IN THE COURT OF APPEAL OF NEW ZEALAND

CA192/05
[2007] NZCA 346

BETWEEN	GLENHARROW HOLDINGS LIMITED Appellant
AND	THE COMMISSIONER OF INLAND REVENUE Respondent

Hearing: 31 October 2006 and 1 November 2006

Court: Chambers, Robertson and Ellen France JJ

Counsel: W M Wilson QC, G J Harley and S L O'Neill for Appellant
J H Coleman, J Comber and S Wellick for Respondent

Judgment: 15 August 2007 at 3 pm

JUDGMENT OF THE COURT

A The appeal of Glenharrow against the finding that s 76 of the Goods and Services Tax Act 1985 applies is dismissed.

B The Commissioner's cross-appeal against the valuation of the tax advantage is allowed. The correct adjustment to counteract the tax advantage is to view the mining licence as having a total value of $290,000.

C The order for costs in favour of Glenharrow against the Commissioner of Inland Revenue in the High Court is quashed and the question of costs in the High Court is referred back to that Court for reconsideration in light of this judgment.

D The Commissioner will have costs of $18,000 plus usual disbursements against Glenharrow in respect of the appeal and cross-appeal. We certify for second counsel.

REASONS

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ROBERTSON AND ELLEN FRANCE JJ

(Given by Robertson J)

Introduction

[1] We heard together an appeal and cross-appeal from a decision of Chisholm J delivered on 23 August 2005 with regard to the taxation implications of the sale and purchase of a mining licence.

[2] The High Court found that the transaction in which the appellant, Glenharrow Holdings Limited (Glenharrow), acquired the licence for $45 million with vendor finance of $44,920,000 was not a sham. Chisholm J also found that the principal purpose of the transaction was to work the licence and extract stone which, at the time the transaction was entered into, was a genuine potentially achievable purpose.

[3] Chisholm J concluded that, in terms of s 76 of the Goods and Services Tax Act 1985 (GSTA), the sale and purchase agreement combined with the vendor financing was an arrangement to defeat the intention and application of the Act. That was because the Judge found that the original valuation of the licence and the subsequent purchase price were "grossly inflated": at [213].

[4] The Judge said that the correct adjustment was to disallow the input tax credit on the $44,920,000 but to allow an input tax credit on $9,757,000. That figure reflected the GST input credit already paid on the sum of $80,000 and the Judge's finding as to the value of the licence.

[5] The appellant challenges the Judge's conclusion that s 76 applies and the finding as to the correct adjustment. In that context, the appellant says the Judge was wrong to conclude that the valuation of the licence was grossly inflated.

[6] The Commissioner of Inland Revenue (Commissioner) challenges the High Court judgment as to the quantum of the adjustment of tax refundable. The Commissioner also challenges the award of costs against him made in the High Court.

[7] We have not found it necessary or appropriate to approach the appeal on any basis other than that which counsel adopted before us, in the High Court and before the Taxation Appeal Authority.

Background

[8] At the heart of the litigation is a mining licence (ML32.2682) which was issued on 15 November 1990 for a ten year term.

[9] It relates to land which is about 1200 metres above sea level and is inaccessible by road. The licence indicated that it covered 107 hectares, but it has subsequently been confirmed by survey that the area is nearer 80 hectares.

[10] The licence had restrictive conditions imposed by the Minister of Energy, limiting the licensee to handheld methods of extraction, required minimal environmental disturbance and prohibiting the erection of buildings without prior approval. There was also a requirement that the licence be continually worked.

[11] In addition there were conditions imposed by the Minister of Conservation, namely that the licensee could not remove greenstone, could only use handheld methods to remove serpentinite, bowenite and talc, and no track or wheeled vehicle was permitted to be used.

[12] The licence covered a V shaped area of land to the north east of Mt Griffen in Westland and was originally issued to Messrs Sweetman and Havill. On 19 August 1993 Mr Havill sold his share to South Pacific Resource Commodity Traders for $5,000. On 31 October 1994 the licence was transferred to Messrs Tainui and Wilson for $100 who in turn transferred it to Michael Meates for $,10,000 on 20 December 1996.

[13] Glenharrow was a shelf company acquired by Mr Gerard Fahey to hold the licence. Mr Fahey is the sole director and shareholder of the appellant. He had grown up in the Mt Griffen area of Westland, but had moved to Christchurch in

1970. Chisholm J found at [47] that he and the vendor, Mr Meates, were "not really" known to each other.

[14] During the mid-1990s, Mr Fahey, through a variety of circumstances, became interested in obtaining the licence. He spoke with Mr Meates who in turn discussed the possibility with his cousin, Mark Meates, who had studied valuation as part of his MBA degree at Columbia University in New York City. Mark Meates was asked to put a value on the licence. He provided a brief report dated 3 June 1997 in which he indicated a range of between $45 million and $180 million and "conservatively" valued the licence at $45 million.

[15] Michael Meates told Mr Fahey that $45 million was the price. Mr Fahey agreed on the spot on the basis that there would be vendor finance.

[16] Neither Mr Fahey nor Glenharrow obtained an independent valuation prior to purchase. Mr Fahey said he would have been prepared to pay $60 million for the mining licence. He determined that, by utilising a helicopter to extract stone, 15,000 tonnes of stone at $4,000 per tonne could be exploited.

[17] The Judge found that the skeleton of the agreement was recorded on a letter of instruction from Mr Meates to his solicitor Mr Pengelly which Mr Fahey and Mr Meates prepared over several days. It was partly typewritten and partly handwritten – the handwritten parts of the document are shown in italics:

> No 2 RD
> Wainihinihi, Kumara
>
> B C Pengelly,
> Solicitor,
> Christchurch.
>
> Dear Bruce,
>
> *Purchase Price $45,000,000*
>
> I have made an unconditional agreement to sell to Gerard Fahey, Glenharrow Holdings Ltd, all of my interest in the estate in land I hold on Mount Griffen (*107* hectares) covered by Mining Licence *ML 32.2682*. Gerard will pay to you on or before 30 June 1997 a deposit of $80,000 (eighty thousand dollars). Please pay this into a trust account in my name and I will advise you in writing how it is to be disbursed.

> I will be taking a mortgage back over the rest of the purchase price. The mortgage is to be over the licence and the company and the shares in the company. Payments in reduction of the capital are to be made six monthly. In terest [sic] on the remaining balance is to be at ten per cent. It will take two years for the mining operation to get organised and no interest is payable for the first two years. *No repayment of capital for 3 yrs.*
>
> There will be some sort of formal documentation and I would like you to [sic] that for me ans [sic] to do whatever else needs to be done.
>
> Yours sincerely
>
> Michael Meates
>
> *Any disagreement: An arbitrator*
> *Richard Wilding / Terry McCormick*
>
> *Glenharrow Holdings Ltd* *"G M Fahey"*
> *(Director) 28/6/97*
> *I accept these terms as set out above, as well as hand written additions.*
> *"M W Meates"*

[18] The $80,000 deposit was paid to Mr Pengelly's trust account on 30 June 1997. Mr Pengelly declined to act on joint instructions. Mr Fahey and Glenharrow were referred to another solicitor, Mr O'Neill, who acted on the draft of the sale agreement and securities.

[19] Michael Meates had to obtain legal title to the licence which he had acquired just on a handshake. He executed a transfer to Glenharrow on 22 August 1997.

[20] On 14 November 1997 the vendor and purchaser executed a sale agreement recording a price of $45 million (including GST) and recording that the deposit of $80,000 had been paid. The sale agreement was conditional on Ministerial consent, with settlement to follow in seven days.

[21] The vendor finance of $44,920,000 was agreed to be advanced on terms and conditions contained in the securities. On 28 November 1997 at settlement a debenture and mortgage of shares were executed. Mr Pengelly's trust account cheque for $44,920,000 (representing the amount advanced as vendor finance secured by the debenture) was delivered to Mr O'Neill acting for Glenharrow as purchaser. Mr O'Neill's cheque for that amount (as Glenharrow's payment of the balance of the purchase price) was delivered to Mr Pengelly. The cheques were both

banked on 1 December 1997. There is no suggestion that either of the clients provided any financial resources to their respective solicitors.

[22] The statutory consent process for the transfer of the mining licence was not concluded until November 1998, although the delay was not attributable to Glenharrow.

[23] There were various steps with regard to the modification of the licence, some of which were immediately successful and others which required Court intervention: *Glenharrow Holdings Limited v Attorney-General* [2001] 1 NZLR 578 (HC).

