



WEEKLY COMMENT: FRIDAY 20 MARCH 2015

1. This week I look at Case *TRA 02/10* [2015] NZTRA 01, which concerns the GST definition of when two companies are associated under s. 2A(1)(a) of the *Goods and Services Tax Act 1985* (“the GST Act”). The High Court judgment in *Concepts 124 Limited v Commissioner of Inland Revenue* [2014] NZHC 2140, which had just been handed down while the case was being heard had a deciding influence. I discussed the Concepts case in *Weekly Comment* 23 January 2015.

Facts in Case TRA 02/10

2. The disputant company (“the Disputant”) purchased a block of land for development from X Land Holdings Ltd and claimed GST input tax totalling \$505,550.60. The Commissioner disallowed the claim on the grounds that:
 - (a) The purchaser and the vendor were associated under s. 2A(1)(a)(iii) of the GST Act, which states that two companies are associated if a group of persons “has control of each of those companies by any other means whatsoever”; or
 - (b) The arrangement was a tax avoidance arrangement, for which a shortfall penalty for abusive tax avoidance was imposed.
3. The ownership structure was complicated and is helpfully summarised by the judge in two appendices to the judgment: Appendix A and Appendix B. The important aspect is the fact that the shares in the vendor and the purchaser were held by trustee companies in trust for seemingly unrelated beneficiary companies, although the two trustee companies were commonly owned:
 - (a) The shares in the Disputant company were held by X Nominees Ltd on trust for X Construction Ltd. The shares in the trustee, X Nominees Ltd, were 100% owned, through two intermediate companies, by X Management Ltd.
 - (b) The shares in the vendor company were held, through an intermediate company, by X Management Ltd, on trust for X Foundries Ltd.
4. As the judge eventually found, the complications in the structure appeared to have been designed to cause a break in association so as to allow the claim for input tax, thereby constituting tax avoidance. However, the case contains a useful discussion on the meaning of control “by any other means whatsoever”.

Control of companies by any other means whatsoever

5. As noted, the shares in the Disputant were held on trust for X Construction Ltd, which was 99% owned by X Ventures Ltd, which was in liquidation and had been struck off the Register of Companies in 1996. Therefore, the Crown had legal control, or if X Ventures Ltd was reinstated to the Register then under s. 330 of the Companies Act 1993, the company reverted to the shareholders from the date it was struck off.
6. The shares in the vendor were held on trust for X Foundries Ltd, and the shares in this company were in turn held on trust for Mr. and Mrs. M who lived in the United States.
7. The Commissioner argued that despite the separate ownership, both companies were controlled by the common director, Mr. R. It was noted at [66] that:

“The Commissioner further submits that the complicated ownership structure adds to the uncertainty of a conclusion based on legal control. She contends that the purported ultimate beneficial owners of the Disputant and the Vendor may be able to ‘pull the levers’ but not have anything happen at the other end of the chain.”
8. The judge stated the general rule is that a person controls a company if they have the majority of votes at a general meeting of the company. In *Mendes v The Commissioner of Probate Duties (Vict)* [1967] HCA 23, [1967] 122 CLR 152, Windeyer J said:

“For the purposes of the revenue laws a member of a company who holds enough shares to give a majority of votes at a general meeting has “control” of the company. That is the general rule. Control in that sense means the capacity to carry an ordinary resolution at a general meeting.”
9. The judge noted that the argument that “controlling interest” equated to beneficial ownership was rejected in *British American Tobacco Company Limited v IRC* [1943] AC 335 (HL) where Viscount Simon said:

“I find it impossible to adopt the view that a person who (by having requisite voting power in a company subject to his will and ordering) can make the ultimate decision as to where and how the business of the company shall be carried on and who thus has, in fact, control of the company’s affairs, is a person of whom it can be said that he has not in this connection got a controlling interest in the company.”
10. The fact that shares were held on trust was considered irrelevant for determining whether the shareholder had control of the company in *IRC v J Bibby & Sons Ltd* [1945] 1 All ER 667 (HL), where the Court said:

“When the section speaks of directors having a controlling interest in a company, what it is immediately concerned with in using the words “controlling interest” is not the extent to which the individuals are beneficially interested in the profits of the company ... but the extent to which they have vested in them the power of controlling by votes the decisions which will bind the company in the shape of resolutions passed by the shareholders in general meeting ...

For the purpose of such a test the fact that a vote-carrying share is vested in a director as trustee seems immaterial. ...”

11. A test similar to “control by any other means whatsoever” was considered in *Himley Estates Limited v Commissioners of Inland Revenue* (1932) 17 TC 367 (HC). Lord Hanworth MR suggested that the test may be referring to circumstances where the voting power is in the hands of persons who are subservient by some means to another person. In that case, the measure and value of those “other means” should indicate that the exercise of the authority given under the articles of association is in the hands of those persons.
12. The judge referred to the example of such control referred to by Clifford J in the *Concepts* case, where he stated:

“... control by any other means is ... control by means other than through voting interests/shareholders voting rights. For example, a person, including a company, could obtain control of another company by a range of contractual mechanisms whereby voting interests/shareholder voting rights held by other persons were in fact controlled by that person.”
13. The judge did note that in *Case K54* (1988) 10 NZTC 444, it was suggested that control could be decided as a matter of fact if it is not capable of being resolved as a matter of law. Further, as noted in *S. Berendsen Ltd v Inland Revenue Commissioners* [1957] 2 All ER 612 (CA), the effectiveness of legal control could be questioned if “the man at the far end who pulls the lever would pull it in vain, because the mechanism was so complicated that no discernible effect would be seen at the other end of the machine”.
14. Despite the latter comments, the judge concluded that the case law is well established that control refers to legal control, and the other forms of control are the alternative means of legal control through contractual mechanisms referred to by Clifford J, and not factual control. The judge concluded that the Disputant and the Vendor were not associated through “control by any other means”.
15. In this case, the judge followed the precedent in *Concepts* and decided the companies were associated under s. 2A(1)(a)(i) of the GST Act through common ownership despite the existence of the trusts. I commented on the decision in *Concepts* in Weekly Comment 23 January 2015.

Tax avoidance

16. The rest of the case concerned whether there was an arrangement to avoid tax. In finding that there was tax avoidance the judge noted that:
 - (a) Parliamentary contemplation in relation to transactions between associated persons was to limit the availability of GST input tax deductions on such transactions;
 - (b) The elaborate ownership structure had been conceived principally to break the association between the Disputant and Vendor companies to obtain the input tax deduction without the limit contemplated by Parliament;
 - (c) The parties had “gone to such efforts to minimise their formal association” that a high degree of contrivance, pretence and artificiality is evident in the transaction”;
 - (d) There were several unrealistic features, including the facts that:
 - (i) The transaction was not settled in accordance with the documentation; and

- (ii) There was no mortgage taken over the property which was extraordinary in a sale to an unrelated third party;
 - (e) The payments were made by a series of cheque swaps and journal entries; and
 - (f) The sale proceeds ended up being held by a company in a contractual relationship with the Disputant instead of by the Vendor.
17. For the purpose of imposing shortfall penalties, the Disputant was found to have taken an abusive tax position, and also a tax position that failed to meet the standard of being “about as likely as not to be correct”.
18. The Disputant was found liable for shortfall penalties for taking an abusive tax position.



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