Privy Council Appeal No. 22 of 1986

The Commissioner of Inland Revenue *Appellant*

v.

Challenge Corporation Limited *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 20TH OCTOBER 1986

Present at the Hearing:

LORD KEITH OF KINKEL
LORD BRIGHTMAN
LORD TEMPLEMAN
LORD OLIVER OF AYLMERTON
LORD GOFF OF CHIEVELEY

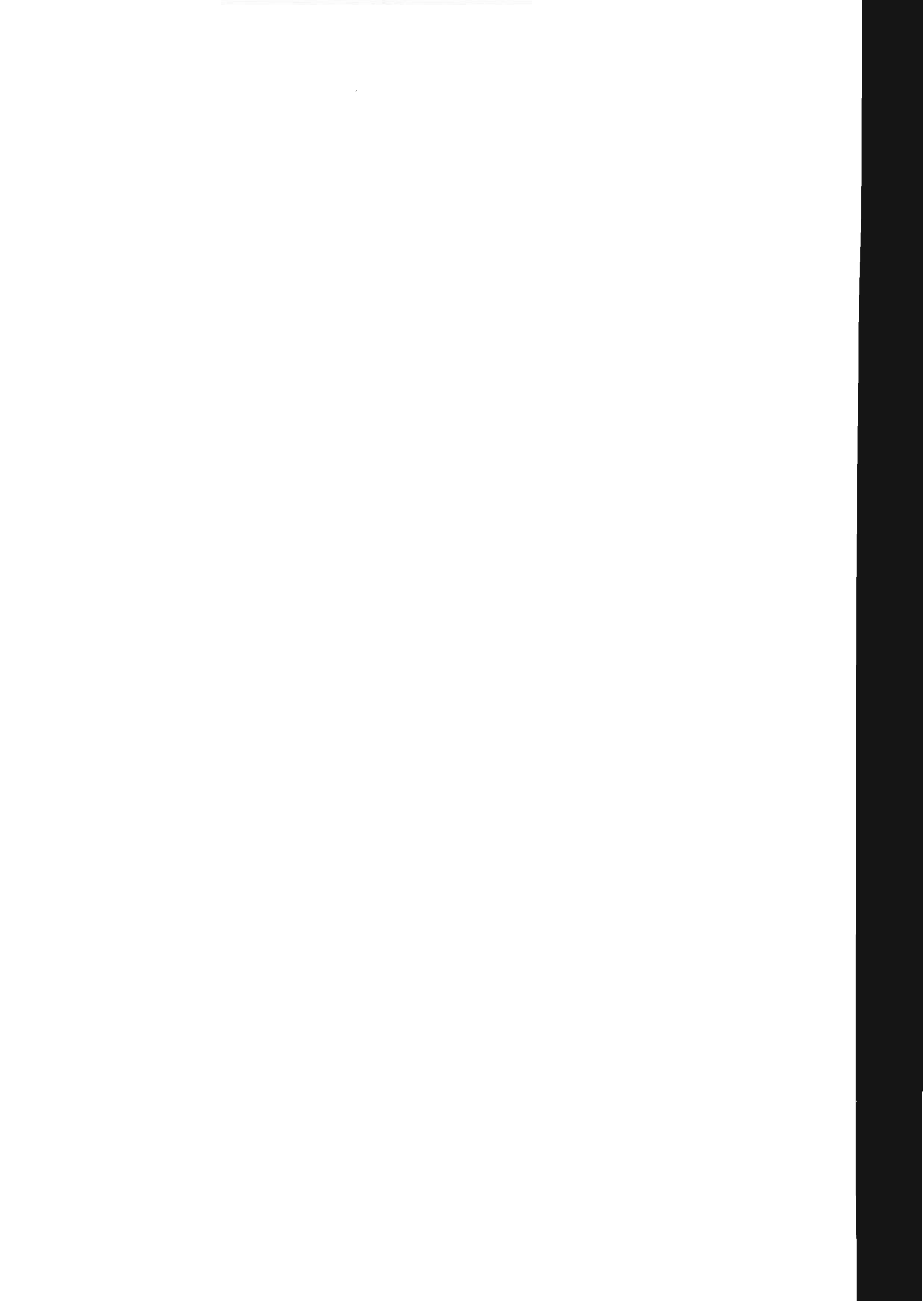
*[Majority Judgment delivered by **Lord Templeman**]*

By an agreement dated 28th February 1978 Merbank Corporation Limited ("Merbank") sold to the respondent, Challenge Corporation Limited ("Challenge"), the whole of the issued share capital of Perth Property Developments Limited ("Perth") at the price of $10,000 or at the price equal to 22½% of the amount of the tax loss of $5.8 million incurred by Perth which proved to be deductible from the assessable income of the Challenge group of companies, whichever price should prove to be higher.

By section 99 of the Income Tax Act 1976 of New Zealand, any "contract" shall be "absolutely void as against" the appellant Commissioner of Inland Revenue "if and to the extent that, directly or indirectly, its purpose or effect" is to reduce "any liability to income tax".

The purpose of the agreement dated 28th February 1978 was to reduce the liability to income tax of the Challenge group of companies by $2.85 million. The agreement is therefore absolutely void against the Commissioner to the extent that its effect would enable the tax loss of Perth to be deducted from the assessable income of the Challenge group.

[45]



Challenge asserts that, notwithstanding section 99, Challenge is entitled to treat the agreement as valid against the Commissioner, because section 191 of the Act allows losses to be transferred in certain circumstances between members of a group of companies.

The question is whether, as the Commissioner contends, section 191 takes effect as if the agreement did not exist, or whether, as Challenge contends, section 191 takes effect as if section 99 did not exist. In the High Court of New Zealand, Barker J. found in favour of Challenge. He was upheld by a majority (Cooke and Richardson JJ.) of the Court of Appeal (Woodhouse P. dissenting). The Commissioner appeals to the Board.

Section 99 is headed "Agreements purporting to alter incidence of tax to be void" and, so far as material, provided in the relevant income tax year ended 31st March 1978 as follows:-

"(1) For the purposes of this section -

'Arrangement' means any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect:

'Liability' includes a potential or prospective liability in respect of future income:

'Tax avoidance' includes -

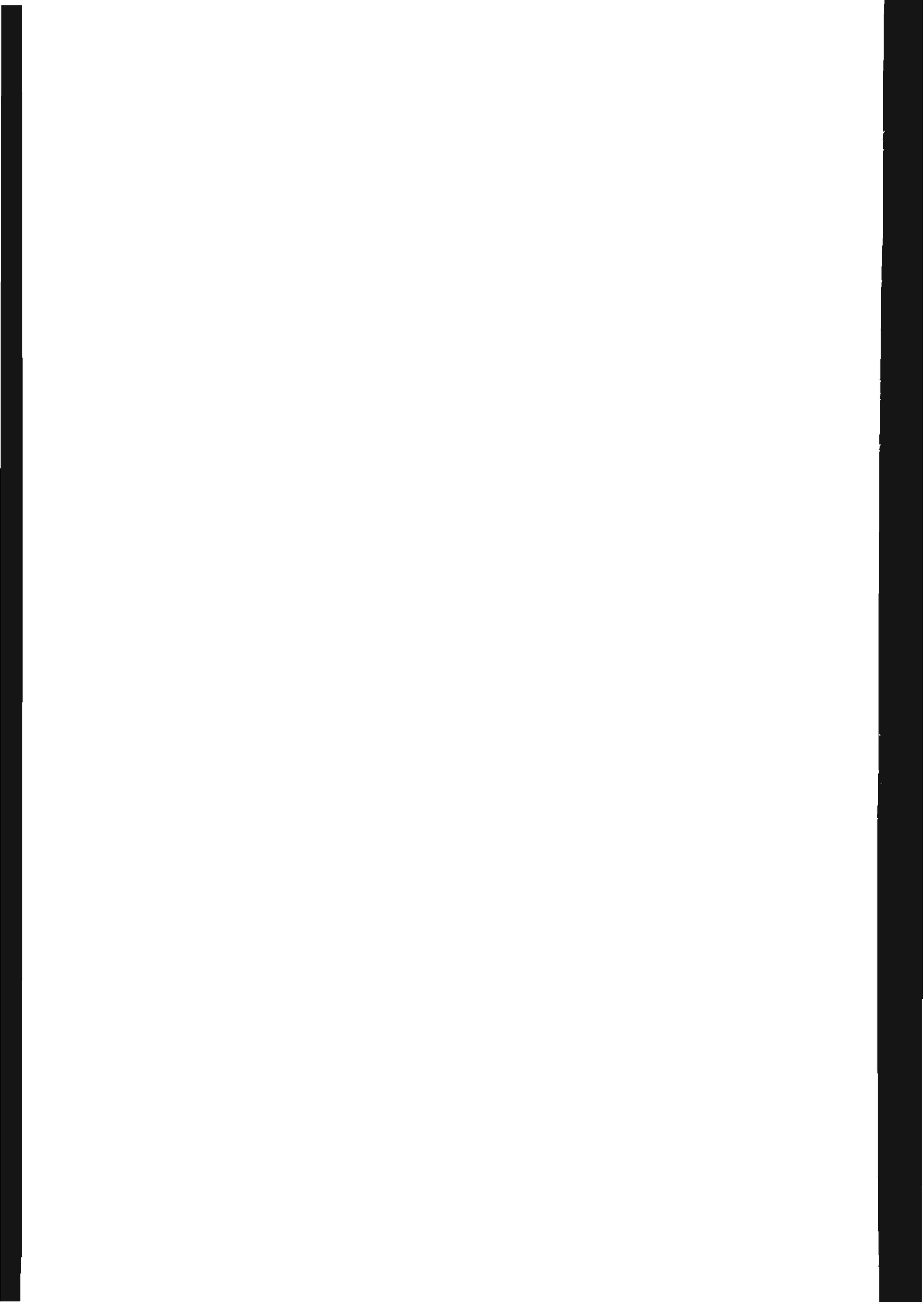
(a) Directly or indirectly altering the incidence of any income tax:

(b) Directly or indirectly relieving any person from liability to pay income tax:

(c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax.

(2) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly, -

(a) Its purpose or effect is tax avoidance; or



(b) Where it has two or more purposes or effects, one of its purposes or effects (not being a merely incidental purpose or effect) is tax avoidance, whether or not any other or others of its purposes or effects relate to, or are referable to, ordinary business or family dealings, -

whether or not any person affected by that arrangement is a party thereto.

