IN THE COURT OF APPEAL OF NEW ZEALAND

CA126/04
[2007] NZCA 256

BETWEEN	CH'ELLE PROPERTIES (NZ) LIMITED Appellant
AND	COMMISSIONER OF INLAND REVENUE Respondent

Hearing: 31 August 2006

Court: Chambers, Robertson and Ellen France JJ

Counsel: D G Hayes for Appellant
R J Ellis and S J Reeves for Respondent

Judgment: 25 June 2007 at 4 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The respondent is entitled to costs of $6,000 plus usual disbursements.

REASONS OF THE COURT

(Given by Robertson J)

Introduction

[1] In this appeal the question was whether a claim for $9 million for GST credits by Ch'elle Properties (NZ) Ltd (Ch'elle) involved an arrangement which

defeated the intention and application of the Goods and Services Tax Act 1985 (GST Act) contrary to s 76 of that Act.

[2] This was the view of the Commissioner of Inland Revenue (Commissioner) which was upheld both by the Taxation Review Authority (TRA) and Rodney Hansen J in the High Court: [2004] 3 NZLR 274.

[3] The issue is: what is the intent and application of the GST Act and was it defeated in this case? This involves a consideration of timely balance between outputs and inputs and whether the test in s 76 of the GST Act is objective or subjective. There is a supplementary point as to whether s 25 of the GST Act has any application.

Factual circumstances

[4] In 1996 and 1997, Nigel Ashby incorporated a total of 114 companies. He was the sole director of all the companies and the shareholders were the trustees of his family trust. None of the companies had any assets or bank accounts. They were all administered under the umbrella of a management company, Queen Street Property Group, which was also controlled by Mr Ashby.

[5] For GST purposes, each of the companies was registered on a payment basis.

[6] Michelle Wilson, a friend of Mr Ashby's former wife, incorporated the appellant, Ch'elle, in July 1998. She registered it the following month for GST on a monthly invoice basis. Ch'elle declared its taxable activity was 'property trader'. It had no assets or bank accounts. Ms Wilson had no commercial experience or expertise relative to property trading.

[7] In August 1998, Ch'elle entered into an agreement with M W Developments to purchase a property in Edgeworth Road in Glenfield. The transaction was initiated by Mr Ashby who was M W Developments' tax agent.

[8] Ch'elle applied to the Commissioner in August 1998 for a private ruling under Part VA of the Tax Administration Act 1994 (TA Act) in relation to the GST implications of this transaction.

[9] The letter seeking the ruling advised:

(a) Settlement would be deferred for 12 years;

(b) The purchase price (payable in 12 years) was $655,000;

(c) An immediate deposit of $100 was payable by Ch'elle with a further $64,900 payable upon receipt of the GST refund; and,

(d) Ch'elle was registered on an invoice basis.

[10] Two similar transactions in relation to other properties on the North Shore were entered into later that year by Ch'elle also orchestrated by Mr Ashby.

[11] On 5 November 1998, each of the 114 Ashby companies entered into a conditional contract to purchase from Waverley Developments Ltd a lot in a subdivision in Dominion Road, Papakura for $70,000. Each contract provided for a deposit of $10.00 on execution and the remainder was payable on the date for settlement specified in the contracts which was 31 August 1999.

[12] On 21 May 1999 Ch'elle entered into conditional contracts with the 114 individual Ashby companies to purchase these properties for a total price of $80 million, in other words, an average of about $700,000 per contract.

[13] Settlement was deferred for between 10 and 20 years. An initial deposit of $10.00 was payable on execution, with the balance of the deposit ($29,990) being payable subsequently. The vendor did not hold the deposits received as a stakeholder. During the deferred settlement period, the vendor company was to construct a house on each section.

[14] Each of the vendor companies issued an invoice to Ch'elle for the total ultimate price.

[15] On 15 June 1999 the Commissioner issued a private ruling to Ch'elle in relation to the Edgeworth Road property. It was expressed to be applicable only to the one transaction and approved the payment of a GST refund. Because the Rulings Unit considered the sale and purchase agreement to be a credit contract, the refund was based on the present day value of the property rather than its estimated value at the date of settlement 12 years later.

