Structural inequities and concepts of tax avoidance

G. J. Harley*

I. INTRODUCTION

A. The Commissioner's Submissions on Tax Avoidance to the Task Force

The Commissioner of Inland Revenue's submissions on "tax avoidance" to the Task Force on Tax Reform concentrated on ten aspects of tax planning. The Commissioner labelled everything from fringe benefits, to horticulture ventures, to leveraged leasing, to assignments of income and to family trusts as falling under the umbrella of "tax avoidance". Then, in just 21 lines, the Commissioner explained what he meant by the term "tax avoidance". The Commissioner also informed the Task Force that taxpayers, in increasing numbers, are embarking on tax avoidance schemes.

One feature of the Task Force report is the almost unquestioning acceptance of many of the Commissioner's submissions. For my part, I would reject up to seven of the ten areas singled out as being "tax avoidance" devices, at least on the Commissioner's own simplistic view of what that term meant. Instead, I would classify most of the areas as being either the specific result of deliberate tax preferences (that is, concessions or incentives enacted deliberately by Parliament) or totally inadequate legislative provisions, and often a combination of both.

The submissions made by the Commissioner are characterised by a simple and unarticulated premise: that taxpayers deliberately availing themselves of tax preferences are "tax avoiders". The Task Force itself responded to that premise in a schizophrenic way. The Task Force accepted the Commissioner's objection to many of the particular areas identified. Its response, in terms of the proposed cures, was divided in two.

The first cure, prescribed for fringe benefits in particular, is proposed by the Task Force in terms of horizontal equity. The second cure, prescribed for tax litigants and one-person superannuation schemes, is to label certain activities as "tax avoidance" or to treat them as such.

The Task Force also offered a third response — best described as a palliative — to income splitting. Instead of attempting to prevent income splitting, which the

* Barrister and Solicitor, Wellington. The author acknowledges the assistance derived in preparing this paper from an article by Alan Gunn "Tax Avoidance" (1978) 76 Mich. L.Rev. 733.

Commissioner labelled as "tax avoidance", the Task Force recommended that it be made available in additional, but limited, circumstances, namely for married couples, where one spouse does not earn income. That recommendation of itself would provide a further structural inequity in our tax system.

B. *Themes of Paper*

In this paper I argue that the Task Force generally failed to recognise the real basis for what the Commissioner was attempting to say. The principal contention that I make is that "tax avoidance" is a nonsense in conceptual terms, largely because of the way in which the Income Tax Act 1976 is structured, and the tax preferences and incentives that it contains. Accordingly, my submissions are that:

(a) So called "tax avoidance" as identified by the Commissioner in his submissions to the Task Force, is a direct result of structural inequities in the Act itself and its definition of the tax base;

(b) If the Task Force had been consistent then its analysis of fringe benefits, in terms of horizontal equities, would have extended to a major critique of tax preferences generally. Such a rigorous analysis would have shown that its income splitting proposal was too narrow in concept to be justified or fair;

(c) Such a critique, expressed in terms of horizontal equities, shows "tax avoidance" to be a meaningless concept. At the same time, that critique demonstrates that our tax base generally is hopelessly unfair.

II. WHETHER "TAX AVOIDANCE" HAS A REAL MEANING

A. *Conceptual Confusion*

A simple series of examples shows the futility of basing tax policy on tax avoidance notions.

New Zealand imposes a stamp duty on the use of cheques. The duty is imposed on each cheque. If a person decides to avoid cheque duty, that person will use cash. The same illustration can be turned to the income tax. If one does not wish to pay income tax, one can fail to earn any income at all.

The Canadian *Report of the Royal Commission on Taxation*[1] (the Carter Report) flatly asserted that: ". . . motive would seem to be an essential element of tax avoidance . . . ".[2] Any taxpayer, so Carter went on,[3]

> . . . who adopts one of several possible courses because that one will save him the most tax must be distinguished from the taxpayer who adopts the same course for business or personal reasons.

My question is simply, why? Consider again the examples above. Should we tax

1 Queen's Printer, Ottawa, 1966.

2 Ibid. Vol. 3, 538.

3 Idem.

the stamp duty "avoider" who collects several accounts from one supplier and pays them by one cheque? Should we do so only when we can prove that this single cheque user did so to avoid the tax on several cheques? Why should we treat such a person differently from a trader who only uses cash because he likes the feel of pockets stuffed with coins and notes?

