THE EVOLUTION FROM FORM TO SUBSTANCE IN TAX LAW: THE DEMISE OF THE DYSFUNCTIONAL "METWAND"

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"… timber trees cannot be felled with the stroke of a goose quill."[1]

TABLE OF CONTENTS

PART 1

Introduction
The basic principle
Morality and tax avoidance
Form over substance
Some illogical thinking
Ramsay and other more enlightened cases
"Bite the bullet" - and do what Parliament asked
And the Commissioner of Inland Revenue?
The cost to the country
The King is dead - long live the King
And uncertainty?
A. Wattie v Commissioner of Inland Revenue
B. Commissioner of Inland Revenue v Bank of New Zealand Investments Ltd
A shift in thinking

PART 2

And now *Ben Nevis*
But traces of form over substance linger
Cases applying *Ben Nevis*
A. The bank cases
B. *Commissioner of Inland Revenue v Penny and Hooper*
C. *Krukziener v Commissioner of Inland Revenue*
The journey's end?

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1 *Liford's Case* (1614) 11 Co Rep 46b at 50a; 77 ER 1206 at 1214.

I. INTRODUCTION

In my six years on the Court of Appeal I delivered five dissenting judgments in taxation appeals. Each judgment favoured the Commissioner of Inland Revenue.

This outcome did not, of course, indicate a bias towards the tax collector any more than the majority judgments to which I dissented indicated a bias in favour of the taxpayer. The divergence is simply due to the fact I adopted a different approach from the President, Sir Ivor Richardson, and the majority he commanded on that Court.

The common theme of these judgments was my rejection of the doctrine of form over substance. In *Peters v Davison*,[2] I referred to what has happened in practice with the over-zealous application of the form over substance doctrine by various corporate taxpayers and their tax advisers. The doctrine, I claimed, had spawned a culture in certain sections of the community and the specialist tax advice industry dedicated to extreme legalism in the interpretation and application of the income tax legislation.

In *Wattie v Commisioner of Inland Revenue*,[3] I was critical of the so called doctrine of economic equivalence. I also suggested that the "sham or genuine, no halfway house" rule could not withstand scrutiny.[4] In *Colonial Mutual life Assurance Society Ltd v Commissioner of Inland Revenue*,[5] I confirmed that the doctrine is an extremely flexible and portable concept all too often invoked to exclude recognition of the substance of a transaction or even avoid a rigorous analysis of the legal arrangement actually entered into. Finally, in *Commissioner of Inland Revenue v Bank of New Zealand Investments Ltd* I challenged the form over substance doctrine at some length.[6]

In 2005 I completed the draft of an article entitled: "Form Over Substance in Tax Law: The Dysfunctional Metwand". The use of the word "metwand" was, of course, a reference to Lord Tomlin's dedicated use of that word in the phrase "the golden and streight metwand of the law" in *Inland Revenue Commissioner v Duke of Westminster*.[7] Shortly afterwards, the *Ben Nevis* case began its determined path through the court hierarchy. The facts in that case clearly raised the question of the tension between form and substance. As a relatively recently retired Judge of the Court of Appeal, and an even more recently retired Acting Judge of the Supreme Court, I thought it possibly inappropriate to submit the article for publication. For that reason, the article languished in the bottom draw of my desk or, more accurately, among the "documents" on my computer. It was revisited temporarily to include a section on the morality of tax avoidance inspired by the excellent paper by Zoë Prebble and John Prebble, "The Morality of Tax Avoidance."[8]

With the passage of time, and because the Supreme Court has now spoken authoritatively on the question of tax avoidance in *Ben Nevis Forestry Ventures and Ors v Commissioner of Inland Revenue*[9] and *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*,[10] and the further fact

2 *Peters v Davison* [1999] 2 NZLR 164 at 201. (A separate judgment).

3 *Wattie v Commissioner of Inland Revenue* (1997) 18 NZTC 13297 at 13, 311.

4 Ibid, at 13, 310–13, 311.

5 *Colonial Mutual Life Assurance Society Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15614 at [125].

6 *Commissioner of Inland Revenue v Bank of New Zealand Investments Ltd* [2002] 1 NZLR 450 at 467 *et seq*. The fifth case in which I dissented, not mentioned above, is *Auckland Harbour Board v Commissioner of Inland Revenue* (1999) 19 NZTC 15433.

7 *Inland Revenue Commissioner v Duke of Westminster* [1936] AC 1.

8 "The Morality of Tax Avoidance" (2010) 43 Creighton Law Review 693.

9 *Ben Nevis Forestry Ventures and Ors v Commissioner of Inland Revenue* [2009] 2 NZLR 289.

10 *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2009] 2 NZLR 359.

that the principles set out in those decisions have been applied in subsequent cases, my hesitancy has evaporated. I therefore propose to set out my original thinking relating to the doctrine of form over substance in tax law and then assess the impact and implications of the Supreme Court's decisions on that doctrine. This framework is appropriate as it is impossible to assess the significance of those decisions without a full appreciation of the regime which they replace.

I take the view that *Ben Nevis* and *Glenharrow* represent a marked, although not entirely overt, departure from the form over substance doctrine. Although I conclude that the Court still has further to go in order to achieve a tax law which is logical and coherent and which provides tax advisers with a greater measure of certainty than is presently the case.

II. The Basic Principle

The basic principle that has motivated my thinking was clearly, and I would like to think succinctly, spelt out in *Peters v Davison*:[11]

> The objective of the Income Tax Act is to collect tax on income. Income is derived from the substance of a transaction, not its form. It is therefore necessary to have regard to the substance of a transaction and not just the form in which it is fabricated to determine the true income and the tax which is payable on that income. For either the tax authorities or the Courts to do otherwise is to thwart the objective of the Act.

This rejection of the form over substance doctrine is part of a wider judicial philosophy or approach – the rejection of formalism or formalistic thinking in judicial adjudication.[12]

In endeavouring to reconstruct legal formalism in 1988, Professor Weinrib observed that in the last two centuries formalism has been killed again and again, but has always refused to stay dead. The great bulk of legal scholarship, however, asserts that its death is irreversible.[13] That assertion is no doubt correct but, even though officially dead, it exerts a cadaverous influence from the grave. Formalism, or formalistic thinking, is very much evident in practice and at times exhibits a coercive influence on judicial thinking.

Formalism, of course, does not have the same meaning to everyone, but although the term may be used in different ways, the notion that it represents decision making according to rule or doctrine is common to its usage. "Rule" in this context implies the language of rule formulation; "doctrine" dictates that the literal mandate of the rule is to be preferred. Formalistic thinking precedes the unquestioning acceptance and application of rules to particular cases and sustains legal doctrines, however unsound or illogical they may be.

Tax law billets formalistic thinking more than any other area of the law. The crippling example of this penchant or fetish for formalism is the form over substance doctrine. It is an open acknowledgement that form will dictate the nature of a transaction and so, if necessary, subvert the true substance of the transaction.

This approach on my part brought me into conflict, albeit friendly conflict, with Sir Ivor Richardson, the doyen of tax lawyers and a lawyer and judge who has exerted a dominant influence

11 Above n 2, at 201.

12 See EW Thomas, *The Judicial Process: Realism, Pragmatism, Practical Reasoning and Principles* (Cambridge University Press, 2005) at Chapter 3.

13 Ibid, at 56.

on the content and direction of tax law in this country for more than three decades.[14] It is this divergence in our viewpoints, and not any lack of respect for one of this country's foremost jurists, which accounts for the five dissenting judgments mentioned above.

III. Morality and Tax Avoidance

In *Commissioner of Inland Revenue v Bank of New Zealand Investments Ltd*[15] I dealt with the "morality" of tax avoidance in broad terms; it distorts the tax base, undermines the integrity of the tax system and is inequitable as between taxpayers. The language is the prosaic language of judges sensitive to the unfairness of tax avoidance. A more philosophical exercise is avoided.

Such an exercise, however, is not irrelevant to the question of tax avoidance and should not be evaded by the commentator. In this regard, I am fortunate to have had the advantage of reading the outstanding contribution by Zoë Prebble and John Prebble to which I have already referred. The authors examine the morality of tax evasion and tax avoidance in considerable depth.[16] It is not possible to reproduce Zoë and John Prebbles' paper in full or repeat all the arguments advanced in it. For the purpose of this article, it will suffice to briefly summarise the salient points or, at least, the salient points that I wish to endorse.

(1) Tax evasion and tax avoidance are not economically dissimilar. They are each undertaken in pursuit of the same broad aim, that is to minimise or avoid tax liability. They are motivated by the same desire and have the same economic consequences. Tax evasion is, of course, illegal while tax avoidance is not necessarily illegal per se. Tax avoidance does not require a finding of fraud. Nor is it ordinarily subject to criminal punishment. Hence, the difference between evasion and avoidance can be seen as essentially a matter of law and not of relevant fact.[17] Indeed, as the authors point out, tax avoidance can often comprise a more involved and substantial mental element in that the "detailed planning of a tax avoidance scheme suggests a mind deeply engaged in the enterprise of minimizing taxes."[18]

(2) The authors systematically refute a number of assumptions that attach to the question of the morality of tax avoidance. The first is the assumption that taxpayers are morally entitled to their pre-tax incomes and that taxation is an unjustified governmental invasion of an individual's private property rights. There is nothing, however, in the notion that individuals possess such a right, even invoking Lockian concepts, to ordain that private property rights confer any such entitlement. As the authors point out, a legal system cannot exist without a government

14 Sir Ivor Richardson was a recognised tax law expert when in practice, and the leading counsel in taxation matters when Crown Counsel with the Crown Law Office from 1963-1966. He was the Chairman of the Committee of Inquiry into Inflation Accounting in 1975-1977. He prepared income tax codes for Mauritius and Western Samoa, which were enacted in 1974, and the estate and gift duties legislation of Western Samoa, which was enacted in 1978. Sir Ivor has published books on *The Estate and Gift Duties Act, 1968* (1969), *Tax Free Fringe Benefits* (with RL Congreve, 1975), and *Adams and Richardson's Law of Estate and Gift Duty* (with RL Congreve, 5th ed, 1978). In 1993-1994 Sir Ivor undertook an Organisational Review of the Inland Revenue Department. He was a member of the Court of Appeal from 1977 and the President of the Court from 1996 until he retired in 2002.

15 Above n 6, at 471-473.

16 Above n 8. See also William B Barker "The Ideology of Tax Avoidance" (2009) 40 Loyola University Chicago Law Journal at 229.

17 Ibid, at 727.

18 Ibid, at 722.

and a government depends on taxation. Consequently, it is "meaningless" to speak of a prima facie property right to one's pre-tax income.[19]

I would go further than the authors. The notion that there is a moral entitlement to one's pre tax income is nothing more than a prejudice inherent in an ideological commitment to an untrammeled free market and so-called "small government". Once it is acknowledged that government is essential, as must be the case, the question is how far governmental activity and expenditure should extend and, in the absence of the prejudice I have referred to above, it cannot be sensibly argued that any sort of moral sanction requires governmental expenditure to be minimal. Small government is at best a political or economic preference; it is not a moral imperative.

(3) Another assumption that cannot withstand scrutiny is that tax avoidance is not harmful. Tax avoidance is not victimless. As Zoe and John Prebble point out, the lack of individually identifiable victims is not the same thing as a lack of victims altogether. Nor is it correct that sufficiently diffuse harm is the same as a total absence of harm. Furthermore, while the harm which results from an individual's failure to comply with his or her tax liability may be so diluted as to be negligible, if everyone refused to comply the negligible harm would amount to a "very great harm".[20]

The assumption that tax avoidance is not harmful must yield to a more realistic view. It results in a misallocation of resources. Taxpayers spend time and money devising tax avoidance schemes and this expenditure of effort represents a dead weight loss to the economy. While the taxpayer may obtain a tax benefit he or she is not undertaking any actual beneficial activity.[21] In fact, the more prevalent the tax avoidance, the greater the need to increase the tax rates and raise additional taxes. In the result almost everyone is worse off.[22]

As the authors also proceed to point out, tax avoidance not only depletes the government's revenue but also undermines a government's progressivity policies. In practice, it has substantially negative distributional consequences simply because not all taxpayers are able or willing to devise or take advantage of tax avoidance schemes. Generally, the authors claim, it is the more wealthy taxpayers, or those with a more sophisticated knowledge of tax law, who are in a position to take advantage of tax avoidance opportunities.[23]

Furthermore, tax avoidance risks undermining public confidence in the tax system. The authors remark on the vicious circle that eventuates: as confidence in the system falters members of the public become less likely to comply voluntarily with the tax laws.[24]

I am in total agreement with the authors. The notion that tax avoidance is not harmful is basically an anarchical assertion which is demonstrably untrue. Far from providing a moral foundation for tax avoidance, the harm tax avoidance causes confirms that it is essentially immoral. Further, I would hesitate to admit that a system which is demonstrably inequitable can ever be said to be moral.

(4) The authors rightly contend that tax avoidance cannot be considered moral on the basis that tax avoidance is "legal". To this end they refute the notion that tax avoidance must be categorised as either "mala prohibita", that is, a prohibited evil, or "mala in se", that is, an evil in

19 Ibid, at 721.

20 Ibid, at 725.

21 Ibid.

22 Ibid.

23 Ibid, at 726.

24 Ibid.

itself, by demonstrating that the concepts are not mutually exclusive or exhaustive. They correctly assert that: [25]

> People who say that tax avoidance is not immoral seem to rely on a false dichotomy: it is not correct to say that unless a wrong is immoral entirely independently of all law, its content must be morally neutral and that its sole claim to moral weight must be derived from a general obligation to obey the law.

There is ample logical space between these two paradigms for the imposition of a moral duty independent of a general obligation to obey the law.

The authors identify this moral duty as something like a duty "to contribute to one's cooperative society".[26] Taxation law gives shape to this moral duty by defining the measure of taxes on the forms of income that a taxpayer must pay. Viewed this way, tax evasion is morally wrong, not only because it is illegal, but also because, within our legal and societal context, "our broad moral obligation to contribute to the collective has taken the specific shape of a duty to pay our taxes".[27] Tax evasion is thus a wrong in a "deep sense" and therefore morally wrong by virtue of its content as well as its legal status. Being economically similar, tax avoidance is also morally wrong.

While not dissenting from the authors' analysis I can, for myself, reach the same conclusion by a shorter route. Society is inherently interdependent and interactive.[28] It cannot function without the governmental apparatus to regulate that interdependence and interaction. All citizens participate in that necessary governmental apparatus and obtain a greater or lesser benefit from its operation. That participation and benefit give rise to a general duty to contribute taxes to maintain that apparatus. Irrespective of the law, therefore, this duty can be properly perceived as a moral duty resting on citizens in an inherently interdependent and interactive society. It follows that to breach that duty, either by avoiding a tax liability by evasion or avoidance, is to commit an immoral act.

These arguments are appealing, not only because they debunk much of the sophistry and semantics attaching to the distinction between tax evasion and tax avoidance, but also because they make it that much more difficult to resist an argument that tax evasion is immoral but tax avoidance is not. It becomes even more difficult to support a positive argument that citizens enjoy a moral entitlement to avoid tax.

I am fully conscious that rejecting the assumption that tax avoidance is a "moral entitlement" and otherwise not seriously harmful and replacing those assumptions with a positive assertion that tax avoidance is immoral will not sit comfortably with many corporate taxpayers and lawyers and accountants engaged in the tax advice industry. So be it.[29] Conduct which is immoral cannot be sanctioned simply to accommodate the sensitivities of the generally more wealthy taxpayers and their tax advisers. Rather, the appropriate response is to stop short of endorsing arrangements which alter the incidence of tax to an extent that the purpose or effect of the tax avoidance cannot be said to be merely incidental.

