Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Financing arrangement to fund the refurbishment of a capital asset

Decision date | Rā o te Whakatau: 8 April 2024

Issue date | Rā Tuku: 13 February 2025

TDS 25/02

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This document is a summary of the original technical decision so it may not contain all the facts or assumptions relevant to that decision.

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Subjects | Kaupapa

The proposed financing arrangement is to fund the refurbishment of a capital asset. The Applicants were two companies that were unable to source finance from traditional bank lending or by way of supplier financing.

Taxation laws | Ture take

All legislative references are to the Income Tax Act 2007 (ITA) and the Goods and Services Tax Act 1985 (GSTA).

Summary of facts | Whakarāpopoto o Meka

1. The Arrangement was a proposed financing arrangement to fund the refurbishment of a capital asset (Asset). The Applicants were two companies – ABC Ltd and DEF Ltd (ABC and DEF). The Applicants were unable to source finance from traditional bank lending or by way of supplier financing.
2. The relationship between the Applicants and the background to the Arrangement was as follows:
   - ABC had a licence for use of the Asset. ABC had a contractual obligation to hand the Asset back to the licensor in good condition at the end of the licence.
   - ABC operated and maintained the Asset and sub-licensed the use of the Asset to various licensees.
   - ABC was effectively wholly owned by DEF.
   - Shares in DEF were required to be held for a licensee to hold a licence from ABC. That is, the shareholders of DEF and ultimate shareholders of ABC were also the licensees.
3. Under the Arrangement, to obtain the required financing for the refurbishment it was proposed that:
   - The shareholders of DEF would make a series of interest-free loans over time to ABC to meet part of the cost of refurbishing the Asset. The remaining balance would be met from existing cash balances and future net operating cashflows of ABC, including periodic increases in existing licence fees.
   - Capital works licence fees payable would be charged to cover the refurbishment costs on a straight-line basis over the tax life of the new assets.

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- The loan repayments would match the capital works licence fees payable by the licensees.

4. The obligation of the licensees to pay the capital works licence fees to ABC would be set off against ABC's obligation to repay a portion of the principal amount of the interest-free loans to the licensees/shareholders. The set-off arrangement would be done via monthly invoices, which would show:
   - the licence fees due (comprising portions to cover both operating expenses and the capital works),
   - the set-off of the amount due against the loan principal owed, and
   - the remaining cash balance payable.

Issues | Take

5. The Tax Counsel Office (TCO) considered the following issues:

Income tax

- Whether the interest-free loans by shareholders in DEF to ABC involved downward value transfers and gave rise to a deemed dividend to ABC under s CD 6(1).
- Whether for each income year ABC derived taxable income under s CB 1 in respect of the licences that includes the capital works licence fees receivable from licensees that was set off in that income year against the loan principal of the loans to ABC.
- Whether a deemed dividend arose in relation to the making available of the licences to shareholders in DEF under s CD 6(1), with consequence that ABC had an obligation to withhold resident withholding tax (RWT) under the RWT rules.
- Whether ABC had depreciation loss deductions under s DA 1(1) for a portion of its cost of depreciable property acquired and installed under the refurbishment programme on a straight-line basis over the life of the property as per IRD depreciation tables.
- Whether s FA 2B (which treats certain debt securities stapled to shares as equity) applied.
- On repayment of loan principal by offset against licence fees, whether any income or deduction or RWT arose for ABC under the financial arrangements rules or RWT rules.
- Whether s BG 1 applied to negate or vary the above outcomes.

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GST

- Whether ABC would be entitled to GST input tax credits under s 20(3) of the GSTA on capital expenditures without any adjustment under ss 21 to 21H of the GSTA.
- Under s 8(1) and 9(3) of the GSTA, whether ABC would be subject to GST in each GST period on the capital works licence fees paid by offset against ABC loan principal in that period.
- Whether there would be any substitution for ABC of open market value in place of the agreed licence fees under s 10(3) of the GSTA because the licences from ABC to the licensees were not "associated supplies" within the meaning in paragraph (a) or paragraph (b) of s 2(1) of the GSTA.
- Whether ss 5(14B), 14(1B)(b) and 10(3) of the GSTA applied.
- Whether s 76 of the GSTA applied to negate or vary the GST conclusions reached.

Decisions | Whakatau

6. TCO concluded that:

Income tax

- The interest-free loans by shareholders in DEF to ABC did not give rise to a deemed dividend to ABC under s CD 4.
- The provision of the licences by ABC to the shareholders in DEF did not give rise to a deemed dividend to the shareholders under s CD 4. ABC was not required to withhold or pay an amount of tax under s RA 6 in relation to the provision of the licences to the shareholders in DEF.
- The licence fees receivable (that includes the capital works licence fees) from licensees was business income for ABC under s CB 1 and was allocated as income to the income year in which ABC derived the amount under s BD 3(2).
- To the extent ABC owned depreciable property (as defined in s EE 6 and EE 7) that was used or available for use to derive assessable income, ABC could elect to use the straight-line method of depreciation under s EE 12 subject to the calculation rules under ss EE 9 to EE 11 to quantify its depreciation loss deductions under s DA 1(1) for each income year.
- Section FA 2B did not apply to the interest-free loans made by the shareholders of DEF to ABC.