[24] In January 2000 the Chief Inspector of Mines withdrew consent for a modified work programme which had been lodged in March 1998. There were further disputes and much delay. Glenharrow issued judicial review proceedings on 14 November 2000, the day before the mining licence expired. Glenharrow ultimately failed in its challenge proceedings in the Privy Council: *Glenharrow Holdings Limited v Attorney-General* [2005] 2 NZLR 289.

[25] When the licence expired by effluxion of time on 15 November 2000, Glenharrow had extracted only 36 tonnes pursuant to the licence.

[26] Glenharrow made two GST input credit claims. First, on 28 June 1997, there was a claim in relation to the deposit of $80,000 paid in its return for the period August/September 1997. The Commissioner accepted this claim and paid a refund in January 2001. Second, on 2 May 1998 Glenharrow sought a refund of $4,995,236, being the tax fraction of the amount of vendor finance ($44,920,000).

[27] While Glenharrow was a registered person under the GSTA, Michael Meates as vendor, was not. He was not therefore able or liable to charge Glenharrow, or account for GST, in respect of either component of the sale price.

[28] In disallowing the input credit sought by Glenharrow in respect of the $44,920,000, the Commissioner said the sale and purchase agreement price of $45 million was a sham, or alternatively, that s 76 of the GSTA was applicable.

[29] After the statutory dispute resolution procedures had been followed, Glenharrow issued challenge proceedings which were heard by Chisholm J and have led to this appeal.

The High Court decision

[30] Chisholm J found that the transaction was not a sham: (2005) 22 NZTC 19, 319. He found that the provision of vendor finance was bona fide and held at [140]:

> Both Michael Meates and Gerard Fahey gave evidence about the structure of the arrangement. Mr Meates's explanation was that while he would have preferred cash, he realised that he would have to leave in substantial finance if the transaction was to proceed and he elected to do so on the basis that he would get value out of the licence by Mr Fahey working it and paying him. Mr Fahey saw the vendor finance as a temporary measure because he intended to refinance and was confident of his ability to do so. Those explanations are plausible and I do not think that of itself the vendor finance arrangement supports the proposition that the arrangement could not have been bona fide.

[31] And subsequently he said at [148]:

> The exchange of cheques on settlement attracted a good deal of adverse comment. Given that it had been decided at the outset that Mr Meates would be providing vendor finance, that he did not have the necessary funds and that the deed of sale specified the method of settlement, an exchange of cheques was inevitable. I do not read anything sinister into the exchange or the fact that trust account cheques, not bank cheques, were exchanged. Again if there was anything sinister the solicitors on each side must have been parties to the sham. In my view the swapping of cheques was a legitimate commercial technique to achieve the objective of the parties.

[32] Chisholm J accepted that both Mr Meates and Mr Fahey gave truthful evidence about their intentions, namely that Mr Meates sold with the intention that the $45 million would be paid in full and Mr Fahey purchased with the intention of mining the licence and meeting the payments due from revenue. He concluded at [163]:

> As it turned out both were much too optimistic, but that does not detract from the fact that the agreement was genuine and the parties intended to implement it according to its terms. There was no sham.

[33] Subsequently, the Judge found that the principal purpose for the purchase of the licence was making taxable supplies, and upon that he concluded at [166]:

> … I have no difficulty in accepting that the necessary principal purpose has been established. When it purchased the licence Glenharrow's primary or fundamental purpose was to work the licence and extract stone. As at 28 June 1997 that was a genuine and potentially achievable purpose. The totality of the circumstances do not negate that principal purpose.

[34] The Judge also rejected the Commissioner's argument that the $44,920,000 was not paid for the purchase of the mining licence but to procure a GST refund. Chisholm J determined that there was no element of pretence in the arrangement because Glenharrow and Mr Meates were "entirely genuine in their belief that they had bought and sold the licence for $45 million": at [189].

[35] Notwithstanding that finding, the Judge went on to hold that s 76 applied to Glenharrow because the consideration paid for the mining licence was grossly inflated so as to defeat the intent and application of the GSTA: at [213].

[36] In reaching that view Chisholm J heard evidence as to the value of the mining licence from a number of witnesses on behalf of the Commissioner. These witnesses all used different methodologies.

[37] Chisholm J largely disregarded the evidence of Mr McPhail, a businessman who valued the licence at $1 million. The Judge considered that the objective valuation of what a "typical investor" would have paid was unhelpful: [190].

[38] Dr Rabone, a consultant geologist, assessed the geological resource and technical and financial factors relating to the licence as understood at 28 June 1997. He suggested that the most appropriate valuation method was the net resource value (the in-ground value of the resource less all costs on extraction, processing and sale) and identified the factors which must be considered: at [69].

[39] Dr Rabone also identified some key limiting factors in relation to the licence. He questioned the accuracy of information available at the time of entering the contract, the quality of stone, and the uncertainty regarding the boundaries of the licence.

[40] The technical data provided by Dr Rabone was used by Mr Frankham, a chartered accountant, in his calculations. Mr Frankham used a discounted cash flow methodology. Such a methodology provides a "fair market value", that is a value at a point in time when the buyer and seller are under no pressure to act and both parties have a reasonable knowledge of the facts. Mr Frankham valued the licence at $3.769 million.

Chisholm J's valuation findings

[41] Chisholm J found that the methodology used by Mr Frankham was the most useful, and largely agreed with the formula used. The Judge, however, based on his findings of fact, found that two of the figures used by Mr Frankham were incorrect.

[42] Using different figures but the same formula as Mr Frankham, the Judge estimated the value of the mining licence to be approximately $8 million. Accordingly he found that s 76 was triggered because the consideration of $45 million was grossly inflated.

Is the scheme void for tax avoidance?

(i) Legislation

[43] Section 76 of the GSTA (in the form which existed at the relevant time) provided:

> **76 Agreement to defeat the intention and application of Act to be void**
>
> (1) Notwithstanding anything in this Act, where the Commissioner is satisfied that an arrangement has been entered into between persons to defeat the intent and application of this Act, or of any provision of this Act, the Commissioner shall treat the arrangement as void for the purposes of this Act and shall adjust the amount of tax payable by any registered person (or refundable to that person by the Commissioner) who is affected by the arrangement, whether or not that registered person is a party to it, in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that registered person from or under that arrangement.

[44] What constituted an "arrangement" was defined in s 76(4):

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

[45] It is common ground that an "arrangement" had been entered into between Mr Meates and Glenharrow.

[46] Section 8(1) outlines the general operation of the GSTA. GST is not charged on commodities themselves but on the supply of commodities. GST is imposed on the supply of goods and services by a registered person in the course of a taxable activity. Supply is given a broad definition in the Act and includes "all forms of supply": s 5(1). The charge imposed is calculated as a percentage of the value of the supply.

[47] The mechanism for determining the value of supply is provided in s 10:

> **10 Value of supply of goods and services**
>
> (1) For the purposes of this Act the following provisions of this section shall apply for determining the value of any supply of goods and services.
> (2) Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,—
> (a) To the extent that the consideration for the supply is consideration in money, the amount of the money:
> (b) To the extent that the consideration for the supply is not consideration in money, the open market value of that consideration.
> (3) Subject to subsections (3A), and (8), where -
> (a) A supply is made by a person for no consideration or for a consideration that is less than the open market value of the supply; and
> (b) The supplier and the recipient are associated persons and
> (c) The supply is not a fringe benefit that the supplier has, or is deemed to have, provided or granted under the FBT rules of the Income Tax Act 1994 to the recipient, being a person employed under a contract of service by the supplier, -
>
> the consideration in money for the supply shall be deemed to be the open market value of that supply.
> …

[48] The value of supply is generally determined in accordance with the actual consideration paid for the goods or services. The two main exceptions to this are:

(a) when the consideration was not paid in money; and

(b) when the supply is an associated supply.

[49] Associated persons are defined in s 2 (now s 2A) as including relatives and other persons whose relationship suggest an arrangement which is not at arm's length.

[50] Where either of these exceptions apply, value of supply is treated as the open market value of that supply. Generally, the open market value of a supply of goods and services is the price (including GST) which similar goods and services would fetch in similar circumstances if the supply was freely made and the parties to the transaction were not associated persons: s 4(2).

[51] Where a registered person accounts for GST on an invoice basis, the person claims GST on receipt of an invoice (or on payment) of goods/services purchased and accounts for GST when payment (or an invoice) is received for goods/services they have supplied. There can be a delay between the receipt of tax credits for input tax and the payment of output tax upon the supply of goods/services by the registered person.