In directing the courts to adopt an approach which enables decisions to be made in individual cases through a process of statutory construction which focuses objectively on features of the arrangement in issue, the majority in *Ben Nevis* expressly enjoin judges not to be "distracted by in-

25 Ibid, at 731.

26 Ibid, at 736.

27 Ibid, at 737.

28 Thomas, *The Judicial Process*, above n 12, at 371-373.

29 The question whether the concept of tax avoidance could be jettisoned from the statutory regime and be replaced by a dichotomy of tax liability and tax evasion is a question for another day.

tuitive subjective impressions of the morality of what taxation advisers have set up."[30] The phrase leaves open the question whether objective impressions of the morality of tax avoidance are permissible. Although one might prefer to omit the word "impressions", objectivity is a primary judicial trait. Together with impartiality, it is the rationale underlying judicial independence. Judges do not commonly advert to their intuitive impression, subjective or objective, of the morality of the subject-matter in issue, although, of course, from time to time overt reference may be made to the "merits" of a case. Nor, however, is it common to read an express appellate exhortation not to be influenced by the morality of the subject-matter. While much of the law may reflect a moral precept, the courts remain outwardly morally neutral.

One can accept that the intuitive subjective impressions of the morality of tax arrangements should not distract the judge from the legal task at hand. If, however, the arrangement is capable of an "objective" impression of its morality, the argument against it being set to one side does not seem so compelling. The exhortation then becomes close to telling the courts not to be distracted by the merits, an exhortation that must fall on the sword of reality.

I suspect that the majority's perception of the need for this caution reflects the thinking of the past and one or more of the features identified by Zoē and John Prebble. There is no greater, or lesser, need for the courts not to be distracted by impressions of the morality of the subject matter when considering a tax case than when considering a claim that a benefit has been obtained illegally, or that a promoter has obtained funding from investors without adhering to the rules, or that a party has exploited another party in entering into or in carrying out a contract, or in any number of other claims that come before the courts. Just as the courts finally declined to adopt a different approach to the interpretation of statutes so, too, they must decline to set tax law apart as some sort of legal eunuch.

I wish to make it clear, however, that these observations have been invoked, or provoked, by the majority's unexpected exhortation. In dealing with the morality of tax avoidance I am not to be taken as suggesting that judges should incorporate their impressions, objective or subjective, of the morality of the arrangement in question into their judgments, much less enter upon a philosophical discourse on the subject. They need go no further than indicate the value judgment on which their decision is based in pursuit of the need for transparency in judicial adjudication.[31] Rather, my purpose in adverting to the subject has simply been to negate the notion that tax avoidance is not immoral or that it warrants special or separate treatment or consideration on that account.

Tax avoidance is deserving of opprobrium and, in determining that a taxpayer's arrangement has crossed the line and become tax avoidance, judges will and should be conscious that they are making a decision that carries that opprobrium with it. Tax advisers discussing an arrangement with their clients need to be aware that this opprobrium may attach to their advice if it crosses that line.

30 Above n 9, at [102].

31 Thomas, *The Judicial Process*, above n 12, at 306-307, 349-350 and 352-353.

IV. Form Over Substance

In ascertaining what is meant by "form over substance", it is convenient to start with Sir Ivor Richardson's dicta (as Richardson J) in *Re Securitibank Ltd (No 2) Ltd*[32] in 1978. The transactions in question had the same economic effect as a loan but that effect had been achieved by selling instruments at a discount. Richardson J said:[33]

> It is well settled that, where documents have been drawn to define the relationship of persons involved in a business operation, the true nature of the transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out (*Helby v Mathews* [1895] AC 471; *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1; *Commissioners of Inland Revenue v Wesleyan & General Assurance Society* (1946) 30 TC 11). As Lord Tomlin said in the *Duke of Westminster* case:
>
> '…the **substance** is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles…'
>
> It is the **legal character** of the transaction which is decisive, not the overall economic consequences to the parties. (*Commissioner of Inland Revenue v Europa Oil (NZ) Ltd* [1971] NZLR 641, 648-649; [1971] AC 760, 771-772; *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue* [1976] 1 NZLR 546, 553; [1976] 1 WLR 464, 472).' (Emphasis added).

We see here in embryonic form the confusion of thought that was to permeate much of the courts' thinking in examining transactions in revenue cases over the next 30 years. The initial quest is stated to be the ascertainment of the "true nature or substance" of the transaction. But how is this "true nature" to be ascertained? Richardson J's answer was to treat the legal arrangements entered into as being "decisive". Consequently, in his view, the substance of the transaction in *Re Securitibank (No 2) Ltd*[34] was not whether it was a loan or not but the transaction which resulted from the legal form which had been adopted. It is the legal character and not the overall economic consequences to the parties which is decisive. Economic equivalence, along with economic reality, is forsworn.[35]

Sir Ivor Richardson had, of course, done no more than apply Lord Tomlin's dictum in the *Duke of Westminster* case.[36] However it is not generally appreciated that the Law Lord's dictum enjoys a less than respectable legal pedigree. Prior to that case it had been accepted that regard should be had to the substance of a transaction and not merely its form. Indeed, the submission of counsel for the Commissioners in the *Duke of Westminster* case went no further than contending that the "substance of the transaction is to be regarded, and not merely the form".[37]

Thus, in *Helby v Mathews*[38] Lord Hershell LC observed:

> It is said that the substance of the transaction evidenced by the agreement must be looked at, and not its mere words. I quite agree.

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32 *Re Securitibank Ltd (No 2) Ltd* [1978] 2 NZLR 136. It is to be noted that *Re Securitibank Ltd (No 2)* was a case involving the construction of bills of exchange.

33 Ibid, at 167.

34 Ibid, at 167-168.

35 See also *Commissioner of Inland Revenue v Europa Oil (NZ) Ltd (No 1)* [1971] NZLR 641.

36 Above n 7.

37 Ibid, at 6.

38 *Helby v Mathews* [1895] AC 471 at 475.

In *Attorney-General v Worrall*[39] Lopes LJ stated:

> It is clear that in deciding questions of this kind [acceptance of a covenant in satisfaction of a mortgage debt] we have to look at the substance of the transaction…

In *St Louis Breweries Ltd v Apthorpe*[40] Willis J said:

> …in matters of this kind, especially in Revenue matters, it seems to me that one ought to look at the substance, and not merely at matters of machinery and form…

Lord Halsbury LC then said in *Secretary of State in Council of India v Scoble*:[41]

> Still, looking at the whole nature and substance of the transaction (and it is agreed on all sides that we must look at the nature of the transaction and not be bound by the mere use of the words), this is not the case of a purchase of an annuity;

Lord Atkinson in *Lethbridge v Attorney-General*[42] confirmed:

> It has been many times decided that in dealing with questions arising on the Finance Act of 1894 and the Succession Duty Acts regard should be had to the substance of the transactions on which these questions turn rather than to the forms of conveyancing which the parties to them may have adopted to carry out their objects.

Pollock MR, just over a decade before the *Duke of Westminster* case, also stated in *Back v Daniels*:[43]

> The agreement …in form confers a tenancy upon the Respondents … The terms of the agreement do not conclude the matter; it is necessary to have regard to the substance of it.

In the *Duke of Westminster* case Lord Tomlin set out to reject a perceived "misunderstanding" in revenue cases to the effect that the courts could ignore the "legal character" of a transaction and have regard to "the substance of the matter". He indicated his commitment to this view, as well as to diehard formalism, in the following passage: [44]

> The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting 'the incertain [sic] and crooked cord of discretion' for 'the golden and streight metwand of the law'.

Apart from a general reference to "revenue cases", Lord Tomlin referred to only two of the five cases cited by counsel for the Revenue Commissioners in argument, and he reinterpreted their effect. Lord Hershell's statement in *Helby v Mathews* was somewhat tenuously claimed to be saying no more than that the substance of a transaction embodied in a written instrument is to be found by construing the document as a whole.[45] The reader is invited to refer back to Lord Hershell's statement. Lord Halsbury also would have been surprised to learn that, in *Secretary of State in Council of India v Scoble*, he had simply been giving utterance to the indisputable rule

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39 *Attorney-General v Worrall* [1895] 1 QB 99 at 105.

40 *St Louis Breweries Ltd v Apthorpe* (1898) 79 LT 551; 28 Digest 29149; 4 Tax Case 111.

41 *Secretary of State in Council of India v Scoble* [1903] AC 299 at 302.

42 *Lethbridge v Attorney-General* [1907] AC 19 at 26-27. See also *Earl Howe v Inland Revenue Commissioners* [1919] 2 KB 336, where the Court of Appeal had regard to the fact that the insurance premiums in dispute were not in the nature of income payments, which would have permitted a deduction, even though that was the structure of the documentation.

43 *Back v Daniel*s [1925] 1 KB 526 at 536.

44 Above n 7, at 19.

45 Ibid, at 20.

that surrounding circumstances must be regarded in construing a document. Again, it will suffice for the reader to refer back to Lord Halsbury's dictum.

Formalism encourages a form of judicial delusion and even, at times, it must be said, a lack of intellectual rigour or honesty. Although no doubt unintended, for Lord Tomlin was playing the formalistic game, these features are evident in his review and dismissal of the earlier case law. He was not dispelling a "misunderstanding" at all, but rather reversing the established law, and his review of the case law is incomplete. As demonstrated above, those cases which Lord Tomlin mentions are dealt with summarily and superficially. He purports to "explain" what the Judges meant in those cases when they clearly did not mean what he attributed to them. Reference to what they actually said belies his "explanation". Most significantly, reference to the facts and the findings in those cases confirms beyond serious argument that the courts had previously had regard to the substance of the transactions in issue.

Added to these shortcomings is the doubt that has been cast on the validity of the reasoning in the *Duke of Westminster* case by Lord Roskill in *Furniss (Inspector of Taxes) v Dawson*,[46] and Lord Steyn and Lord Cooke in *Inland Revenue Commissioners v McGuckian*.[47] These cases are touched upon below.

It is unfortunate, therefore, that Lord Tomlin's dictum has been reiterated with such unquestioning approval without closer examination and analysis. Lord Tomlin uttered his famous pronouncement at a time when legal formalism was on the ascendancy in the United Kingdom. The canonical status conferred on the Law Lord's dictum without any attempt to assess the strength of his limited analysis of the previous case law reflected the lingering influence of formalism 40 odd years on.

Above all, the suitability of Lord Tomlin's dictum to a jurisdiction having a general anti-avoidance provision in the statute governing tax law was required. Unlike this country, England did not have, and still does not have, a general anti-avoidance provision. Some positive effort had to be made to reconcile Lord Tomlin's dictum with a tax regime in which a general tax anti-avoidance provision is an "essential pillar of the tax system",[48] although no such effort was made. The failure or oversight is of gargantuan proportions. It is clear from the language of the majority of the Law Lords (Lord Atkins dissented) that, if the Revenue Commissioners had to hand and been able to rely upon a general anti-avoidance provision, their Lordships in the majority would have been hard pressed to reach the conclusion they did.

If these inquiries had been undertaken it may have been possible to avoid the form over substance doctrine taking hold, but take hold it did. Although the wording may vary, Sir Ivor Richardson's endorsement of Lord Tomlin's dictum, or the form over substance formulation which resulted, has been repeated many times over. For example, in *New Zealand Investment Bank Ltd v Euro-National Corporation Ltd*,[49] Richardson J repeated the essence of the doctrine:

> …the true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out. It is not to be determined by an assessment of the broad substance of the transaction measured by the overall economic consequences to the participants. The forms adopted cannot be dismissed as mere machinery for effecting other purposes. At common law there is no

46 *Furniss (Inspector of Taxes) v Dawson* [1984] AC 474 at 515.

47 *Inland Revenue Commissioners v McGuckian* [1997] 3 All ER 817.

48 See below under the heading: "'Bite the Bullet' — and Do What Parliament Asked".

49 *New Zealand Investment Bank Ltd v Euro-National Corporation Ltd* [1992] 3 NZLR 528 at 539.

> half-way house between sham and characterisation of the transaction according to the true nature of the legal arrangements actually entered into and carried out.

It will be noted that the formulation which had been adopted in *Re Securitibank Ltd (No 2)*[50] has undergone a subtle variation. The reference to the "true nature and substance" of the transaction has become a reference to the "true nature" of the transaction. The word "substance" has seemingly disappeared into the ethos. This divergence in the use of the English language is evident by reference to my dicta in the *Bank of New Zealand Investments* case[51] where I hold firm to the view that, whatever approach is adopted in respect of specific tax sections, a general anti-avoidance provision requires the courts to examine the substance of the transaction. I then state: "Semantics aside, this question can only be answered by reference to the true nature of the transaction",[52] and the "true nature" of the transaction can only be determined by having regard to its actual or economic reality.

V. Some Illogical Thinking

One of the most unsatisfactory features of formalistic thinking is that it distorts logical thought. Complacent with its self-proclaimed internal coherence, it nurtures a perverse logic and neglects the rigour which ordinary reasoning would bring to the subject. Three examples of this deficiency in respect of the form over substance doctrine may be touched upon.

I have already adverted to the first. How can one sensibly speak of the "true nature" of a transaction without meaning the actual substance of the transaction? Form cannot dictate substance. The "true nature", that is, the substance, of a transaction cannot change simply because the legal form of the transaction changes.

Take a straightforward example. A makes a gift to B, but the gift is presented in the form of an annuity. What is the "true nature" of the transaction: a gift or annuity? What, then, must be the formalists' formula: a gift in the form of an annuity is an annuity?[53]

It is a bit like the proverbial wolf dressed as a sheep; those with a form over substance bent would say that, as it looks like a sheep and has documents saying it is a sheep, it must be a sheep, but the more astute ones among us know, of course, that in reality it is a wolf.

A moment's reflection along these lines is enough to confirm that the form over substance doctrine as enunciated in the past is plainly wanting in rigorous thinking.

The second logical deficiency in the form over substance doctrine is that it thwarts the key question. If the transaction is contrary to a specific requirement of the Act, no question of tax avoidance arises. The taxpayer will be liable for the disputed tax. If, however, the legal form of the transaction complies with the technical requirements of the Act in accordance with this doctrine the transaction will not amount to tax avoidance because its true nature will have been

50 Above n 32.

51 Above n 6, at [113].

52 Ibid.

53 In seeking to defend and extol Sir Ivor Richardson's thinking, David Simcock conflates legal form with substance. Indeed, he introduces the notion of three concepts: legal form, legal substance and economic substance in "A Banned Substance: Form and Substance in the Judgments of Sir Ivor Richardson – A Clarity of Vision" (2002) 8 NZJT&P 209, esp. 210, n 4. Consequently, Simcock would presumably say that the "legal substance" of a gift in the form of an annuity is an annuity – which ignores the actual substance! The claim equates "legal substance" with "legal form" and otherwise bastardises the true meaning of the word "substance". Simcock's reasoning illustrates the lengths to which it is necessary to go in order to try to make analytical sense of the form over substance doctrine.

ordained by its legal form. The circularity of the reasoning is plain to see. If the form of the transaction is "legal" it will not amount to tax avoidance because its "true nature" will be "legal".

In the third place, irrespective that the legal form of a transaction is said to be decisive, the tests introduced to determine whether or not the transaction amounts to tax avoidance necessitate an examination of the substance of the arrangement. How can the courts determine whether a transaction has a "business purpose", apart from the purpose of gaining a tax advantage, without examining the substance of the transaction? Or, how can the courts know whether the transaction is "genuine" or "artificial" or "contrived" or a "pretence", to coin words having regular currency, without regard to its substance? How can the courts have regard to the economic reality in terms of the test in the *Challenge Corporation Ltd v Commissioner of Inland Revenue* case[54] without having regard to the true character or economic consequences of the transaction? How can the courts determine that certain steps in a transaction are fiscally ineffective and to be disregarded in terms of the principle in *W T Ramsay Ltd v Inland Revenue Commissioners*[55] without a full understanding of the substance of the transaction?

The courts require these questions to be asked. Yet, if the "true nature" of the transaction is to be determined by the legal form, they serve no discernable purpose. In insisting on form over substance, and then applying these various tests, the courts have been playing word games. Once recourse is had to the actual substance of a transaction, it is spurious to revert to the notion that the legal form must be "decisive" in determining the true nature of the transaction.