[16] Later that month, Ch'elle filed a GST return for the period ending 31 May 1999 claiming input tax credits of $398,333 in relation to 13 property transactions. These were the three transactions on the North Shore (including Edgeworth Road which was specifically covered by the private ruling) and ten of the 114 Papakura transactions.

[17] In September 1999, the Commissioner paid Ch'elle $29,000 in relation to the Edgeworth Road transaction. That is not in issue in the proceedings.

[18] On 20 October 1999 Ch'elle filed a further GST return for the remaining 104 properties claiming $9 million in input tax credits based on the estimated market value on the respective settlement dates 10 to 20 years into the future.

[19] The Commissioner, on 14 March 2000, issued notices disallowing the claims. These were rejected by the appellant in May of that year.

[20] On 12 September 2000, all 114 contracts between Waverley Developments and the companies were cancelled for failure to settle on the stipulated date of October 1999.

[21] The dispute was considered by the Commissioner's Adjudication Unit. Following the release of its report, the Commissioner raised an assessment disallowing all input tax credits claimed other than those in relation to the three North Shore properties. Ch'elle then filed a notice of claim with the Taxation Review Authority. It held against Ch'elle. On appeal to the High Court, the same conclusion was reached although for slightly different reasons.

Was the scheme void because of tax avoidance?

[22] Section 76(1) of the Act, which was in force at the relevant time, provides:

> **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.

What was the arrangement between the parties?

[23] Section 76(4) provided:

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

[24] The steps and transactions that constitute the arrangement in this case were:

(a) The incorporation by Nigel Ashby of 114 companies (the Ashby companies);

(b) The registration of those companies for GST purposes on a payment basis;

(c) The incorporation of the appellant on 27 July 1998;

(d) The registration of the appellant for GST purposes on an invoice basis;

(e) The entry of the Ashby companies into conditional contracts to purchase from a third party Lots 1 to 114 in Dominion Road, Papakura on 5 November 1998;

(g) The entry by the appellant into conditional contracts with the 114 individual Ashby companies to purchase the 114 Dominion Road sections on 21 May 1999 and in particular terms stipulating that:

(i) there be a deferral of settlement for between 10 and 20 years;

(ii) an initial deposit of only $10 was required;

(iii) that the vendor would not hold the deposits as stakeholders;

(iv) an invoice for the full amount owing on settlement was issued at the time the contracts were signed;

(h) The submission by the appellant of a GST return in relation to 13 properties claiming input credits of $398,333; and

(i) The submission by the appellant of a further GST return for the remaining properties claiming nearly $9 million in input credits on 20 October 1999.

Did the arrangement defeat the intent and application of the GST Act?

[25] Mr Hayes, for the appellant, contended that s 76 required a subjective intent. This cannot be the case. This would lead to the anomalous situation where an identical transaction might in one case be sustainable, but in another struck down as tax avoidance because in the first instance the operator mistakenly, naively, unrealistically or opportunistically was of the view that what was being done was unassailable. The second, however, which involved a more confident person who thought it was worth "having a go" would be struck down. It is the objective

assessment of the arrangement which will provide the answer as to whether it defeats the intention and application of the Act and is therefore void.

[26] This approach has long been the law. Woodhouse P in *CIR v Challenge Corporation Ltd* [1986] 2 NZLR 513 at 533 (CA) said:

> I am satisfied as well that the issue ... is something to be decided, not subjectively in terms of motive, but objectively by reference to the arrangement itself.

[27] The same thrust is apparent in the recent decision of this Court: *Accent Management and Ors v Commissioner of Inland Revenue* [2007] NZCA 230 at [113] (ff).

[28] Mr Hayes also argued that the various actions of the appellant were specifically allowed for under the GST Act, and therefore there could not have been defeating of the intent and application of the Act.

[29] That submission overlooks the purpose and operation of the provision. As with all general anti-avoidance provisions, its purpose is to strike down arrangements that frustrate the taxing regime, despite the arrangement's technical compliance with substantive taxing provisions. Whatever might be said about separate items in a scheme of arrangement, s 76 provides for an overview and an assessment of the combined effect of the individual components.