A real life example will bring these issues home. The High Court of Australia has recently upheld a solicitor's right to assign one half of his professional income to his wife.[4] This is a recognition of income splitting, pure and simple. The dominant effect of the transaction was to split what was a single income amongst two taxpayers and so make use of two structural features of Australia's tax legislation. The first is the graduated rate structure, and the second is the individual as the taxable unit.

In terms of tax policy, do we really care why the taxpayer assigned half of his income? Does it matter if he did it to avoid tax by making use of the legislative structure and that was the only reason? Should we treat such an assignment as effective for tax purposes if made through genuinely personal reasons such as a feeling between married people of a joint venture with shared resources?

In my submissions, the reasons or motive may be of some interest, but must be totally disregarded for tax purposes for reasons of equity. As New Zealand courts have already recognised, such assignments for tax purposes cannot be accepted without the complete subversion of our tax policy. Whether or not we like the policy, we tax individuals as the taxable unit. We tax individuals according to what they earn.

The New Zealand Commissioner now faces a further challenge to our settled law on assignments, as a result of the Australian position. My hope is that the courts will make short work of it, not on the basis of woolly tax avoidance notions, but on the basis of the developed assignment doctrine. That doctrine rests on the proposition — though not articulated in the New Zealand cases to any great degree — of notions of horizontal equity between taxpayers.

When we examine our tax laws in that light, we can see that the policy is subverted at every turn. We treat taxpayers in like situations in completely different ways, Thus, referring to section 67 of the Income Tax Act 1976, we tax the profits of the person who purchases land with the intention of resale. Why do we care about intention? An accidental profit is still a profit. The result: people lie. They solemnly assert that their purpose was anything but deriving profit on resale. The more cunning will enter into subsequent transactions, perhaps through a company, and sell the shares, so that section 67 cannot apply at all. The profit is the same. What is the basis for distinction in terms of tax result?

My point is that a tax base which makes such distinctions is artificially narrow and an invitation to self-help. If Parliament determines that we should charge land purchased for investment to tax, on what basis does it determine that no tax should be paid unless the taxpayer intended to profit (and who does not from

4 *F.C.T.* v. *Everett* (1980) 10 A.T.R. 608.

an "investment") or if the taxpayer did not realise the gain until after ten years? Equally, the horizontal equity of the tax base requires that all such investments — not just land — should be brought to the charge.

For present purposes, it is unnecessary for me to expand on this question because the essential thrust of Professor McKay's[5] paper, appearing earlier in this book, covers the capital gains argument. I support it. I will instead examine the area of fringe benefits, as a further illustration of my arguments in relation to the tax base definition.

The Task Force was at its best, in my view, in terms of its fringe benefits analysis. The Task Force saw fringe benefits in precisely the same terms as the recipients who receive them: as untaxed income. Company cars alone were considered to involve about 150 million dollars in lost revenue. The report concluded:[6]

> The failure to tax fringe benefits contributes significantly to unfairness in the tax system. . . .[I]t may be generally concluded that Government is implicitly accepting the propriety of this form of tax avoidance.

In the same passage, the Committee referred to the "serious implications for equity"[7] for the "remaining tax base".[8]

The point I wish to make is that in the above passage the Task Force described the use of fringe benefits as involving "tax avoidance". That reference is articulated in terms of the premise adopted by the Task Force which is taxpayer equity. Notice that the reference is, however, cloaked with "motivation", whereas (at least as I read the thrust of the argument) motive is not in fact considered in any way relevant to the Task Force's recommendation. Horizontal equity is accepted as the determinant. Untaxed fringe benefits are a tax preference. They cannot be justified in terms of tax policy. As between taxpayers, they are unfair, and that unfairness is structural and not a result of motivation — tax avoidance or otherwise.

The conceptual confusion I have discussed in this part of my paper is sharply identified by the High Court of Australia's attitude to tax avoidance cases.

B. The High Court of Australia's Choice Principle

When the High Court of Australia gave judgment in *Cridland* v. *F.C.T.*[9] it seemed in my opinion that Australia's general anti-avoidance provision — section 260 of the Income Tax Assessment Act 1936 — was a dead letter. Those familiar with the Barwick High Court's judicial hostility to the repeated attempts by the Australian Federal Commissioner to attack tax shelter schemes by use of section 260 will know the deliberate judicial policy adopted to destroy it.