A fourth distortion of logical thought is apparent in the formulation and application of the "sham or nothing" classification. While purporting to exempt this classification from anti-avoidance provisions where the legislature has mandated a broader or different test, adherents of the concept nevertheless effectively import it into their test for anti-avoidance when insisting that the legal form of the transaction is decisive. If the legal form is decisive, it is difficult to see how a transaction in a legal form could be a sham, short of being shown to be tax evasion.[56]

VI. *RAMSAY* AND OTHER MORE ENLIGHTENED CASES

Notwithstanding the absence of a general anti-avoidance provision in the United Kingdom, dicta can be found in that jurisdiction supporting a more realistic appraisal of the transaction in question than that generally adopted in this country prior to *Ben Nevis* and *Glenharrow*. *W T Ramsay Ltd v Inland Revenue Commissioners*,[57] *Inland Revenue Commissioners v Burmah Oil Co Ltd*,[58] *Furniss*

54 *Challenge Corporation Ltd v Commissioner of Inland Revenue* [1987] 1 AC 155; [1986] NZLR 513 from 555.

55 *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300.

56 The sham doctrine could usefully disappear from the tax lexicon. If a transaction is a sham because the documents do not reflect the true intention or true contract of the parties, and they obtain a reduction in the tax payable, it is tax evasion. The notion that such a situation could exist in the absence of fraudulent intent on the part of the parties is highly improbable. If such a situation did arise so as to excuse the parties from tax evasion, the transaction could appropriately be treated as tax avoidance in that it changes the ordinary incidence of tax. Little purpose is therefore served by differentiating the sham transaction from tax avoidance in the first place. While a bogus transaction may be theoretically isolated as a sham, there is in truth a marginal distinction to be drawn between a sham and a pretence. Indeed, to exclude the application of the word "sham" from tax avoidance arrangements, such as the scheme in *Ben Nevis*, is an affront to the ordinary meaning of the word. It would be preferable to drop the separate treatment of the so-called sham and simply treat it as a variety of tax avoidance or, if fraudulent intent is present, as tax evasion.

57 Above n 55.

58 *Furniss (Inspector of Taxes) v Dawson* [1982] STC 30.

(Inspector of Taxes) v Dawson[59] and *Inland Revenue Commissioners v McGuckian*[60] are notable departures from the legalistic approach which has otherwise been preferred.[61]

In *Ramsay* and *Burmah Oil* the taxpayers sought an allowance by including in the transaction a series of self-cancelling transactions, thus creating a "loss". In substance, because the transactions were self-cancelling, the loss was not a "real" loss, and the transaction could not therefore be condoned. The reasoning is not unlike that adopted by the Privy Council in the *Challenge* case.[62] The taxpayer in that case did not in reality incur the requisite expenditure which would have justified the allowance. As has been pointed out, each of these cases can be explained on the basis that there is a significant divergence between the legal form of the transaction and its actual or economic reality.[63] In a real sense, the taxpayers in these cases were hiding behind a legal form which did not accord with the economic reality or substance of the transactions.

This subterfuge was recognised, in particular by Lord Steyn and Lord Cooke, in *Inland Revenue Commissioner*s *v McGuckian*.[64] Lord Steyn traced the shift away from a literalist approach to statutory interpretation to the purposive methods of construction which had taken place over the previous 30 years, but, he said, under the influence of the "narrow *Duke of Westminster* doctrine, tax law remained remarkably resistant to the new non-formalist methods of interpretation. Tax law was by and large left behind as some island of literal interpretation."[65] Lord Steyn pointed out that the combination of two features, the literal interpretation of tax statutes and the "formalistic" insistence on examining steps in a composite scheme separately, had allowed tax avoidance schemes to flourish to the detriment of the general body of tax payers.[66]

In language as apposite as it is appealing, Lord Steyn rued the fact that the courts appeared to be relegated to the role of spectators concentrating on the individual moves in a highly skilled game. The courts, he suggested, were mesmerised by the moves in this game, and paid no regard to the strategy of the participants or the end result. "The courts", he added, "become habituated to the narrow view of their role".[67] *Ramsay* is perceived as the "intellectual breakthrough" on both fronts.

Lord Steyn acknowledged that Lord Tomlin's observations in the *Duke of Westminster* case still point to a material consideration, namely, the general liberty of the citizen to arrange his affairs as he thinks fit.[68] He added, however, that those observations have ceased to be "canonical as

59 Above n 46.

60 Above n 47.

61 Michael D'Ascenzo "Substance versus Form: the ATO Approach: 1" (paper presented to the 13th National Convention of the Taxation Institute of Australia, March 1997) states without qualification that the English courts have retreated from a strict application of the *Duke of Westminster* doctrine following the House of Lord's decision in *Ramsay* in 1982 at 296.

62 Above n 54.

63 Nabil F Orow "Towards a Conceptually Coherent Theory of Tax Avoidance – Part 2" (1995) 1 NZJTL&P 307. In this excellent article, Orow undertakes a comprehensive examination of the elements which constitute tax avoidance. Admirably, he concludes that Parliament's intent or purpose must be conclusive of the legitimacy or otherwise of transactions that seek and obtain a fiscal benefit.

64 Above n 47.

65 Ibid, at 824.

66 Ibid.

67 Ibid.

68 Ibid, at 825.

to the consequence of a tax avoidance scheme".[69] Lord Steyn then emphasised the importance of giving effect to the intention of Parliament and concluded:

> In asserting the power to examine the substance of a composite transaction the House of Lords [in *Ramsay*] was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis. Given the reasoning underlying the new approach it is wrong to regard the decisions of the House of Lords since the *Ramsay* case as necessarily marking the limit of the law on tax avoidance schemes.[70]

Lord Cooke expressly endorsed the approach put forward by Lord Steyn, including the barely veiled invitation to develop the law in a more realistic fashion. The approach in *Ramsay,* he pointed out, did not depend on general anti-avoidance provisions such as those found in Australasia. One must go back to the discernable intent of the taxing Act. Following Lord Roskill's example in *Furniss's* case,[71] Lord Cooke refrained from speculating whether a sharper focus on the concept of "wages" in the light of the purpose and circumstances of the case would have led to a different result in the *Duke of Westminster* case.[72] Clearly, both Law Lords intended to cast doubt on the validity of the reasoning in that case. Lord Cooke then reiterated the message in their Lordship's speeches in *Furniss* to the effect that "the journey's end may not yet have been found".[73]

Certainly, strong support for the thesis I am pursuing can be found in cases such as *Ramsay*, *Burmah Oil*, *Furniss*, and *McGuckian,* but they have not been mentioned with the intention of obtaining that benediction. Rather, my immediate purpose is to acknowledge that form over substance has not invariably prevailed and that, if the judicial will is there, the basis already exists in the case law to subvert the form over substance doctrine within the bounds of accepted judicial discipline. No revolution in orthodox methodology is required, for example, to take up the suggestion in *Furniss* and *McGuckian*, and overtly extend the principle in *Ramsay* to a single or unified transaction.

VII. "Bite the Bullet" and Do What Parliament Asked

With the establishment of the Supreme Court as our final appellate court, the opportunity exists to put the perverse thinking of the past behind us and positively proclaim that substance, and not form, will be the decisive factor in ascertaining the tax legality of transactions.

I emphasise that this suggestion does not mean that the legal form of a transaction is irrelevant. On the contrary, the inquiry will not be complete without a full understanding of the rights and obligations created by the legal documentation. Both form and substance are to be examined. The point is that it is the substance of the transaction, and not its legal form, which will be decisive. In short, the transaction will be void against the Commissioner if, in actual or economic substance, it amounts to tax avoidance. In such circumstances, the transaction will not be saved from the reach of the Inland Revenue Department by reason of its legal form.

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69 Ibid. Lord Diplock had already observed in the *Burmah Oil* case that Lord Tomlin's dicta tells us little or nothing as to what method of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would otherwise be payable. Above n 58, at 32-33.

70 Above n 47, at 825.

71 Above n 46, at 515.

72 Above n 47, at 830.

73 Ibid.

It may well be that the bedrock principle that I spelt out in *Peters v Davison* is simplistic,[74] but it is not intended to provide a precise formula for the tax collector or the taxpayer. Rather, it seeks to encapsulate two basic points: the first is trite, that is, that it is the objective of the Act to collect tax on income; the second is that income is derived from the substance of a transaction, not its form, and it is only the substance of a transaction which will reveal the true income. It is for both the Commissioner and the courts to give effect to this fundamental objective of the legislation.

The need to resort to Parliament's intent is particularly marked in respect of this country's long-standing commitment to a general anti-avoidance provision. I traversed this subject in the *Bank of New Zealand Investments* case.[75] The provision nullifies against the Commissioner any arrangement to the extent that it has the purpose or effect of tax avoidance, unless that purpose or effect is merely incidental. I will not repeat at length what I said in the judgment. Four propositions will suffice to summarise the gist of my observations.

(1) The section (then s 99) was enacted to promote Parliament's perception of what is required in the public interest. A general anti-avoidance provision was also thought to be necessary to supplement specific anti-avoidance provisions in the tax legislation, or, more pointedly, the technical or drafting limitations in those provisions.

(2) Tax avoidance diminishes and distorts the tax base and undermines the integrity of the tax system of this country.

(3) The courts' approach to the interpretation of our successive anti-avoidance sections has been unacceptably negative.[76] They have rejected a broad application of the section and over-burdened it with a morass of glosses, concepts, distinctions and doctrines which Parliament did not contemplate.

(4) Parliament intended its general anti-avoidance provision to be fully effective. It was described by Woodhouse P as "obviously a central pillar of the income tax legislation".[77] The same description was repeated by Richardson P 16 years later in the *Bank of New Zealand Investments* case. Section 99, he stated, is "an essential pillar of the tax system".[78] The approach of the two judges, however, is markedly different.[79] Only Richardson P then subjected that essential pillar to a formulation in which legal form is decisive over the actual substance of a transaction. It is surely incongruent to downgrade an "essential pillar of the tax system" in such a manner.

Lord Hoffmann's description of s 99 as a "long stop" when speaking for the Privy Council in *Commissioner of Inland Revenue v Auckland Harbour Board*[80] has been roundly assailed. Blanchard J has pointed out[81] that this dictum appears to be in conflict with the views expressed by the High Court of Australia in *John v Federal Commissioner of Taxation*[82] and the Supreme Court of Canada in *Stubart Investments Ltd v The Queen*.[83] The tax statutes in both Australia and Canada contain general anti-avoidance provisions.

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74 Above n 2.

75 Above n 6, esp. [63]–[90].

76 Ibid, see the cases referred to at [84].

77 Above n 54, at 532.

78 Above n 6, at [39].

79 Ibid, for Woodhouse J's approach, see the *Bank of New Zealand Investments* case at [85]–[88].

80 *Commissioner of Inland Revenue v Auckland Harbour Board* [1986] 2 NZLR 513 (CA) at 532.

81 The *Bank of New Zealand Investments*, above n 6, at 499.

82 *John v Federal Commissioner of Taxation* (1989) 166 CLR 417.

83 *Stubart Investments Ltd v The Queen* (1984) 10 DLR (4th) 1.

It is true that our successive general anti-avoidance provisions have been repeatedly described as the core bulwark against tax avoidance in this country and the central means of protecting the integrity of our tax system.[84] If substance is to be decisive over form, however, it should also be decisive in the interpretation of the specific tax provisions. Once the arrangement is analysed in the light of the specific tax provisions regard to its substance will determine whether it amounts to tax avoidance or not. In many cases reference to the anti-avoidance provision may be concomitant only and in that sense the anti-avoidance provision could conceivably be described as a "long stop" or, perhaps, a "back stop", but the better view would be to regard the general anti-avoidance provision and the specific tax provisions as complementary. Neither is overbearing and both require regard to be had to the substance of the transaction and for that substance to be decisive.

This is not to say that, in the overall scheme of the Act, the general anti-avoidance provision does not have a central role. Its directive infuses the whole of the statute. The significance and function of the general anti-avoidance provision was spelt out in Parliament at the time s 99 of the 1976 Act was enacted. Dr AM Finlay, then Minister of Justice, claimed in the House that the section was "one of the most enlightened and beneficial pieces of legislation in the statute book". He pointed out that, if everyone paid the tax Parliament intended, there would be two important and widely welcomed results. One would be that the tax burden would be more equitably shared resulting in a significant lightening of the burden for what he called the ordinary taxpayer. The second would be that the country's tax legislation would be enormously simplified. He expressed the hope that the proclivity to avoid tax in this country would be minimised.[85]

The Minister referred with approval to the judgment of Woodhouse J in *Elmiger v Commissioner of Inland Revenue*.[86] The distinguished Judge's judgment was also referred to in debate by the Hon Michael Connolly[87]and Mr Frank O'Flynn QC.[88] In his judgment, Woodhouse J approached the subject of tax avoidance with refreshing realism. He made the following points:

(1) The ingenious legal devices that are contrived to enable individual taxpayers to minimise or avoid their tax liabilities were often, not merely sterile or unproductive in themselves, but had social consequences which were contrary to the public interest.[89]

(2) It is not surprising that, having regard to the fact the legislature is usually several steps behind the ever-developing arrangements worked out by experts on behalf of their taxpayer clients, the legislature should attempt to anticipate the manoeuvres of some taxpayers to obtain tax advantages denied generally to the same class of taxpayer and enact a general anti-avoidance provision. Nor could it be thought "unfair to those affected" that the method adopted by the legislature should be "…the method of general proscription".[90]

(3) Transactions are caught by the anti-avoidance provisions if there is associated with them the additional purpose or effect of tax relief in the sense contemplated by the section pursued as a

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84 See eg Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance, December 1998 at [2.53] [2.58] and [2.120] [2.122]. See also Consultative Committee on Taxation of Income from Capital, *The Core Provisions of the Income Tax Act 1976*, Discussion Paper, September 1990 at [1.3].

85 Debate on the Land and Income Tax Bill (No 2), Hansard, 393 New Zealand Parliamentary Debates 1974 at 4191-4192.

86 *Elmiger v Commissioner of Inland Revenue* [1966] NZLR 683.

87 Above n 85, at 4228.

88 Ibid, at 4239.

89 Above n 86, at 686-687.

90 Ibid.

> goal in itself and not arising as a natural incident of some other purpose. If this is not the case, "appropriate legal window-dressing" could still be devised to defeat the general object of the section.[91]

It bears repeating that Woodhouse J's judgment was the judgment expressly referred to in Parliament prior to the re-enactment of the general anti-avoidance provision in the 1976 Act. The approach adopted by Sir Ivor Richardson in *Re Securitybank Ltd (No 2)*, a bare two years after that Act had been passed, is clearly at odds with the tenor of this judgment and its unqualified endorsement by Parliament. Richardson J did not refer to *Elmiger's* case in *Re Securitibank Ltd (No 2)*, but Woodhouse J also delivered a judgment in that case and it is plain that he did not resile from what he said in *Elmiger*. Having asked what more parties could do to give legal effect to their transaction when they have succeeded in every respect in matching their mutual intentions and purpose with the documentation and form that is used, he said:

> Of course it is possible for a statutory provision to declare something to be what otherwise it is not; and in that regard I have mentioned the Income Tax Acts. In that context Parliament has decided that the otherwise legally effective transactions of taxpayers are to be ignored by the Commissioner if the object was the avoidance of tax by altering its incidence.[92]

VIII. And the Commissioner of Inland Revenue?

In highlighting the need for a new substantive approach, my focus has been on the courts, but it would be amiss to ignore the criticism levelled at the Commissioner of Inland Revenue.