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- The repayment of the interest-free loan principal by ABC to the shareholders in DEF by offset against licence fees payable by the shareholders did not give rise to income or deductions under ss CC 3 or DB 7 for ABC.
- ABC was not required to withhold or pay an amount of tax under s RA 6 in relation to the interest-free loan repayments to the shareholders of DEF.
- Section BG 1 did not apply to negate or vary the income tax outcomes under the above conclusions.

GST

- ABC would be entitled to GST input tax credits under s 20(3) for GST on capital expenditures under ABC's work programme without any adjustment under ss 21-21H.
- Under ss 8(1) and 9(3), ABC would be subject to GST in each GST period on the capital works licence fees paid by offset against ABC loan principal in that period.
- There would be no substitution for ABC of open market value in place of the agreed licence fees under s 10(3) because the licences from ABC to the licensees were not "associated supplies" within the meaning in paragraph (a) or paragraph (b) of s 2(1).
- Sections 5(14B), 14(1B)(b) and 10(3) did not apply to or for the licence rights.
- Section 76 did not apply to negate or vary the above conclusions.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Whether any deemed dividends arise

7. The issues were:
   - Whether the interest-free loans by shareholders in DEF to ABC involved downward value transfers and did not give rise to a deemed dividend to ABC under s CD 6(1).
   - Whether a deemed dividend arose in relation to the making available of the licences to shareholders in DEF under s CD 6(1), with consequence that ABC had an obligation to withhold RWT under the RWT rules.
8. Section CD 1 provides that a dividend derived by a person is income of the person. Section CD 3 provides that ss CD 4 to CD 20 define what is a dividend. For present

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purposes, ss CD 4 to CD 6 are relevant in determining whether a deemed dividend arises under the Arrangement:

- Section CD 4(1) provides that a transfer of company value from a company to a person is a dividend if the cause of the transfer is a shareholding in the company.
- Under s CD 5(1) a transfer of company value from a company to a person would occur when:
  - the company provides money or money's worth to the person; and
  - if the person provides money or money's worth to the company in exchange, the market value of what the company provides is more than the market value of what the person provides.
- Under s CD 6, a transfer of company value would be caused by a shareholding where:
  - the recipient is a shareholder in the company, or is associated with a shareholder in the company; and
  - the company makes the transfer because of that shareholding.

9. TCO considered whether there was a "transfer of company value" as defined in s CD 5 from a company to a person, and if so, whether the transfer was caused by a shareholding relationship under s CD 6.

10. One indication that a transfer was caused by a shareholding was if the terms of the arrangement that resulted in the transfer were different from the terms on which the company would enter into a similar arrangement if no shareholding were involved.[1]

Interest-free loans to be provided by the shareholders in DEF to ABC

11. The provision of the interest-free loans would give rise to a transfer of value as the market value of what was provided by the shareholders (the interest-free loan) was more than the market value provided by ABC for the loans. Therefore, there was a transfer of value from the shareholders to ABC. However, for a dividend to arise under s CD 4, there needed to be a "transfer of company value" from a company to a person that was caused by a shareholding in the company.

12. In respect of the interest-free loans provided by the non-corporate shareholders of DEF, there could be no deemed dividend arising as there was no "transfer of company value"

[1] Section CD 6(2), *Case V9* (2001) 20 NZTC, 10,101 and *Campbell v CIR* [1968] NZLR 1 (HC).

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from a company to a person (ie, the transfer of value was not being provided by a company).

13. In respect of the interest-free loans provided by the corporate shareholders of DEF, there was a transfer of company value (the benefit of the interest-free loan) by a company (a corporate shareholder) to a person (ABC).

14. However, TCO considered it could not be said that the transfer is caused by a shareholding relationship. This was because TCO was satisfied that ABC (the recipient of value) did not hold shares in any corporate shareholder of DEF, and was not associated with any shareholders of DEF under ss YB 1-YB 14, so the general test in s CD 6(1)(a) was not satisfied. Accordingly, no deemed dividend arose on the interest-free loans provided by shareholders in DEF to ABC under s CD 4 as s CD 6(1)(a) was not satisfied.

Licences by ABC to the shareholders in DEF

15. The licence fees to be charged to the DEF shareholders (who are also the licensees) would be at market value (which is a condition to the ruling). Accordingly, TCO considered that the provision of the licences would not give rise to a transfer of company value from ABC to the shareholders under s CD 5 because the shareholders/licensees would be paying market value for the licences; ie, there was no difference in money's worth provided by the shareholders and ABC, so there was no resulting transfer of value.

16. Accordingly, TCO considered it would not be necessary to consider whether a transfer was "caused by a shareholding" under s CD 6, as there was no transfer of company "value" from the provision of licences. Therefore, there was no deemed dividend arising under s CD 4 on the provision of licences.

17. As TCO considered that there was no deemed dividend arising under s CD 4, TCO also concluded that ABC was not required to withhold or pay an amount of tax under s RA 6 as there was no payment of resident passive income (as defined in s RE 2) in relation to the provision of the licences to the shareholders in DEF.