(3) Where an arrangement is void in accordance with sub-section (2) of this section, the assessable income and the non-assessable income of any person affected by that arrangement shall be adjusted in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that person from or under that arrangement ..."

Section 191 is headed "Companies included in a group of companies" and, so far as material, provided in the relevant income tax year as follows:-

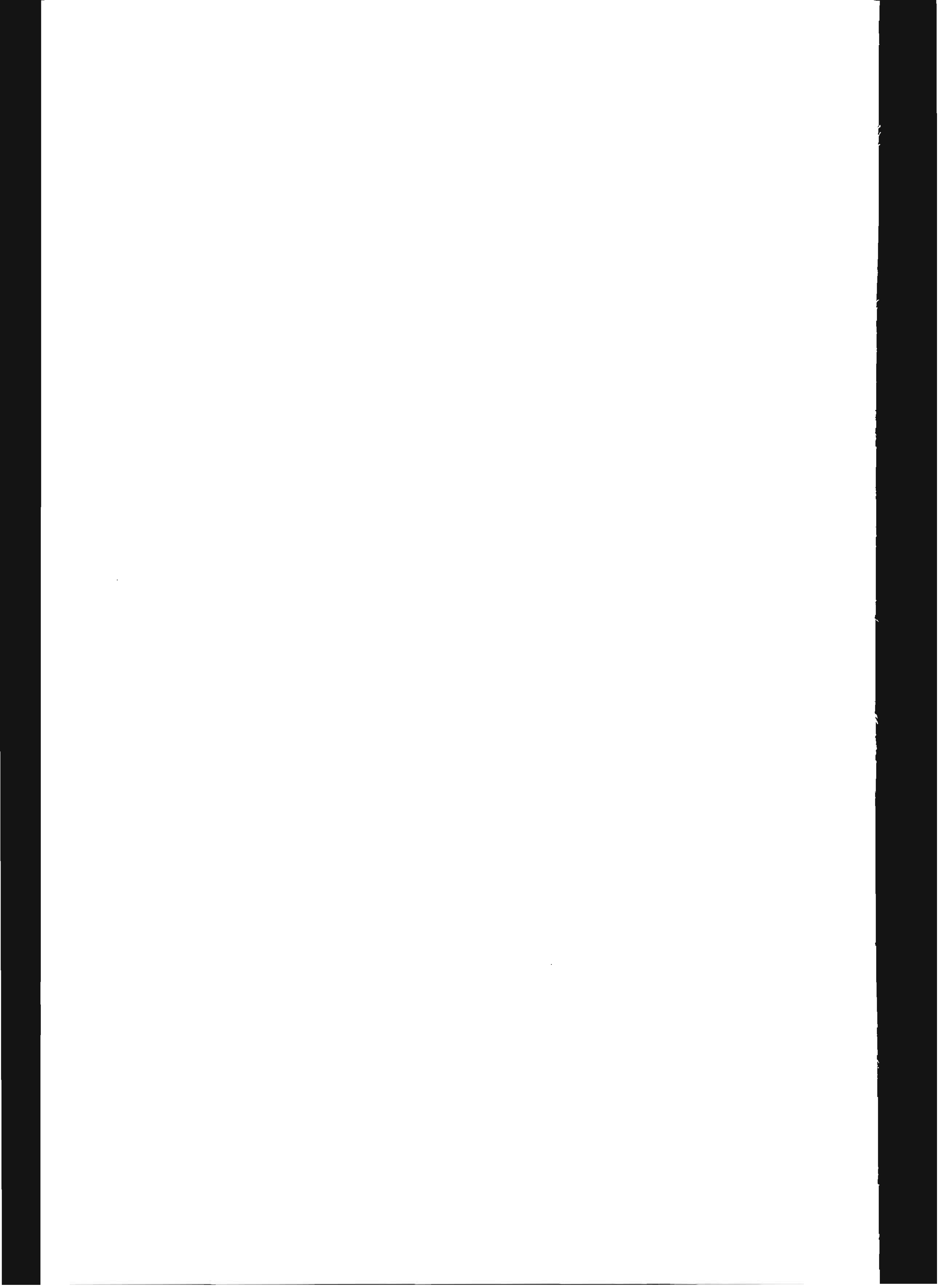
"(1) For the purposes of this section -

(a) Where a nominee of any person holds any paid-up capital, or any allotted shares, or any voting power in a company, or is entitled to a share of profits distributed by a company, that paid-up capital, or those allotted shares, or that voting power, or that title to profits, as the case may be, shall be deemed to be held by that person:

(b) Shares in one company held by another company shall be deemed to be held by the shareholders in the last-mentioned company:

(c) The proportion of the paid-up capital, and of the nominal value of the allotted shares, and of the voting power, and of the title to profits held by any person in any company at the end of any income year shall be determined by the Commissioner; and

(i) In determining those proportions, the Commissioner shall disregard any alteration in those proportions which, in



his opinion, is of a temporary nature and has or purports to have the purpose or effect of in any way -

(A) Altering the incidence of income tax; or

(B) Relieving the company or any other company from its liability to pay income tax, -

by in either case excluding that company or any other company from, or including that company or any other company in, any group of companies in relation to that income year; ...

(2) Subject to this section, every company included in a group of companies shall be assessable and liable for income tax in the same manner as if it were a company not included in a group of companies.

(3) Where, in relation to two or more companies and to any income year, -

(a) The aggregate of the prescribed proportions of the paid-up capital, or of the nominal value of the allotted shares, or of the voting power, in each of those companies which is held by the same persons is not less than two-thirds of the paid-up capital, or of the nominal value of the allotted shares, or of the voting power, as the case may be, in each of those companies; or

(b) The aggregate of the prescribed proportions of the profits for that income year of each of those companies to which the same persons would be entitled if the profits of each of those companies were distributed by way of dividend at the end of that income year is not less than two-thirds of those profits of each of those companies, -

those companies (in this Act referred to as a group of companies) shall, in respect of that income year, be assessed and liable for income tax in accordance with this section.

(4) Sub-section (5) of this section shall apply in any case where, in relation to a group of companies (such group being referred to in this sub-section ... and sub-section (5) as a specified group) ..., -

(a) The same persons held at the end of that income year the whole of the paid-up capital in the same proportions in every company included in the specified group; ...

(5) Where sub-section (4) of this section applies to any specified group and to any income year, -

Any loss ...

may, if that company so elects by notice ... be deducted from the assessable income derived in that income year by such other company or companies included in the specified group as is or are nominated by that company, ...

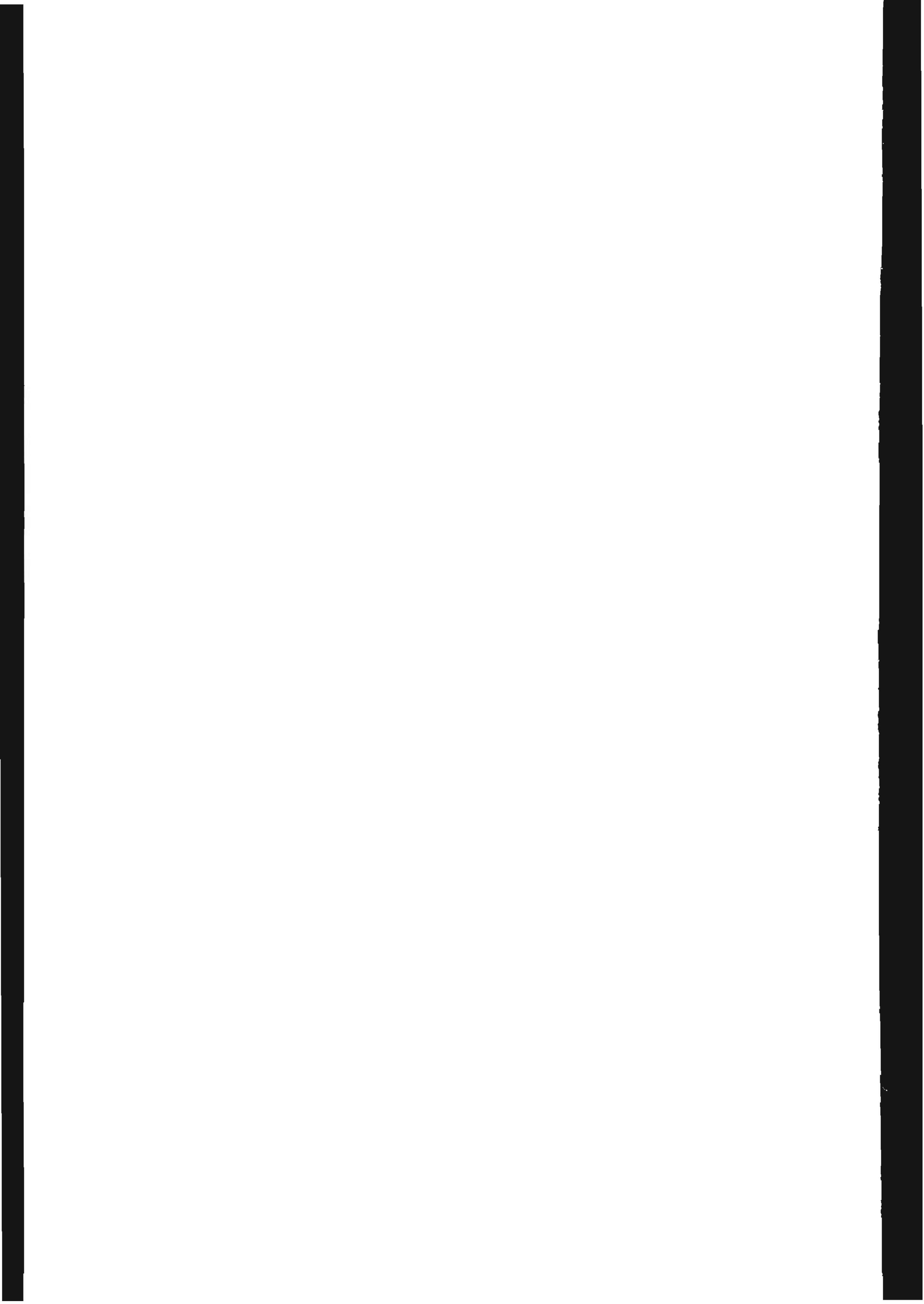
(7) Where -

(a) Any company makes a payment to another company under an agreement providing for the paying company to bear or share in losses or a particular loss of the payee company (being losses or a loss which are deductible under this Act); and ...