[52] If a registered person purchases secondhand goods from a non-registered person the supply is not subject to GST. The registered person may, however, claim one-ninth of the purchase price as a notional input tax credit provided sufficient records of the supply are kept: ss 8, 20(3) and 24(7). The aim of this credit system is to limit the GST paid by the final consumer to the amount of value added by the registered person.

[53] The calculation of the tax payable by a registered person is set out in s 20:

> **20 Calculation of tax payable**
>
> (1) In respect of each taxable period every registered person shall calculate the amount of tax payable by that registered person in accordance with the provisions of this section.
> …

> (3) Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period—
>
> (a) In the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19 of this Act, the amount input tax -
>
> (i) In relation to the supply of goods and services (not being a supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies), made to that registered person during that taxable period:
>
> (ia) input tax in relation to the supply of secondhand goods to which section 3A(1)(c) of the input tax definition applies, to the extent that a payment in respect of that supply has been made during that taxable period:
>
> (ii) input tax invoiced or paid, whichever is the earlier, pursuant to section 12 of this Act during that taxable period:
>
> (iii) any amount calculated in accordance with any one of sections 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b); and

[54] Section 20(3) draws a distinction in terms of input tax credits, on the supply of new and secondhand goods. Input tax credits may be claimed upon receipt of an invoice for new goods (or services) but can only be claimed upon payment for secondhand goods: s 20(3)(a)(i) and (ia). The sale and purchase agreement here involved secondhand goods.

(ii) General principles

[55] A general tax avoidance provision like s 76 is not about denying taxpayers choices as to how they arrange their affairs. Nor does it prevent the securing of tax advantages for which the legislation legitimately provides: *Challenge Corporation Limited v Commissioner for Inland Revenue* [1986] 2 NZLR 513 at 548-9 per Richardson J (CA). General tax avoidance provisions are aimed at transactions that undermine the integrity of the taxation legislation.

[56] It follows that in order to decide whether an arrangement involves tax avoidance, the courts must look for something more than a taxpayer merely taking steps to alter, avoid, reduce or postpone the incidence of their tax liability. A line must be crossed.

[57] The importance of the concept of line drawing was summarised by Lord Millett in *Peterson v Commissioner for Inland Revenue* [2006] 3 NZLR 433 (PC) when he said at [35]:

> The critical question is whether the tax advantage which they obtained amounted to "tax avoidance" capable of being counteracted by s 99, for the Courts of New Zealand have long recognised that not every tax advantage comes within the scope of the section; only those which constitute tax avoidance as properly understood do so.

[58] The principal issue here is whether Chisholm J was right to conclude that, although not a sham, and consistent with the GSTA in black letter terms, the arrangement had crossed the line and was void for tax avoidance.

[59] In determining this issue, it is relevant that tax avoidance can be found where there is a significant divergence between the legal reality of the transaction and its actual or economic reality. In *Commissioners of Inland Revenue v Willoughby* [1997] 1 WLR 1071 at 1079 (HL), Lord Nolan stated:

> The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability.

[60] That also is the approach in *Peterson* at [42]. This case was at the forefront of the submissions of all counsel and we will come back to its effect on this case shortly.

[61] Similarly, this Court in *Accent Management & Ors v Commissioner of Inland Revenue* [2007] NZCA 230 at [126] observed:

> [I]t will usually be safe to infer that specific tax rules as to deductibility are premised on the assumption that they should only be invoked in relation to the incurring of real economic consequences of the type contemplated by the legislature when the rules were enacted.

[62] Against this background, we turn to the submissions in this case.

(iii) Arguments of the taxpayer

[63] The appellant relies on the findings in the High Court: that the agreement for sale and purchase was genuine; that when Glenharrow purchased the licence that was for the principal purpose of working the licence; and that as at the time the first GST input credit claim was made (28 June 1997), working the licence was a genuine and potentially achievable purpose.

[64] The appellant says these findings and the associated rejection of the sham argument point against finding tax avoidance. Glenharrow argues that those findings are relevant to the Commissioner's arguments about whether there has been a true intention to pay and whether the transaction is offensively circular.

[65] In developing this submission, Glenharrow argues that there cannot be any illegitimate tax advantage in terms of s 76. That is because, on the Judge's findings, Glenharrow has acquired the licence having paid $45 million for the principal purpose of making taxable supplies. That must be the end of the matter because the payment was of the $45 million price and that payment is the GST transaction relevant to the input credit mechanism. That legal consequence has no direct legal connection to how the amount was financed. It is only by improperly conflating the transactions, i.e. payment and the vendor finance, as Glenharrow says the Commissioner does, that the Commissioner concludes this was tax avoidance.

[66] The appellant's submission is that this case is like *Peterson* where the taxpayer was found to have incurred the cost of acquiring the rights in the films, albeit substantially funded by vendor finance. All of the claimed depreciation and other benefits went with that. This reflected the underlying scheme of the Act and the income tax avoidance provisions could not be used to overcome that result. Here, the "end in view" is to acquire the mining licence for the principal purpose of making taxable supplies. This cannot engage s 76.

[67] The appellant also says that in terms of s 10(2) of the GSTA, $45 million is the value of the supply. Where the dealing is at arm's length there is no ability to go behind the consideration paid and no basis for concluding that the price was "grossly

inflated". It is not for the Commissioner to tell taxpayers how much they should pay for their assets or from whom they should buy them. The requirement that supplies are at open market value is expressly limited to supplies between associated persons.

[68] Finally, in terms of the likely delays in repayment here, Glenharrow's argument is that the GSTA is indifferent to what counsel described as "exaggerations" in timing.

[69] Accordingly, the appellant argued that the factual circumstances found in the High Court left no room for reaching the view that there had been a crossing of the line.

(iv) The Commissioner's response

[70] Mr Coleman accepts that the arrangement complied with the black letter terms of the GSTA, but submits that two aspects of the scheme and purpose of the GSTA were frustrated:

(a) The implicit view of the GSTA that supplies are not intended to be at grossly inflated prices but rather at open market value thereby limiting the amount of the input tax credit.

(b) The intention that the input tax deduction for a secondhand good is intended to be limited to the extent that payment is made in the GST period in question: s 20(3)(a)(ia). That intention was frustrated by the cheque swap and loan in the circumstances of this case.

[71] As to the first point, the Commissioner argues that although the Act only expressly requires supplies between associated persons to be at market value, the underlying concept of the GSTA is that supplies between parties who are at arm's length will be at open market value.

[72] On the second point, the Commissioner's view of the essential facts can be encapsulated as:

(a) the only asset of Glenharrow was the licence;

(b) there was no guarantee by Mr Fahey or anyone else to back up that obligation Mr Coleman also noted the evidence of Mr Simon Mortlock, an experienced solicitor, that it was unusual to settle with trust account cheques where solicitors had not first received clear funds from their clients before drawing the cheque on the firm's trust account;

(c) the mortgage which Mr Meates held over the shares meant that he could take back control of the licence if the project was not successful;

(d) Mr Meates accepted that he would be repaid only once Glenharrow started to work the licence; and

(e) Mr Fahey confirmed that Glenharrow's ability to pay was dependent on that occurring.

[73] Flowing from these unchallenged facts, the Commissioner argues that in economic terms the arrangement was only a conditional obligation to repay the loan and that there was no definitive commitment to repay irrespective of the success or failure of the venture.

[74] The Commissioner accepts that, in purely juristic terms, the concept of payment is met by the discharge of the obligation on the sale and purchase agreement, either by payment of money or the replacement of that obligation with another. Also that the discharge of the obligation in a sale and purchase agreement can be covered by a deed of acknowledgement of debt and a supporting loan which will constitute payment. However, Mr Coleman submits that, when the entire arrangement between the parties was looked at objectively, the vendor finance of $44,920,000 could only be paid from working the mine. Thus the economic liability was entirely conditional on the success of the Glenharrow project. He contends that

the arrangement constituted tax avoidance as Glenharrow had not suffered the economic burden intended by Parliament in order to qualify for tax credits.

(v) Applying the principles to the facts

[75] There was no dispute as to the "arrangement" between the parties. This can be summarised as:

(a) the agreement to sell the licence for $45,000,000 and the agreement for the vendor to lend $44,920,000 to Glenharrow which would be used to "pay" the balance of the purchase price beyond the $80,000 originally paid as a deposit;

(b) the steps and transactions by which this arrangement was carried into effect were:

(i) the 28 June 1997 letter agreeing to sell ML 32.2682;

(ii) the 22 August 1997 mortgage of the mining licence for the fixed sum;

(iii) the 14 November 1997 deed of sale between the appellant and Michael Meates;

(iv) the undated debenture between the appellant and Michael Meates;

(v) the 28 November 1997 deed of mortgage of shares; and

(vi) the 28 November 1997 debenture.