Conclusion

18. TCO concluded that:

- The interest-free loans by shareholders in DEF to ABC would not give rise to a deemed dividend to ABC under s CD 4.
- The provision of the licences by ABC to the shareholders in DEF would not give rise to a deemed dividend to the shareholders under s CD 4. ABC was not required to

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withhold or pay an amount of tax under s RA 6 in relation to the provision of the licences to the shareholders in DEF.

Issue 2 | Take tuarua: Income tax implications of licence fees and timing of derivation

Business income under s CB 1

19. The issue was whether the licence fees received by ABC, which included the capital works licence fees, would be business income under s CB 1.

20. Under s CB 1(1), an amount derived from a business was income of a person. This did not apply to an amount that was of a capital nature.

21. TCO considered the essential question in determining whether the licence fees were business income was whether the licence fees were derived from the current operations of ABC's business, and not merely connected to the fact that the business existed.[2]

22. The licence fees charged by ABC were designed to broadly cover ABC's operating expenditure incurred in operation of the Asset. TCO noted that the licence agreement allowed for additional licence fees to be charged to meet the cost of refurbishment work. This supported that the licence fees (including the capital works licence fees) would be an amount received by ABC in the ordinary course of its business operations for the provision of the licences to use the Asset.

23. TCO considered that the licence fees receivable (that includes the capital works licence fees) from licensees was business income for ABC under s CB 1.

Timing of derivation

24. Section BD 3(1) provides that income must be allocated to an income year. The general rule in s BD 3(2) provides that income is allocated to the income year in which it is derived unless an alternative provision in Parts C or E to I provides a basis for allocation. Therefore, it was necessary for TCO to establish that no provision in any of Parts C or E to I provided for allocation of the licence fee income on another basis.

[2] *CIR v City Motor Service Ltd; CIR v Napier Motors Ltd* [1969] NZLR 1010, at 1,017 and 1,019.

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25. TCO noted that Parts C and F to I of the Act did not apply to the allocation of the licence fee income. Accordingly, TCO focussed on Part E. TCO considered the provisions of Part E that might apply to allocate the licence fee income were:

- *Subpart EW – financial arrangements rules*

  TCO considered that the licence agreement was prima facie a "financial arrangement" under s EW 3(2) as under the agreement a person (ABC) receives money (licence fees monthly in advance) in consideration for that person (ABC) providing money (licence to use, occupy and enjoy the Asset) to any person (the licensees) at a future time (from the date of commencement of the licence until termination).

  Further, TCO considered that the licence agreements were a "short-term agreement for sale and purchase" as defined in s YA 1, and thus were an "excepted financial arrangement" under s EW 5(22). This was because the licence agreement was a conditional agreement to acquire services. The use of the Asset was provided continuously over the term of the licence agreement, ABC rendered periodic (monthly) invoices in advance to the licensees for the services, with the service taking place over the course of the month (ie, performed before the 93rd day after each invoice was rendered).

  Therefore, TCO considered the financial arrangements rules did not apply to alter the allocation of income or expenditure in respect of the licence fee agreement.

- *Section EI 4B – which allows the spreading of land inducement payments on a lease or licence as income or expenditure*

  TCO noted that ABC must derive the licence fees as income under s CC 1B before s EI 4B can apply to spread the income. TCO considered that the licence fees were not consideration for the "grant, renewal, extension or transfer" of the licence. Rather, TCO considered the licence fees were an amount paid by reference to rights held and services provided over the term of the licence.

  Therefore, TCO considered that s CC 1B did not apply to the licence fee income and the timing provision in s EI 4B did not apply to alter the timing of income derivation on the licence fee income.

- *Sections EJ 10 or EJ 10B – in relation to certain lease payments*

  TCO noted that ss EJ 10 and EJ10B contained timing rules that may apply in respect of a lease that was of a personal property lease asset.

  TCO considered the licence fee agreement did not satisfy the definition of a "lease" in s YA 1 as there was no transfer of any asset to the licensees, and the licensees did not have the right to possess the Asset under the agreement. Further, the

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agreement was for the use of land (real property) and other ancillary facilities, and so could not be a lease of "personal property" as defined in s YA 1.

Therefore, TCO considered the timing rules in ss EJ 10 or EJ 10B had no application to alter the timing of the licence fee income.

Conclusion

26. As TCO considered that no specific timing provisions under Part E applied to the licence fee agreement, TCO concluded that the licence fees receivable (including the capital works licence fees) from licensees was business income for ABC under s CB 1 and was allocated as income to the income year in which ABC derived the amount under s BD 3(2).

Issue 3 | Take tuatoru: Deduction for depreciation losses

27. The issue was whether ABC had depreciation loss deductions under s DA 1(1) for the cost of depreciable property acquired and installed under the refurbishment programme.

28. Under s EE 1, a person has an amount of depreciation loss if:

   - the taxpayer owns property,
   - the property is depreciable property as defined,
   - the property is used, or is available for use, to derive assessable income (ie, the general permission in s DA 1 is satisfied), and
   - the amount of the depreciation loss is calculated in the appropriate manner by application of the correct method and rate of depreciation under ss EE 9 to EE 11.