(c) Both companies are companies which are included in the same group of companies for the income year corresponding with the income year in respect of which the payment is made; ...

the payment shall be deemed to be assessable income derived by the payee company on the last day of the accounting period in respect of which it is made, and to be deductible by the paying company as if it were expenditure necessarily incurred in the production of assessable income on that day."

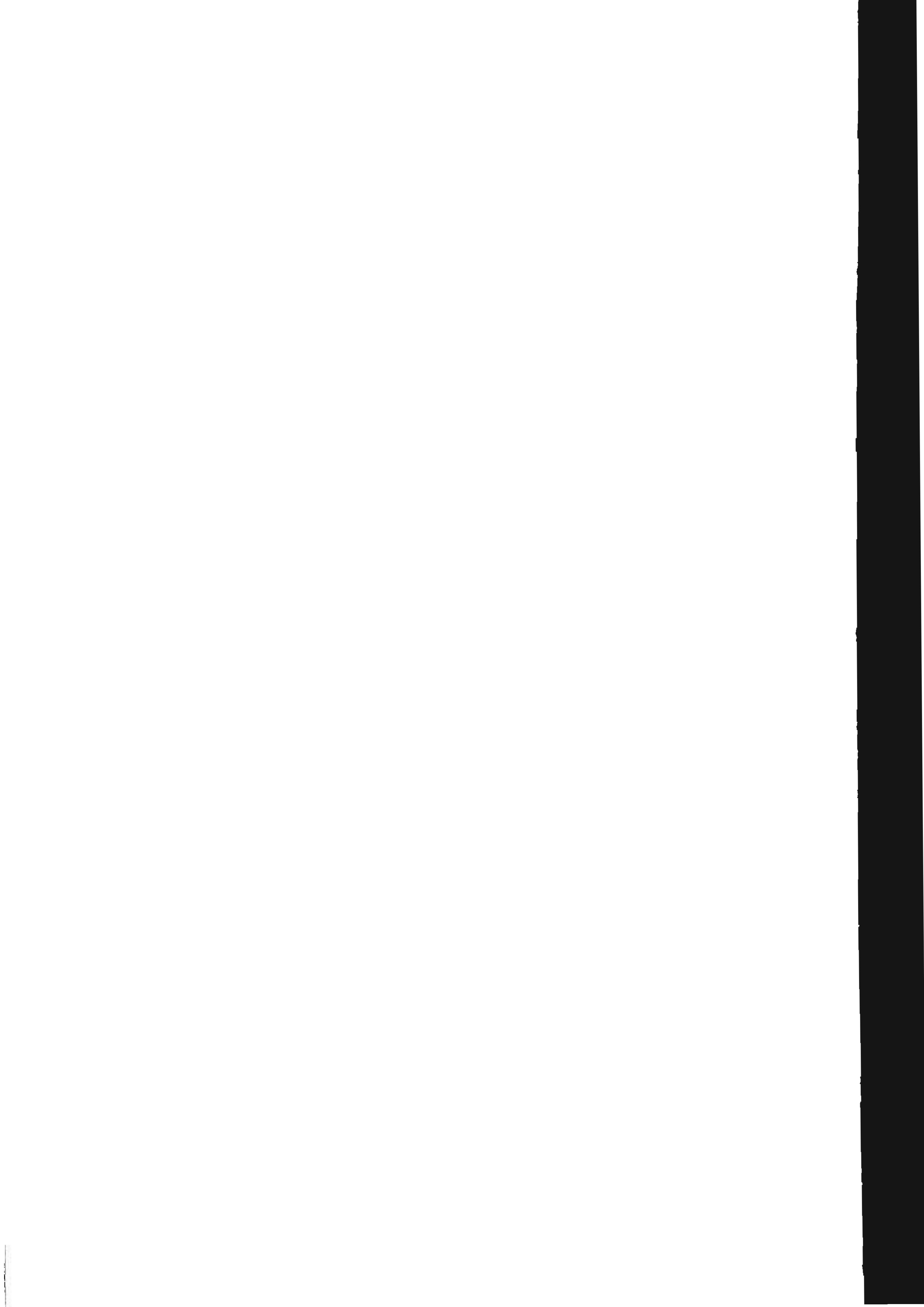
Prior to 28th February 1978 Challenge was the parent company of a number of subsidiary companies including the taxpayer subsidiaries which had made assessable profits exceeding $5.8 million. Parent and subsidiaries formed a specified group of companies for the purposes of section 191. Perth had made a deductible loss of $5.8 million before Perth, by virtue of the agreement dated 28th February 1978, became a member of the Challenge specified group of



companies. Subsequently Perth gave notice of election under section 191 transferring Perth's loss of $5.8 million to the taxpayer subsidiaries of Challenge which had earned assessable income exceeding $5.8 million and those taxpayer subsidiaries claimed to deduct Perth's loss from their own assessable income by virtue of section 191(5), thus reducing their tax liability by $2.85 million.

Section 191 was intended to give effect to the reality of group profits and losses. When one member of a group makes a profit of $5.8 million and another member of a group makes a loss of $5.8 million then the reality is that the group has made neither a profit nor a loss and that the members of the group should not be liable to tax. Section 191 in these circumstances is not an instrument of tax avoidance. But in the present circumstances the reality is that the Challenge Group never made a loss of $5.8 million. A loss of $5.8 million was made by Perth and that loss fell on Merbank before Challenge contracted to buy Perth. Section 191 in these circumstances is an instrument of tax avoidance which falls foul of section 99.

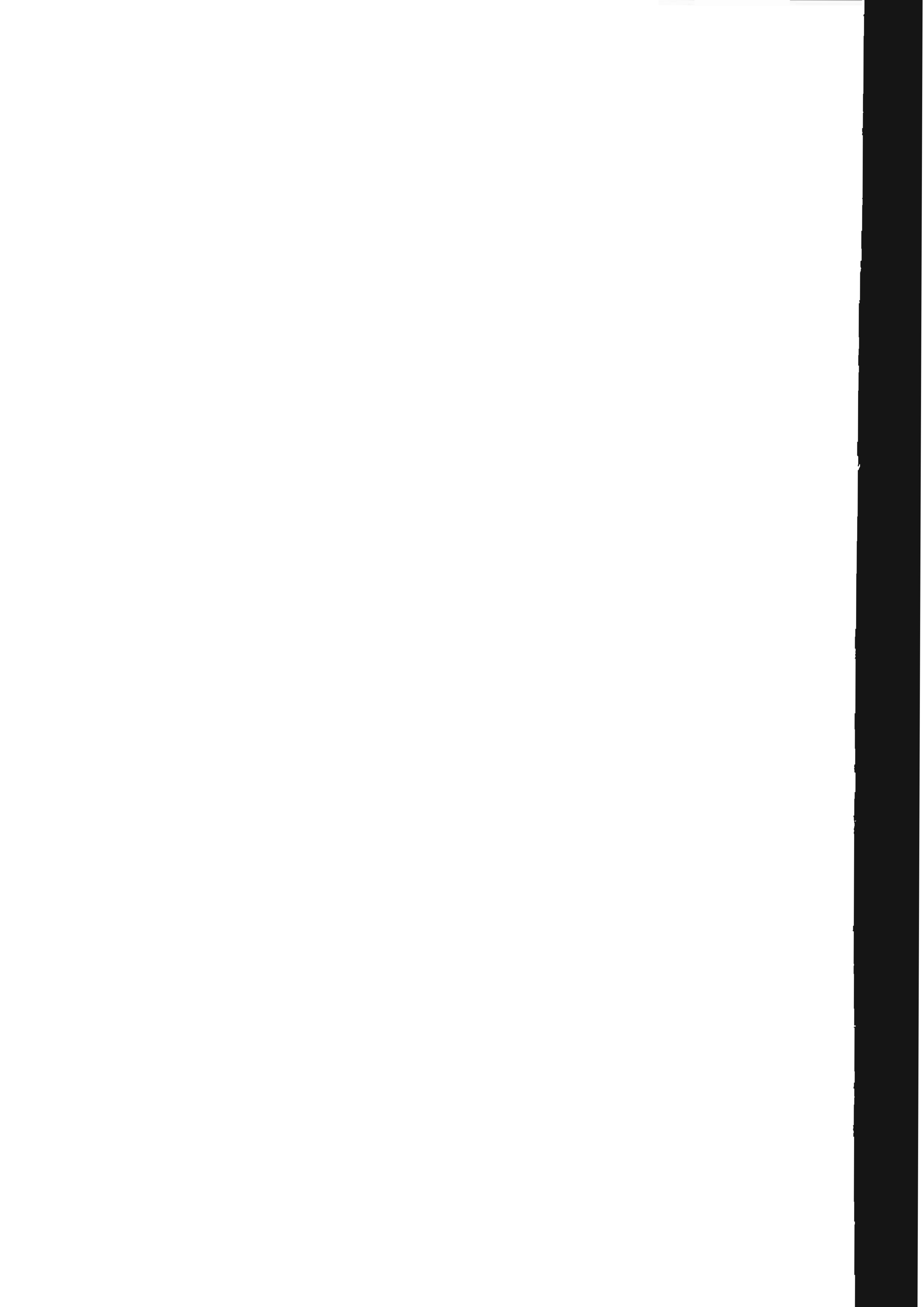
A loss of $5.8 million was made by Perth. Perth was indebted to its parent Merbank in a sum roughly corresponding to the loss made by Perth. As a preliminary, to or as part of the arrangement made between Merbank and Challenge finalised by the agreement dated 28th February 1978, Merbank in effect wrote off and released the debt of $5.8 million owed by Perth to Merbank. Thus the loss of $5.8 million was sustained by Perth before Perth became part of the Challenge group of companies. The loss sustained by Perth was in fact borne by Merbank. The agreement dated 28th February 1978 transferred to Challenge the shareholding of Perth which was valueless. The only purpose of the agreement was to enable control of the tax benefit of Perth's loss to be transferred from Merbank to Challenge. Subject to section 99 the assessable income of Challenge and the taxpayer subsidiaries comprising the Challenge group prior to 28th February 1978 could be reduced by the amount of the loss sustained by Perth and suffered by Merbank prior to 28th February 1978. Stripped of pretence, one taxpayer, Challenge, was purchasing the tax benefit of a loss sustained by another taxpayer, Perth. If successful, Challenge would obtain a tax advantage of $2.85 million by means of an arrangement and the benefit of that tax advantage would then be divided between Challenge and Merbank. A clearer case for the application of section 99 cannot be imagined. If such an arrangement were not caught by section 99 and were recognised by the Courts for tax purposes, income tax would only be collected from those profitable companies which failed to come to terms with loss making companies.