5 L. McKay "Capital Taxation" supra, 12.
6 *Report of the Task Force on Tax Reform* (Government Printer, Wellington, 1982) 156.
7 Idem.
8 Idem.
9 (1977) 8 A.T.R. 169.

It is tempting to launch into a detailed examination of the reasoning adopted in the tax avoidance cases considered by the Barwick High Court in the last decade. Such an examination does show lack of legal reasoning, but my purpose is to direct attention to the underlying structural inequities by which taxpayers have sought tax advantages, and which the High Court of Australia's judgments exposed. I rely on *Cridland's* case because it well shows the ultimate position reached by the Barwick Court.

The essence of the Barwick Court's approach or judicial philosophy to the section 260 cases is the so-called "doctrine of choice". This choice principle is unwieldly in concept and was never fully articulated or reasoned by the Court. In summary form, I would describe the choice principle in the following way:

(a) The Income Tax Assessment Act 1936 contains a set of base rules which order the way in which assessable income is defined and determined. In outline, assessable income as defined is brought to charge, allowable deductions and expenses are set off, and taxable income is determined.

(b) The Act contains a plethora of special provisions, incentives, penalties, preferences, deferrals, restrictions, holidays and credits. These are of general application in the sense that taxpayers fitting their prescriptions and criteria are entitled, indeed encouraged, to use them and rely on them for tax benefits.

(c) There is a variety of ways in which taxpayers can structure or organise their affairs. Much of that structuring results from — indeed is encouraged by — the special provisions in the Act itself.

(d) The highest courts in the commonwealth, and in the United States of America, have recognised for decades that taxpayers are entitled to organise their affairs to suit themselves, including to achieve minimum tax exposure.

(e) Therefore, whenever a taxpayer organises him or herself in a particular way so as to achieve a particular result, he or she has exercised a "tax choice" and cannot be pilloried as a "tax avoider".

III. CHOICES IN OUTLINE

Some simple examples will illustrate the choice principle in the New Zealand context for the business taxpayer.

A. Formation of Company

Our law offers the business taxpayer a choice of two forms of business enterprise — either as a sole trader (or partnership thereof) or through a company. If that business is carried on by the taxpayer individually (or with others, as a co-venture or partnership), the tax result is that the individual tax rate scale applies. The company rate of tax applies where the business is incorporated. The tax rates applicable to the business income generated are different, and whichever form is adopted will itself force further choices to be exercised.

B. Dividend or Bonus Issue

If the company form is adopted, after-tax profits can be distributed either as dividends or they can be capitalised and distributed by way of bonus shares. Revenue sourced dividends are taxable to individuals as income; bonus shares are subject to a much lower bonus issue tax payable by the company. It is a matter of choice as to the form of distribution.

C. Company or Special Type of Company

Our Income Tax Act also makes further specific provisions for certain types of company: the obvious examples are privately controlled investment companies, subject to penalty by way of excess retention tax (section 247) and petroleum mining companies (sections 214A-C). In the latter case, promoters can choose to form a company complying with the specified requirements and confer income tax benefits to investors of capital accordingly.

The Act is full of such choices. They are exercised by taxpayers every day, either to obtain the tax preference offered or to avoid the tax penalty provided for. They are inherently motive or purpose oriented.

Cridland's case involved the purported exercise of such a choice. The facts involved an accountant who set out to use a provision in the Act meant for farmers. The provision enabled a farmer to average his farm business income over several years. A scheme involving unit trusts was developed whereby university students could become farmers. Each unit cost $1, and the trust bought farm land so that under the relevant provision of the Act, a unit holder was deemed to be a farmer. Over 5000 units were taken up and very few unit holders ever paid their money.

The High Court recognised that the scheme was deliberate in its effort to secure averaging advantages meant to be available to farmers. Mason J., speaking for the unanimous High Court, held that "tax avoidance" was not in issue, as the Federal Commissioner had contended, because:[10]

> [The choice principle] is not confined to cases in which the Act offers two alternative bases of taxation; it proceeds on the footing that the taxpayer is entitled to create a situation by entry into a transaction which will attract tax consequences for which the Act makes specific provision and that the validity of the transaction is not affected by s.260 merely because the tax consequences which it attracts are advantageous to the taxpayer and he enters into the transaction deliberately with a view to gaining that advantage.