[30] The comments of Lord Templeman in relation to s 99 of the Income Tax Act 1976, in *Challenge* at 559 (PC) in an analogous context are instructive:

> Tax avoidance schemes largely depend on the exploitation of one or more exemptions or reliefs or provisions or principles of tax legislation. Section 99 would be useless if a mechanical and meticulous compliance with some other section of the Act were sufficient to oust s 99. Richardson J, giving judgment in the Court of Appeal in favour of Challenge, nevertheless recognised that "s 99 would be a dead letter if it were subordinate to all the specific provisions of the legislation" ([1986] 2 NZLR at p 549).

[31] In order to assess whether s 76 is triggered it is necessary to assess the scheme and purpose of the GST Act.

[32] Ms Ellis accepted that the arrangement complied with the black letter terms of the GST Act, but submitted that two aspects of the scheme and purpose of the GST Act were frustrated:

(a) The GST Act intends and requires that an overall balance will be achieved between the output and inputs of a registered person. The arrangement upsets that balance because of the 10 to 20 year gap between payment by the Commissioner to the appellant of an input tax credit and the possibility of the appellant making taxable supplies and thereby incurring output tax; and

(b) While the GST Act allows for the accounting of GST on different bases, the Act intends that the effects of the mismatching be minimised. The arrangement defeats this by exploiting the mismatching.

(i) Overall balance between inputs and outputs

[33] The general intent of the GST Act is to impose a broadly based consumption tax. In *King v Bennetts* (1994) 16 NZTC 11,370 at 11,372 this Court outlined the operation of the GST Act:

> Registered persons must pay tax on all sales of goods and services, but are entitled to add it to the price. Such persons can obtain refunds of the GST paid by them on their own purchases from registered suppliers. This effectively means that each person through whose hands a product passes will in the end pay tax only on the added value, with the total tax being paid in the end by the ultimate consumer.

[34] Under s 8(1), 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).

[35] Taxable activity is defined in s 6 as being:

> Any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club.

[36] A person who undertakes, or intends to undertake, a taxable activity is permitted to register for GST: s 51(3). Registration is compulsory where the total value of supplies made in the course of that activity during the preceding year has exceeded $30,000: s 51(1)(a).

[37] GST is paid and claimed (in the form of input tax) on goods/services purchased by registered persons for the principal purpose of making taxable supplies (GST Act, s 3A) and charged (in the form of output tax) on supplies made by the registered person: s 20. 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.

[38] The Act is predicated on an overall balance being achieved between a registered person's liability to pay output tax and entitlement to receive input tax credits. Registration (and therefore entitlement to obtain input credits) turns on the existence of a taxable activity and the making (or intended making) of supplies.

[39] This is confirmed by reference to s 5(3) of the Act which provides:

> For the purposes of this Act, where a person ceases to be a registered person, any goods and services then forming part of the assets of a taxable activity carried on by that person shall be deemed to be supplied by that person in the course of that taxable activity at a time immediately before that person ceases to be a registered person, unless the taxable activity is carried on by another person who, pursuant to section 58 of this Act, is deemed to be a registered person.

[40] The effect of this subsection is that any input tax credits claimed by a taxpayer in respect of the acquisition of assets in the furtherance of a taxable activity will ultimately be balanced by the payment of output tax on the deemed supply of those same assets upon deregistration.

[41] The wider the temporal gap between the taxpayer's eligibility for an input tax credit and its liability for output tax, the less likely the arrangement conforms with the intent of the Act. We do not suggest that the Act intends that there be no delay, but that significant delay can indicate a crossing of the line into tax avoidance.

[42] We endorse the finding of Rodney Hansen J (at [47]) that in the circumstances of this case the balance between outputs and inputs is grossly distorted by the gap of ten and twenty years between Ch'elle receiving an input credit and the time at which liability may arise for output tax on Ch'elle's taxable supply. The 10 to 20 year delay in all the circumstances defeats the intent of the Act and accordingly triggers s 76.

(ii) Exploitation of mismatching of accounting base regimes

[43] Section 19 outlines the three alternative methods upon which GST can be accounted for: invoice basis; payments basis; and hybrid basis. The method adopted determines when output and input tax is payable.

[44] The essential distinction between the invoice and payments accounting bases is that an invoice basis requires GST to be returned pursuant to the accrual approach whereas the payments basis requires GST to be accounted for on a cash approach.