The response of Challenge to this analysis is threefold. First, Challenge say that section 191 confers a specific exemption on a group of companies which fulfils the conditions set forth in section 191 at the end of an income year. The Challenge group included Perth and satisfied the specified conditions at the end of the income year ended 31st March 1978. Section 99 does not apply where the conditions specified in section 191 are satisfied. That argument cannot be correct. Tax avoidance schemes largely depend on the exploitation of one or more exemptions or reliefs or provisions or principles of tax legislation. Section 99 would be useless if a mechanical and meticulous compliance with some other section of the Act were sufficient to oust section 99. Richardson J., giving judgment in the Court of Appeal in favour of Challenge, nevertheless recognised that "section 99 would be a dead letter if it were subordinate to all the specific provisions of the legislation".

Secondly, Challenge say that section 191 contains its own particular tax avoidance provision and by necessary implication excludes the general anti-tax avoidance provisions of section 99. The provisions of section 191(1)(c)(i) enabled the Commissioner to disregard any temporary alteration in the shareholding or constitution of a company where the purpose or the effect of the alteration is tax avoidance. Therefore, it is said, Parliament must have intended that section 99 should not apply to a group of companies seeking to operate section 191. Parliament must have intended that any permanent form of tax avoidance or any other form of tax avoidance except the particular form proscribed by section 191(1)(c)(i) should be permitted to succeed. In the opinion of the Board this argument attributes to Parliament a benevolent attitude towards tax avoidance by companies which is unlikely and unnecessary.

A likely explanation is that Parliament was indifferent to or unmindful of any overlap between the general provisions of section 99 and the particular provisions of section 191(1)(c)(i) or that, in view of the well-known difficulties encountered in the formulation and enforcement of effective anti-tax avoidance provisions, Parliament thought that an overlap might be useful and could not be harmful. Parliament may have had in mind two different tax avoidance positions. There could be tax avoidance in the introduction into a group of companies of a company which had already made a loss; any tax advantage obtained as a result of that introduction would fall foul of section 99. There could also be tax avoidance in the manipulation of the shareholdings or constitution of a company in order to obtain temporary compliance with the



conditions specified by section 191; that manipulation would fall foul of section 191(1)(c)(i). The possibility that such manipulation might also be frustrated by the operation of section 99 does not lead to the conclusion that Parliament must have intended to permit permanent tax avoidance schemes to exploit section 191. The provisions of section 99 are of general application and, in the absence of an express direction by Parliament excluding section 191 from the ambit of section 99, their Lordships consider that section 99 must be applied in the present circumstances.

This conclusion is supported by the legislative history of sections 99 and 191. The Land and Income Tax Act 1954 included, by way of a general anti-tax avoidance measure, a provision in these terms:-

> "108. Agreements purporting to alter incidence of taxation to be void -
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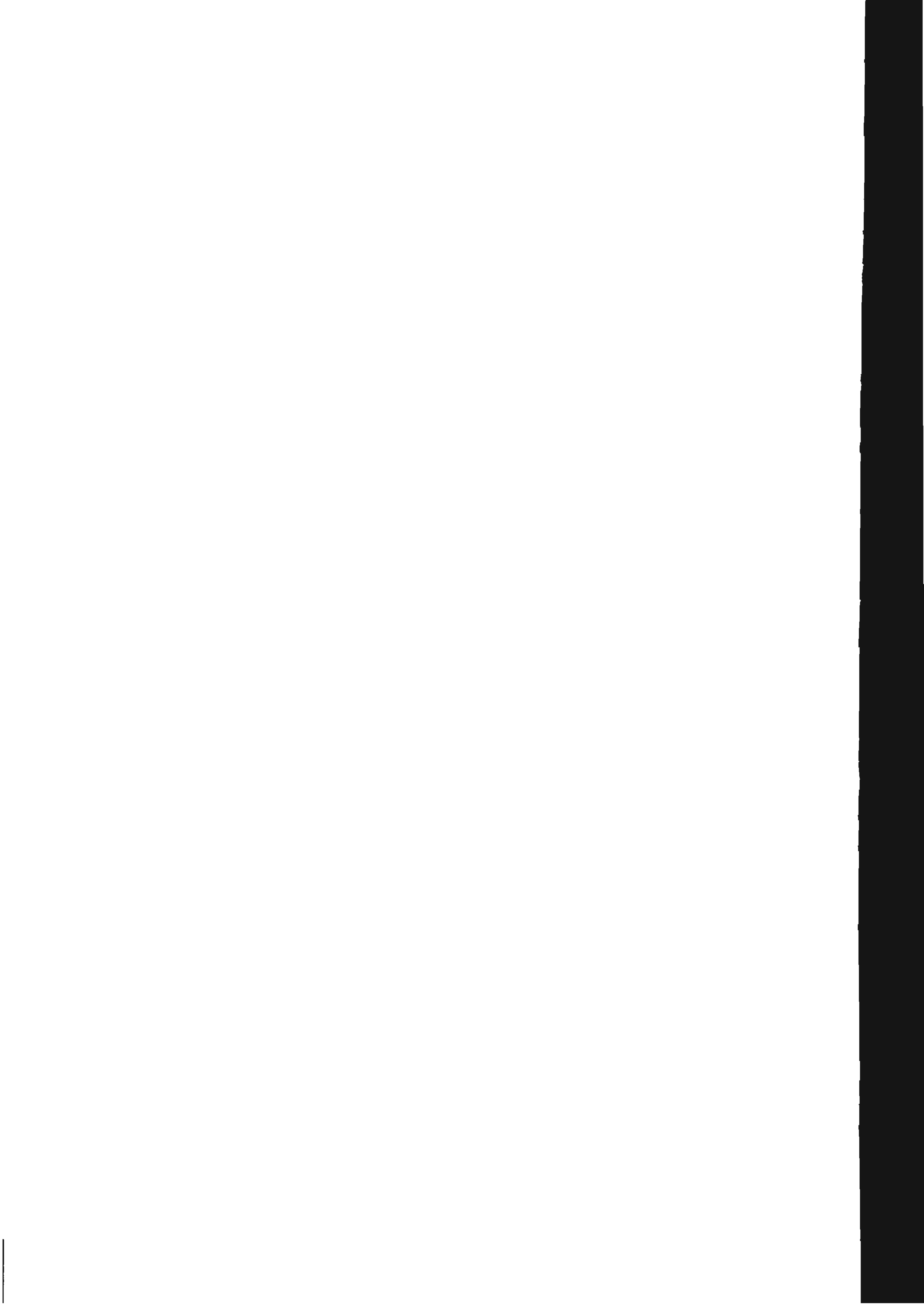
> Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax."

Section 141 of the Act of 1954 provided for group losses to be transferred between companies within the group. Between 1954 and 1969, section 141 did not refer to tax avoidance and therefore section 141 must have been subject to the anti-tax avoidance effect of section 108. The provisions of section 108 were however subjected to some judicial criticism. In the words of Richardson J. in the present case "the old section 108 was found to be both unreasonably restrictive and too broad in its application". Section 141 of the Act of 1954 dealing with group relief was amended in 1969 by section 19 of the Land and Income Tax Amendment Act (No. 2) 1969 which introduced a special anti-tax avoidance provision in terms identical to the terms of section 191(1)(c)(i) of the Act of 1976. If Parliament had intended in 1969 to alter the law by exempting section 141 from the provisions of section 108 and to allow for the first time permanent as opposed to temporary tax avoidance schemes formulated by groups of companies exploiting section 141, then Parliament would have made this clear and would not have relied on an implication from an amendment to section 141 which was designed to frustrate a special tax avoidance device. The 1969 amendment to section 141 is consistent with an intention on the part of Parliament to supplement and reinforce section 108 which in some respects had proved and was later to



prove ineffective. The 1969 amendment to section 141 is not consistent with an intention on the part of Parliament to repeal section 108 in its application to section 141. Section 108 was amended and replaced by a more extensive general anti-tax avoidance measure in 1974. The amendment and replacement of section 108 in 1974 could not impliedly exempt section 141 from its ambit. The Act of 1976 was a consolidating measure. Section 99 of the Act of 1976 reproduced the 1954 general anti-tax avoidance provisions of section 108 as amended in 1974. Section 191 of the Act of 1976 reproduced the group profit provisions of section 141 as amended in 1969. There was at no time any pressing need to prevent an overlap of general and specific anti-tax avoidance measures. It was better to be safe than sorry. An overlap between section 99 and section 191 cannot be unfair to the tax avoider but a construction of section 191 which silently repeals section 99 would be unfair to the general body of taxpayers. Their Lordships agree with the observations of Woodhouse P. in the present case that:-

> "... it would be quite extraordinary ... for the draftsman to carefully prevent a tax advantage because the shareholding was 'of a temporary nature' and yet consciously decide that Parliament would wish to give its blessing (and then only by implication) to a manufactured and barely tangible association of the kind under review."

For their third argument and in support of their second argument, Challenge advanced the threat that if their chosen method of tax avoidance is not rendered effective by the courts, any commercial transaction or family arrangement will be fraught with uncertain, capricious or harsh fiscal consequences and will be vulnerable to action by the Commissioner under section 99. It was suggested before the Board that a seven-year covenant or a settlement of capital might be void against the Commissioner under section 99 as an arrangement entered into for two or more purposes or effects one of which would be tax avoidance, namely, a reduction in the tax payable by the covenantor or the settlor. Indeed the Solicitor-General on behalf of the Commissioner seemed inclined to agree. In the judgments in the courts of New Zealand there are references to other disturbing suggestions, for example that the purchase of life insurance in order to qualify for tax exemption would incur the wrath of the Commissioner under section 99. Barker J. speculated that "a company carrying on business to obtain export incentives could find its business threatened by the use of section 99 by the Commissioner". The frequent argument by the tax avoider that he seeks to protect the interests of a

taxpayer who does not indulge in tax avoidance requires serious but sceptical consideration. There are however discernible distinctions between a transaction which is a sham, a transaction which effects the evasion of tax, a transaction which mitigates tax and a transaction which avoids tax.