The Committee of Experts responsible for the Tax Compliance Report 1998 recorded that it was not so much deficiencies in the anti-avoidance provisions, as the Commissioner's past understanding and application of those provisions that is the problem.[93] The Committee believed that, in order to preserve the integrity of the tax system, a far greater degree of "robustness" in the administration of the anti-avoidance provisions is required. "The tax system", it concluded, "needs to be robust if it is to cope".[94]

The Committee of Experts' view that the problem rested with the Commissioner was echoed in the Report of the Commission of Inquiry into Certain Matters Relating to Taxation.[95] The Department of Inland Revenue, the Commission said, had adopted a "conservative interpretation" of the general anti-avoidance provisions on the tax issue and the "weaknesses exposed in the wine-box deals is not the legislation itself … but the use of it by the Commissioner".[96]

To my mind, however, these criticisms are largely misplaced. While the Commissioner may have too readily acquiesced in the application of the form over substance doctrine and been unduly conservative in his utilisation of the general anti-avoidance provisions, the courts must bear the primary responsibility for this default. What point is there in the Commissioner seeking to be more robust in enforcing the provisions if the courts do not vest them with the objective and scope that Parliament intended? Put another way, why should the Commissioner be proactive in invok-

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91 Ibid, at 694.

92 Above n 32, at 165.

93 Above n 84, at [13.47].

94 Ibid, at [13.5].

95 Ronald Davison Commission of Inquiry into *Certain Matters Relating to Taxation* (Report of the Wine-Box Inquiry, 1997).

96 Ibid, at 3:1:50.

ing the anti-avoidance provisions if the prevalent judicial approach will render that proactivity futile? What good is there in the Commissioner challenging the legality of tax transactions on the basis of their actual substance if the courts treat their legal form as decisive?

Hence, I believe that it is the judicial approach which has prevailed, and not any perceived lack of robustness by the Commissioner; that is to be condemned.

IX. The Cost to the Country

The approach epitomised in the form over substance doctrine has created a climate in which the tax avoidance industry has flourished.

Secure in the knowledge that legal form will have primacy over the substance of the transaction, taxpayers, or their advisers, have been encouraged to develop arrangements which will manifest a "true nature" based in the documentation and not the economic reality of the transaction. Even if the arrangement is challenged, the taxpayers and their advisers have been comforted by the further knowledge that the issue will be beset by all the glosses, concepts, distinctions and doctrines that have developed to give force to this formalistic preserve. These judicial artefacts have been exploited and have created a commercial environment in New Zealand in which tax avoidance has been a significant feature. The tax avoidance industry has thrived on such concepts as form over substance, "economic equivalence", the "sham or nothing" classification, "legal substance" (as distinct from the actual substance), the "choice principle", and the like.

The cost to the country has been enormous. In the *Bank of New Zealand Investments* case I sought to provide some rough estimation of the loss of tax revenue as a result of this judicial approach.[97] It is impossible to be even remotely precise, but there is no doubt that over time the cost to this country, including the dead-weight loss, has run into billions of dollars. I do not, of course, suggest that the entire cost to the revenue of tax avoidance in this country is attributable to the courts' misguided commitment to the form over substance doctrine. Some degree of tax avoidance is inevitable, whatever the system or approach adopted.[98]

Nonetheless, as I conclude in the *Bank of New Zealand Investments* case,[99] the calculation of a more precise figure, or the inability to calculate a more precise figure, is neither here nor there when it is incontrovertible that over time the cost of tax avoidance, as distinct from tax evasion, amounts to billions of dollars and represents a sizable percentage relative to this country's gross national product.

Nor is the cost of sustained judicial support for the form over substance doctrine to be measured in purely fiscal terms. The public perception of this judicial cosseting on the public's confidence in the administration of justice is also significant. Members of the public realise that there is something amiss with the law when they read about tax driven schemes in which the taxpayer's profits are in whole, or in large part, due to a complex scheme that has little or no apparent commercial utility, or which lack commercial viability apart from the tax saving involved, or which are so complicated in form as to defy commercial rationalisation, or which are seemingly brazen in their defiance of Parliament's contemplated objectives, or the like. Judicial imprimatur of schemes of this kind tend to bring the law into disrepute and imperil respect for the courts that

97 Above n 6, at [70]-[72].

98 Ibid, at [72].

99 Ibid, at [71].

administer it. Only the misplaced "mystique" of the law, or the low level of public awareness, prevents this harsh verdict being more widespread.

X. The King is Dead - Long Live the King

The judicial tendency, even where it is appreciated that a doctrine is defective, is to seek to modify it without abandoning it. It is better, it is thought, to reinterpret the doctrine rather than subvert it. Lord Hoffmann fell foul of this tendency in *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* in 2001.[100]

Lord Hoffmann perceived that, if the various discrete transactions in making up a scheme are genuine, their Lordships in *Ramsay* could not collapse them into a composite self-cancelling transaction without it appearing that they had been guilty of ignoring the legal position and looking at the substance of the matter.[101] In an endeavour to reconcile *Ramsay* with the *Duke of Westminster's* case, therefore, Lord Hoffmann was able to perceive an ambiguity in Lord Tomlin's statement that the courts cannot ignore the "legal position" and have regard to "the substance of the matter". He sought to draw a distinction between tax imposed by reference to a "legal concept" and tax imposed by reference to a "commercial concept". In the latter case, to have regard to the "business substance" of the matter, he argued, is not to ignore the legal position but to give effect to it.

I at once stated in the *Bank of New Zealand Investments* case decided shortly afterwards that this attempt to reconcile Lord Tomlin's dictum with what their Lordships decided in *Ramsay* teeters on the brink of casuistry.[102] In holding in *Ramsay* that any steps in a related series of transactions for the purpose of avoiding tax could be disregarded by the Commissioner and the related transaction viewed as a whole, the House of Lords were necessarily having regard to the substance of the transaction contrary to Lord Tomlin's injunction.

At the same time, I expressed my dissatisfaction with Lord Hoffmann's distinction between a tax imposed by reference to a "legal concept" and a tax imposed by reference to a "commercial concept", and his conclusion that to have regard to the "business substance" was not to ignore the legal position but to give effect to it. I suggested that the distinction was unclear, flawed and would cause confusion.

Confirmation was not long in coming. In *DTE Financial Services Ltd v Wilson (Inspector of Taxes)*[103] counsel on one side argued that the word "payment" in the context of PAYE legislation was a "legalistic" concept. Opposing counsel, however, contended that it was a "commercial" concept. The Court found in favour of the Revenue holding that, for the purpose of the PAYE system, "payment" ordinarily means actual payment, that is, a transfer of cash or its equivalent. This sensible appreciation of what the payment actually is was reached without reference to the argument whether it was a "legal" or a "commercial" concept.

The distinction forged by Lord Hoffmann next fell for review in *Barclays Mercantile Business Finance Ltd v Mawson*,[104] a decision of the United Kingdom Court of Appeal. Peter Gibson LJ found the dichotomy difficult to apply. Carnworth LJ experienced the same difficulty and gratui-

100 *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311.

101 Ibid, at [38] and [39].

102 Above n 6, at [105]-[112].

103 *DTE Financial Services Ltd v Wilson (Inspector of Taxes)* [2001] EWCA Civ 455; [2001] STC 777.

104 *Barclays Mercantile Business Finance Ltd v Mawson* [2002] EWCA Civ 1853; [2003] STC 66.

tously recorded that the difficulty had been shared by counsel on both sides. Finally, the Court of Final Appeal in Hong Kong became seized of the issue in *Collector of Stamp Revenue v Arrowtown Assets* in 2004.[105] It will suffice to summarise Lord Millett's direct observations. He held, first, the dichotomy was difficult to understand; secondly, Lord Hoffmann could not have really meant what he appeared to say; and, thirdly, if he did, then his dichotomy was not the law of Hong Kong!

Lord Hoffmann was routed, and he was routed simply because he tried to reinterpret Lord Tomlin's dictum rather than disapprove of it. How much more amenable it would have been if Lord Hoffmann had sought to re-establish the authority of the cases decided before Lord Tomlin reversed their effect in the *Duke of Westminster* case. It would have been even more amenable to acknowledge that the House of Lords had, indeed, broken away from the form over substance doctrine and to have sought to justify that development.

IX. And Uncertainty?

The justification for the form over substance doctrine is said to be the need for certainty, especially the need for certainty in commercial transactions. Certainty is peddled by tax lawyers and specialist tax advisers as a mantra. Fear of creating uncertainty by changing the law becomes a bogey, but it is again a bogey endorsed and promulgated by the judiciary. In *Re Securitibank Ltd (No 2)*,[106] for example, Richardson J claimed that an approach which would subvert the dominance of legal form in ascertaining the "true nature" of a transaction would create undesirable uncertainty in our law. He continued:[107]

> Commercial men are surely entitled to order their affairs to achieve the legal and lawful results which they intend. If they deliberately enter into a genuine commercial transaction intended to operate according to its tenor, what they ask of the law is the assurance, the certainty that their intentions will be recognised.

However this begs the question – or begs a number of questions. What are the "results" which these commercial men intend? Is the transaction a "genuine" commercial transaction? Is the transaction "intended to operate according to its tenor"? What are the parties' "intentions"? Do commercial men expect "the assurance, the certainty" that their intentions will be recognised, even if their intentions are to avoid tax or the avoidance of tax is the effect of their transaction?

No one would dispute that a genuine commercial transaction should be recognised as legitimate, but, equally, a transaction which is in substance tax avoidance should not be recognised as legitimate. Pietistic statements of the kind just referred to add nothing to the debate. They convey the impression that what commercial men and women are seeking is the assurance and certainty that, if they can devise an anti-avoidance transaction in a legitimate legal form, then their intention, whatever it may be, or the purpose and effect of the transaction, whatever it may be, should be recognised as legitimate.

I am not, of course, denigrating certainty as a goal. Obviously, as much certainty as it is possible to achieve is desirable. It is the unrealistic expectation of an unachievable level of certainty that is the problem. The law is inherently uncertain, and taxpayers, no less than other members of the community, must cope with that uncertainty.[108]

105 *Collector of Stamp Revenue v Arrowtown Assets* [2004] 1 HKLRD 77.

106 Above n 32.

107 Ibid, at 173.

108 See Thomas, *The Judicial Process*, above n 12, Chapters 5 and 6.

Geoffrey Lehmann has correctly observed that the belief that taxation law can and should be certain is a "chimera".[109] No provision (or judicial doctrine) will ever enable taxpayers to predict with absolute certainty that a proposed arrangement involving a tax saving will or will not constitute tax avoidance. Most commercial arrangements are undoubtedly legitimate, any tax saving being incidental, but at the margin no bright line can be drawn between a valid commercial scheme and tax avoidance. It has become unproductive to hanker after a level of precision and certainty which can never be realised.

Take our simple example again. If the courts hold that a gift presented as an annuity is not tax avoidance, the community can be relatively confident that other gifts presented as annuities will not be held void as against the Commissioner. Although, equally, if the courts were to hold that a gift presented as an annuity remains a gift for tax purposes, the law would provide the certainty of knowing that a gift presented as an annuity would be treated as a gift.

Moreover, it needs to be appreciated that an attempt to provide greater precision merely means that the boundary between "tax planning" and tax avoidance simply moves. It moves from, say, an assessment whether the transaction in substance provides for the taxpayer a saving from the natural burden of taxation which is generally denied to the same class of taxpayer, that is, where the transaction has the purpose or effect of tax relief pursued as a goal in itself and not arising as a natural incident of some other purpose, to an assessment whether the transaction falls within the scope of one of the glosses, concepts and distinctions which are presently ordained.[110]

Consequently, uncertainty will remain between what is permissible and what is impermissible under any criteria or test. Two points, however, are to be noted. First, futile disputation arising out of the artificiality of the form over substance doctrine will necessarily be reduced and the consequential uncertainty that goes with it correspondingly diminished. In other words, making the substance of the transaction decisive will serve to avoid much arcane argument directed at one or other of the intrinsically problematic glosses, concepts and distinctions which the form over substance doctrine has engendered.

Secondly, would-be tax avoiders lose the inbuilt advantage of the uncertainty created by the form over substance doctrine. With that doctrine the boundary has been drawn almost at the extreme, and certainly in favour of would-be tax avoiders. They are able to take advantage of this uncertainty testing the limits of "legal form" knowing that, if and when challenged, the courts will in all likelihood look to the legal form of the transaction and that the legal form will be decisive. With the abandonment of the doctrine of form over substance a greater number of transactions than at present would be caught by the anti-avoidance provisions and the balance would move in favour of the general taxpayer. That is as it should be. The inevitable uncertainty which exists at the boundary should work to the advantage of the public interest as desired by Parliament.

A related fear which is often voiced by legal experts in tax law is that the lack of precision which would allegedly result from the abandonment of the form over substance doctrine will operate to deter legitimate commercial transactions. It is a claim which, as Lord Templeman stated in the *Challenge* case, "…requires serious but sceptical consideration".[111] Once the claim is given that serious but sceptical consideration, it at once appears exaggerated.

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109 Richard E Krever (ed) "Judicial and Statutory Restrictions on Tax Avoidance" in *Australian Taxation: Principles and Practice* (Melbourne, Longman Cheshire, 1987) at 296.

110 Transaction costs are almost certainly increased in this case.

111 Above n 54, at 167.

A realistic tax law in which the substance of a transaction is decisive in determining its purpose and effect could, in fact, promote certainty in commercial transactions. Commercial men and women would know to focus on the commercial purpose of the transaction and to be hesitant about allowing their transaction to become diverted, or converted, into a device to avoid tax. They would have little difficulty in appreciating what is the true substance of their transaction. One is drawn unwillingly to the thought that the underlying concern of those who fear legitimate transactions will be deterred is that transactions which may presently be undertaken would be unlikely to be acceptable under a regime in which the substance of the transaction is decisive.

I considered the reasons why the claim that a more realistic approach will lead to uncertainty is untenable in the *Bank of New Zealand Investments* case.[112] Again, it will suffice to summarise what I said.

(1) As just pointed out, the boundary between "tax planning" and tax avoidance shifts from one form of assessment in line with the legislation to another form of assessment burdened by the present superfluity of glosses, concepts and distinctions. Commercial decision making is still affected, but at a different point.

(2) There is something awkward about the argument that "legitimate" commercial transactions will be deterred when the question under inquiry is what transactions are legitimate.

(3) Finally, it is not correct that an approach in which substance is predominant over legal form would create a climate detrimental to commercial activity and growth. It has not done so in the United States where the doctrine of form over substance has no currency. Commerce remains vigorous.[113] Of course, business people will wish to reduce the incidence of tax, but few are incapable of knowing whether a proposed transaction has a commercial objective or economic function or is being pursued to gain a tax advantage. It is advice that the latter is permissible if presented in a form which legally "conveys" a commercial purpose that creates the difficulties.

The lack of reality in dealing with the question of certainty is typically part of formalistic thinking. It is evident in any number of tax cases, but two may be selected for attention. In both cases the task will be to first confirm that the decisions exemplify the form over substance approach before then examining whether they facilitate certainty and predictability in the law.

A. Wattie v Commissioner of Inland Revenue

The issue in *Wattie v Commissioner of Inland Revenue*[114] was whether an inducement payment paid by a landlord to a tenant to enter into a lease was capital or revenue for tax purposes in the hands of the tenant. The rent fixed in the lease was well in excess of the market rent and, in substance, the inducement payment offset the inflated rent. The majority of the Court of Appeal (I dissented) held that the payment was on capital account, and their decision was unanimously upheld by the Privy Council. The Board assimilated the inducement payment with a premium paid by a tenant to a landlord to obtain a lease (which is on capital account) and therefore held that the inducement payment was capital (a "negative premium").

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112 Above n 6, at 476-478.

113 United States' Courts can look behind the form of a transaction to determine its substance for tax purposes. See *Commissioner v Coart Holding* Co 324 US 331 334 (1945); *Gregory* v *Helvering* 293 US 465 469-470 (1935); and *Shoenberg v Commissioner* 77 F2d 446 449 (CA8) cert denied 296 US 586 (1935).