[76] There were other transactions which took place thereafter, but inasmuch as this litigation relates to the tax year ending 31 March 1998, they are not of direct relevance. They may be evidence which is relevant within a valuation context.

[77] Chisholm J was not wrong to find tax avoidance on the basis of a grossly inflated valuation. We accept the Commissioner's submission that transactions at non market value can in some circumstances defeat the intent and application of the Act. It is the case that the explicit recognition of the need for transactions to be at open market value is confined to transactions which are not at arm's length. However, the need for a particular rule for those transactions merely reflects the increased potential to transact at non market value in those situations given the absence of the normal tension between buyer and seller.

[78] We consider the Commissioner is right that a special rule for non market value transactions implies that such transactions can frustrate the scheme of the Act. Section 76(2)(d) also allowed the Commissioner to deem a supply to be at open market value. That too supports the Commissioner's approach.

[79] Eugen Trombitas, "The Role for a General Anti-avoidance Rule in a GST" in Krevor and White (eds) *GST in Retrospect and Prospect* (2007) 431 at 478 is critical of the High Court's finding on this aspect. Mr Trombitas relies on the absence of any reference in s 76, as it was at the time, to "purpose or effect". While the old s 76 language was different, we see no good reason for reading down its scope in the way the author contends. We are satisfied that the old version does not incorporate a subjective test. To give such an interpretation would render the section, which is intended to operate as a "backstop" provision, virtually inoperative.

[80] As to the effect of this approach on the present transaction, Glenharrow challenged the Judge's approach to valuation. However, the Judge was plainly entitled to conclude that although Mark Meates was not involved in any sham, his valuation was grossly inflated. As the Judge said, at [135], Mark Meates methodology was "unorthdox". It was also open to the Judge to treat matters such as the volume of stone as being of less importance given other limiting factors on the licence particularly its restrictive conditions.

[81] In any event, we also consider the Commissioner is right that the arrangement constituted tax avoidance because in economic terms the arrangement was only a conditional obligation to repay the loan and there was no definitive commitment to

repay irrespective of the success or failure of the venture. The loan was secured by way of a share mortgage with provision for Mr Meates to be able to take back control of the licence if the project was not successful. The mere completion of loan documents and the swapping of cheques was insufficient to constitute the economic sacrifice Parliament intended in limiting the secondhand goods refund to the extent that payment is made in the period in question. $80,000 was paid and is not in dispute. The rest, although expressed as an absolute obligation, was, in sensible commercial terms, only conditional.

[82] The payment of the bulk of the consideration was the loan, backed by the debenture and the associated security documents. Whatever they said on their face, they were an obligation for more than $44 million taken on by a $100 shelf company with no other assets, no guarantees and entirely dependant on the success of a speculative operation. However genuine the parties were, and despite the absence of pretence, when assessed objectively, the only way in which the vendor finance could be repaid was from working the mine. Thus the economic liability was entirely conditional on the success of the Glenharrow project. To treat this as the basis for an input tax credit in the month that the documents were entered into defeated the intention and application of the GSTA. Although there was an expressed legal obligation, it was artificial.

[83] Glenharrow relies on the rejection of the Commissioner's argument in *Commissioner of Inland Revenue v Auckland Harbour Board* [2001] 3 NZLR 289 (PC) that the accrual regime as a whole was constructed on the assumption that transfers of financial arrangements would be at market value. But for present purposes it is relevant that their Lordships described general tax avoidance provisions, like s 76, as being aimed at transactions "which in commercial terms fall within the charge to tax but have been, intentionally *or otherwise*, structured in such a way that on a purely juristic analysis they do not.": at [11] (emphasis added).

[84] Mr Harley also reminds us of authority that a court must determine whether or not the arrangement breached s 76 by viewing the contractual documents and their force and intent as at the date of execution: *Ashton and Another v Commissioner of Inland Revenue* [1975] 2 NZLR 717 at 722 (PC). In the passage relied on by the

appellant, Viscount Dilhorne said that whether the purpose or effect of the arrangement amounted to tax avoidance "must in their Lordships' opinion be determined only by reference to the arrangement and not by reference to the parties' subsequent conduct." The approach to the consideration of subsequent conduct in contractual interpretation more generally has been discussed recently by the Supreme Court in *Wholesale Distributors Limited v Gibbons Holdings Limited* [2007] NZSC 37. But in any event, the principal concern to which the Privy Council's observation was directed was to avoid a focus on motive and on evidence about what the parties intended. That is not in issue here and in determining whether there is the frustration of a statutory regime, the subsequent contractual documentation should not be entirely ignored. It is at least, as Mr Harley accepts, relevant as evidence of the background.

[85] The very first letter created by the parties (without legal advice) contemplated that there was to be no interest at all on this extraordinarily large advance for two years to allow "for the mining operation to get organised". There was no repayment of capital for three years. Although there were undoubted expectations that there might be renewals or extensions of the licence, the hard legal reality is that the licence expired on 15 November 2000. This transaction was entered into at a time when legislation was before the House which had the potential to substantially impact on this sort of activity: Ngai Tahu (Pounamu Vesting) Act 1997.

[86] Without in any way attributing blame or responsibility, the factual reality is that there was not an ability to immediately start exploiting the mining licence. There had to be subsequent variations of the obligations as the years went by and no cash stream was created from which Glenharrow could satisfy its debt. The mortgage document completed in August 1997 provided for the repayment of the $45 million in three equal installments of $15 million on 31 March 1999, 31 March 2000 and 31 March 2001 with 20% penalty interest. This was a slight variation from the original agreement, but totally unrealistic as far as an unsupported $100 company was concerned.

[87] No stamp duty was ever paid on the transactional documents. A deed of 28 November 1997 provided that the $44,920,000 was repayable on demand.

Interest was payable as demanded at a rate nominated by the lender not exceeding the vendor's bank overdraft rate. A second mortgage of shares executed on that date indicated that repayment was due on the dates described in the debenture, which in fact did not include any date for repayment.

[88] On 31 July 1998 there was a further debenture, which provided for the principal sum to be repaid on 31 March 2001 and a mortgaging of the shares held by Glenharrow to Mr Meates, but with no provision as to interest in the event of default.

[89] There was a further debenture securing $50 million executed on 30 March 2001 – the day before the 1998 debenture was due to be repaid. The associated term loan was for $44,920,000 repayable on demand with penalty interest at 16%.

[90] It is not to be overlooked that this transaction entailed the sale of the mining licence for $45 million when previous prices had ranged from between $100 and $10,000. These previous sale prices were made at times when there was a longer period left before the mining licence expired and the potential for a greater period of exploitation meant the licence would be more valuable.

[91] Mr Harley is right that the GSTA contemplates some mismatches in terms of timing but, as this Court said in *Ch'elle Properties (NZ) Limited v Commissioner of Inland Revenue* [2007] NZCA 256 at [41], significant temporal mismatches can indicate a crossing of the line into tax avoidance.

[92] We are satisfied that the line had been crossed and the arrangement had become tax avoidance because the obligation to pay the purchase price was replaced, in commercial terms, by only a conditional commitment to repay the loan. Glenharrow did not suffer the economic burden intended by Parliament. The arrangement therefore breached s 76.

Impact of the *Peterson* decision

[93] We need to deal then with the appellant's argument that the decision of the Privy Council in *Peterson* meant that a finding of tax avoidance arising because the requirement of payment was not properly satisfied was not open to this Court. We are persuaded that this is not the case as *Peterson* is distinguishable.

[94] Mr Peterson and other investors paid a production company certain amounts to acquire the rights to two films that the production company was making. The amounts the investors paid to the production company for each of the films were made up of their own funds ($x) and funds they borrowed by means of a non-recourse loan ($y). Unbeknown to the investors, the production company only required $x to make the films. The money borrowed was circled back to the lender almost immediately. The investors deducted from their other sources of income an amount in respect of depreciation on their acquisition costs of the films ($x+y). The depreciation rate was 50% meaning that they could deduct their entire acquisition costs over two years. The Commissioner accepted the investors' claim to a depreciation deduction for the amount represented by $x, but disallowed the balance of the claim on the basis that the amount $y did not represent a cost incurred in the making of the film.