29. TCO noted that:

   - ABC would own the depreciable property (as defined in s EE 6 and EE 7) to be acquired and installed under the refurbishment programme.
   - Under the refurbishment programme, the depreciable property was expected to become available for use, or be used in, ABC's business to derive assessable income progressively as the works and related installation progresses.
   - The amount of depreciation loss was to be calculated under ss EE 9 to EE 11. Section EE 9 provided that one of the methods of calculating an amount of depreciation loss was the straight-line method. Under s EE 12(2)(b) the straight-line method could be used for any item of depreciable property

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30. Therefore, TCO concluded that, to the extent ABC owned depreciable property (as defined in s EE 6 and EE 7) that was used or available for use to derive assessable income, ABC could elect to use the straight-line method of depreciation under s EE 12 (subject to the calculation rules under ss EE 9 to EE 11) to quantify its depreciation loss deductions under s DA 1(1) for each income year.

Issue 4 | Take tuawhā: Whether there is a stapled debt security

31. The issue was whether s FA 2B applied to recharacterise the interest-free loans as equity.

32. The description of the Arrangement stated that the shares in DEF and the loan to ABC must always be held together such that the loans (and any new loans by new shareholders) would in substance be "stapled" to the shares in DEF.

33. In respect of s FA 2B:

    - TCO considered that the meaning of stapled as outlined in s FA 2B(5) would be satisfied in that the loans and the shares must be held together. Further, the exclusion in s FA 2B(6) did not apply because DEF was a widely-held company.
    - TCO considered the interest-free loans would not constitute a "debt security" as defined in s FA 2B(4). While the loans were "financial arrangements" that did provide funds for ABC, the loans did not give rise to any amount for which ABC would otherwise have a deduction. TCO noted this was consistent with its conclusion on the application of the financial arrangements rules to the interest-free loan (discussed in this summary).
    - Even if the section did apply to the interest-free loans, it would have no effect as there was no interest payable on the loans to be treated as a dividend and in respect of which a deduction could be denied: s FA 2B(2).

34. Accordingly, TCO concluded that s FA 2B did not apply to the interest-free loans.

Issue 5 | Take tuarima: Financial arrangements rules and RWT

35. The issue was whether the repayment of the interest-free loan principal by ABC to the shareholders in DEF by offset against licence fees payable by the shareholders gave rise to income or deductions (under ss CC 3 or DB 7) for ABC.

36. TCO considered the interest-free loan and licence fee agreement were part of the same wider arrangement, given the knowledge and connection of the parties with respect to each element of the agreements, and given the existence of some interdependence of

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cash flows under the agreements.[3] TCO considered this wider arrangement was a financial arrangement, comprising a financial arrangement under s EW 3(2) (the interest-free loan), and an excepted financial arrangement under s EW 5(22) (the licence fee agreement).

37. Under s EW 6(3), amounts solely attributable to the excepted financial arrangement must be taken into account. Applying the financial arrangements rules, no income or expenditure arose for ABC in respect of the interest-free loan, or the licence fee agreement, as there was no net flow of consideration under either arrangement. The financial arrangements rules do not deem interest to arise on interest-free loans. The consideration for the services provided under the licence fee agreement as determined under s EW 32 is the same as its stated value under the Arrangement as the licence fees are charged at market value and there is no discount component in the contract for services to be spread.

38. Accordingly, TCO concluded that the repayment of the interest-free loan principal by ABC to the shareholders in DEF by offset against licence fees payable by the shareholders did not give rise to income or deductions under ss CC 3 or DB 7 for ABC.[4]

39. If there was no amount to spread under the financial arrangements rules, the amounts paid and received under the agreements might still be recognised as income derived or expenditure incurred under the relevant provisions of the Act (outside the financial arrangements rules). Therefore, this conclusion did not affect TCO's earlier conclusion that the licence fees receivable by ABC were business income for ABC under s CB 1 and was allocated as income to the income year in which ABC derived the amount under s BD 3(2).

40. TCO also considered whether there was income from "interest" as defined in s YA 1, which could have RWT implications. TCO concluded that there was no "interest" arising on the interest-free loans as while there was money lent, the only cashflows under the interest-free loans were the advancing of principal and the repayment of that principal, and TCO had concluded earlier that no income or deductions arose in respect of the interest-free loan and licence fee agreement under the financial arrangements rules. Therefore, TCO concluded that ABC was not required to withhold or pay an amount of tax under s RA 6 in relation to the interest-free loan repayments.

[3] *CIR v Dewavrin Segard (NZ) Ltd* (1994) 16 NZTC 11,048 (CA).

[4] TCO included references to ss CC 3 and DB 7 which were the provisions under which financial arrangement income or deductions could arise.

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Issue 6 | Take tuaono: Whether s BG 1 applied

41. The issue was whether s BG 1 applied to negate or vary any of the other income tax rulings being sought.

42. Section BG 1(1) provides that a "tax avoidance arrangement" is void as against the Commissioner. Section GA 1 enables the Commissioner to make an adjustment to counteract a tax advantage obtained from or under a tax avoidance arrangement.

43. The Supreme Court in *Ben Nevis* considered it desirable to settle the approach to applying s BG 1.[5] This approach is referred to as the Parliamentary contemplation test, which is an intensely fact-based inquiry. *Ben Nevis* has been followed in subsequent judicial decisions.