114 Above n 3; [1999] 1 NZLR 529 (PC).

The same issue came before the Supreme Court of Canada after the Court of Appeal's decision but before the hearing of the appeal in the Privy Council. The Supreme Court of Canada in *Ikea Ltd v The Queen*[115] unanimously reached the opposite conclusion to the majority in the Court of Appeal and to the Privy Council. The Supreme Court declined to ignore the fact that the inducement payment bore directly on the annual rent to be paid and held that it was therefore on revenue account. Its decision was perfunctorily dismissed by the Privy Council with these words:

> Their Lordships would wish to make no comment upon the decision of the Supreme Court of Canada in the *Ikea* case…save to observe that the Canadian Courts appear to have adopted a different approach from that of the Courts of New Zealand and the United Kingdom, and of Their Lordships' Board.[116]

This peremptory observation is, the reader might think, an imperious way to deal with the considered reasoning of a senior appellate Court in a current decision, but, perhaps, the Board was wise not to have spelt out the different approach? To have done so would have required the Board to acknowledge that New Zealand and the United Kingdom adhere to a more formalistic approach than the Canadian Court. It is difficult to imagine that their Lordships' justification for their approach could have sounded anything other than outdated and weak.

For completeness, it may also be mentioned that the High Court of Australia was subsequently called upon to rule on the same issue in *Federal Commissioner of Taxation v Montgomery*.[117] A majority of the High Court[118] held that the inducement payment in issue was assessable income in the hands of the taxpayer.

The High Court's decision contains a crushing refutation of the notion of a "negative premium".[119] The majority reject the assertion of a congruence or symmetry between a payment by a lessee to obtain the advantage of a lease and an amount received by the lessee in agreeing to take a lease and, therefore, held that it was wrong to assume that it did. As this exact congruence or symmetry between the capital or revenue character of a sum as a receipt and its character as expenditure cannot be maintained, the notion that it is a "negative premium" is not sustainable. The Privy Council looked to the form of the payment and the form of the receipt; the majority in the High Court looked to the "character" of the payment and the "character" of the receipt, and readily distinguished the two.

The reasoning of the Privy Council and the majority in the Court of Appeal in *Wattie's* case is intractably formalistic. The transaction is in the form of an inducement payment and the fact that the rent is inflated to offset the payment is effectively disregarded. This flawed reasoning is set out in the judgment of Blanchard J writing for the majority in the Court of Appeal:

> In economic terms that sum [the inducement payment] obviously had rental equivalence and could be looked upon as a rental subsidy. But it is well established that economic equivalence is not the determinant of the characterisation of a payment for tax purposes.[120]

Then:

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115 *Ikea Ltd v The Queen* [1998] 1 SCR 196. The Federal Court of Appeal in this case thought that the issue so clear cut that it did not call on the Commissioner's counsel to respond to the submission advanced on behalf of the taxpayer and delivered an oral judgment!

116 Above n 114, at 539.

117 *Federal Commissioner of Taxation v Montgomery* (1999) 164 ALR 435.

118 Gaudron, Gummow, Kirby and Hayne JJ.

119 Above n 117, at [95].

120 Above n 3, at 13.

> We have concluded that the appellants are right to characterise the cash inducement sum as a negative premium. That is a capital item in the same way as in *McKenzies*' the payment by a lessee to obtain surrender of its lease was a capital item. It is the mirror image. This lessor was asking Coopers & Lybrand to relieve it of untenanted premises by taking a burdensome lease. In *McKenzie* it was the lessee asking the lessor to relieve it of its unwanted lease by accepting a surrender and consequently untenanted premises.[121]

With respect to this learned Judge, this statement is indefensible. The payment in *Wattie* is not the "mirror image" of the payment moving from the tenant to the landlord in *McKenzie*.[122] The untenanted premises may have become burdensome to the landlord in *Wattie*, but that is beside the point; the issue is whether the inducement payment was capital or revenue in the hands of the tenant. The lease was not in substance burdensome to the tenant once the fact the inflated rent was offset by the inducement payment is taken into account. The lease in *McKenzie*, on the other hand, had become burdensome (which is why the tenant was prepared to pay a premium to be rid of the lease). For this reason, the payment in *McKenzie* can properly be described as a premium, that is, a payment made in consideration of the landlord accepting a surrender of the lease.

The same can be said for the analogy adopted by the Privy Council; a payment by a prospective tenant to a prospective landlord seeking a lease. In such cases the premium provides consideration for the grant of the lease. To describe the payment in *Wattie* as a "negative premium", that is, the converse of a premium paid by the tenant, however, is to again succumb to form. Whereas the premium paid by a tenant to a landlord provides consideration, that is, a quid pro quo, for the grant of the lease, an inducement payment paid by the landlord to the tenant where the rent is inflated and the payment amortised in the rent over the period of the lease provides no consideration. Other than on paper, there is no quid pro quo. The economic advantage to the tenant is to be found in the saving in tax otherwise payable.

How, then, does the Privy Council's decision (and the Court of Appeal's) in *Wattie* promote greater certainty and predictability in the law? How does it avoid deterring commercial men and women from entering into legitimate transactions? It does neither.

The decision in *Wattie* rules that transactions involving inducement payments made by a landlord to a tenant are not void as against the Commissioner, but so, too, if the decision had been to the opposite effect it would have been clarified that transactions in which such inducement payments are offset by an inflated rent are void as against the Commissioner. The law is no less certain and predictable in Canada and Australia because the senior appellate courts in those countries have seen fit to favour the substance of the transaction. Nor would commercial men and women be deterred from entering into genuine commercial transactions; they would simply be required to accept that transactions of the kind in issue in *Wattie* are not legitimate.

B. Commissioner of Inland Revenue v Bank of New Zealand Investments Ltd

Finally, regard may be had to the *Bank of New Zealand Investments* case.[123] The majority's judgment in this case need not be examined in detail as their reasoning has been rejected by the Privy Council in *Peterson v Commissioner of Inland Revenue*.[124] Speaking for the majority,[125] Lord Mil-

121 Ibid, at 13, 305.

122 *Commissioner of Inland Revenue v McKenzie (NZ) Ltd* [1988] 2 NZLR 736.

123 Above n 6.

124 *Peterson v Commissioner of Inland Revenue* [2006] NZLR 433 at [33]-[34]; (2005) 22 NZTC 19 098 at [33-34].

125 Lord Millett, Baroness Hale of Richmond and Lord Brown of Eaton-under-Heywood.

lett said that their Lordships did not consider an "arrangement" for the purposes of s 99 requires a consensus or meeting of minds. The taxpayer need not be a party to "the arrangement" or, indeed, be privy to its details. The majority of their Lordships expressly preferred the reasoning in my dissenting judgment.[126] The pertinent paragraphs were endorsed by the minority.[127]

The crucial question in the *Bank of New Zealand Investments* case was whether a series of transactions fell within the definition of "arrangement" in s 99 having regard to the fact (as found at first instance) that Bank of New Zealand Investments Ltd was not involved in or aware of the exact nature or details of the transactions to be undertaken by the promoter of the scheme, Capital Markets Ltd. The majority in the Court of Appeal held that the transactions could be divided into "upstream" and "downstream" transactions and that the latter transactions could be disregarded when determining the tax legitimacy of the "upstream" transactions. In form the "upstream" transactions comprised a standard commercial redeemable preference share arrangement which entitled Bank of New Zealand Investments Ltd's parent, the Bank of New Zealand, to a deduction in terms of the Act. The "downstream" transactions in which the tax avoidance was alleged to have occurred formed no part of that arrangement. By virtue of this reasoning, the majority were able to claim that the "purpose and effect" of the transaction was not tax avoidance.

The substance of the arrangement is set out in a diagram in my dissenting judgment.[128] The aims of the transaction were, first, to allow Bank of New Zealand Investments Ltd to raise funds in such a way that the interest it paid on those funds was deductible and, secondly, to convert the assessable income stream generated by the investment of those funds into exempt income. It was that part of the arrangement designed to give effect to the latter objective that the Commissioner claimed amounted to tax avoidance.

Overall, the arrangement resulted in a tax saving which was shared by the parties. Without this tax advantage, the transaction would not have been commercially viable. Indeed, it would have been pointless. In substance, the effect of the arrangement was undeniably the avoidance of tax.[129]

Again it may be asked how the decision of the majority assisted the aim of certainty and predictability and would deter "genuine" commercial transactions. Knowledge that a transaction cannot be artificially divided into "upstream" and "downstream" transactions to avoid tax, it might be thought, would add greater certainty to the law than would a law that permitted such a problematic distinction. Moreover, is it to be assumed that the law in the United Kingdom is now less certain

126 Above, n 124 at [33] and [34].

127 Lord Bingham of Cornhill and Lord Scott of Foscote, at 460.

128 Above n 6, at 491.

129 Some entertain a residual concern relating to those investors who invest monies with, say, a bank or managed fund expecting a commercial return on their investment without thought of a tax saving, unaware that the bank, or its subsidiary, or the managed fund is in fact practising tax avoidance or indulging in transactions which may be challenged on the ground that they constitute tax avoidance. It can be argued that their investment is commercially viable irrespective of any tax saving. Investors in this category can be distinguished from the investors in the *Bank of New Zealand Investments* case in that they have not invested their monies for the purpose of securing or participating in a tax saving, but this is to introduce immediately a gloss or distinction. It is preferable to expect investors to be sufficiently astute and diligent in knowing the fate of their monies and the general nature of the investment made on their behalf so as to preclude them from pleading their ignorance. Furthermore, if the format spelt out by Blanchard J in *Glenharrow* is to be followed, the purpose and effect of an arrangement is to be determined "objectively". Thus, the subjective knowledge of the taxpayer cannot be relevant to the "effect" of the arrangement, and the "purpose" follows from that effect.

than in New Zealand because the House of Lords have declined to accept and apply the majority's' reasoning in this case?

Nor would commercial men and women be deterred from entering into genuine commercial transactions if the Court of Appeal had interpreted s 99 so as to preclude tax avoiding transactions being dissevered from the legally sound transactions when they are part of the same arrangement. The boundary between what is acceptable and what is not acceptable would simply be shifted. What commercial men and women would be deterred from doing, of course, would be entering into any arrangement in the knowledge that they would benefit from a tax saving, the exact nature or details of which are unknown to them, when the purpose and effect of the overall arrangement is tax avoidance. The balance may have swung against the would-be tax avoider, but that does not make the law less certain.

XII. A Shift in Thinking

In overtly shifting the regime from one of form over substance to one of substance over form the Supreme Court could usefully confront a number of basic questions. Why have the courts for so long evinced such a deep-rooted hostility to repeated anti-avoidance provisions? Why, notwithstanding their general commitment to the principle of parliamentary supremacy, have judges been willing to frustrate Parliament's intent?

Then, why, a bare two years after Parliament re-enacted s 99 and, in the process endorsed *Elmiger v Commissioner of Inland Revenue*,[130] did the courts adopt a doctrine overtly at odds with Parliament's objective? Why was Lord Tomlin's dictum in the *Duke of Westminster* case accepted in New Zealand without closer examination of the relevance, utility and applicability of the dictum to this country? Why was the doctrine of form over substance never subjected to the rigour of logical thought? In what way does the doctrine, with all the glosses, concepts and distinctions which it engenders, really serve the goals of certainty and predictability? How pragmatic is it to persevere with a doctrine that must attract all these glosses, concepts and distinctions in order to survive? How is it that the most vigorous free market and industrial economy in the world, the United States, has been able to administer its tax laws without detriment to commerce in the absence of a form over substance doctrine or any mutation of it?

The decision of the majority of the Privy Council in the *Peterson* case[131] should not daunt the Supreme Court from adopting the course I advocate. That case involved the taxpayer's claims for depreciation in respect of two films: "The Lie of the Land" and "Utu".[132] Investors were induced to invest in the films by the prospect of being able to deduct the entire cost of their investment over a two year period and the fact that part of the funding for the film would be provided by way of a non-recourse loan; the borrowers were under no liability to repay the capital or interest, the lender's right to repayment coming out of the profits of the film. The majority in the Privy Council held that non-recourse funding is a common commercial practice and that the investors had incurred the full cost of making the films even though the loans were made for a period of a few days only. The minority held that the non-recourse loan was nothing more than a device to produce a higher capital sum to be depreciated and, therefore, a higher depreciation claim. The loans

130 Above n 86.

131 Above n 124.

132 The facts are succinctly summarised by Andrew Beck in *Tax Avoidance – The Peterson Debacle* (New Zealand Tax Planning Report No 2, 2005 CCH New Zealand Ltd).

were not required for the making of the films as the production costs had been inflated by the producers in order to justify the need for the loans. There was no commercial reason for this device. Simply put, the inflation of the costs was the means of qualifying for a higher tax deduction than would otherwise have been available.[133]

One recoils from asserting that a judgment of senior appellate judges is substandard, and I so recoil, but the judgment is undoubtedly open to criticism, and it has received that criticism.[134] It is, perhaps, not surprising that, of the eleven Judges who considered the case, only three determined that the transaction in issue was not tax avoidance, but, of course, they were the three that counted.[135] Nor is it surprising that the Law Lords who dissented were unusually forceful in expressing their hostility to the majority's reasoning.[136]

Now is not the time, however, to parade in detail the deficiencies in the majority's judgment; they made mistakes of fact and seem not to have fully comprehended the transactions in issue; they resurrected the distinction between "tax mitigation" and "tax avoidance" in the even less satisfactory form of "tax advantage" and "tax avoidance"; their reference to "economic advantage" is irritatingly incomplete; they failed or were unable to point to the loss or expenditure which would entitle the taxpayer to the allowance in question in terms of the formula in *Challenge*; they were inconsistent in rejecting the majority's judgment in the *Bank of New Zealand Investments* case and then seemingly treating the investor's transaction as a separate transaction from that of the promoter of the scheme and the non-recourse lender; and, most importantly, they sanctioned an arrangement which was plainly outside Parliament's objective in enacting a provision designed to encourage investment in films, and on which the taxpayer relied.

For present purposes, I wish only to emphasise the debacle which results when judges endeavour to work within the existing judge-made framework. The reasoning of the majority in *Peterson's* case is dogged by a determination to make the legal form of the arrangement prevail and an equally determined reluctance to go to its substance. How much better it would have been to find that the *Bank of New Zealand Investments* case was wrongly decided and, looking at the arrangement as a whole, conclude that, in substance and economic reality, the scheme was outside Parliament's contemplation in enacting the depreciation provisions in issue. As Andrew Beck has stated, by no stretch of the imagination could it be argued that the legislature intended to condone the inflation of a purchase price so as to produce a higher depreciation claim.[137] It is a paradigm case of tax avoidance.

Apart from seeking to re-establish that the substance of a transaction is decisive, it would be imprudent to seek to formulate a more universal principle or response to tax avoidance disputes. Certainly, with substance being decisive, a number of the present glosses, concepts and distinc-

133 *Peterson's* case, above n 124, at [91].

134 Above n 132. For criticism in the opposite direction, see Geoff Harley, "Peterson – a Review of the Facts" (New Zealand Tax Planning Report No 5 2005 CCH New Zealand Ltd).

135 There is no magic in the numbers game. In *Wattie v Commissioner of Inland Revenue* (above n 3), for example, of the total of 31 judges in New Zealand (including the Privy Council), Canada and Australia, who considered the issue, a majority of one held that the inducement payment was on revenue account, but excluding the judges in the New Zealand jurisdiction, the majority is substantial; 14 to 6.

136 The writer knows of only one other issue where their Lordships have been so forceful in expressing their distaste for the contending views which have divided them. See the death penalty cases in the Privy Council: *Boyce v The Queen* [2004] UKPC 32; [2004] 3 WLR 786; and *Mathew v State of Trinidad and Tobago* [2004] UKPC; [2004] 3 WLR 812. See also, EW Thomas "The Privy Council and the Death Penalty" (2005) 121 LQR 175.

137 Beck, above n 132, at 13.

tions can be expected to fall by the wayside. Such concepts as "economic equivalence", the "sham or nothing" classification and the "choice" principle would, at least, require re-examination as to their relevance and validity. I imagine that what will evolve will be a more fluid approach to questions of tax avoidance in which different transactions will attract a different emphasis: the artificiality of the transaction in one, the lack of commercial viability apart from the tax saving involved in a second, the demonstrable pretence in a third, the contrived complexity of the arrangement in a fourth, the exploitation of a loophole in a fifth, the cabalistic use of a tax haven in a sixth, the unaccountable utilisation of back to back agreements in a seventh, the existence of secrecy in the next, and so on.