In the present case Barker J. pointed out that the transaction was not a sham. It was not so constructed as to create a false impression in the eyes of the tax authority. The appearance created by the documentation was precisely the reality. In other words Challenge purchased the shares of Perth; Challenge did not pretend to purchase the shares of Perth. The question is whether that purchase was also an arrangement under section 99.

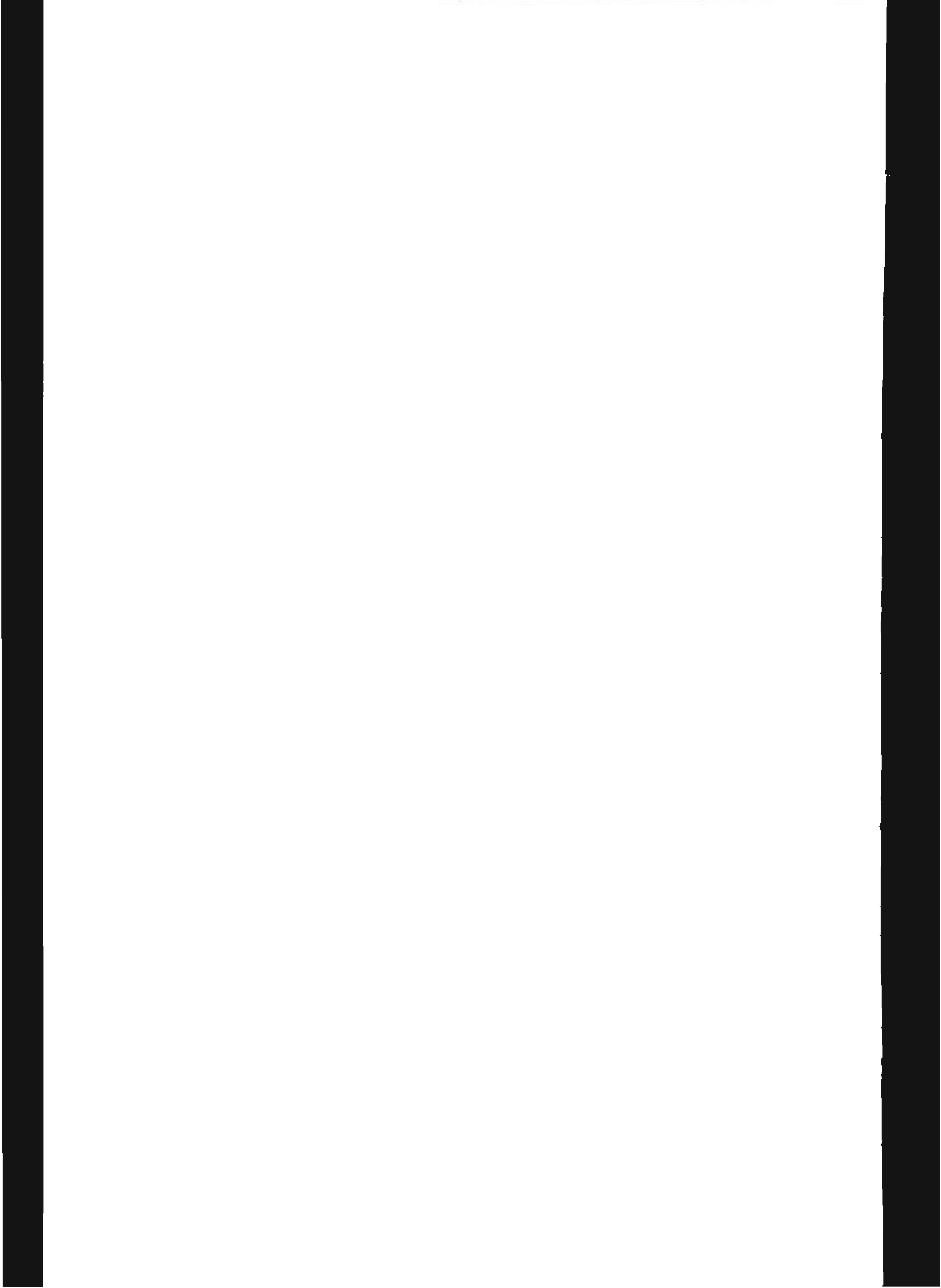
Tax evasion also can be dismissed. Evasion occurs when the Commissioner is not informed of all the facts relevant to an assessment of tax. Innocent evasion may lead to a re-assessment. Fraudulent evasion may lead to a criminal prosecution as well as re-assessment. In the present case Challenge fulfilled their duty to inform the Commissioner of all the relevant facts.

The material distinction in the present case is between tax mitigation and tax avoidance. A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in *CIR v. Duke of Westminster* [1936] A.C. 1 "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be". In that case however the distinction between tax mitigation and tax avoidance was neither considered nor applied.

Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an "arrangement" but from the reduction of income which he accepts or the expenditure which he incurs.

Thus when a taxpayer executes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant.

When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions



the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.

Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitles the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium.

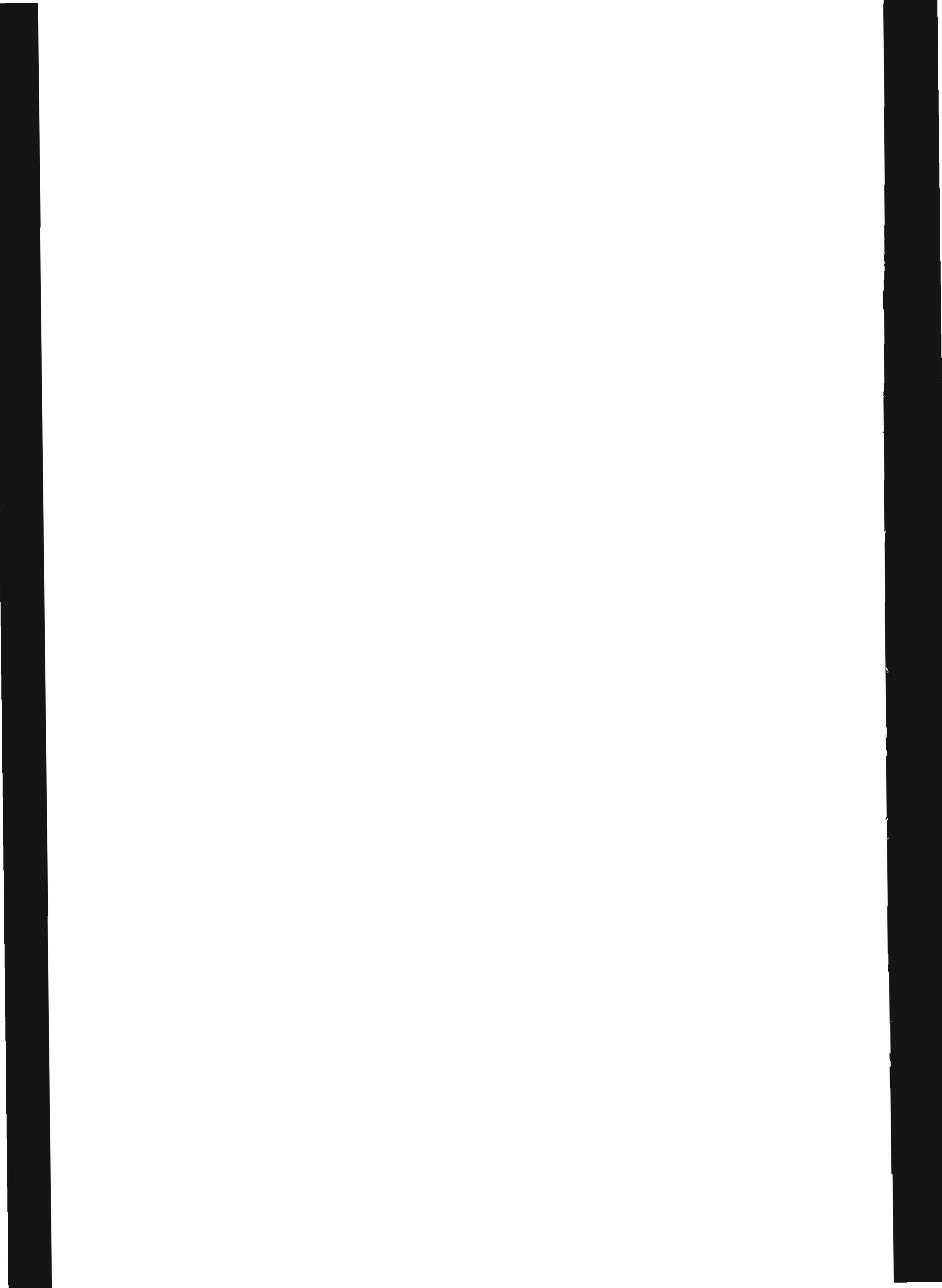
A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief.

When a member of a specified group of companies sustains a loss, section 191 allows the loss to reduce the assessable income of other members of the group. The tax advantage results from the loss sustained by one member of the group and suffered by the whole group.

Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.

Section 99 does apply to tax avoidance. Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.

In the present case the taxpayer subsidiaries seek to reduce their assessable income by a loss of $5.8 million which was sustained by Perth and suffered by Merbank and was not sustained by the taxpayers or suffered by Challenge. It is true that Challenge expended $10,000 in purchasing the shares in Perth but this purchase price is not deductible against Challenge's assessable income. Apart from the risk of losing $10,000, the Challenge group never risked anything, never lost anything and never spent anything but now claim to deduct a loss of $5.8 million. Challenge have practised tax avoidance to which section 99 applies. Challenge have not practised tax mitigation because the Challenge group never suffered the loss of $5.8 million which would entitle them to a reduction in their tax liability of $2.85 million. The tax advantage stems from the arrangement with Merbank and not from any loss sustained by Challenge or the Challenge group.