44. TCO's approach in making this decision is consistent with Interpretation statement: IS 23/01 Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007 (3 February 2023) (IS 23/01). IS 23/01 will not be replicated in this TDS but in summary the steps are as follows:

    - Understanding the legal form of the arrangement. This involves identifying and understanding the steps and transactions that make up the arrangement, the commercial or private purposes of the arrangement and the arrangement's tax effects.
    - Determining whether the arrangement has a tax avoidance purpose or effect. This involves:
        - Identifying and understanding Parliament's purpose for the specific provisions that are used or circumvented by the arrangement.
        - Understanding the commercial and economic reality of the arrangement as a whole by using the factors identified by the courts. Artificiality and contrivance are significant factors.
        - Considering the implications of the preceding steps and answering the ultimate question under the Parliamentary contemplation test: Does the arrangement, when viewed in a commercially and economically realistic way, make use of or circumvent the specific provisions in a manner consistent with Parliament's purpose?
    - If the arrangement has a tax avoidance purpose or effect that is not the sole purpose or effect of the arrangement, consider the merely incidental test. The

[5] *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289.

merely incidental test considers many of the same matters that are considered under the Parliamentary contemplation test.

45. Taking into account all of the relevant facts and circumstances (noting that as this is a summary it may not contain all the facts or assumptions relevant to the decision and, therefore, cannot be relied on) the Tax Counsel Office concluded as follows.

The Arrangement

46. The Arrangement was the proposed financing arrangement to fund the refurbishment of the Asset, including the following steps:

- The shareholders of DEF would make a series of interest-free loans over time to ABC to meet part of the cost of refurbishment of the Asset.
- Capital works licence fees would be charged to cover the refurbishment costs on a straight-line basis over the tax life of the new assets.
- The loan repayments would match the capital works licence fees payable by the licensees to recover capital refurbishment costs under the licences. In substance, the shares in DEF and the loan to ABC were required to be held together.

47. TCO considered that the legislation was working as intended in respect of the following tax effects of the Arrangement:

- Dividend income was only intended to arise when a transfer of company value was caused by a shareholding relationship. Parliament was concerned with the transfer of value received by shareholders (being a return on investment), rather than value being provided by shareholders to a company they held shares in (downward transfers of value).
- The licence fees charged were based on an arm's length market rate (which was included as a condition of the ruling), and as such there was no transfer of value or dividend arising on the provision of the licence to the shareholders.
- ABC still derived the same amount of taxable licence fee income over time (being the charges to the licensees for the cost of operating the Asset). The provision of the loans did not distort ABC's timing of derivation of the licence fees.
- The depreciation deductions claimable reflected the spreading of actual costs incurred by ABC in acquiring depreciable property used or available for use in deriving its assessable income.

48. TCO considered that ABC may be receiving a benefit (in the form of the value of the interest-free loans) that did not give rise to taxable income in its hands. Accordingly,

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TCO analysed the tax effects that could potentially arise from a s BG 1 perspective in respect of the provision of the interest-free loans, which were:

- No financial arrangement income or deduction arose under subpart EW, ss CC 3 or DB 7 in respect of the interest-free loans. The repayment of the interest-free loan principal by ABC to the shareholders in DEF by offset against licence fees payable by the shareholders did not give rise to income or deductions under ss CC 3 or DB 7 for ABC.
- Section FA 2B did not apply to the interest-free loans issued by ABC to the shareholders of DEF.
- ABC was not required to withhold or pay an amount of tax under s RA 6 in relation to the interest-free loan repayments to the shareholders of DEF.
- No income arose for ABC under s CC 1B because the benefit of the interest-free loan was not consideration for the grant, renewal, extension or transfer of the licence.

Parliamentary contemplation

49. TCO considered that Parliament contemplated capital could be provided by way of interest-free loans. TCO also considered that the focus in the Act was on actual payments and net gains and losses. While various provisions were aimed at ensuring excessive interest deductions were not taken in New Zealand, there were no provisions seeking to create income where no amount was actually received over and above the money lent in this context.

50. TCO was satisfied the provision of capital by way of interest-free loans from its ultimate shareholders had a commercial purpose that objectively met ABC's genuine commercial need to raise funding for the refurbishment of the Asset because it had been unable to obtain third-party financing (which was a condition of the ruling). The shareholders of DEF and indirectly of ABC had a united purpose to carry out the capital works.

51. TCO considered the use of interest-free loans did not artificially change the amount or timing of derivation of ABC's licence fee income. Similarly, the shareholders did not receive any real economic gain for providing the interest-free funding as they were still being charged market rates for the licence fees (which was another condition of the ruling). As such, there was no indication that the absence of interest on the loans was artificially set to obtain a tax advantage.

52. TCO considered it was clear that it was not intended for s CC 1B to capture every payment received "in relation to" a land right. There needed to be a direct link between the payment and the grant, renewal, extension or transfer of the land right.

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53. TCO considered the Arrangement made use of the relevant provisions in a manner that was consistent with Parliament's purpose for those provisions. Therefore, TCO concluded the Arrangement did not have a tax avoidance purpose or effect.

Conclusion

54. TCO concluded that there was no tax avoidance purpose or effect of this Arrangement. Accordingly, TCO concluded that in the context of the issues being ruled on, s BG 1 did not apply to negate or vary the black letter outcomes above. It was therefore not necessary for TCO to go on to consider the merely incidental test.