[95] The central issue in *Peterson* was whether the tax advantage amounted to tax avoidance. The majority of Judges in the Privy Council found that the investors had entered into a genuine transaction and paid $x+y to the production company to acquire the films. They concluded that the investors had incurred the expenditure that Parliament contemplated would entitle them to the deduction and that the arrangement did not amount to tax avoidance: at [39]. The majority also noted at [42], however, that if the taxpayer had not suffered the economic burden intended, then they would have found that s 99 was applicable:

> If the commissioner had shown that the features on which he relied, singly or in combination, had the effect that the investors, while purporting to incur a liability to apply $x+y to acquire the film. had not suffered the economic burden of such expenditure before tax which Parliament intended to qualify them for a depreciation allowance, then he could invoke s 99 to disallow the deduction.

[96] In this respect, it is apparent that artificiality surrounding the manner of payment would have been sufficient had it defeated the intent and application of the Act. Lord Millett stated at [48]:

> The starting point would be for the commissioner to obtain a finding of the TRA that the loans were made on uncommercial terms such that no commercial lender would advance money unless it received some additional consideration for doing so.

[97] Both the majority and minority judgments in *Peterson* agreed on the general principles for approaching the application of general tax avoidance provisions. As noted by Professor John Prebble, both the majority and the minority largely accepted the arguments of the Commissioner: "The *Peterson* Case and its Impact on the Rules in *BNZ Investments Ltd* and *Cecil Bros*" in Sawyer (ed) *Taxation Issues in the Twenty-First Century* (2006) 117. The difference between the two approaches largely came down to a difference of opinion as to whether the investors had suffered the prerequisite pre-tax economic consequences intended by the legislature. The majority approach was influenced in no small part by what they considered to be inadequacies in the Commissioner's pleadings.

[98] *Peterson* is distinguishable from the case currently before this Court by reference to two main factors:

(a) factual findings regarding the economic burden suffered; and

(b) scope of the inquiry.

(i) Factual findings regarding the economic burden suffered

[99] The majority in *Peterson* found that the recourse loans did not lack commercial reality. To take one of the two films, *Lie of the Land,* the terms of the loan were:

(a) The loan was a non-recourse loan thus the lender was only entitled to repayment from the profits of the movie once it was made;

(b) The lender had the right to exploit and market the film in the home video market in the United States and required all net receipts therefrom to be applied in repayment of the loan;

(c) The net receipts of marketing the film everywhere else were to be applied first to paying the investors (for the $1.2m contribution to the film). Once this occurred, these earnings could be used to repay the loan; and

(d) Interest on the loan was only 10% when mortgage rates at the relevant time were approximately 14%.

[100] By contrast, in the present case the terms of the loan were:

(a) The borrower, a $100 shelf company, secured the loan but Mr Fahey, as director, was not required to guarantee the loan – except to the extent of the value of his Glenharrow shares;

(b) Repayments were reliant on Glenharrow working the mining licence. However, at the time of sale the mining licence had only 3.33 years left to run. Further capital repayments were not required to be paid for the first three years of operation and interest payments were not required for the first two years;

(c) The loan was secured by way of a share mortgage with provision for Mr Meates to be able to take back control of the licence if the project was not successful; and

(d) The price was $45 million when previously the licence was sold for between $100 and $5,000.

[101] We are satisfied that, in the context of this case, the arrangement was artificial and failed to incur the economic burden intended by Parliament to entitle Glenharrow to input tax credits.

(ii) Scope of the inquiry

[102] The majority in *Peterson* took a restricted view of the transactions in that they limited the scope of their inquiry to the taxpayer and the production company. The majority did not consider what happened after the taxpayer had parted with $x+y and particularly the recycling of $y. The scope of the inquiry is not at issue in this case. Both parties were fully involved in the transaction and so clearly come within focus. Full knowledge of the details of the arrangement can be attributed to each.

[103] There may also be some distinction based on the weight placed by the majority on the statutory purpose of the depreciation allowance scheme. Lord Millett said at [41] – [42]:

> The statutory object in granting a depreciation allowance is to provide a tax equivalent to the normal accounting practice of writing off against profits the capital costs of acquiring an asset to be used for the purposes of trade … Consistently with the statutory purpose, it is not only necessary but also sufficient that the taxpayer should have incurred capital expenditure in acquiring an asset for the purposes of trade. The focus is on the party who acquires the asset. It does not matter what the party who disposes of the asset does with the money … It is therefore quite wrong to suggest that the purpose of the statutory depreciation regime, when invoked by persons who have incurred a liability to pay a capital sum to acquire a film, is not satisfied unless the disponor applies the proceedings in making the film.

[104] The scheme and purpose of the GSTA is different. GST is not a tax on business profits or turnover. It is a tax on consumption and is ultimately paid by the consumer. GST is paid and claimed (in the form of input tax) on goods purchased by registered persons and charged (in the form of output tax) on supplies made each step along the chain of ownership until the goods or services reach the end-user. GST paid is "collected" by the registered person and returned at regular intervals to the Inland Revenue Department. A registered person whose input tax surpasses their output tax is entitled to a tax credit.

[105] The purpose of this scheme is to ensure that GST is not paid twice and that it is ultimately paid by the end-user. The operation of the scheme, however, depends on the integrity of the chain of ownership. Payment by registered persons is

essential. The scheme requires registered persons to take on more than conditional obligations to pay for the goods/services purchased.

Conclusion

[106] All of this simply confirms the fact that whatever the documentation had said the arrangement did not engage any meaningful legal obligation. It involved none of the economic sacrifice that the GSTA is concerned with at its heart. There was no sensible enforceable means of adherence to the obligations by this company to repay money. In the operation of the arrangement, a perversion of the Act occurred.

[107] Accordingly, we confirm that s 76 applied to the transaction. The appeal is dismissed.

Cross-appeal

Value of the tax advantage

[108] At the relevant time, s 76(1) provided that where a transaction is found to amount to tax avoidance, the Commissioner is entitled to "treat the arrangement as void" for taxation purposes and to adjust the tax payable so as to counteract any tax advantage obtained from the arrangement. The central issue of the cross-appeal is whether the adjustment made by Chisholm J to Glenharrow's tax assessment can be challenged.

[109] As we have said, Glenharrow claimed GST input tax credits in two stages. The refund in relation to the $80,000 deposit is not in dispute. The second claim is the amount that was disputed and the tax credit was never paid.

[110] Before us, the Commissioner challenges the High Court judgment as to the appropriate amount upon which the input tax credit for the second claim was to be calculated. He offers a number of alternative assessments, but his principal submission is that, as the arrangements made for the payment of the $44,920,000 put

no real commercial obligation on Glenharrow to repay any of this amount, the correct figure to assess input tax credits was zero. Accordingly, Glenharrow was only entitled to the input tax credits on the $80,000 paid by way of deposit that it has already received.

The case in the High Court

[111] In the High Court the Judge found that the sale and purchase of the mining licence constituted tax avoidance because the consideration paid for the licence was grossly inflated. The Judge determined the real value to be approximately $8 million. The Judge found that the tax advantage obtained by Glenharrow was sufficiently counteracted by reassessing its input tax entitlement upon the actual market value (that is the revalued figure) of the mining licence as opposed to the $44,920,000 purchase price.

[112] As we have said, we are satisfied that documentation setting out the financial arrangements for the payment of the remainder of the purchase price for the mining licence did not impose any meaningful legal obligation on Glenharrow. The conditional nature of the repayment scheme meant that the requirement of "payment" under s 20(3)(a)(ia) of the GSTA was undermined. In light of the basis upon which we reach a finding of tax avoidance, a different outcome in terms of the correct adjustment to Glenharrow's tax assessment arises.

[113] Any adjustment made must be made only to the extent necessary to counteract any tax advantage. Section 76(4) defines tax advantage:

> 'Tax advantage' includes—
>
> (a) Any reduction in the liability of any registered person to pay tax:
>
> (b) Any increase in the entitlement of any registered person to a refund of tax:
>
> (c) Any reduction in the total consideration payable by any person in respect of any supply of goods and services.

[114] In this case the tax advantage is Glenharrow's increased entitlement to a tax refund because of its obtaining tax input credits from the purchase of the mining

licence when they had not suffered the economic burden intended by the GSTA in terms of "payment" of the purchase price.

[115] In addition to the $80,000 paid by way of deposit, $210,030.53 was paid by Glenharrow to Mr Meates in payment of the $44,920,000 loan. This was paid in two instalments ($100,030.53 on 23 December 2003 and $110,000 on 29 November 2004) in response to two statutory demands made by Mr Meates. The statutory demand stated that the money paid would "be made on capital account and be deducted from the existing capital debt".

[116] Accordingly, the only way in which Glenharrow's tax advantage can be counteracted is to assess their entitlement to input tax credits at a further $210,000, being the amount of money that Glenharrow paid to Mr Meates in repayment of the $44,920,000 loan. Glenharrow should not be entitled to any tax credits for the empty obligations they undertook when acquiring the mining licence.