Each of these features would, however, serve to explain the Court's thinking as to why the transaction amounted to tax avoidance rather than encapsulate a legal principle. Such features would be fact-driven and particular to the specific transaction. As Woodhouse P said in the *Challenge* case, each case raises a question of fact and degree to be decided on a case by case basis.[138]

The one overriding feature that should command the unreserved allegiance of the Supreme Court is to give effect to Parliament's intent. The wording of s BG1 does not require a gloss; the section itself provides the principle to be applied by the courts.

There are two aspects in which I would reiterate that respect for the supremacy of Parliament should be acknowledged and implemented.

The first is to do what Parliament has intended since that institution enacted a general anti-avoidance provision in 1878.[139] The general anti-avoidance provision has been undermined by a perverse judicial approach for far too long. The judiciary must made a conscious effort to subvert its own predisposition as to the requirements of certainty and the needs of the commercial community and accept Parliament's perception of what is required in the public interest. The general anti-avoidance provision is a broad statutory injunction to render void as against the Commissioner those transactions in which the taxpayer seeks to take advantage of ordinary legal purposes to obtain relief from the natural burden of taxation denied generally to the same class of taxpayer. Simply stated, Parliament's intent, as well as the wording it has used to convey its intent, cannot now embrace even the remnants of the form over substance doctrine.

The second respect in which the intention of Parliament should be expressly recognised as dominant arises in examining the transaction itself. Invariably, the legislation on which the taxpayer relies will be directed at a particular class or particular circumstances and purport to possess a legislative objective or reflect a legislative policy. That class or those circumstances should be present and the transaction should fall within that objective or policy before being countenanced as a legitimate transaction for tax purposes.[140] If, having regard to its substance, the arrangement amounts to tax avoidance it cannot fall within that objective or policy. Parliament cannot be presumed to have suspended its strong anti-avoidance policy, as evidenced by the general anti-avoidance provision, when directing its legislative attention to a particular class or particular circumstances.

As Nabil Orow states, tax avoidance is the obtaining of an unintended fiscal relief or advantage and that perception requires the focus to be on the law "maker" rather than the law "breaker".[141]

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138 Above n 54, at 534.

139 Land Tax Act 1878, s 62.

140 See my comments on the Majority's decision in *Peterson v Commissioner of Inland Revenue* above.

141 Orow, above n 63, at 339-340.

In other words, the emphasis should shift from what the taxpayer has done, or omitted to do, to the question of what Parliament intended in enacting the legislation on which the taxpayer relies. Literal or technical compliance should be of no or little avail to taxpayers unless they can bring themselves within the scope and purpose of the legislation which is relied upon to give their transaction legitimacy. That question can only be sensibly addressed by having regard to the substance of the transaction and making that substance decisive.

If it is accepted that legal form, while relevant, should no longer be decisive and attention is redirected to the actual or economic substance of a transaction, the incoherency and inconsistencies ascendant in the present law and the courts' decisions will disappear or, at least, diminish; the aims of certainty and predictability will be enhanced by the firm knowledge that the courts will look beyond the legal form to the substance of a transaction; the issues and argument will benefit from being redirected from the present glosses, concepts, and distinctions associated with tax avoidance to the substance of the transactions; the existing inbuilt advantage conferred on would-be tax avoiders will be removed; the tax base will be significantly enhanced; and the tax system of this country will be immeasurably more equitable.

PART 2

XIII. AND NOW *BEN NEVIS*

The scheme in issue in *Ben Nevis* was undoubtedly tax avoidance. It was a scheme devised by promoters and marketed to investors with the express purpose of reducing the ordinary incidence of tax, and it certainly had that effect. The fact such a blatant scheme could be promoted in the first place and then defended with vigour up to the Supreme Court demonstrates how far the form over substance doctrine had become embedded in tax law. The scheme depended on form routing substance.

Irrespective of the past approach the appellants were doomed to fail and it is not surprising that they failed at every level in the court hierarchy. Indeed, it was not a hard case. Any other result than that found by the Courts would have made a mockery of the general anti-avoidance provision and Parliament's intention that the provision be implemented by the courts. Consequently, the facts of *Ben Nevis* provided the Supreme Court with the opportunity to bury the form over substance doctrine once and for all, but the Court, and certainly the majority, stopped short of doing so.

Nevertheless, the doctrine suffered a severe setback. The reality is that, when examining the promoters' scheme for the purpose of determining whether it amounted to tax avoidance, the Court looked to its substance. In this exercise the Court's rejection of form and regard to the economic or fiscal reality of the scheme was complete. It would appear, however, that the doctrine, or traces of the doctrine, linger in the majority's finding that, notwithstanding that the scheme constituted tax avoidance, it complied with the specific provisions on which the promoters relied.

It would be remiss, however, to go further without adverting to the considerable advances made in *Ben Nevis* and Glenharrow. Tipping J's treatment of the legislative history and case law in his judgment for the Court in *Ben Nevis* is impressive and Blanchard J's articulation of the reasons why the transaction in *Glenharrow* fell foul of the general anti-avoidance provision in the Goods and Services Tax Act 1985 provides a model for the commercial analysis of the reality of a transaction. The gains made in moving towards a more sensible and stable tax avoidance regime in these judgments should not be ignored.

(1) The assertion is now secure that, in applying the general anti-avoidance provision, the courts are to have regard to the substance of the arrangement. While not spelt out in so many words the substance will be decisive.[142] This departure from the previous law loses none of its force by being articulated without the Court expressly overruling any previous cases. In particular, it would have assisted clarification if Richardson J's approach in the *Challenge* case[143] and the decision of the majority in the Privy Council in *Peterson v Commissioner of Inland Revenue*[144] had been openly disapproved. Making the substance of an arrangement decisive for the purposes of s BG1, but not for the purposes of the specific tax provisions, results in an incongruity upon which I will touch below.

(2) In looking to the substance of an arrangement for the purposes of s BG1, the courts' capacity to have regard to a range of factors is limited only by their relevance.[145] The courts are not limited to purely legal considerations. This endorsement of a realistic approach based on the facts of the particular case is to be welcomed. It mirrors my prediction set out above that a more fluid approach to the question of tax avoidance will evolve in which different transactions will attract a different emphasis. As I have already claimed, the general principle applicable to all tax avoidance disputes is contained in the general anti-avoidance provision, and it seems to have been accepted by the Court that it would be imprudent to seek to implant a judicial version of the principle on the wording and ambit of that provision.

(3) The fact that tax avoidance can be found in individual steps or in a combination of steps in an arrangement is affirmed.[146] The Court could not sensibly hold otherwise having regard to the express wording of the definition of "arrangement" in s BG1. As I will suggest below, this affirmation could have been usefully associated with an endorsement of the *Ramsay* principle.

(4) *Elmiger's* case, on which I have placed so much emphasis above, is reinstated as an important and influential judgment.[147] Woodhouse J's approach in that case is reinforced by the favourable treatment accorded to his judgment in the *Challenge* case.[148] At the same time, the approach of Richardson J in that case is, in effect, if not in so many words, disapproved. This disapproval is inherent in the Court's rejection of the notion that the scope of the general anti-avoidance provision is to be read down so that it does not operate on arrangements which comply with particular specific tax provisions. The "scheme and purpose" of the legislation does not require the general anti-avoidance provision to be subjugated to the special concession provisions.[149]

(5) The Court in *Ben Nevis* acknowledges that the case law has become encumbered by "considerations and tests" that are not specified in the legislation.[150] It urges the courts to keep the

142 See *Ben Nevis*, above n 9, [107], [108] and [109] and *Glenharrow*, above n 10, at [40], [47] and [49].

143 See above under the heading "Form Over Substance".

144 Above n 124. I agree with Michael Littlewood "The Supreme Court and Tax Avoidance" (2009) NZLJ at 151 and 155, that the tone of the judgments in *Ben Nevis*, and I would add *Glenharrow*, seem much less tolerant of aggressive tax planning than the majority in *Peterson's* case. For the reasons I have indicated above, it is difficult to believe that the Supreme Court would have found, as the majority in *Peterson's* case did, that the arrangement in issue was tax mitigation and not tax avoidance.

145 See *Ben Nevis*, above n 9, at [108] and [109].

146 Ibid, at [105].

147 Ibid, at [75].

148 Ibid, at [84].

149 Ibid, at [89].

150 Ibid, at [13].

"judicial glosses and elaborations" on the statutory language to a minimum.[151] This exhortation reflects my own disparagement of the "glosses, concepts and distinctions" which have beset tax law.

(6) It is also fair to claim that the purposive approach to the interpretation of tax legislation is confirmed, although, perhaps, a little hesitantly. The majority state that the English decisions provide helpful insights to the extent that they have adopted a more purposive approach to the interpretation of tax legislation.[152] Three of the cases referred to above, *Furniss (Inspector of Taxes) v Dawson*, *Inland Revenue Commissioner v McGuckian* and *MacNiven v Westmoreland Investments Ltd*, are cited in support.[153] Although the scheme and purpose approach of the Privy Council is approbated,[154] the Court is careful to point out that this approach does not require the courts to focus on the specific provisions in isolation of wider considerations. It is noted, however, that the absence of a general anti-avoidance provision in England requires care in applying English cases. I agree that this care is warranted generally, but do not apprehend that the Court intends that the required care should diminish the value of the purposive approach to the interpretation of the tax statute.

(7) The breadth of the "choice" principle inspired by the *Duke of Westminster* case has been curtailed. Tax beneficial choices are now constrained by the fact that the choices made in utilising tax incentives conferred in specific provisions are proscribed by the general anti-avoidance provision.[155]

(8) Observations in both *Ben Nevis* and *Glenharrow* indicate a much more realistic attitude to the question of certainty in tax law than has been the case in the past. In commenting on the argument that the tax legislation should be interpreted in a way which gives taxpayers reasonable certainty in tax planning, the majority in *Ben Nevis* observe that Parliament has left the general anti-avoidance provision deliberately general. The courts, they state, should not strive to provide greater certainty than Parliament has chosen to provide.[156] In *Glenharrow* Blanchard J, speaking for the Court, stated that uncertainty is inherent where transactions having artificial features are combined with advantageous tax consequences not contemplated by the scheme or purpose of the Act. There will, he said, inevitably be uncertainty wherever a taxing statute contains a general anti-avoidance provision intended to deal with and counteract artificial tax favourable transactions.[157]

The Court's acceptance of the reality that uncertainty is inherent in the application of the general anti-avoidance provision is gratifying and should go some way towards muting the tax advice industry's unrealistic expectations. The majority's reasoning, however, turns on the perception that Parliament, in enacting and re-enacting the general anti-avoidance provision, must be taken to have intended a measure of uncertainty. While this reasoning is correct in itself, it is incomplete. As indicated above, a greater level of certainty – of less uncertainty – can be achieved if it is accepted that the substance of a transaction is decisive. The commercial community will know to focus on the commercial purpose of the transaction and be cau-

151 Ibid, at [104].

152 Ibid, at [110].

153 Above, n 46, 47 and 100, and *Ben Nevis*, above n 9, at [110].

154 See *Ben Nevis*, above n 9, at [98] and [99].

155 Ibid, at [111].

156 Ibid, at [112].

157 *Glenharrow*, above n 10, at [48].

tious about allowing the transaction to become diverted, or converted, into a device to avoid tax.

As it would be naïve to suggest that business people do not or will not appreciate the true substance of their transaction, making the substance of the arrangement decisive will lend itself to greater certainty in that the variety of "choices" proffered by tax advisers will have to be closely screened by those who will be liable for the consequences of any tax avoidance.[158] In other words, greater certainty will arise from the fact that transactions will be driven by commercial considerations and the tax advantage of a particular course only accepted as viable if it is truly incidental to the arrangement.

(9) The Court in both *Ben Nevis* and *Glenharrow* confirm that courts are to disregard the subjective purpose of the parties in applying general anti-avoidance provisions. In construing the meaning of the words "the purpose and effect" of an arrangement, the majority in *Ben Nevis* are content to adopt the finding of the Privy Council in *Newton v Commissioner of Taxation of the Commonwealth of Australia*.[159] In short, the word "purpose" means the end in view and not the motive, and "effect" means the end accomplished and achieved. Read as a whole the phrase denotes concerted action to the end of avoiding tax.[160]

Blanchard J deals with the issue at greater length in *Glenharrow*. His observations are extremely helpful in establishing that the courts are to ask what "objectively" is the purpose of the arrangement and that question in turn requires an examination of the effect of the arrangement. The courts will necessarily consider what effect the arrangement has had, what it has achieved, and work backwards from that effect to determine what objectively the arrangement must be taken to have had as its purpose. A general anti-avoidance provision, therefore, is concerned, not with the purpose "of the parties", but with the purpose "of the arrangement".[161]

I regard this statement of Blanchard J as being of considerable importance. If one is to work backwards from the effect of the arrangement, it is difficult to see how much of the sophisticated arguments advanced on behalf on taxpayers to support the legal form of an arrangement can be plausibly mounted. It is difficult to accept, for example, that the majority of the Privy Council in *Peterson's* case[162] could have sustained their opinion if they had worked backwards from the effect of the scheme in that case. In practical terms Blanchard J's proposed format may prove to be one of the most influential factors in the move from form over substance to substance over form.

In any event, the approach adopted in both decisions undoubtedly requires the courts to have regard to the substance of the arrangement and to then discern from the findings in that regard "the purpose and effect" of the arrangement. No lesser course of inquiry is now permissible.

Once again a caveat is required. I do not apprehend that anything the Court has said in either of the judgments precludes courts from taking into account the intention of the parties where that intention is to avoid the incidence of tax. It would be a strange outcome if, where the evidence establishes that the parties intended to avoid tax, the courts had to disregard that evidence. Rather, as

158 Over zealous tax advisers who expose their clients to the severe consequences of tax avoidance can no longer be assured that they are beyond the reach of legal liability.

159 *Newton v Commissioner of Taxation of the Commonwealth of Australia* [1958] AC 450.

160 *Ben Nevis*, above n 9, at [73].

161 *Glenharrow*, above n 10, at [35]-[39].

162 Above n 124.

the minority say in *Ben Nevis*, while motive is not determinative, it may be evidence which sheds light on a purpose of tax avoidance and so is not wholly irrelevant.[163]

XIV. But Traces of Form Over Substance Linger

I admit to being troubled by the reasoning of the majority. It seems to perpetuate unnecessarily the traces of the past regime when, in order for a transaction which complied in form with the specific tax provisions of the Act to be immune from the reach of the general anti-avoidance provision, the specific provision had to override the general anti-avoidance provision. The minority avoids this pitfall by holding that the specific tax provisions and the general anti-avoidance provision are not in potential conflict and do not therefore require reconciliation. I agree with this perception, but while it is essential to have regard to the specific tax provisions in issue, I do not accept that it is necessary to embark upon the two stage process as also apparently endorsed by the minority.[164]

Once it is accepted, as the majority effectively do, that for the purposes of s BG1 the substance of an arrangement is decisive, it is incongruent to perceive the relationship between the specific tax provisions and the general anti-avoidance provision as being in conflict or potential conflict. The substance of the arrangement is the same in both cases. If the arrangement constitutes tax avoidance it cannot be said to be authorised by the specific tax provisions. To hold otherwise would be to attribute to Parliament an intention when enacting the specific tax provisions to authorise tax avoidance on the part of the taxpayers providing they adhere to the "legal structures and obligations the parties have created" purportedly pursuant to the specific provisions.[165] As already pointed out, there can be no such legislative presumption. Yet, but for the general anti-avoidance provision this would be the result of the majority's reasoning in respect of the approach to be taken to arrangements purportedly made pursuant to the specific provisions.

Consequently, the perception that there is a conflict or potential conflict between the specific tax provisions and the general anti-avoidance provision can be seen as a "hangover" from the past when the form of an arrangement was held to have satisfied the scheme and purpose test and would then override the general anti-avoidance provision. With the move to make the substance of the arrangement decisive the need to reconcile the conflicting or apparently conflicting specific and general provisions does not now arise. Neither the specific tax provisions nor the general anti-avoidance provision condone tax avoidance.