It was argued that if this appeal by the Commissioner succeeds a purchase of shares in a company which becomes part of a specified group will always be void under section 99. But a purchase of shares will only be void insofar as it leads to tax avoidance and not tax mitigation.

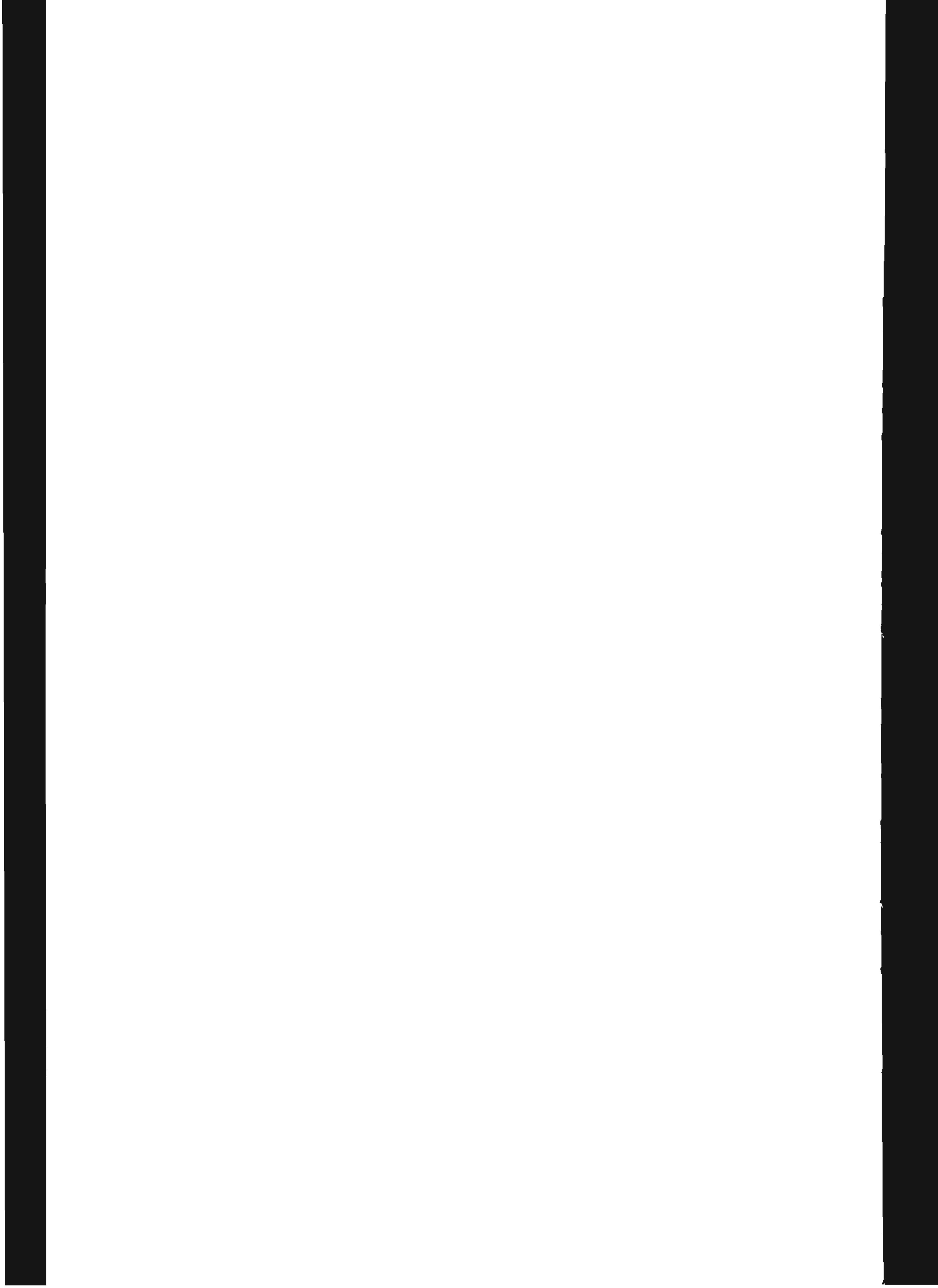
In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax.

In *CIR v. Duke of Westminster* (*supra*), the Duke avoided tax by reducing his assessable income without reducing his income by the method of substituting an annuity for a wage payable to his gardener. So long as the gardener continued to work, the Duke gained a tax advantage over other taxpayers who paid wages to their working gardeners.

In *Black Nominees Ltd. v. Nicol* [1975] 50 T.C. 229 an actress sought to avoid income tax by reducing her assessable income without reducing her income. She converted her earnings into instalments of capital by a number of transactions each designed to take advantage of some specific exemption or relief provision of the taxing statute. She attempted to obtain a tax advantage over other actresses and other taxpayers who paid tax on their earnings.

In *Chinn v. Collins* [1981] 1 All E.R. 189 the trustees and beneficiaries under a settlement attempted to avoid capital gains tax payable on the distribution of trust property. By a number of transactions each designed to take advantage of some specific exemption or relief provision of the taxing statute, the beneficiary entitled to trust shares was converted into a purchaser of the shares without involving him in the expenditure of a purchase price. The beneficiary attempted to obtain a tax advantage over other beneficiaries who paid capital gains tax when they became entitled to trust property.

In *Ramsay v. CIR* and *Eilbeck v. Rawling* [1982] A.C. 300 the taxpayer attempted to avoid capital gains tax by making a deductible loss matched by a non-chargeable gain and setting off the loss against a pre-existing chargeable gain. In reality the taxpayer did not make any loss. The taxpayer attempted to obtain a tax advantage over other taxpayers who paid capital gains tax on chargeable gains.

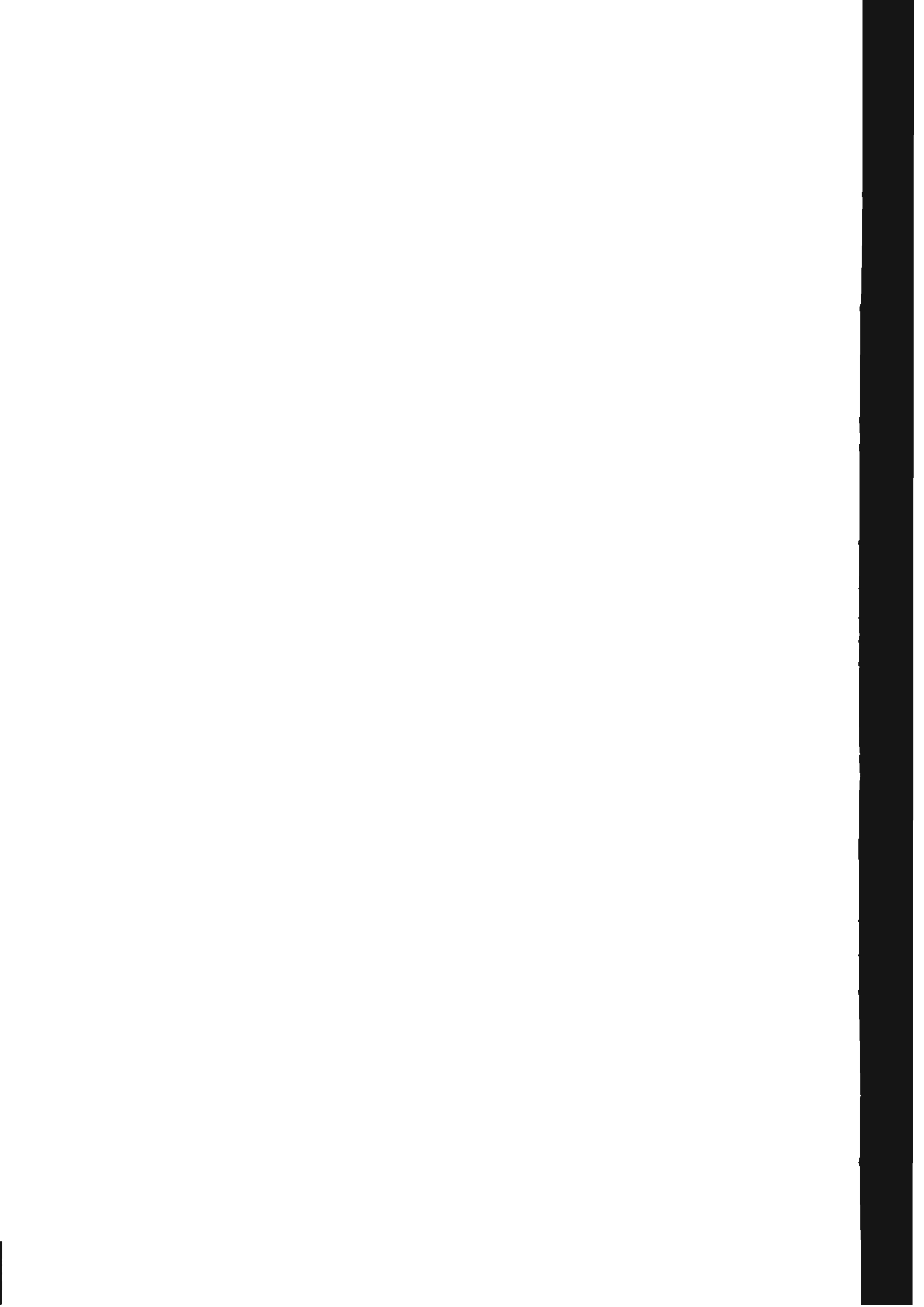


In *CIR v. Burmah Oil Co.* [1980] 54 T.C. 200 the House of Lords refused to accept that the taxpayer "had achieved the magic result of creating a tax loss that was not a real loss"; per Lord Fraser of Tullybelton at page 221. Lord Scarman said at page 222 that in considering any tax avoidance scheme "it is now crucial ... to take the analysis far enough to determine whether a profit, gain or loss is really to be found".

Most tax avoidance involves a pretence; see the analysis in *Ramsay v. CIR* [1979] 3 All E.R. 213 at 214. In the present case Challenge and their taxpayer subsidiaries pretend that they suffered a loss when in truth the loss was sustained by Perth and suffered by Merbank. In New Zealand section 99 would apply to all the cited English cases of income tax avoidance. Section 99 also applies where, as in this case, the taxpayer alleges that he has achieved the magic result of creating a tax loss by purchasing the tax loss of another taxpayer. In order to escape section 99 a transferable loss must be sustained by a member of a group which suffers the loss.