[117] The Commissioner submitted that as the additional $210,000 was not paid during the March 1998 tax period, it could not give rise to an increase in the refund to which Glenharrow was entitled. We do not accept that approach because:

(a) Glenharrow, in making the subsequent payments totalling $210,000, became entitled to an input tax credit on that amount as it had suffered the economic consequences intended by Parliament.

(b) Glenharrow put in a claim for input credits for the entire price of the mining licence. It cannot be expected to have put in subsequent claims for payments made when, in its eyes, it had a viable claim for the entire $45 million.

(c) To only give tax credits for the $80,000 and require Glenharrow to put in another claim for the $210,000 simply prolongs the dispute between the parties.

(d) The Commissioner's power to counteract the tax advantage is wide enough to include conceptualising the tax advantage as including the $210,000 subsequently paid by Glenharrow. The power is to adjust the tax refundable as the Commissioner "considers appropriate so as to counteract any tax advantage obtained by that registered person from or under that agreement": GSTA, s 76(1). Glenharrow, in paying the $210,000, and thereby suffering the intended consequences, has reduced its tax advantage by that amount. Section 76(1) does not require the focus to be limited to any particular tax period.

[118] We are satisfied that Glenharrow is entitled to tax credits for the $80,000 deposit and the $210,000 actually paid for the mining licence (that is the repayment of the vendor finance). As Glenharrow has already received entitlements to tax credits for the $80,000 deposit, it is now restricted to an entitlement of tax credits to the value of $210,000.

The costs order in the High Court

[119] In the High Court, Chisholm J determined that the plaintiff was entitled to costs against the defendant. He called for memoranda as to scale and other aspects of that issue.

[120] The Commissioner submited that a more balanced award of costs in the High Court would have been an award in favour of the Commissioner of four fifths of the award that he would have been entitled to. That Commissioner says that would have reflected the parties' relative successes and avoid an "overly technical" approach focusing on part of the relief sought in the statement of claim.

[121] Mr Wilson submited that, in the absence of any payment into Court or Calderbank proposal, it was open to Chisholm J to award costs in favour of Glenharrow.

[122] That is a perspective, but it ignores the fact that the Commissioner had successfully argued that the proper value was not $45 million and that s 76 did apply to the transaction. While the Commissioner lost the sham argument and did not prevail in his contention that the relevant value for GST purposes was only $80,000, in this Court he has almost achieved that point in our conclusion that the value is only $210,000. On the other hand, Glenharrow's contention of $45 million as the relevant valuation was rejected in the High Court and again, before us and in both Courts, s 76 has been held to apply.

[123] In all these circumstances, it is impossible to see a basis upon which it could be concluded that the Commissioner did not substantially prevail in the outcome of the proceedings. The starting point that costs will follow the event would suggest an order in the Commissioner's favour. The argument made by Glenharrow that the Commissioner's ill-founded allegations of fraud and perjury is insufficient in our view to justify the adoption of a different approach in the circumstances of this case.

[124] Accordingly, the Commissioner's cross-appeal against the costs order made in favour of Glenharrow in the High Court is quashed. The question of costs in the High Court is referred back to that Court for reconsideration in light of this judgment.

Costs on appeal

[125] Mr Wilson argued that, whatever the outcome of this appeal, Glenharrow should have costs because, notwithstanding the unequivocal rejection by Chisholm J of the allegations of fraud and perjury, the Commissioner continues to raise those matters in support of arguments in this Court. Accordingly he argued in his notes on oral argument in reply at [116]:

> Solicitor and client costs in this Court and in the High Court should therefore follow in Glenharrow's favour. Those allegations are of the most serious nature. Paragraph 80 of the Commissioner's cross appeal submission is a departure from reality. He alleged fraud and perjury and is responsible for that. He has statutory duties under ss 6 and 6A to uphold the integrity of the tax system, and pay regard to taxpayers' perceptions of that integrity. Glenharrow has a firm view about the Commissioner's stance against it. There must be consequences reflected against the Commissioner, as there

> would have been (with penalties) if the Commissioner had succeeded in making those allegations out against Glenharrow.

[126] In our view that is to overstate the position. A more objective assessment is that the non-commerciality of the arrangement was at the forefront of the argument advanced by the Commissioner. Before us he has succeeded.

[127] We therefore hold that there is no good reason why costs should not be awarded in his favour against Glenharrow in the normal way.

[128] There will be an order for costs of $18,000 together with usual disbursements. We certify for second counsel.

Result

[129] The appeal of Glenharrow against the finding that s 76 of the Goods and Services Tax Act 1985 applies is dismissed.

[130] The Commissioner's cross-appeal against valuation of the tax advantage is allowed. The correct adjustment to counteract the tax advantage is to view the mining licence as having a value of $290,000.

[131] The order for costs in favour of Glenharrow in the High Court is quashed. The question of costs in the High Court is referred back to that Court for reconsideration in light of this judgment.

[132] The Commissioner will have costs against Glenharrow in respect of the hearing of the appeal and cross-appeal in this Court in the sum of $18,000 together with usual disbursements. We certify for second counsel.

CHAMBERS J

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The Commissioner makes concessions

[133] It is clear that the Commissioner, right from the start, considered the arrangement between Mr Meates and Mr Fahey to be a sham. That coloured his thinking right through the tax investigation process and indeed was his principal argument in the High Court. But that contention was blown out of the water by Chisholm J's strong findings of fact. His Honour found (at [163] of his decision) that Messrs Meates and Fahey had given truthful evidence about their intentions when they entered into the agreement to purchase the licence. He went on:

> Mr Meates sold the licence with the intention that the price of $45 million would be paid in full. Mr Fahey purchased the licence with the intention of mining it and meeting the payments due to Mr Meates from the revenue. As it turned out both were much too optimistic, but that does not detract from the fact that the agreement was genuine and the parties intended to implement it according to its terms. There was no sham.

[134] His Honour's findings were so strong in this regard that the Commissioner decided an appeal on the sham point was doomed to failure. He decided to switch gears and pursue his fallback argument: if it is not a sham, it must be tax avoidance. I shall explore that contention shortly. But the important matter to note is that this appeal presents to us on a quite different basis from the case presented to Chisholm J. We proceed on the basis that the parties genuinely intended to fulfil all their obligations to each other. All they were guilty of is undue optimism, but they would not be the first businessmen to fall into that trap.

[135] The Commissioner's second concession is that the consideration for the mining licence for the purpose of the GSTA was $45 million. I have considerable reservations about that concession, as I shall explain in the next section of this opinion. But I have concluded the Commissioner should not be given the opportunity to resile from it, even if he wanted to.

[136] I should add that he probably does not want to resile from it in any event! After all, the Commissioner largely won before Chisholm J, notwithstanding that the judge proceeded on the basis that the consideration was $45 million. And, of course, the Commissioner has completely persuaded my colleagues. My colleagues do not share my reservation as to whether the "consideration" for GST purposes really was $45 million.

[137] I have started this opinion recording those concessions as the significance of them is fundamental to the view I have formed of this case. I happen to think the second concession was wrongly made, although I acknowledge immediately that I may be wrong in thinking that. The views I have tentatively formed as to what the "consideration" actually was for GST purposes are the product of my own post-hearing analysis. I have not had the benefit of counsel's input. There was, however, no point in seeking further submissions from counsel, as my colleagues have no doubt that $45 million was the consideration. In those circumstances, to have reverted to counsel for my benefit alone would have been an idle luxury, needlessly increasing the parties' costs and causing further delay to the issue of this judgment.

[138] Let me explain briefly the structure of this brief opinion. First, I shall express my tentative view as to why the second concession might have been unwisely made. Secondly, I shall discuss why, in my view, the Commissioner cannot rely on s 76. Thirdly, I shall briefly set out the judgment I would have given had my views commanded majority support.

Why the "consideration" for the mining licence may not have been $45 million

[139] The Commissioner has always asserted that the consideration for the mining licence was $45 million. In return for Mr Meates transferring the licence to Glenharrow, Glenharrow gave Mr Meates two cheques totalling $45 million. To my mind, however, that is simplistic and involves looking at only one part of the parties' overall arrangement. In order to get the $45 million, Mr Meates had to make a loan of $44,920,000 on completely non-commercial terms. It was not even certain whether interest would be payable on the loan or when it had to be repaid. In working out the true consideration for the licence, one would need to consider all the promises each made to the other. At common law, it is never necessary to "value" consideration. As I shall show, that is necessary under the GSTA. And my broad (if tentative) proposition is that the "value" of what Mr Meates got was something far below $45 million.