Another way of making this point is to focus on what the majority actually said. If the language is not inconsistent it is certainly awkward. On the one hand, the majority sets out to give appropriate effect to both the specific tax provisions and the general anti-avoidance provision by proclaiming that they are to work "in tandem" with neither to be regarded as "overriding" the other.[166] On the other hand, a specific tax provision is to be construed as having regard to its "ordinary meaning",[167] the "legal structures and obligations the parties have created", and without

163 *Ben Nevis*, above n 9, at [8].

164 See [2] and [3]. Further, while legal, commercial or accounting terminology may differ and the appropriate terminology to adopt may turn on the context of the provision, the minority's distinction between "legal substance" and "commercial substance" is unfortunate. The distinction is illusory. It has shades of Lord Hoffmann's attempt to distinguish "legal concepts" from "commercial concepts" in *MacNiven's* case, and one can only hope that it suffers the same ignominious ending. See above under the heading "The King is Dead; Long Live the King".

165 Ibid, at [47].

166 Ibid, at [103].

167 Ibid, at [103] and [106].

conducting an analysis in terms of its economic substance and consequences.[168] Adopting this approach the arrangement may be within the scope of the specific tax provisions, but it may then fall foul of the general anti-avoidance provision. If this is the case the provisions have not worked "in tandem". The general anti-avoidance provision is in fact "overriding" the specific tax provisions. Oddly, the "tandem" has handle bars at both ends pointing in different directions.

The majority spell out the basis of their approach in paragraph [103] when they purport to draw a sharp distinction between the purpose of specific tax provisions and the purpose of the general anti-avoidance provision. Of course, the purposes differ. The distinction, however, provides a false basis for a finding that the purpose of a specific provision can be determined having regard to its ordinary meaning (and the legal structures and obligations the parties have created without regard to its economic substance and consequences) and the two step format which is then endorsed. In short, neither the purpose of the specific tax provisions nor the purpose of the general anti-avoidance provision embraces tax avoidance.

Courts will, of course, have full regard to the purpose, and policy, contemplated by Parliament in enacting a specific provision. That analysis will be inevitable in order to assess the merit of the taxpayer's claimed justification for the arrangement. Drawing a distinction between the purpose of the specific tax provisions and the purpose of the general anti-avoidance provision, however, is artificial without recognition or effect being given to the basic precept that the specific tax provisions do not authorise tax avoidance. How can it be said, for instance, that an arrangement conforms with the purpose of a specific tax provision, as intended by Parliament, when that purpose does not and cannot encompass tax avoidance? In adhering to a substance over form approach, therefore, the purpose, and policy, of specific tax provisions will not be neglected if the courts focus on the inevitable question whether the arrangement constitutes tax avoidance without the diversion inherent in the two step process. A unified approach not only serves Parliament's intent, but also is both realistic and sensible.

In so far, therefore, as neither the special tax provisions nor the general anti-avoidance provision authorise tax avoidance, the primary exercise, while not disregarding the legal structure and obligations, is to analyse the arrangement having regard to its economic substance and consequences. As the substance of the arrangement is the same whether the courts are considering the application of the specific tax provisions or the general anti-avoidance provision, a finding that the arrangement amounts to tax avoidance will mean both that the arrangement was not authorised under the specific tax provisions and that it is void under the general anti-avoidance provision. This will be so even though the utilisation of the specific tax provision relates to only a single step in the arrangement and may seem innocuous in itself. Parliament has neither condoned nor authorised the specific provision's use as part of a larger or more complex scheme which amounts to tax avoidance.

I would reiterate that the majority's error does not so much lie in requiring the courts to have regard to the legal structures and obligations which the parties have created as in the fact they require courts to reach a finding that, but for the general anti-avoidance provision, the arrangement falls within the specific provisions of the Act. It would, of course, remain legitimate for a taxpayer to pursue a tax benefit specifically provided for in the Act, but only up to the point that the arrangement alters the incidence of tax so as to constitute tax avoidance. A finding that the arrangement is within the scope of the specific tax provisions is not necessary for the essential inquiry.

168 Ibid, at [47].

As already said, that essential inquiry is to determine whether there is an arrangement and, if so, the substance and scope of the arrangement. As the legal structure and obligations the parties have created will be taken into account in that inquiry the courts can move straight to the question whether the arrangement constitutes tax avoidance. The resulting finding will serve the purpose of both the specific tax provisions and the general anti-avoidance provision.

It goes without saying that, if a court holds that no tax avoidance is involved, there may be a residual question as to whether the arrangement satisfies the particular requirements of the specific provision, but that inquiry, proceeding on the basis that tax avoidance is not involved, will be much more narrowly focused. Furthermore, this more limited inquiry will benefit from the fact it is not proceeding under the shadow of the wider question of tax avoidance.

I do not doubt that it will be argued that this approach renders the general anti-avoidance provision redundant and that Parliament cannot have intended to enact a redundant provision. This again, however, is to hark back to the notion, appropriate in the era of form over substance, that there is a conflict or potential conflict between specific tax provisions and the general anti-avoidance provision which requires reconciliation. This dichotomy becomes futile once it is accepted, as logically it must be, that the substance of an arrangement is the same for the purposes of the specific tax provisions and the general anti-avoidance provision. The specific tax provisions and the general anti-avoidance provisions can truly ride in tandem; the two seats and the handle bar pointing in the same direction.

The general anti-avoidance provision otherwise serves Parliament's intention in a number of respects. Firstly, it ensures that the question of tax avoidance has primacy in the interpretation and application of the tax legislation. Secondly, it provides a composite definition of tax avoidance evidencing Parliament's underlying policy relating to the imposition and collection of taxation in this country. Thirdly, it will, or should, notwithstanding the best efforts of the draftspersons, forestall or counter technical or drafting limitations in the specific tax provisions. Fourthly, if, as I believe, the ingenuity of tax advisers is boundless, its presence is necessary to repel or deter the unforeseen and unpredictable products of that boundless ingenuity. Fifthly, the general anti-avoidance provision will, or should, at the same time preclude unproductive argument directed at the form of the arrangement. Finally, of course, s BG1 provides the remedies where tax avoidance is found to exist.

I deliberately exclude from the above reasons why the general anti-avoidance is not redundant, the situation contemplated by the minority in *Ben Nevis* whereby a claim may fall within the meaning of a specific tax provision, purposively interpreted, and yet be part of an arrangement which constitutes tax avoidance under the general anti-avoidance provision. The general anti-avoidance provision is not necessary for that purpose as the utilisation of a specific tax provision as a step in an arrangement which amounts to tax avoidance is an illegitimate use of that provision. The particular claim under the specific tax provision has no point outside or apart from the arrangement. It is again to regress to the habit of thought engendered by the doctrine of form over substance, as well as being unrealistic, to try to vest the claim with a separate identity or life of its own. There may, perhaps, be cases where the claim under the specific tax provision can be severed from the overall arrangement and still serve some valid purpose contemplated by Parliament, but any such case, if it should arise, can be identified and dealt with accordingly.

I believe that an approach which rules the substance of a transaction decisive for both the special specific tax provisions and the general anti-avoidance provision will make the application of tax law more certain than the formula adopted by the majority in *Ben Nevis*. A number of learned

commentators writing about *Ben Nevis* (or *Glenharrow*) admit to finding the reasoning or application of the decisions uncertain.[169]

I have attended two tax conferences and one tax seminar since those decisions were given and it is not an overstatement to say that the tax advice industry is in disarray. Indeed, at the first conference almost every tax expert who spoke claimed that *Ben Nevis* and *Glenharrow* had not changed the law, or had not significantly changed the law, and this claim clearly reflected the belief (perhaps parented by wishful thinking) of the tax specialists in the audience. I detected some shift in thinking at the later seminar and conference, but not much, and that shift was due more to the way in which *Ben Nevis* had been applied in later cases than to *Ben Nevis* itself.

By and large, it seems that tax advisers still feel secure in approaching the specific tax provisions as they have in the past but are now haunted by the prospect that what was or is an apparently permissible scheme may be held to be impermissible under s BG1. As one commentator observed at the seminar, the only change *Ben Nevis* has made to his practice is that, having implemented the arrangement based on the specific tax provisions, he takes the precaution of advising his clients that he cannot guarantee that it will not be held void under s BG1. As I have sought to stress, greater certainty will ensue if tax advisers know that, in addition to attending to its legal form, they have to confront the substance of the transaction and assess it for its implications in terms of tax avoidance.

XV. Cases Applying *Ben Nevis*

The four significant tax avoidance cases which have followed *Ben Nevis* and *Glenharrow* involved schemes which previously would, or would arguably, have been regarded as legitimate under the specific tax provisions on which they relied. As to be expected, the courts followed the two step format laid down in *Ben Nevis*. Without question, the decisions reflect the change in the law and advance the premise that the substance of the arrangement is decisive. Yet the same outcomes could have been achieved more effectively and coherently if, having analysed the arrangement in the context of the specific tax provisions, the courts had moved direct to the question of tax avoidance without making a finding as to the legitimacy of the arrangement under the specific provisions.

A. The Bank Cases

The first two cases that may be touched upon are *Bank of New Zealand Investments Ltd and Ors v The Commissioner of Inland Revenue*[170] and *Westpac Banking Corporation v The Commissioner of Inland Revenue*.[171] Both cases involved an essentially similar arrangement made up of complex structured finance transactions with overseas counterparties. Wild J in the *Bank of New Zealand Investments* case and Harrison J in the *Westpac* case held that the transactions in question were entered into for the primary purpose of avoiding tax and amounted to tax avoidance for the pur-

169 See eg, Michael Littlewood, "The Supreme Court and Tax Avoidance" (2009) NZLJ 151 at 155; Marl Keating, "Supreme Court Lays Down Tax Avoidance for First Time" [2009] No 1 Tax Planning Reports; Craig Elliffe and Mark Keating, "Tax Avoidance - Still Waiting For Godot?" (2009) 23 NZULR 368; Craig Elliffe and Jess Cameron, "The Test for Tax Avoidance in New Zealand: A Judicial Sea Change" (2010) 16 NZBLQ 440; and Eugene Trombitas "The Conceptual Approach to Tax Avoidance in the 21st Century" (2009) 15 NZJLT 352.

170 *Bank of New Zealand Investments Ltd and Ors v The Commissioner of Inland Revenue* (2009) 24 NZTC 23 at 582.

171 *Westpac Banking Corporation v The Commissioner of Inland Revenue* (2009) 24 NZTC 23 at 834.

poses of s BG1. Both Judges immersed themselves in the complex nature of the transactions and approached the steps in the *Ben Nevis* formula with a thorough grasp of the specific tax provisions and the detail and workings of the arrangement. From that platform, and with the factual position firmly resolved, both Judges could have immediately addressed the question whether the transactions amounted to tax avoidance.

Inconveniently for the majority's two step formula, however, Wild J and Harrison J reached different conclusions as to the validity of the arrangement in relation to the application of the specific tax provisions.[172] While rejecting one of the Bank's arguments, Wild J held that the guarantee procurement fee which the Bank paid the subsidiary of the counterparty, ostensibly for the subsidiary's services in procuring a guarantee from its "highly-rated" parent, was expenditure under Part EH of the Act and was therefore deductible. For his part, Harrison J held that the guarantee procurement fee was not within the scope of the specific provision and was therefore not deductible. In the result, Harrison J's judgment is the more coherent of the two.

The different conclusions demonstrate a problem in ruling on the validity of the transaction under the specific tax provisions when the arrangement is void for tax avoidance. Differing judicial guidance has been given to the tax advice industry as to the application of the specific provisions in other circumstances which might not amount to tax avoidance under s BG1. The point is that, once it has been found that the arrangement amounts to tax avoidance, the findings as to the legitimacy of the arrangement under the specific tax provisions became largely academic. In a real sense, the Judges were asked to resolve a question which their subsequent conclusion rendered hypothetical.

B. Commissioner of Inland Revenue v Penny and Hooper

In *Commissioner of Inland Revenue v Penny and Hooper*[173] the arrangement in issue was the commonplace structure whereby the professional practice of the taxpayers is conducted through a company which is owned by their family trusts. Dividends are then distributed to members of the taxpayer's family. The taxpayer receives a salary from the company as consideration for his or her services. In *Penny and Hooper* the salary received by the taxpayers, orthopedic surgeons, was well below a commercially realistic salary. A majority in the Court of Appeal, Hammond and Randerson JJ, (with Ellen France J dissenting) reversed the decision of MacKenzie J at first instance. All Judges accepted that the structure adopted by the taxpayers was a legitimate legal structure in itself. They differed on whether the structure as constituted, including the commercially unrealistic salary, amounted to tax avoidance under s BG1.

In holding that the arrangement amounted to tax avoidance, Hammond and Randerson JJ took into account a wide array of factors. Randerson J's judgment is particularly helpful for its comprehensive analysis of the arrangement, and Hammond J's judgment is valuable for the references to the American case law. Critical to their judgments was the fact that the salaries were fixed at an artificially low level far removed from economic or commercial reality. In the result, the structure was void as against the Commissioner. Randerson J pithily summarised the gist of the case; incorporation became the vehicle by which the taxpayers obtained the benefit of a lower company

172 This difference is highlighted in an article by Mike Lennard "A Tale of Two Banks" (2009) Taxation Today No 24 at 1.

173 *Commissioner of Inland Revenue v Penny and Hooper* [2010] 3 NZLR 360.

tax rate while still enjoying the full benefit of the income for themselves personally and their families.[174]

Both Hammond and Randerson JJ explained that not all such structures will be impermissible. Each case will depend on the extent of the element of artificiality, contrivance or pretence. Marginal cases are unlikely to be challenged, but it perhaps needs to be clarified that the change in structure from a sole trader to a company was not a critical element leading to the majority's conclusion that the arrangement in issue amounted to tax avoidance.[175] The critical feature was the structure itself.

The fact that the identification of an unlawful structure may turn on drawing a line between an acceptable salary and a commercially unrealistic salary may not appeal to those accustomed to undue literalism in tax law. However tax law is not exempt from Oliver Wendall Holmes' adage: "[W]here to draw the line … is the question in pretty much everything worth arguing in the law."[176] Woodhouse P was expressing much the same sentiment in the *Challenge Corporation* case, cited with apparent approval by the majority in *Ben Nevis*, when he said that the qualifying wording and ambit of the general anti-avoidance provision is a question of fact and degree in each case.[177] That perception accords with the reality. The basic question whether a tax arrangement is tax avoidance is more often than not a question of where to draw the line. Tax law cannot lay preemptive claim to bright lines.

It may be noted, yet again, that it would have been more coherent for the Court to have been permitted to examine the substance of the arrangement in the context of the specific tax provisions and at once address the question whether it amounted to tax avoidance. Only if the arrangement did not amount to tax avoidance would its compliance with the specific provisions need to be addressed, and that question could then be more effectively dealt with in the knowledge that tax avoidance was not involved.

As at the time of writing, leave to appeal to the Supreme Court has been granted to the taxpayers in *Penny and Hooper*. A different approach or perception to that adopted in the judgments of the courts below is available and will no doubt be considered by the Court. Hence, one or two observations as to how the substance over form approach could apply to the facts of that case may not be misplaced. Unlike the time when I first wrote the body of this article, the date of my retirement has long since past and my influence is limited to such logic and common sense as my words, advertently or inadvertently, may import.

It is not difficult to anticipate that counsel for the taxpayers in similar cases will seek to argue that the salary paid to their taxpayer client is "commercially realistic" and for that reason the arrangement in issue is not tax avoidance. So, too, tax advisers when setting up such schemes will examine that question with their clients in an effort to determine at what point it can be plausibly claimed that the salary is not a pretence. Much consideration will be given to the question as to where the line can be drawn before the arrangement will attract the ire of the Commissioner or the condemnation of the courts if proceedings should follow. Based on the judgments in *Penny and Hooper* tax advisers may reasonably expect a margin or allowance in their clients' favour.

