Editorial

ADRIAN SAWYER AND LIN MEI TAN

Editors

1.0 ARTICLES IN THE CURRENT ISSUE

In this fourth and final issue of the *New Zealand Journal of Taxation Law and Policy* (the *Journal*) for 2022 we feature a comment and four articles. The comment and four articles encompass a diverse array of subjects, namely: an analysis of the various *Parore* decisions; cross border taxation of business profits; determination of corporate residence; taxation and cultural matters concerning Polynesian peoples; and an historical analysis of tariff and customs houses in New Zealand.

In the case comment, Alistair Hodson observes that aspects of tax administration are intensely procedural. The tax disputes process is no exception, and in particular, focuses on the importance of timeliness by both parties to a formal tax dispute. Hodson's case comment considers the litigation journey of the *Commissioner of Inland Revenue v Parore*,[1] a series of cases where the ultimate result was a stay of proceedings and a breach of fair trial rights. The then Commissioner of Inland Revenue (Commissioner) had used her statutory powers under the Tax Administration Act 1994 (TAA) to require Mr Parore to disclose his prospective defence. Mr Parore had effectively lost his right to silence and right to a fair trial. Hodson notes that there are several aspects to the *Parore* litigation that serve as a timely reminder to Inland Revenue that an unwarranted delay to action on their behalf can lead to an unfavourable outcome to the Department.

In the first of the four articles, Christina Allen observes that the international effort to co-ordinate tax rules across nations began nearly a century ago, originally aimed at eliminating double taxation. The effort was expanded so that business profits could be properly taxed worldwide. The Organisation for Economic Co-operation and Development (OECD) has a large-scale initiative underway to reset international tax norms to prevent base erosion and profit shifting; however, this is unlikely to settle the tax challenges of the 21st century since it will create additional complexity and lead to further conceptual distortions. Allen tracks the historical development and evolution of international tax rules related to business profits, as set out by the League of Nations, the Organisation for European Economic Co-operation (OEEC), the United Nations (UN) and the OECD. The author observes that these rules have changed over time without a foundation of clear and coherent principles, causing schisms in dealing with multiple taxpaying entities and intragroup transactions. The fragmented approach to a narrow set of problems demonstrates that international tax settlement is far from over. A better alternative for taxing businesses, Allen argues, would be to remove the concept of corporate residence and subsequently reconceptualise base allocation rules to determine the jurisdictions to tax.

Dale Pinto, Christina Allen and Nicole Wilson-Rogers, in the second article, observe that articulating an optimal global standard for determining corporate residency for tax purposes is notoriously difficult, especially given the competing theories underpinning corporate taxation. However, exploring this topic is key when considered against the backdrop of an unprecedented and intensifying examination of the taxing rights of corporations by the global community. Since 2013, the OECD has endeavoured to codify international tax rules governing cross-border transactions under the Base Erosion and Profit Shifting (BEPS) project and, as part of these efforts, removed the corporate residence tiebreaker rule that hinged on the place of effective management in its model tax convention, with the UN following suit. Pinto et al consider an optimal basis for attributing residency to corporations. In particular, they examine the background and competing theories in relation to corporate residency in both domestic and international tax contexts. The authors argue that the place of effective management remains fit for purpose on a view that strategic and high-level managerial activities provide a requisite economic nexus to establish taxing rights. Pinto and ors also argue that the lack of a standard tiebreaker rule for corporate residence is expected to exacerbate international tax conflicts at a conceptual level and thus advocates reviving place of effective management as a tiebreaker rule for corporate residence. The authors note the inefficiencies in the mutual agreement procedure as a mechanism for resolving dual-residency disputes. Alternatively, when dual residency arises, Pinto and ors suggest that a legislative model based on the place of effective management should be restored

[1] *Commissioner of Inland Revenue v Parore* [2021] NZDC 17946; *Commissioner of Inland Revenue v Parore* (2021) 30 NZTC 25,013; *Commissioner of Inland Revenue v Richard Allen Parore* [2022] NZHC 488.

and supplemented by a second-order hierarchical order of residency tests to address the totality of the circumstances.

In the third article, Sue Yong observes that non-communicable diseases (NCDs), such as cardiovascular diseases, diabetes, cancer, and chronic respiratory diseases, are prevalent and increasing in developed and developing countries. In 2020, Australia, New Zealand, Samoa, and Tonga had one of the highest numbers of deaths from NCDs in the world, ranging from 81 to 89 per cent of all deaths. The situation is so dire that the Pacific Island ministers declared an NCD crisis in their Leaders Forum in 2011. The costs of treating NCDs are rising, and the World Health Organization (WHO) recommends fiscal measures, including taxation and subsidies, to combat NCDs. With that, Yong comments that the WHO's recommendations were adopted by nearly 75 per cent of the Pacific Island nations to combat the NCD crisis. Despite that, NCDs continue to increase, which suggests that some contextual factors may have undermined the effectiveness of fiscal tools adopted by the Pacific Island nations. Hence, Yong aims to evaluate the impact of contextual and cultural factors on the effectiveness of the fiscal measures undertaken in Samoa and Tonga in addressing the NCD crisis. This is pertinent for the Pacific Island nations as they are steeped in culture and traditions in which the sociocultural environment and food perception differ from western developed nations. The social and cultural factors and the role of chiefs, nobles and church leaders must be accounted for when recommending measures to address the Pacific region's deadly and costly NCD crisis. Yong concludes that lessons can be learnt for other Pacific Island nations, and Australia and New Zealand due to their high Polynesian population, experiencing high levels of NCDs.