[140] There are two possible approaches. The first is based on the value of what Mr Meates got for his licence. The second approach is based on what Glenharrow got for its $45 million. They are probably two sides of the same coin and, although different provisions of the GSTA are engaged, both approaches probably lead either to the same result or, at least, to very similar results.

The first approach

[141] A number of interlocked agreements made up this transaction. The transaction would not have occurred without each piece of the contractual jigsaw being in place. It is, as I have said, simplistic to say Mr Meates got $45 million for the licence, and nothing in the GSTA, to my mind, compels one to conclude that $45 million was the consideration. It is true that Mr Meates had, under the arrangement, *the chance to make $45 million*, and perhaps, at his most optimistic moments, he thought that chance might be fulfilled. But the chance to make $45 million does not equate to $45 million in the hand. Had a third party come along shortly after Mr Meates and Glenharrow made their agreement and offered Mr Meates $20 million for his entire bundle of rights under the transaction, he would

have accepted that like a shot. $20 million in the hand would have been much better than what the bundle of rights was truly worth, given the large uncertainty inherent in the realisation of more than that sum.

[142] Where a taxable supply of goods and services is made, the first matter to be determined under the GSTA is the value of that supply. The primary rule is set out in s 10(2):

> Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of, -
>
> (a) to the extent that the consideration for the supply is consideration in money, the amount of the money:
>
> (b) to the extent that the consideration for the supply is not consideration in money, the open market value of that consideration.

[143] There are, to my mind, two reasons why consideration in money has been given a separate paragraph in that definition. First, money is money. There is no point in applying the Act's test for "open market value" to money. $100 is $100. Secondly, where consideration is exclusively money consideration, the Commissioner, generally speaking, is required to accept it. It is not for the Commissioner to come along and say that, in his view, the goods or services have been sold for too much or too little. There are exceptions to that general principle. One is where a supply is between associated persons: s 10(3). In those circumstances, "the consideration in money for the supply shall be deemed to be the open market value of that supply". That does not mean, of course, that the agreement between those associated persons is varied one iota. It simply means that, *for the purposes of the GSTA*, and as against the Commissioner, the consideration for the supply is deemed to be the open market value of the supply. It is on that open market value that calculations and assessments of input and output tax will be made.

[144] "Consideration", for the purposes of the Act, is defined in s 2(1):

> **Consideration**, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person;

> but does not include any payment made by any person as an unconditional gift to any non-profit body:

[145] What is noteworthy about that definition is its breadth and the fact that the payment, act, or forbearance may be made not only by the recipient of the supply but also "any other person". In my view, the consideration for the licence in this case was not purely a monetary consideration. It involved a mixture of payments and promises on the recipient's part, which were in turn contingent upon payments and promises by the supplier.

[146] Such an approach, in my view, does not violate the well-known rule that the Commissioner may not disregard the economic or business character of what was done: *Europa Oil (NZ) Ltd v Commissioner of Inland Revenue (No 2)* [1976] 1 NZLR 546 at 552 and 559 (PC) and *Commissioner of Inland Revenue v Wattie* [1999] 1 NZLR 529 (PC). What is permissible, and indeed necessary, is an assessment of the total value of the consideration in the transaction – neither the GSTA nor the rule in *Europa* prevents this inquiry. Rather, the Act mandates it: the Commissioner (or a court) must look to all of the payments and promises together, and assess the combined value of the consideration in money and the other types of consideration: s 10(2). An example of this approach is seen in *Iona Farm Limited v Commissioner of Inland Revenue* (1999) 19 NZTC 15,261 at 15,268-15,272 (HC).

[147] It follows, therefore, that the value of the licence for the purposes of the Act is "the open market value" of the overall consideration. I do not find consider that the reasoning of the majority (at[67]) prevents such a valuation. "Open market value" is defined in s 4(2) of the Act:

> For the purposes of this Act, the open market value of any supply of goods and services at any date shall be the consideration in money which the supply of those goods and services would generally fetch if supplied in similar circumstances at that date in New Zealand, being a supply freely offered and made between persons who are not associated persons.

[148] What that section requires is a valuation of what Mr Meates got at the date of the transaction in exchange for the immediate transfer of the licence.

[149] This is an exercise which no one has so far attempted. It is not the valuation exercise that was undertaken in the High Court. That was an exercise purporting to value the licence if sold on the open market. What we need to value is *what Mr Meates got*. That is a quite different exercise.

[150] Of course, it will be relevant to that valuation how many minerals are in the ground. Suppose, for example, it could be conclusively proved that the total amount of serpentinite and bowenite in the licence area was worth only $10 million. Obviously, in those circumstances, the chance of Glenharrow paying $45 million would be remote. So the amount of minerals would be a factor in the valuation, but only one factor. The less mineral present, the less likely Glenharrow would be to fulfil its obligations under the agreement.

[151] What then are the other factors which go to assessing the open market value of what Mr Meates got? Obviously, the package must be worth at least $80,000, as he got that amount in clear funds. But how much more would a reasonable and willing purchaser, negotiating at arm's length, pay for what Mr Meates got? I cannot answer that, but I suggest any reasonable purchaser would bear in mind the following factors:

(a) The purchaser was a company without other assets, and its promises were not backed by any guarantor.

(b) Glenharrow did not assume any responsibility to work the licence.

(c) Glenharrow might not be successful in having the licence varied or its term renewed. The existing licence was due to expire in 2000.

(d) If Glenharrow defaulted, Mr Meates or his assignee (assuming sale of his rights) would be entitled to get the licence back.

[152] There are other considerations which the reasonable purchaser would bear in mind; I do not need to mention them all. But, in essence, what I am suggesting is

that the open market value of what Mr Meates got would have been somewhat higher than $80,000, but, almost certainly, nowhere near Chisholm J's valuation of the minerals, and a mile away from the $45 million the parties have assumed. This reflects the fact that a reasonable purchaser would have regarded the chance to make $45 million as pretty remote, and would have paid accordingly.

[153] My provisional view is, therefore, that the parties proceeded in error in assuming the consideration was $45 million. The true value of it was a much smaller sum – and, of course, it is on that much smaller sum, whatever it is, that Glenharrow's claim for input tax should have been assessed.

The alternative approach

[154] The second approach involves regarding the $45 million payment as sacrosanct for the purposes of "consideration" under the Act, but then to ask what Glenharrow got for its money. It got much more than a mere mining licence. It got in return a cheque for $44,920,000 on extremely favourable (and non-commercial) terms. The licence was, for the purposes of the Act, "a taxable supply", but the loan was not, even though it carried huge value. Without it, the taxable supply would have warranted a figure way below the consideration actually paid.

[155] As it happens, another subsection of s 10 deals with this situation. Section 10(18) provides:

> Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

[156] Dr Harley, for Glenharrow, would say that the GSTA is not interested in how the purchaser funds the purchase. Up to a point, I agree. If A sells B goods for $100, the value of that transaction is $100 whether B has the money in the bank or has to borrow it from C. I accept too that, generally speaking, that would still be the case where A finances B's purchase on normal commercial terms. What A is getting in those circumstances is still worth $100. But there comes a point, I think, where A's provision of finance may be under such non-commercial terms that the law does

require a proper market value of the actual consideration. This is not a question of applying s 76, for the transaction may be completely genuine in every respect, as Chisholm J found this one was.

Where does this lead me to?

[157] If either of the above approaches is right, then the Act already provides a mechanism for assessing the true value of the consideration without needing to have any recourse to s 76. But I stress again that my tentative thesis may well be wrong. I am particularly conscious that the very experienced counsel for the Commissioner have not run this argument, even though it is significantly in the Commissioner's favour. A possible explanation for that, however, is that the Commissioner has always approached this case with blinkers on: the Commissioner's view throughout has really been that this arrangement was a sham, a view which in reality remains dominant, though disguised, in his tax avoidance argument. It seems not to have occurred to the Commissioner that Mr Meates, as a canny and astute businessman, was quite happy to take a chance on how much he could get for the licence. Obviously he would get at least $80,000, and, if luck went his way, considerably more. There is nothing inherently wrong with structuring the sale of a product along those lines.

[158] As well, although I have a high respect for the Commissioner and his legal advisors, it is possible these alternative approaches were overlooked, especially in circumstances where the Commissioner had satisfied himself he was dealing with a sham. (See, for instance, the explanation by Professor John Prebble for the Commissioner's loss in *Peterson*: "The *Peterson* Case and its Impact on the Rules in *BNZ Investments Ltd* and *Cecil Bros*" in Sawyer (ed) *Taxation Issues in the Twenty-First Century* (2006) 117 at 128.)