Issue 7 | Take tuawhitu: Input tax credits without adjustments

55. The issue was whether ABC would be entitled to GST input tax credits under s 20(3) of the GSTA for GST on capital expenditures under the refurbishment programme without any adjustment under ss 21 to 21H of the GSTA.

Entitlement to input tax credits

56. Under s 20(3)(a), ABC would be required to deduct from the output tax attributable to the taxable period one or more of the following:

- Input tax in relation to the supply of goods and services (not being a supply of "secondhand goods" to which s 3A(1)(c) applies) made to ABC during the taxable period.
- Input tax in relation to the supply of "secondhand goods" to which s 3A(1)(c) applies to the extent that a payment in respect of that supply was made during the taxable period.
- Input tax invoiced or paid, whichever is the earlier, under s 12 during that taxable period on the importation of goods (not being fine metal) into New Zealand.
- Any amount calculated in accordance with any of ss 25(2)(b), 25(5), 25AA(2)(b) or 25AA(3)(b).

57. As noted above:

- ABC had a license for use of the Asset, and
- ABC operated and maintained the Asset and sub-licensed the use of the Asset to various licensees.

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58. TCO was satisfied that ABC's business was a taxable activity and ABC's supplies of rights to licensees were taxable supplies. ABC would be carrying on that taxable activity and making those taxable supplies of rights when the cost of the refurbishment programme was incurred. The licence fees would consist of the regular licence fees that licensees paid to cover the operating costs of the Asset along with an increase for the capital works licence fee.

59. TCO considered that the input tax arising out of the refurbishment programme would be incurred to acquire goods or services that had sufficient nexus to the taxable supplies produced by ABC.

60. Finally, TCO considered that ABC would not make exempt supplies to which an apportionment of the refurbishment costs under s 20(3C) could potentially be required.[6]

Adjustments under ss 21 to 21H

61. Section 21(1) requires a registered person to work out at the end of an adjustment period if an adjustment needs to be made for the period. The adjustment, if required, would be for any percentage difference in a supply of goods or services compared to the actual use of those goods for making taxable supplies.

62. Applying this to ABC, TCO considered that the goods or services acquired by the refurbishment programme were wholly connected to taxable supplies to be produced by ABC. The percentage intended use of the goods or services at acquisition therefore was 100%. If the nature of ABC's business did not change (ie, ABC did not start using the Asset to make non-taxable or exempt supplies), then the percentage actual use of the relevant goods or services would also be 100% (ie, those goods or services would still be wholly connected to taxable supplies produced by ABC). No percentage difference would arise and no adjustment would need to be made under ss 21–21H for the goods or services to be acquired by the refurbishment programme.

Conclusion

63. TCO concluded that ABC:

- would be entitled to claim a full deduction for the input tax credits under s 20(3) arising out of the refurbishment programme at the time of supply of the relevant goods or services; and

[6] TCO considered that s 20(3D) would not apply to the Arrangement.

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- would not have to make any adjustment under ss 21 to 21H for the input tax arising out of the refurbishment programme.

Issue 8 | Take tuawaru: Is GST imposed on licence fees paid by offset against loan principal?

64. The issue was whether ABC would be subject to GST on the licence fees paid by offset against loan principal under ss 8(1) and 9(3) of the GSTA.

65. TCO considered that the licence fees would be subject to GST under s 8(1).

66. A supply of goods and services is generally deemed to occur at the earlier of when an invoice is issued by the supplier or the recipient or a payment is received for the supply under s 9(1). However, s 9(1) is subject to s 9(2) and (3).

67. Relevantly, TCO considered s 9(3)(a) applied when services were supplied under any agreement that provided for periodic payments. Those services would be deemed to be successively supplied for successive parts of the period of the agreement, and each of the successive supplies is deemed to take place at the earlier of when a payment becomes due or is received.

68. For the purposes of s 9(3)(a), the licences record an agreement between ABC and the licensees under which ABC granted rights to use the Asset in exchange for consideration including the payment of the capital works licence fee. Those capital works licence fees would be periodical payments that would only become due for payment when ABC's repayments of the interest-free loans also became due.

69. Therefore, TCO considered the periodical capital works licence fees for ABC's services would be deemed to be successively supplied. Also, TCO considered each of those successive supplies would be deemed to take place at the earlier of when a payment became due or was received.

70. TCO concluded that, under s 8(1) and 9(3), ABC would be subject to GST on the capital works licence fees in each GST period in which those fees were paid on the due date by way of set off against ABC's repayments of the interest-free loans.[7]

[7] Having reached this conclusion, TCO did not need to also consider s 9(2).

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Issue 9 | Take tuaiwa: Will open market value be substituted for the agreed licence fees amount?

71. The issue was whether s 10(3) would apply to treat the consideration for the supply of licence rights as being the "open market value" of that supply in substitution for the agreed licence fees. In essence, TCO was required to determine whether the supply of licence rights was an "associated supply" under s 10(3)(b).

72. TCO noted that the definition of "associated supply" applied to:

- supplies that a supplier made to an associated recipient, and/or
- certain supplies under an "equity security" or "participatory security".