In the present case the facts are starkly simple. Perth appears to have had no assets and no debts. The only purpose of the agreement dated 28th February 1978 was tax avoidance. If Perth had assets, no doubt the purchase price paid by Challenge would have been higher than the 10,000 dollar minimum payable pursuant to the agreement. In that event the agreement would have had two purposes, the disposition of the assets and tax avoidance. Section 99 would have required the Commissioner to eliminate the tax advantage claimed. If Perth had debts, the tax avoidance arrangement would have been difficult if not impossible without the agreement of the creditors. But section 99 would still require the elimination of the tax advantage. Whatever the circumstances or complications, if a taxpayer asserts a reduction in assessable income, or if a taxpayer seeks tax relief without suffering the expenditure which qualifies for such relief, then tax avoidance is involved and the Commissioner is entitled and bound by section 99 to adjust the assessable income of the taxpayer so as to eliminate the tax advantage sought to be obtained.

Their Lordships will humbly advise Her Majesty that the appeal should be allowed, that the assessment made by the Commissioner on 12th March 1980 should be restored and that the costs of the Commissioner before the New Zealand courts should be paid by Challenge. Challenge must also pay the Commissioner's costs before the Board.

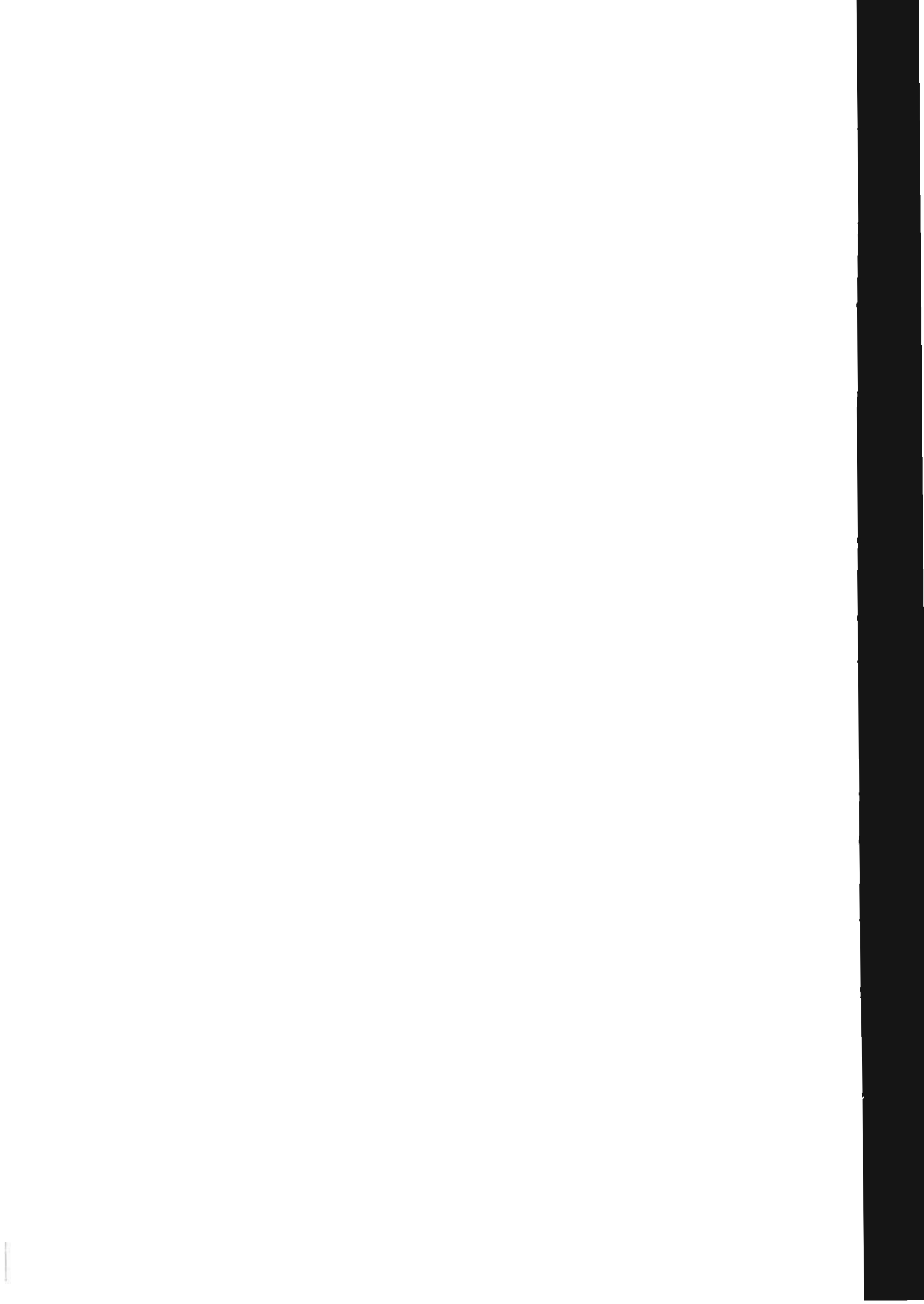


[Dissenting Judgment delivered by
Lord Oliver of Aylmerton]

I have the misfortune to take a different view of this appeal from that taken by the Board. I would, for my part, concur with the majority judgment in the Court of Appeal.

I entirely agree that if section 99 stood alone and in isolation from the other provisions of the statute it would be difficult to imagine a clearer case than this of a transaction entered into for the purpose of tax avoidance as defined by the section. I can also appreciate the argument that, whilst sections 188 and 191 provide a statutory code for the regulation of the basis of taxation of a group of companies once established, nevertheless the effectiveness of the anterior stage of establishing the group structure itself may fall to be tested by reference to section 99 alone before one ever comes to the question of how the provisions of sections 188 and 191 are to be operated.

I would find no difficulty whatever in accepting that argument were it not for the provisions of section 191(1)(c)(i). It is at this point, however, that I part company from the Board for I cannot, for my part, construe those provisions as importing a requirement that they are to be regarded, as it were, at a stage later than that at which the provisions of section 99 fall to be considered. Both sections are part of the same consolidating statute and it is, as it seems to me, inevitable that they have to be considered together with a view to testing their impact upon one another. So viewed I find myself oppressed by the difficulty of giving any sensible meaning to or operation for the provisions of sections 188 and 191 if section 99 properly falls to be construed as widely as the appellant urges and as, I confess, its literal terms suggest. For sections 188 and 191 are, in terms, concerned with conferring - and deliberately conferring - upon corporate taxpayers an option to regulate their affairs in a way which will reduce the liability of a group and of individual companies within the group to income tax. That is, by definition, 'tax avoidance' and I find myself quite unable to understand how a decision of a board of directors, for instance, to make a subvention payment under section 191(7) or to elect to give notice under section 191(5) can fail to be a 'plan' or 'understanding' which constitutes an 'arrangement' as defined by section 99(1). If that is right, then the avoidance of the plan or understanding directed by section 99(1) has the instant effect of depriving the relevant provisions of section 191 of any operation at all. To say that, for instance, an election under section 191(5) is valid except where it is made for the purpose of tax

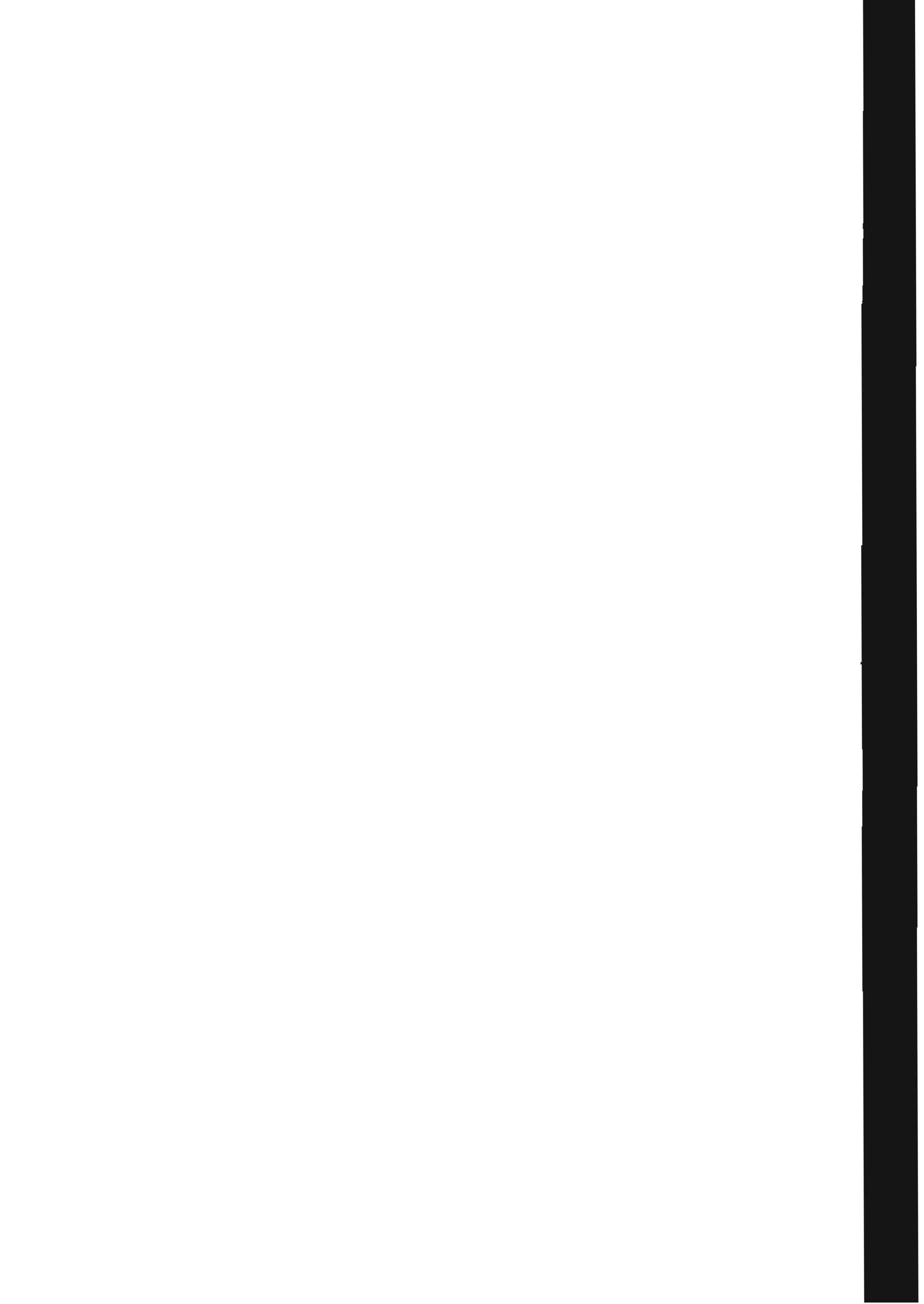


avoidance (as defined by section 99) is to emasculate section 191(5), for there can be no other purpose in the election thus contemplated than tax avoidance. And yet the two provisions, appearing as they do in the same consolidating statute, were clearly intended to stand together. For my part, I am driven to the same conclusion as that reached by the majority of the Court of Appeal, namely that the only possible reconciliation of sections 99 and 191 is to treat the latter as providing the code for group taxation and one which contains its own exhaustive anti-avoidance provisions, so that section 99 falls to be read as subject to a limitation that it does not avoid a transaction authorised in terms by section 191.