Cridland offers a sharp dilemma, which has plagued New Zealand and Australian courts for more than 30 years. In *Cridland* itself, the promoter of the unit trust candidly acknowledged the bases for the scheme. The High Court held that the scheme literally complied with the requisite conditions for averaging. On that basis, the High Court upheld the scheme as effective, notwithstanding its avowed purpose. The effect of the judgment was finally to destroy section 260.

10 Ibid. 173-174.

I submit that we should repeal New Zealand's similar general anti-avoidance provision, section 99, before the New Zealand courts are faced with similar conceptual difficulties, which are ultimately impossible of resolution while we concentrate on tax avoidance dogma. Instead, we should turn our focus on to the tax preferences which invite taxpayers to adopt a tax inspired course of action. Should they exist at all?

IV. ANALYSIS IN HORIZONTAL EQUITY TERMS

A. Preliminary Comments

What is intriguing in section 99 is its focus on denying the results of tax motivated behaviour. Yet, our Act has a great number of provisions which depend upon motive for their success if, indeed, they are successful at all.

I have focused on three particular areas of tax encouraged activity in order to demonstrate the difficulties faced by the High Court in *Cridland*. In the end, I have concluded that provisions such as section 99 and 260 can never be satisfactory or acceptably effective to protect the tax base.

B. Horticultural Ventures

As the Commissioner informed the Task Force, horticulture has become a major industry. It is rumoured to provide effective tax shelters, especially to those with substantial earnings. These rumours, of course, extend beyond horticulture to farming generally and to aquaculture. The relevant provisions of the Act are sections 126, 127 and 128.

For horticulture, on which I wish to concentrate, sections 126 and 127 allow the horticulturalist to deduct currently capital expenditure incurred in developing the property. Of itself, this is unusual because capital allowances are not often a feature of an income tax base. This type of expenditure is usually funded from borrowings, and the interest charges are also currently deducted.

The broad effect obtained from leveraging by borrowing, and the current deduction of expenditure on capital account, is to reduce significantly the tax payable on other income sources in the first few years of development. People are entering into syndicated horticultural schemes because they will obtain a net cash benefit for tax purposes as well as acquiring what may be a most valuable investment providing subsequent taxable income and a tax free capital gain.

The effectiveness of the incentives is artifically enhanced by both the leverage used and the effects of inflation. Borrowed dollars are deducted for tax purposes, together with interest, and invested in assets which have continued to appreciate at least in accord with inflation. Those borrowings are subsequently repaid in depreciated dollars so giving a double financial benefit.

These two sections provide for an explicit tax preference. The preference is used by those taxpayers on high incomes for investment purposes. The investment benefits are enhanced artificially, but largely deliberately, by the tax result achieved when the investment is realised. Section 129 provides that a taxpayer selling up

after five years from the date of expenditure is not liable to recapture of the benefit derived from the tax system. Generally, neither is the profit on the land during the holding period when realised subject to income tax under section 67.

Even to the most hardened capitalist and defender of farm related incentives, this system has to cause at least one eyebrow to be raised. In summary, the scheme is that:

(a) The taxpayer can deduct most of the capital development costs as incurred;

(b) Much is financed through borrowings, the subject of current interest expense deductions and pay-back in depreciated currency;

(c) Historically, the land values have grown at least apace with inflation;

(d) Sale after 5 years of the last capital cost deduction results in non-assessability of the profits.

The conversion of income deductions of capital expenses into tax free capital gains which this scheme involves is sometimes called "double dipping".

I find the Task Force's treatment of this area unsatisfactory. Apart from commenting on the inadequacy of the Treasury's tax expenditure budget and the lack of cost benefit analysis, the Task Force neither seriously questioned the wisdom of providing such incentives in the system, nor described their effect in terms of taxpayer equity. It is not simply a question of accountability for hidden government expenditure. Nor is it enough to be sure that the incentives are economically effective. In terms of tax reform, these incentives stand out as an example of structural inequity. By way of contrast, the Task Force saw fringe benefits as causing a serious erosion of taxpayer equity. Its recommendation was to bring them to charge. I ask: how can these differences in standards be explained? The issue — tax base definition and taxpayer equity — is the same.

C. One Person Superannuation Schemes

The Task Force referred briefly to the current demand for one person superannuation schemes. Numbers of people, some of whom are not self-employed, are forming these tax exempt funds. By a variety of methods, investment assets are diverted into these superannuation funds, and the profits are realised tax-free. They can be paid from the fund tax-free subsequently.