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174 At [118].

175 See Keith Kendall "Tax Avoidance after *Penny*" (2010) NZLJ 245 at 246.

176 *Irwin v Gabit* 268 US 161 and 168 [1925].

177 Above n 138.

Such an outcome focusing on the question whether the salary is or is not commercially realistic is unfortunate in that it does not fully embrace the substance of the arrangement. Certainly, the level at which the salary has been set will be a critical feature, but the "purpose or effect" of the arrangement emerges from the scheme as a whole. The salary may be within an acceptable range but a tax saving or tax advantage may still be obtained by the taxpayer as a result of the overall structure of the scheme.[178] In other words, the tax advantage to the taxpayer is unlikely to be able to be assessed by reference to the salary alone. The taxpayer will also, as in *Penny and Hooper*, have retained control or effective control over the income earned from the practice and enjoy the benefit of the income of the company (or trusts) for him or herself and their families. Tax avoidance remains a significant purpose and effect of the arrangement.

In this context, it is helpful to refer to the decision of the Privy Council in *Peate v Commissioner of Taxation of Commonwealth of Australia*.[179] Michael Littlewood has pointed out that the decision was not mentioned in any of the judgments, either at first instance or on appeal, in *Penny and Hooper*.[180] The arrangement in *Peate's* case, however, was not dissimilar to the arrangement in *Penny and Hooper*.

In *Peate's* case the taxpayers were doctors. Seven of them practiced in a partnership. They dissolved the partnership and replaced it with a series of agreements. Under these agreements: first, a company ("Westbank") was incorporated with the doctors as directors; secondly, a "family" company was formed for each doctor's family with the doctor agreeing to serve the family company as a "medical practitioner" in the business carried on by Westbank at a salary; thirdly, the shares in the family companies were held by trustees on settlement for the doctors' children and wives; and, fourthly, Westbank entered into separate agreements with each of the family companies and each of the doctors to the effect that each family company would, for a fee, arrange for the doctors to serve Westbank as a medical practitioner.

In an opinion delivered by Viscount Dilhorne, the Privy Council held that the arrangement had the purpose and effect of avoiding liability for tax and therefore amounted to tax avoidance. Lord Donovan agreed with this finding, but delivered a dissenting judgment contending that the section in issue failed to provide a remedy.

It is of interest that the judgments do not disclose the level of salary paid to the doctors. Prior to the adoption of the scheme, the doctors received 14 per cent of the net profits of the partnership. Under the scheme to which that percentage adhered, the doctors received by way of service fees or dividends the same percentage of the net profits of Westbank to which they had been entitled under the partnership.[181] The shares in that company were also allotted to each of the family companies in the same proportion.

Notwithstanding that the doctors adhered to the percentage of net profits available under the partnership, however, their Lordships held that tax had been avoided on the difference between the salary the taxpayer and his wife as directors of the family company agreed he should receive

178 Experience rather than, or bolstered by, cynicism suggests that tax advisers of a literalist frame of mind will fix, or recommend, a salary at a realistic level and obtain the tax saving by increasing the service fees or dividends, or both, or by introducing some other modification designed to reduce the income paid to the taxpayer by the company or trust.

179 *Peate v Commissioner of Taxation of Commonwealth of Australia* [1967] AC 308.

180 "*Penny and Hooper* and *Stare Decisis*" (Publication pending).

181 Following the withdrawal of one of the doctors, the percentage changed slightly but the change does not have bearing on the principle in issue.

and the amount received each year by the family company from Westbank in service fees and dividends. This difference was ascertained by, in effect, disregarding the scheme and treating the fees paid to Westbank and the family companies as fees paid to the doctor. In essence, the effect of the arrangement was to reduce the tax liability of the taxpayer in respect of the provision of the same medical services.

In my view, while it is to be expected that the courts will have regard to the features of the arrangement which point to tax avoidance, such as the commercial reality of the salary, it is important not to neglect the substance of the arrangement. In *Penny and Hooper* the purpose and effect of the arrangement was to reduce the incidence of the tax payable by the taxpayers in respect of the services they provided as orthopedic surgeons. A reduction in the ordinary incidence of tax payable by them clearly occurred. That was the effect of the arrangement, and working backwards from that effect, must be taken to have been its purpose. Nor could the purpose and effect be said to be merely incidental. Consequently, irrespective whether the salary was commercially realistic or not, the fact the taxpayers obtained an overall tax advantage means that they should not be able to maintain the arrangement as against the Commissioner, certainly in the absence of some other compelling reason as to why the arrangement was adopted. Cutting to the quick, the taxpayers' income was what the patients paid for the medical services less expenses.

I would emphasise that I am not saying the extent of the tax saving is immaterial. It may well be that the fact the tax saving in a particular case is minimal may support the taxpayer's claim that the arrangement was made for a legitimate purpose and that the tax saving is merely incidental to that purpose. However where, as a result of the arrangement the taxpayer pays less tax for the professional services he or she renders than if they had remained unincorporated or had not created a trust, this claim may be difficult for the taxpayer to establish.

C. Krukziener v Commissioner of Inland Revenue

A more recent case is *Krukziener v Commissioner of Inland Revenue*,[182] a well crafted judgment of Courtney J. The structure which Mr Krukziener, a property developer, employed to carry on his business was one which is commonly adopted to isolate the creditor risks associated with individual projects to protect the developer's group should the particular development fail. Mr Krukziener did not receive a salary. His financial return was to be by way of a distribution of profits from successful projects. Pending such distributions, Mr Krukziener's living expenses were met from advances made to him from the current accounts of other entities in his group, usually through the payment of his personal credit card debts.[183]

Although these advances were recorded as loans, no agreement had been made for their repayment. Nor was there any evidence of any demand for payment having been made. The funds advanced remained outstanding. From 1977 onwards, however, repayments were made to Mr Krukziener from a non-taxable capital distribution following the sale of a property owned by one of the group. Courtney J did not focus so much on the practice in the property industry whereby developers draw on the expected future profits of a project as the way in which the practice was implemented in this case. The learned Judge noted, in particular, that the current account advances

182 *Krukziener v Commissioner of Inland Revenue* HC AK CIV 2010-404-000728.

183 Ibid, at [10].

were repaid only when non-taxable distributions became available.[184] She therefore concluded that the arrangement had a more than a merely incidental purpose or effect of avoiding tax.

What is significant about this judgment is that, under the heading: "Was there an arrangement?",[185] Courtney J effectively traversed the substance of the arrangement in the context of the specific tax provisions in point and identified the features in the arrangement which constituted tax avoidance. Although the learned Judge then proceeded to apply the formula laid down in *Ben Nevis* to the arrangement she had analysed, the critical work had been done. The elements constituting tax avoidance had been identified in the Judge's careful analysis of the arrangement. Her subsequent application of the two step approach in *Ben Nevis* largely consists of her particular responses to counsels' submissions and a reiteration of the elements of the arrangement already shown to be tax avoidance.

I would suggest that a fair reading of the above cases leaves one with the impression that the essential inquiry undertaken by the courts has been into the features and intricacies of the arrangement in issue and that the findings made in that regard have directed the finding of tax avoidance. To some extent, the foray into the legitimacy of the arrangement in terms of the first step in *Ben Nevis* has the appearance of a deviation. There must be a real risk in future cases that the legitimacy of the arrangement under the specific provisions will be assumed, perhaps unconsciously, in order for the courts to grapple with the inevitable question of tax avoidance. With that risk may come the further risk that the courts' conclusion in relation to the interpretation and application of the specific provisions may in other circumstances provide taxpayers and their tax advisers with a literal interpretation of the specific provisions which is not warranted and which may lead to needless litigation. As Michael Littlewood has pointed out, the application of the formula in *Ben Nevis* may actually facilitate tax avoidance.[186]

XVI. The Journey's End?

For the reasons traversed above I consider that, when a suitable case arises, the Supreme Court should take the opportunity to review and reconsider the approach to be adopted by the courts in cases where the Commissioner alleges tax avoidance. *Ben Nevis* need not be regarded as the last word. The fact that the Court divided three to two in respect of the approach to be adopted is reason enough for the Court to revisit the issue. It can do so having regard to the way in which the two step formula in *Ben Nevis* has been applied in later cases and its impact on the tax advice industry. If this review is undertaken the matters which the Court might usefully consider can be shortly listed.

(1) The Court could give full effect to Parliament's intent by expressly proclaiming that the substance of an arrangement is to be decisive whenever the question of tax avoidance is in issue. It should be clarified that the era when form prevailed over substance is at an end in respect of both the general anti-avoidance provision and the specific tax provisions.

    It is my belief that a clear statement to this effect will do more to increase the level of certainty in the application of tax law than any other statement by the Court. It will require the commercial community and tax advisers to confront the substance of a proposed arrangement and reject it if the tax saving is not genuinely incidental to its commercial objective and ra-

184 Ibid, at [23] and [24].

185 Ibid, at [5]-[27].

186 Michael Littlewood, above n 169, at 155.

tionale. The ingenuity of tax advisers to devise schemes in the guise of tax planning which are in substance tax avoidance arrangements will not disappear entirely, but the climate and scope for them to do so will be much more limited than at present. Certainly, schemes devised by promoters and marketed to investors as in *Ben Nevis* will, or should, wane and ultimately wither away.

(2) The Court should expressly confirm that the purposive approach applies to the tax statute, including specific tax provisions. In particular, the observations of Lord Steyn and Lord Cooke in *Inland Revenue Commissioners v McGuckian*,[187] referred to above, are too persuasive to be relegated to a footnote in any reappraisal of our tax law.

(3) The decision of the majority in the Privy Council in *Peterson's* case[188] should be expressly disapproved. As argued above, the judgment of the majority in that case is not sound and leaving it unscathed conveys a mixed message to the tax advice industry. It is plainly incompatible with the greater aggression to tax avoidance evident in *Ben Nevis* and *Glenharrow*. The express rejection of the reasoning of the majority of the Privy Council in *Peterson's* case will make it clear to tax advisers that they cannot now rely on the approach adopted by the majority in interpreting and applying specific tax provisions.

(4) Although England does not have a statutory general anti-avoidance provision and the cases must be approached with care, as discussed above, the principle formulated in *Ramsay* could be usefully incorporated in our tax law. As intimated by the minority in *Ben Nevis*, it is compatible with our statutory regime. Endorsing the principle would leave no doubt that substance over form applied to specific tax provisions. As many schemes rely on more than one specific tax provision, it is important that the courts be enjoined to consider the arrangement as a whole when considering their validity under the specific provisions and not just pursuant to the general anti-avoidance section.

(5) Subject to the above exceptions which are in line with the Court's approach, the Court could usefully indicate that earlier cases upholding arrangements based on their form, as distinct from their substance, are no longer authoritative.

(6) Contrary to settled law, dicta in *Peterson's* case suggest that the onus of proof where tax avoidance is in issue rests on the Commissioner. This suggestion is not consistent with the Court's decisions in *Ben Nevis* and *Glenharrow*. It is for the taxpayer to establish that there is no arrangement, if that be the case, or, if there is an arrangement, that the purpose and effect of the arrangement is not tax avoidance.

(7) Finally, the Court could revise the two stage formula laid down by the majority in *Ben Nevis*. It could be made clear that a thorough examination of the specific tax provisions, including their purpose and the legislative policy behind them, is required in order to determine the nature and scope of the arrangement in issue. Once that exercise has been completed the courts should address the question whether the arrangement amounts to tax avoidance. No finding would be required at this stage as to whether the scheme complies with the specific tax provisions. A finding of tax avoidance would mean that the arrangement contravened both the specific tax provisions and the general anti-avoidance provision.

As acknowledged above, if it were found that the arrangement did not amount to tax avoidance the question would still remain as to whether it complied with the specific tax provisions

187 Above n 47.

188 Above n 124.

> on which the taxpayer relied. The focus of this question, or the exercise in resolving that question, however, would be much narrower and would benefit from being divorced from the prospect that, irrespective of any apparent compliance, it may nevertheless prove to be outside the intent of the provision.

Ben Nevis and *Glenharrow* represent a positive advance in the move towards a more coherent, predictable and equitable tax system, but as Lord Cooke observed at an earlier time in *Inland Revenue Commissioners v McGuckian*, "… the journey's end may not yet have been found".[189] That journey's end, I believe, will be found when the doctrine of form over substance is firmly rejected and it is made clear that the substance of an arrangement is decisive, not only in determining whether an arrangement is void under the general anti-avoidance provision, but also in determining the legitimacy of an arrangement under the specific tax provisions that abound in our monumental tax statute.

XVII. ADDENDUM

At the time the above article was submitted for publication, leave to appeal to the Supreme Court had been granted to the taxpayers in *Penny and Hooper*. The Court delivered its decision on 24 August 2011.[190] Not unexpectedly, the taxpayers' appeal was dismissed in a unanimous decision delivered by Blanchard J.

The Court does not expressly state that, in determining whether an arrangement amounts to tax avoidance, substance is to prevail over form, but there can be little doubt that this is the effect of the decision. Irrespective of the form it may take, the structure will be void against the Commissioner unless the tax advantage is merely incidental to the purpose and effect of the structure.[191]

First, the Court examined the substance of the structure which the taxpayers had adopted and concluded that there was no legitimate reason for the artificially low salary and that, as a result, the predominant purpose of the structure was the avoidance of tax. The Court was not immobilised by the form of the structure.

It is true that the Court was content to focus on the artificially low salary rather than the structure as a whole. As I point out (footnote 178) a realistic salary could be paid and, yet, the arrangement could still have the purpose and effect of altering the incidence of tax. It is disappointing that the Court has not seen fit to close off the possibility of variations in the structure designed to obtain an impermissible tax saving.

Secondly, the Court unreservedly endorses the decision of the Privy Council in *Peate's* case. Indeed, Blanchard J includes no less than seven quotations from the judgments in the High Court of Australia. Both the Privy Council and the High Court make no bones about addressing the substance of the similar arrangement in that case.

Blanchard J appears to suggest that the structure in issue in *Peate's* case also centred on an artificially low salary.[192] Such a suggestion, if intended, would be incorrect. Neither the Judges in the Privy Council nor the High Court comment adversely on the level of the salaries paid to the doctors. The key point is that, while the "family" company (Raleigh) received by way of service fees or dividends the same percentage of the net profits as the taxpayer had been entitled to when

189 Above n 73.

190 *Penny v Commissioner of Inland Revenue* [2011] NZSC 95.

191 At [47] and [49].

192 At [39] to [46].

in partnership, the taxpayer had the ability as the governing director of that company to depress his own salary.[193] The essential purpose of the structure was to divert income away from the participating doctors to or for the benefit of their families to the end that a substantial part of the tax otherwise payable would be avoided. Avoidance was determined by calculating the tax that would have been payable by the doctors operating in partnership as against the tax paid by the various entities under the structure.

Nevertheless, the Court has unequivocally endorsed the approach in *Peate's* case, and it would be imprudent to assume that the Court will not have regard to the overall tax saving obtained by the adoption of the structure as well as any particular individual feature of the structure, such as the salary level, if it has the effect of altering the ordinary incidence of taxation.

Thirdly, the fact substance is decisive over form is evident in the arguments the Court rejected. In finding for the taxpayers at first instance, MacKenzie J essentially followed the form over substance approach. His reasoning was endorsed by Ellen France J in a dissenting judgment in the Court of Appeal. This approach is disavowed. Similarly, Blanchard J systematically rejects the arguments put forward by Mr Harley for the taxpayers. The taxpayers could not have had a more committed and articulate counsel to run the tired arguments of the form over substance era, but rejected they are. Mr Harley's submission, for example, that the prescription in the Act of the categories of taxpayers as individuals, companies, trusts and so forth, with some special anti-avoidance rules for related-party transactions, leaves no room for the operation of s BG1 is firmly dismissed.[194]

While it cannot yet be said that the Court in *Penny and Hooper* has reached the "journey's end", it is certainly a sizable step along the way.

193 At 468, per Kitto J and 473, per Taylor J.

194 At [45].