Jonathan Barrett, in the final article, notes that beyond the design of structures, architecture can be conceived as a means of communicating signs. Whare nui on marae (meeting houses), and places of worship are laden with symbols and messages. The buildings in which taxes are administered may also communicate concepts, such as the dignified authority of the state. Barrett's research considers the signs communicated by the customs houses constructed in New Zealand between 1841, the year a tariff first applied in the country, and 1914. The start of WWI marked the inexorable decline in the importance of customs duties as a source of government revenue, and the ascendency of income tax. With the decline in customs revenue, came the diminishment of customs houses as prominent public buildings. The Dunedin customs house (1938) was the only architecturally significant customs house built in New Zealand after 1914.

As New Zealand developed from a fiscally precarious colony towards an economically confident dominion, albeit through booms and busts, Barrett observes that customs houses evolved from simple buildings projecting solidity and plainness to confections of civic ostentation. The path of development was not, however, straightforward. As gold rushes came and went, ports of entry were declared and decommissioned in some settlements that are barely discernible today. Nevertheless, from a Carpenter Gothic construction in Russell, the compact Neo-classical buildings in Oamaru and Timaru, to Auckland's example of Francophile Second Empire design – none of which remain as customs houses – we have been endowed with buildings that continue to communicate ideas about taxation and national development in New Zealand. Barrett's review considers the signs these buildings convey.

2.0 POLICY, LEGISLATIVE AND CASE LAW DEVELOPMENTS

2.1 Legislative and policy developments

Since our last *Editorial* in the September 2022 issue of the *Journal*, legislative and policy developments have been minimal, although the rate of technical information released by Inland Revenue continues to gather momentum, with regular releases of items for consultation or publication in various for a including the Tax Information Bulletin. In this issue of the *Journal,* we comment briefly on the current omnibus taxation bill, provide an update to "the fall out" over the Cost of Living Payments Act 2022, and reflect upon the Supreme Court's decision in *Frucor*.

2.2 Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) 2022

On 8 September 2022, the Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2) 2022 (the Bill) was introduced to Parliament.[2] This is the second version of the Bill as the original was tabled on 30 August 2022. The original Bill, in addition to containing the provisions set out in the second version, also sought to subject services supplied by managers and investment managers of managed funds and retirement schemes to 15 per cent GST on a "consistent basis". As a result of considerable outcry from variously affected parties and a realisation that the Government did not have the support for the proposals that it had thought it had, the earlier Bill was withdrawn, and the second version issued around ten days later. The Bill is currently before the Finance and Expenditure Committee (FEC).

[2] See further <https://taxpolicy.ird.govt.nz/news/2022/2022-09-08-tax-bill-introduced>.

The current version of the Bill contains a range of proposed improvements and maintenance measures to ensure the smooth functioning of the tax system, including proposals to:

- set the annual income tax rates for the 2022–23 tax year;
- implement the OECD's information reporting and exchange framework for activities being facilitated by digital platforms in the sharing and gig economy;
- collect GST on accommodation and transportation services provided through electronic marketplaces;
- reform the GST apportionment and adjustment rules;
- clarify the GST treatment of legislative charges;
- modernise and clarify the rules for employers and payers in relation to cross-border workers;
- ensure New Zealand companies affected by recent changes to Australia's corporate residency tax rules have uninterrupted access to New Zealand's loss grouping, consolidation and imputation credit regimes;
- address integrity issues with the application of the domestic dividend exemption and corporate migration rules to dual resident companies;
- introduce a fringe benefit tax exemption for public transport; and
- introduce an exemption from the interest limitation rules for build-to-rent assets.

The FEC is expected to report back on the Bill early in the new year.