[159] Even if my thesis (perhaps with refinements) is right, however, it would not be open to the Commissioner to change course. There may be impediments to a change of course either under the GST Act or under the Tax Administration Act 1994. But even if these were not statutory impediments, it would have been

inappropriate to allow what would have been a significant change of course at appellate stage.

Why the Commissioner cannot rely on s 76

[160] If the tentative view I have expressed is right, then clearly s 76 would not need to have come into play. The value of the consideration would have been assessed at its open market value and Glenharrow's claim for input tax assessed on that value.

[161] But what if my thesis is wrong and the consideration for the licence alone is, under the Act, $45 million? Is s 76 engaged? To my mind, it was not. Chisholm J's findings of fact simply preclude a finding that the parties' arrangement was "entered into…to defeat the intent and application of [the] Act, or any provision of [the] Act". I have already cited (at [133] above) Chisholm J's conclusory findings that the agreement was genuine and that the parties intended to implement it according to its terms. He also found Messrs Meates and Fahey were truthful witnesses, whose evidence he believed as to their intentions when they entered into the agreement to purchase the licence.

[162] Those conclusory assessments were backed up by a number of other findings of fact made in the judgment, many of which were cited to us by Mr Wilson and Dr Harley. I do not mention them all, but two important findings were that Messrs Fahey and Meates had committed themselves to the arrangement even before they knew the potential GST ramifications – indeed, the binding letter makes no mention whatever of GST – and that there was "a rational explanation" for the $45 million purchase price: at [138].

[163] The judge provided that rational explanation at [140]. In essence, Mr Fahey could not put upfront more than the $80,000 he had. There is no doubt whatever on the evidence that Mr Meates viewed the licence as worth much more than that, a thoroughly rational view as is indeed shown by the judge's valuation of almost $10 million. Mr Meates's explanation, which the judge accepted, was that, while he would have preferred cash, he appreciated Mr Fahey could not come up with more,

and so he elected to proceed "on the basis that he would get value out of the licence by Mr Fahey working it and paying him".

[164] That was, in my view, a rational business decision. Of course, the potential amount payable to Mr Meates was high, but the chance of getting it was slim. If all went incredibly well, he might well get his $45 million. At worst, he would get $80,000 and the licence back. The deal was also attractive to Mr Fahey. No doubt, if all went as well as Mr Fahey hoped, he would be prepared to share the largesse with Mr Meates. At the same time, he had the comfort of knowing that, if things went badly, he would effectively pay no more than the $80,000 upfront fee. He was able to do the deal using a limited liability company, with respect to which he had complete discretion as to its asset backing.

[165] So we have, from the parties' viewpoint, a rational structure and a price which, in the circumstances, has "a rational explanation". In addition, we have another very important finding of fact by the judge as to the parties' purpose in entering into the arrangement:

> [166] …I have no difficulty in accepting that the necessary principal purpose has been established. When it purchased the licence Glenharrow's primary or fundamental purpose was to work the licence and extract stone. As of 28 June 1997 that was a genuine and potentially achievable purpose. The totality of the circumstances do not negate that principal purpose.

[166] How then, given these findings of fact, did Chisholm J conclude there was in this case tax avoidance? He appears to have relied heavily on Rodney Hansen J's analysis of s 76 in *Ch'elle Properties (NZ) Ltd v Commissioner of Inland Revenue* [2004] 3 NZLR 274, a decision subsequently upheld by this court (indeed, as it happens, sitting with the present panel): [2007] NZCA 256. But, with respect, *Ch'elle* is easily distinguishable on the facts.

[167] Despite all the findings of fact and as to intent which I have mentioned, Chisholm J found s 76 was engaged for effectively one reason: he concluded the consideration was "grossly inflated": at [186]. With respect, I find that conclusion sits uneasily with other findings he had made as to the parties' genuineness and as to there being "a rational explanation" for the purchase price. But, more important than

that is the fact that, even if the price was grossly inflated, that of itself could not trigger s 76. Dr Harley submitted that the judge's approach violated a longstanding principle of tax law that it is not for the Commissioner or the courts to say how much a taxpayer ought to spend in obtaining his income. He quoted the Privy Council's advice to that effect in *Europa* at 556:

> Their Lordships' finding that the monies paid by the taxpayer company…is deductible under s 111 as being the actual price paid by the taxpayer company for its stock-in-trade under contracts for the sale of goods entered into with Europa Refining is incompatible with those contracts being liable to avoidance under [the anti-avoidance section]…In respect of these contracts the case is on all fours with *Cecil Bros Pty Ltd v Federal Commissioner of Taxation* (1964) 11 CLR 430 in which it was said by the High Court of Australia "it is not for the Court or the commissioner to say how much a taxpayer ought to spend in obtaining his income" (ibid, 434)…

[168] In my respectful view, Chisholm J's approach was at odds with the Privy Council's advice.

[169] Further, the valuation exercise he carried out in order to reach his conclusion that the price was "grossly inflated" failed to compare apples with apples. He approached the matter on the basis of what a willing purchaser would have paid for the licence at the date of the transaction. That method of valuation ignores, however, the fact that the deal was structured, for proper business reasons, to reflect the risk Mr Meates was taking. If the venture did well, Mr Meates would do well; if it bombed, he might get no more than the $80,000 upfront payment.

[170] The majority in this court have found for the Commissioner on the same basis Chisholm J found: at [77] above. They accept that the price was "grossly inflated". They do not cite, however, *Cecil Bros* or *Europa*. Further, they do not explain how it has come about that two businessmen, negotiating at arm's length, as Chisholm J found (see at [116] and [119]), came to agree on a grossly inflated price. The only logical explanation consistent with Chisholm J's findings as to credibility and intentions and purpose is the contingent nature of the full payment. This in turn comes back to my provisional view that what Mr Meates was getting was a package of promises ("consideration") worth nothing like $45 million.

[171] The majority cite from Mr Trombitas's article, which was critical of Chisholm J's decision: at [79]. Mr Trombitas had noted that s 76, as it was at the time of this transaction, did not refer to "purpose or effect". The majority have concluded that there was no significance in the change of statutory language. That may be right, although I note that the Hon Dr Michael Cullen, when introducing the Taxation (Annual Rates, GST and Miscellaneous Provisions) Bill in 2000, said that the GST amendments included "anti-avoidance measures [to] protect the GST base". He added ((23 May 2000) 584 NZPD 2434):

> [The amendments] close avoidance opportunities in relation to second-hand goods, deregistration, deferred settlements, and large assets imported free of GST, amongst other things.

[172] The majority go on to give other reasons as to why in their view this was tax avoidance. Many of their arguments provide strong support for the thesis with which I commenced this opinion as to the true market value of "the consideration". But, if we put that argument to one side, as we must, the reasoning does not to my mind support an avoidance conclusion. They conclude that the legal obligation falling on Glenharrow was "artificial": at [82]. I cannot see how that conclusion can stand with the findings Chisholm J made, findings not challenged on appeal.

[173] It also seems to me wrong, with respect, to evaluate this transaction by what subsequently happened. That seems to me contrary to the Privy Council's advice in *Ashton v Commissioner of Inland Revenue* [1975] 2 NZLR 717 at 722, and the ground for distinguishing that case (given at [84] above) I find unconvincing. That the business enterprise proved to be unsuccessful, despite the best efforts and intentions of the parties, cannot justify a later recharacterisation of the GST claim.

[174] Finally, the majority rely on "temporal mismatches" as a ground for their finding of tax avoidance: at [91]. In support, they quote this court's decision in *Ch'elle* at [41]. But the mismatches in *Ch'elle* were a consequence of a completely artificial arrangement, the whole point of which was to secure a GST advantage. That, Chisholm J has found, was not the point of this arrangement. Glenharrow might have been paying GST itself on its outputs very soon after the arrangement was entered into, had not the venture gone much less successfully than either party hoped.

[175] I have, of course, sympathy for the majority's position. The true consideration for the bare licence was not, I think, $45 million, for the reasons I gave earlier. But that argument having not been taken by the Commissioner, I am not prepared to find for him by adopting an interpretation of s 76 which is broader, in my view, than has ever been allowed by this court or the Privy Council.

The result I would have given

[176] Had my views commanded majority support, I would have allowed Glenharrow's appeal and found that s 76 was not triggered. It follows that the Commissioner's cross-appeal would have failed.

Solicitors:
S O'Neill, Christchurch, for Appellant
Crown Law Office, Wellington for Respondent