Associated persons

73. The definition of "associated persons" in s 2 of the GSTA states that two companies would be associated persons if there is a group of persons who have voting interests, or if a market value circumstance exists for either company, market value interests, in each of those companies of 50% or more when added together or who have control of each of those companies by any other means whatsoever. Further, a company and a person other than a company would be associated if the person has voting interests, or if a market value circumstance exists for the company, market value interests, in the company of 25% or more.

74. Under the Arrangement:

- no individual or trust shareholder of DEF had 25% or more ownership of DEF, and no corporate shareholder had 50% or more ownership in DEF; and
- ABC did not hold shares in any corporate shareholder of DEF.

75. The licensees were not persons who are associated with DEF (or, by extension, with its wholly-owned subsidiary ABC) under the above tests.[8]

76. Accordingly, ABC would not be making supplies to associated persons when it supplied licence rights to licensees.

Equity securities or participatory securities

77. TCO noted that:

[8] Neither, on the facts of the Arrangement, did the tripartite test in s 2A(1)(i) appear to apply.

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- An "equity security" was an interest in or right to share in the capital of a body corporate.
- A "participatory security" was a participation right in a "contributory scheme".
- Broadly, a "contributory scheme" (as defined in s 3) included syndicates that had more than five investors or a professional manager. A "contributory scheme" did not include an "equity security" or a "debt security".

78. TCO ruled out the possibility that the supply of a right to receive licence rights might be under a "participatory security". This was because, if the shares in ABC were the source or origin of the licence rights, those shares were an "equity security" that was excluded from the s 3 definition of "participatory security" for the purpose of para (b) of the "associated supply" definition.

79. TCO was satisfied that:
    - Share ownership in ABC was merely a vehicle for procuring the licence rights for licensees.
    - The vehicle for acquiring the licence rights themselves was the licence supplied by ABC (not the shares in ABC) for which licensees separately paid the periodic licence fees.
    - The licence rights (to use, occupy and enjoy the Asset) were discrete and were not an incident of owning shares in ABC.
    - Those rights did not have a source or origin in the shares in ABC and, as such, were not rights attaching to those shares.

80. TCO considered that the licence rights were not rights supplied under a share in ABC. Also, although the mechanism for procuring licence rights was share ownership in ABC, this did not convert the supply to licensees of licence rights into a supply of rights under a GST-exempt "equity security" for the purposes of the s 2(1) "associated supply" definition.

81. Therefore, TCO considered that licensees' right to receive a supply of licence rights from ABC was not a right supplied "under" an equity or participatory security for the purposes of para (b) of the s 2(1) "associated supply" definition. TCO also concluded above that licensees were not persons associated with ABC for the purpose of para (a) of that definition. As such, ABC's supplies of licence rights would not be "associated supplies" as defined in s 2(1).

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Conclusion

82. TCO concluded that s 10(3) would not apply to treat the consideration for the supply of the licence rights as being the "open market value" of those supplies.

Issue 10 | Take tekau: Whether s 76 applied

83. The issue was whether s 76 (tax avoidance) of the GSTA applied in the circumstances.

84. In 2000, s 76 was aligned with a predecessor of s BG 1 of the Income Tax Act 2007 (the income tax general anti-avoidance provision). The Supreme Court in *Ben Nevis* considered it desirable to settle the approach to applying s BG 1.[9] This approach is referred to as the Parliamentary contemplation test, which is an intensely fact-based inquiry. *Ben Nevis* has been followed in subsequent judicial decisions. TCO's approach in making this decision is consistent with IS 23/01 (see above at [44]).

85. The Supreme Court in *Glenharrow* considered the application of an earlier version of s 76.[10] The Court held that the same objective test applied to GST avoidance as it does to income tax avoidance under s BG 1. The Court relied on income tax avoidance cases to support its view. Significantly, the Supreme Court delivered its decision in *Glenharrow* on the same day as its income tax avoidance decision in *Ben Nevis*. Four of the five justices who made up the Supreme Court bench in *Ben Nevis* were also on the bench in *Glenharrow*.

86. Taking into account all of the relevant facts and circumstances (noting that as this is a summary it may not contain all the facts or assumptions relevant to the decision and, therefore, cannot be relied on) TCO concluded as follows.

87. ABC was a GST registered person. ABC, in commercial and economic reality, would incur capital costs under the refurbishment programme. Those costs would be incurred in carrying out capital works that ABC must undertake to comply with its contractual obligations under the head licence for the Asset. ABC would incur the relevant costs in acquiring goods and services that would be charged with tax under s 8(1). ABC's entitlement to claim input tax deductions for the tax charged on those costs in the taxable period in which it holds the taxable supply information for the supply would clearly be within Parliamentary contemplation.

88. To fund the immediate costs to be incurred under the refurbishment programme, ABC would have to look to its economic owners (the DEF shareholders) for finance. This was

[9] *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289.

[10] *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, [2009] 2 NZLR 359.

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because ABC was unable to obtain funding from the banks, or from non-bank lenders or suppliers on terms that it considered affordable (which was a condition of the ruling). Ultimately, the cost of the refurbishment programme would be paid for by a monthly capital works licence fee that was payable by licensees (who were also the DEF shareholders). The monthly capital works licence fees collected would enable ABC to repay the loans.