2.3 Cost of Living Payments legislation – an update

Unsurprisingly in our view, the Cost of Living Payments legislation is the "gift that keep on giving" (or does it?). In our September *Editorial* we observed:[3]

> Furthermore, the *Minister of Revenue stated that Inland Revenue will not be requested to chase up ineligible people to get the money back that had been paid to the*m (unless the money was obtained by fraud or similar means). Any repayments would be up to the voluntary actions of (ineligible) recipients.
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> The approach has been criticised on many fronts, including that many people suffering from the current fiscal crisis are ineligible, that many receiving it do not need it (for example where their partner has a high income and they earn less than $70,000), and that many receiving it are ineligible. Furthermore, it fails to recognise the importance or prior public consultation that would have been possible had the GTPP been followed. …
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> *We anticipate that this will continue to be an evolving story* which underlines the risks inherent in a government setting aside the GTPP in the interests of expediency.[4]

On their website, Inland Revenue states that if a person received the payment and they are not eligible, they must repay it.[5] However, as noted above, this differs to the statement of the Minister of Revenue. Then, on 16 November 2022, it was reported that the new Commissioner, Peter Mersi, advised the FEC that Inland Revenue will soon write to people (70-80,000 in total) who it thinks were wrongly paid some or all of the $350 cost of living payment earlier this year.[6] Apparently, the letters would set out the process people should go through if they thought they were entitled to the payments and would provide information on how to return the payments if they were not entitled to them. Inland Revenue has gained more information during the intervening period such that it believes it can more accurately determine who should be eligible for the payments. We await further developments with interest, including the (financial) outcome of the targeted correspondence.

2.4 The Supreme Court decision in *Frucor*

The long-awaited decision of the Supreme Court in *Frucor* was released on 30 September 2022.[7] There has been much speculation about the reasons for the delay, and when one reads the two judgments (majority and minority), it becomes a little clearer, as each judgment makes comment on the arguments and findings of the other. Also of

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[3] Adrian Sawyer and Lin Mei Tran, "Editorial" (2022) 25(3) NZJTLP 227 at 229-30 (emphasis added).

[4] *Frucor Suntory New Zealand Ltd v Commissioner of Inland Revenue* [2022] NZSC 113 per Winkelmann CJ, William Young, Glazebrook, O'Regan and Ellen France JJ (30/9/2022).

[5] See <www.ird.govt.nz/>.

[6] Tom Pullar-Strecker "Inland Revenue to write to about 70,000 people who wrongly received 'cost of living' payment" (2022) *Stuff* (16 November) at <www.stuff.co.nz/>.

[7] *Frucor*, above n 4.

interest is that two well-respected judges with specialist tax expertise took differing views (William Young J as part of the majority and Glazebrook J as the minority).

In essence three key issues were considered in the case, namely whether the arrangement at issue constituted a tax avoidance arrangement under s BG 1 of the Income Tax Act (ITA), whether the Commissioner's reconstruction under ITA, s GB 1(1) was correct, and, depending upon the response to the first two issues, what (if any) shortfall penalties ought to be imposed.

The majority (Winkelmann CJ, William Young, O'Regan and Ellen France JJ) dismissed Frucor's appeal on the tax avoidance and reconstruction issues. They found that the taxpayer's use of the relevant provisions lay outside of the parliamentary contemplation and therefore the arrangement at issue was a tax avoidance arrangement. This finding was made notwithstanding that the funding arrangement fell within the ambit of interest deductibility provisions and was not caught by any other specific anti-avoidance decision. It reinforces the strict approach that the Supreme Court has taken on avoidance activity over the last fifteen years since their decision in *Ben Nevis*.[8] The majority also found for the Commissioner such that the criteria were satisfied for the abusive tax penalty under TAA, s 141D to apply.

However, Glazebrook J provided an extraordinarily strong dissent, considering that the majority erred in arriving at their conclusion that the economic substance of the transaction should be taxed, without carefully analysing what was within parliament's contemplation. Her Honour observed that Frucor could have achieved the exact same tax effect through other similar arrangements.

It is not our intention to pore through the judgments or to provide a critique. However, it is important to observe that through the three courts, the views on whether there was tax avoidance differed, namely: not tax avoidance by the High Court, tax avoidance by the Court of Appeal (but no penalties), and tax avoidance by a majority in the Supreme Court (with penalties). Of particular note is the process by which the majority sets out to reconcile earlier judgments of the Privy Council and Supreme Court, as well as to justify its decision that the abusive tax position penalty applies. Of equal interest is the minority's rebuttable of the majority decision (on both the finding of avoidance and penalties) along with the extensive discussion on how application of the concept of "economic substance" should be applied and shortfall penalties be determined.

We do not think that it is likely that the Supreme Court will decide on another tax avoidance case in the next few years, so the decision and principles in *Frucor* will be the leading authority and the principal source of 'guidance'. Given the outcome, many taxpayers, in conjunction with their advisers, will need to reassess the risks associated with their tax positions. The tax avoidance boundary in some respects has 'shifted' and the considerations to be taken into account with respect to penalties have become less clear. How might taxpayers gain further certainty? One response which no doubt Inland Revenue would prefer is for taxpayers to become much more conservative in the tax positions they take. Another is to seek a binding ruling from Inland Revenue to achieve some degree of certainty, albeit this comes with further expense and risk. It will also be interesting to see what the new forthcoming Interpretation Statement on the principal tax avoidance provisions of ss BG and GA 1of ITA 2007 entails.

There is much to 'unpack' in this judgment including its ramifications for taxpayers and Inland Revenue going forward. We very much look forward to submissions addressing these points along with further in-depth analysis.

[8] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289.