> (a) is an unacceptable tax position at the time at which the tax position is taken; and
>
> (b) viewed objectively, the taxpayer takes—
>
> (i) in respect, or as a consequence, of an arrangement that is entered into with a dominant purpose of avoiding tax, whether directly or indirectly; or
>
> (ii) where the tax position does not relate to an arrangement described in subparagraph (i), with a dominant purpose of avoiding tax, whether directly or indirectly.

[85] A "tax position" means, broadly, a position or approach regarding a tax law,[61] and it is deemed "unacceptable":[62]

> [i]f, viewed objectively, the tax position fails to meet the standard of being about as likely or not to be correct.

The merits of the arguments for the taxpayer must be substantial, viewed objectively, if this test is to be met.[63]

[86] The first question is whether the position taken was "unacceptable". As to that, Mr Lennard submitted that the taxpayers' various positions were not clearly wrong according to the law as it stood at the time. He emphasised that anti-avoidance law has developed considerably over the past 15 years and submitted that:

> Against the standpoint of tax avoidance law as it stood pre-2003, the Commissioner had never succeeded in a case which involved linear, non-circular, transactions, nor any which involved real, non-temporary transfers of assets and liabilities.

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61 Tax Administration Act, s 4, contains an extended definition.
62 Section 141B.
63 *Ben Nevis*, above n 19, at [184].

Counsel emphasised that in order to succeed the Commissioner had to establish that Weyand was resident, and that both ss NF 5(1) and NF 2 did not apply, and that this was a tax avoidance arrangement: put another way, the taxpayers had to be wrong on every point they had taken. At lowest, he submitted, each of the taxpayers' arguments had some merit.

[87] We accept that anti-avoidance law has evolved, but we are left in no doubt that this arrangement could not have survived full disclosure to the Commissioner when it was established.[64] We have dismissed each of the grounds of appeal. None of them was about as likely as not to be correct when taken.

[88] Further, it is not correct that only by showing that each dimension of the taxpayers' position was wrong can the Commissioner justify the penalty. An arrangement that strictly complies with specific tax laws in some respects can nonetheless involve tax avoidance, as we have noted earlier. The arrangement must be viewed as a whole, as must the tax position that the taxpayers took regarding it. The taxpayers' position here was that Weyand was non-resident and so not liable for income tax; that for the same reason VNL need not account for RWT; that the arrangement was not a tax avoidance arrangement; and that VNL need not deduct NRWT after Weyand ceased to be New Zealand-resident in 2003.[65] On the facts summarised above, notably at [20]–[21] and [38]–[43] and [63]–[67], the first three of these positions were plainly wrong when first taken, in 1998, and the tax avoidance arrangement did not lose its character when Weyand later ceased to be resident.

[89] These conclusions dispose of the remaining requirement of s 141D, namely that the arrangement was entered into for the dominant purpose of avoiding tax.

[90] This ground of appeal fails.

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64 For the test applicable at the time, see *Commissioner of Inland Revenue v Challenge Corp Ltd* [1986] 2 NZLR 513 (PC) at 559–560 per Lord Templeman.

65 *Ben Nevis* at [185]. Mr Lennard accepted that the taxpayers' position must be taken to include the proposition that the arrangement was not a tax avoidance arrangement.

Decision

[91] The appeal is dismissed. The appellants must pay the Commissioner costs for a standard appeal on a band B basis with usual disbursements. We certify for two counsel.

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