I am fortified in the conclusion at which I have arrived by two considerations. In the first place, even the appellants concede that section 99, albeit expressed in the widest possible terms, has to be read subject to some limitation as regards transactions permitted or authorised by other legislative provisions if it is not to produce results that are absurd. Secondly, it seems to me that a consideration of the history of the legislation, far from supporting the contrary conclusion, demonstrates a legislative intention that the limits of permissible tax rearrangement in the case of corporate groups were to be found in the provisions of what is now section 191 and in those provisions alone.

As regards the former of these considerations, the example given in the course of argument was that of the simple gift of income to, for instance, a grandchild of the donor or to a charity by way of deed of covenant. The Board's attention was not specifically drawn to any provisions of the New Zealand legislation equivalent to those of the United Kingdom Income Tax Acts but the example will serve for present purposes. The appellants concede that section 99 does not strike down such an arrangement, even though it undoubtedly has as one of its purposes the alteration of the incidence of tax and the reduction of the total tax payable and so would, prima facie, constitute 'tax avoidance'. The reason why this is so was said to be that the primary purpose of the arrangement was simply the gift of income and the reduction of the donor's income as a result of the gift, the reduction of tax payable merely being 'an incidental purpose or effect'.

With respect to those who take the contrary view, I find this too facile an argument. No doubt the donor's purpose is to make a gift to the donee and thus to that extent to reduce his own income, but there are ways of producing that result which would have no effect upon the tax position of either the donor or the donee and which would not have the effect of reducing in any way the total amount of tax



payable. The purpose and, generally, the sole purpose of effecting the transaction by deed of covenant is to bring into being a contractual obligation which will enable the donor to treat the income given as excluded from his income, which will cause the income given to be treated as that of the donee, and which, in the case of a charity, will enable the donee to recover from the Revenue the tax which the donor is obliged to deduct and pay to the Revenue. Those consequences are not in any sense 'incidental' to the making of the gift. They are the be-all and end-all of making the gift by that particular form of transaction. The consequences of making gifts of income in this way are statutory consequences provided for, and deliberately provided for, in the legislation and to treat them as avoided by the ex facie unlimited terms in which section 99 is expressed would result in the absurdity that a statutory code provided by the legislature expressly for the purpose of relieving the donated income of tax would be effectively deprived of any sensible sphere of operation.

Now if it be right that section 99 has, in some circumstances at least, to be read as subject to the implied limitation that its operation is subject to other provisions of the Act authorising transactions of a particular type and prescribing the tax consequences of such transactions, is section 191 such a provision? For my part, the history of the anti-avoidance legislation impels me to the conclusion that it is. The original statutory anti-avoidance provision was contained in section 108 of the Land and Income Tax Act 1954 which, subject to a formal amendment in 1968, remained in force until 1974. Its terms have already been recited in the judgment of the Board. It was against that background that, in substitution for the existing provisions as regards groups of companies contained in section 141 of the Principal Act of 1954, section 27 of the Land and Income Tax Amendment Act (No. 2) 1968 introduced a new section 141 containing provisions enabling, in certain specified circumstances, losses of a company forming part of a group of companies at a particular time to be set off against the assessable income of other companies in the same group. That section (by sub-section (8)) also authorised the making of subvention payments and directed the tax consequences of such payments. Quite clearly the making of such payments would have, and was intended to have, the effect of altering the incidence of income tax. Nevertheless section 108 could not sensibly be construed as avoiding the very payments which the legislature had expressly authorised to be made.

The new section 141 was amended in the following year by section 19 of the Land and Income Tax

Amendment Act (No. 2) 1969. In particular there was a significant amendment of the provisions of sub-section (3) which had previously provided that, in determining whether a person held the requisite proportion of paid-up capital, shares allotted or title to profits to enable the company concerned to be treated as part of the group for the purposes of the section, the Commissioners should be entitled to ignore shares bearing only a fixed rate of dividend. Section 19 of the Act of 1969 substituted for the existing sub-section 3(c) of section 141 the following new paragraph:-

> "(c) The proportion of the paid-up capital, and of the nominal value of the allotted shares, and of the voting power, and of the title to profits held by any person in any company at the end of any income year shall be determined by the Commissioner; and (i) in determining those proportions, the Commissioner shall disregard any alteration in those proportions which, in his opinion, is of a temporary nature and has or purports to have the purpose or effect of in any way - (A) altering the incidence of income tax; or (B) relieving the company or any other company from its liability to pay income tax, - by in either case excluding that company or any other company from, or including that company or any other company in, any group of companies in relation to that income year."

What is particularly significant about this amendment is that it adopts, in connection with the alteration which the Commissioner is to disregard, the *ipsissima verba* of section 108 (subject only to necessary amendments having regard to the subject-matter). For my part, I am unable to see how an alteration of the proportion in which shares are held, voting power is exercisable or profits are distributed can fail to be 'an arrangement entered into' and it follows either that the legislature, in providing for the disregarding of 'temporary' arrangements, was providing for the avoidance of an arrangement (whether temporary or permanent) already avoided by section 108 or it was deliberately restricting the effect of the anti-avoidance provision to arrangements of a temporary nature. I am not, for my part, persuaded that there can legitimately be attributed to the legislature the eccentric intention of deliberately enacting an amendment which, on the footing that section 141 had to be read subject to section 108, was clearly otiose. In providing specifically for the disregarding of alterations which were (a) temporary and (b) carried out for the purpose of tax avoidance, the legislature must, as it seems to me, have been limiting the extent to which alterations made for the purpose of tax avoidance were to be disregarded in

connection with group taxation. Thus one starts with the position that, immediately prior to the enactment of section 99 of the 1976 Act and the re-enactment of section 141 as section 191 of that Act, the anti-avoidance provisions of section 108 could not sensibly be applied to corporate structural arrangements made to comply with the provisions of section 141 and that that section contained its own anti-avoidance provisions, restricted to temporary alterations.

Before considering the effect of the introduction into this legislative picture of section 99 in the form in which it stood at the time material to this appeal - it has subsequently been amended - I must briefly consider an incidental argument that was raised by the appellant before the Board but which does not appear to have been relied on below and does not appear in the appellant's case. The argument was this, that whatever may be the effect of section 191(1)(c)(i) in a case where there was in the year in question an existing shareholding, it cannot apply to the original acquisition of 100% of the shares of the company, for that is not an alteration in the proportion of the paid-up capital held. I have found myself incapable of accepting this argument. Strictly, I suppose, neither nil nor the whole is a 'proportion', but the section is clearly directed as much to the case where a shareholder holds all the issued shares as to one where he holds only a lesser amount and I cannot for my part suppose that, in referring to alterations in proportion, the legislature was contemplating an increase from, say, 1% to 99% but not an acquisition of the whole share capital, or the attachment of additional voting rights, where some already existed, and not the attachment of voting rights to shares which were previously non-voting shares.

Turning then to the effect of the introduction, in a consolidating statute, of the new section 99, is it reasonable to suppose a legislative intention to subject to the general anti-avoidance provision the group taxation scheme established by previous legislation, containing its own limited anti-avoidance provision and re-enacted in the same terms as before? In answering this question one has, it seems to me, to analyse exactly what section 99 was intended to achieve which was not already achieved by the previous section 108. First it gave a new definition of 'arrangement' in more specific terms. Secondly, it made it clear, if that were needed, that it applied as much to avoidance of prospective as of accrued liabilities. Thirdly, it added to tax avoidance as previously defined the purpose of directly or indirectly avoiding, reducing or postponing any liability to income tax. Fourthly, it made it clear that the provisions were to apply even

if tax avoidance was merely one, and possibly a subsidiary, purpose or effect of the arrangement. The only escape was where tax avoidance was "merely incidental". Finally, it conferred some new and extensive powers on the Commissioner for counteracting the tax advantage sought to be obtained.

I do not for my part find in any of these extensions anything which impels me to the conclusion that the new section was intended to cover transactions which were authorised by other provisions of the Act, and which, as a matter of necessary construction of the preceding legislation, had previously been excluded from the operation of section 108 although literally falling within its terms. If, as I am persuaded was the case, the former section 108 did not bite upon an arrangement made in order to comply with the provisions of section 191, then I cannot for my part find anything in the terms of the new section 99 which would lead to the conclusion that that section was to override the prior construction of section 191 as a self-contained code standing apart from the existing section 108. Such an intention cannot, as I see it, stem from the expanded definition of 'arrangement'. What was done here was already an 'arrangement' within section 108. It is not to be found in the extension, if it was one, of the effectiveness of the section to prospective liability. And it is not to be found in the expanded definition of tax avoidance or in the application of the section to subsidiary as well as to primary purposes. If then it is to stem from anywhere it is only from the bare fact of the enactment of a new anti-avoidance provision which, so far as it covered new ground, did not do so in any respect relevant to section 191. If the prior section 108 did not strike down the transaction in the instant case - and for the reasons I have endeavoured to express I do not believe that it did - then I can see no ground for holding that the introduction of the new section 99 had that effect.

For my part, therefore, I agree with the majority of the Court of Appeal.