[45] If an invoice basis is used the tax is normally brought to account for the return period in which the supply is deemed to be made. In most circumstances this will be the earlier of the time an invoice is issued/received or any payment is received/made: ss 9(1), 20(3)(a) and 20(4)(a). If the payment basis is adopted the tax is generally brought to account only when, and to the extent that, payment is made: ss 20(3)(b) and 20(4)(b).

[46] Section 19(1) provides that the invoice basis is the standard method used. Under s 19A only certain defined persons will be entitled to account for GST on a payment basis namely:

(a) local authorities and non-profit bodies (s19A(1)(a));

(b) persons whose total value of taxable supplies had not exceeded $1 million in the preceding 12 months or was unlikely to exceed $1 million in the following 12 months (s 19A(1)(b)). (The $1 million figure was increased to $1.3 million after 1 October 2000.); or

(c) persons who satisfy the Commissioner that it would be appropriate for them to use the payment basis because of the nature, volume and value of their taxable supplies and the nature of their accounting systems (s 19A)(1)(c)). For example, dairy owners.

[47] The operation of the different accounting bases means that there can be mismatches in terms of the timing between when an input tax credit is claimed on a particular supply and when the payment of output tax on that supply occurs*: Shell New Zealand Holdings Co Ltd v CIR* [1994] 3 NZLR 276 at 283 (CA).

[48] In *Nicholls v CIR* (1999) 19 NZTC 15,233 (CA) Henry J said at [14]:

> The Act distinguishes between taxpayers who are to account on an invoice basis, and those who are to account on a payments (or hybrid) basis. The need for consistency as between liability to pay output tax and the ability to deduct input tax within the same regime is obvious, and is reflected throughout the Act. There is however no need for consistency as between the two different regimes.

[49] This Court stated in *Shell* at 283:

> Heron J was influenced in his conclusion by a concern that there should be no difference in the timing of GST paid and GST refunded. However, given the different taxable periods available to registered persons (one month, two months, and six months – s 15) and the three bases of accounting for GST (invoice, payments and hybrid) inevitably there are numerous mismatches between times at which GST is paid by a recipient to a supplier and at which GST is refunded to the recipient.

[50] The Act permits a degree of mismatching in terms of accounting methods; however, this does not mean that a gross mismatch in timing is irrelevant on a s 76 question. The Act seeks to limit the nature and degree of such mismatching. There are explicit restraints on a taxpayer's ability to register on a payment basis. For example, the $1 million annual turnover rule contained in s 19A(1)(b) is intended, in

part, to prevent either singly high value supplies or multiple lower value supplies occurring between persons who are registered for GST on different accounting bases.

[51] In this case the creation of the Ashby companies (which were entitled to register on a payments basis by virtue of the fact that the value of their proposed taxable supplies fell under the $1 million cap) effectively circumvented this limitation. As a result, the degree of mismatch contemplated and tolerated by the Act escalated to a level which could never have been intended.

[52] We are satisfied that the arrangement triggered s 76 because:

(a) the invoices issued by the 114 Ashby companies were not going to be paid for 10 to 20 years (and consequently no output tax was payable) whereas Ch'elle was immediately entitled to input tax credits for the purchase of the properties thereby defeating the intended balance between input and output tax; and

(b) the proliferation of vendor companies had no rationale or utility beyond creating a mechanism to exploit a tax advantage by coming under the $1 million threshold. This mechanism operated to exploit the mismatch between the invoice and payments accounting bases and thereby defeated the intent and application of the Act.

[53] There was no issue in the appeal as to the response to the breach as confirmed by Rodney Hansen J. Attention was focussed solely upon whether s 76 had been breached.

Section 25 of the GST Act

[54] The final issue raised by the appellant relates to s 25 of the GST Act. This was not initially an issue in the case. It was specifically raised by the TRA who, having raised it and heard argument upon it, ruled against Ch'elle. The issue was argued in the High Court and has been renewed before us.

[55] Given our finding that s 76 applies to the arrangement, there is no need for us to consider the application of s 25 in this case.

Result

[56] There is nothing advanced before us to suggest that the conclusions reached by Rodney Hansen J were other than correct and the appeal is accordingly dismissed.

[57] The respondent is entitled to costs of $6,000 together with usual disbursements.

Solicitors:
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