89. TCO accepted that it was commercially explicable for:

- a company to fund a capital project with finance obtained from its economic owners where external funding was unavailable or considered to be unaffordable,
- a loan between associated persons to be interest-free in that context, and
- a loan to be effectively tied to ownership of the borrower, or to ownership of a person associated with the borrower, so that the interests of the borrower's owners and its creditors did not diverge.

90. TCO considered whether the combined effect of the steps and transactions that made up the Arrangement might suggest that in commercial and economic reality the advances that ABC received from DEF shareholders under the loans would really be repayable. In TCO's view, Parliament would expect that ABC must be subject to a real obligation to repay the loan advances. TCO considered whether it was possible to view the advances as a pre-payment for the capital works licence fees in commercial and economic terms rather than an obligation to repay. The concern was that, if a pre-payment, there would be a significant temporal mismatch spanning 20 or more years. This would be to the extent of the payment treated as periodically supplied over the term of the Arrangement so that input tax credits were obtained in advance of output tax liability arising in later years.

91. The Arrangement, however, and all of its steps or transactions, were commercially explicable involving real economic consequences in terms of capital expenditures that had to be funded and paid for, and were reasonably common in commercial practice in similar contexts. Outgoing sub-licensees would also be repaid their outstanding loan balance using funding provided by incoming sub-licensees. In pursuing those commercial purposes, TCO considered that, on balance, the Arrangement objectively had not been deliberately structured in the way to create or take advantage of a temporal mismatch between outputs and inputs to obtain a tax advantage. In TCO's view, the Arrangement was not artificial or contrived in its commercial context.

92. Therefore, TCO considered that, on balance:

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- The steps and transactions that made up the Arrangement make use of the specific provisions that they engage consistent with Parliament's purposes for those provisions.
- The Arrangement did not have a tax avoidance purpose or effect for the purpose of determining whether s 76 would apply to negate or vary conclusions reached on the application of the GST black letter law provisions being ruled on.

93. As TCO concluded that there was no tax avoidance purpose or effect of this Arrangement, it was not strictly necessary for it to go on to consider the merely incidental test. However, as TCO indicated above, its conclusion was on balance. TCO went on to consider the merely incidental test.

Merely incidental

94. There were three particular tax effects of the Arrangement that, in TCO's view, could potentially cause concern from a s 76 perspective. These tax effects were:

- Treating the physical payment of loan principal by ABC shareholders as occurring under the loans and not (in commercial and economic reality) as consideration for the licence rights.
- Recognising the supply of a financial service as occurring for the payment by ABC and collection by ABC's shareholders of loan repayments.
- Recognising the payments that licensees make for the licence fees by way of set-off against the loan repayments as being the payment that triggers the time of supply of the licence rights under s 9(3)(a).

95. ABC would be obliged to incur expenditure under the refurbishment programme to satisfy its contractual obligations under the head licence. To fund that expenditure, ABC would receive upfront payments as loan advances from the ABC shareholders, who in their alternative capacity as licensees would be obliged to pay monthly capital works licence fees to ABC. The arrangements for the repayment of loan advances, payment of the capital works licence fees and the holding of the loans, viewed objectively, could suggest that the loan advances were in commercial and economic reality a payment for the capital works licence fees.

96. However, TCO concluded that the Arrangement along with its constituent steps and transactions satisfied a real commercial need as ABC was effectively unable to borrow externally due to commercial requirements imposed by external third-party lenders. In addition, it was not possible or practical to obtain Licence fee prepayments from Licensees. Debt financing from shareholders on the other hand was commercially explicable and was a less complicated and practical way to fund the refurbishment.

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Additionally, as ABC had to look to their economic owners for funding, it was commercially explicable for the Loans to be effectively tied to the shares. This achieved another commercially explicable outcome of ensuring that the decision-making among the shareholder group was aligned to the best interests of the Applicants and the body of shareholders as a whole.

97. Consequently, on balance, TCO considered that the Arrangement was appropriately structured around a series of loans under which ABC would assume a legal obligation to repay the advances made to it under those loans. Otherwise, the DEF shareholders/licensees (being the only viable source of finance) would be reluctant to provide the amount of funding required to progress the capital works and the Arrangement would not achieve its commercial purposes. On reaching this conclusion, it must also follow that there was a separate payment:

- by ABC to repay the loans, which constituted the supply of a financial service; and
- by licensees to satisfy their obligation to pay the capital works licence fees on the due date for payment, which to that extent triggered the time of supply of the licence fees.

98. Accordingly, for the reasons set out above and having regard to the commercial purposes of the Arrangement, TCO considered that if a temporal mismatch between outputs and inputs did arise under the Arrangement, and it did constitute a tax avoidance purpose or effect, it would be merely incidental to the commercial purposes of the Arrangement.

Conclusion

99. TCO further concluded that the Arrangement, if it did have a tax avoidance purpose or effect, that purpose or effect would be merely incidental to the commercial purposes of the Arrangement. Therefore, in the context of the issues being ruled on, the Arrangement was not a GST avoidance arrangement for the purposes of s 76 and it did not apply to negate or vary the GST conclusions reached.

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