An example will illustrate how crude but effective such a system can be. A 59 year old person can form such a fund today and purchase, through the fund, some valuable subdivisible land. The fund then embarks on a subdivision and the profits are tax free. At age 60, those profits can be distributed in a lump sum, tax-free, as superannuation.

The Task Force labelled this activity as "tax avoidance" and recommended that the Commissioner of Inland Revenue should have the power to prevent it. With respect, that recommendation (unargued as it was) is quite naive and superficial. There are at least three basic structural problems. None of them is addressed by the Task Force. The unstated reasoning behind its recommendation seems to be as follows:

(a) The individual who engages outside of a superannuation scheme in the subdivision type of activity described is subject to income tax on subdivision profits through section 67(4);

(b) Because the same person has a lump sum private superannuation scheme, of which he or she is the beneficiary, which scheme carried out the profit making subdivision, does not of itself suggest a reason why the profits should be exempt;

(c) Even between 60 year olds, it is difficult to see why or how we should distinguish between the forms of investment vehicle in terms of tax result for exactly the same transaction.

At that level, I am in general agreement with the reasoning. But the analysis should not stop there. The area of superannuation needs to be looked at on a broader plane. In the area of public and private employment, subsidised superannuation is common-place. Employees' contributions are partially tax deductible whereas contributions to private schemes are not. Employers' contributions to such subsidised schemes are also deductible; for the self-employed generally, and for private schemes in particular, that advantage does not usually arise. As between types of superannuation, there is no basis for tax comparison, because public and private employment superannuation is heavily subsidised through the tax system.

The Task Force recognised anomalies between superannuation schemes funded from deductible sources and briefly discussed "savings" alternatives. It did not consider whether or not there may be a case for different treatment, in tax terms, between those schemes relying on deductible contributions which are subsidised and those which do not. By no stretch of the imagination can this response be described as either analytical or sympathetic. It does not isolate the conflicting tax policies which surround superannuation generally. Nor does it consider the effect of subsidised employee schemes in conjunction with national superannuation, which is effectively an additional subsidy enabling many superannuitants to "double dip" the system.

D. Family Trusts

I wish to deal with family trusts by reference back to the Task Force's suggestion that we should permit partial income splitting between husband and wife. This suggestion is in my view simply a provision of a further structural inequity in an attempt to reduce the friction caused by those already there.

Because of the manner in which we tax, family trusts are one of the sources of the greatest tax inequalities in our system. The growth in their use has been spectacular. I have no doubt it is directly related to our tax system. The following figures are illustrative:

(a) By 31 March 1965, there were 6,500 trusts;

(b) By 31 March 1968, there were 20,000 trusts;

(c) By 31 March 1976, there were 56,500 trusts.

I am absolutely certain that the number has grown significantly since. My principal

argument is that the Act's treatment of trusts positively encourages their use. Once again, consider the implications of two examples I have used, in terms of horizontal equity.

Example one: the one person trust

Take the case of a young, single person who is self-employed or enjoys more than one source of income. Let us assume that person has an income, after all deductions, of $82,000 per annum, of which $40,000 is employment related and the balance comes from investment. On current scales the first $22,000 of taxable income is subject to marginal rates, the balance of $60,000 being subject to 60% flat rate.

Every single dollar of income which can be diverted through a family trust is preferred for tax purposes to the point at which a 60% rate of tax is assessed on trustee's income. Trustee's income can be accumulated by the trustee at the minimum rate of 35%. The first $20,000 of income derived by the trustee, which would have been derived by the taxpayer, thus enjoys a tax preference of 25%. This is so even if it is subsequently distributed to the same taxpayer after the relevant 6 month accumulation period has expired.

If the taxpayer subsequently marries and the spouse is not earning income, the trust benefits are further enhanced. The first $20,000 can be paid to that spouse, subject to an average tax rate on beneficiaries' income of 35%. The next $20,000 can be accumulated at a further rate of 35%, giving an overall tax margin of 25% on at least $40,000.

Example two: multiple persons trusts

If the same trust now provides for the taxpayer, spouse and, say, two children, the tax benefits are further increased. By diverting more income through the family trust, the family unit enjoys an enormous tax advantage. That advantage is the direct result of three structural considerations. The first is the recognition of family trusts for differential tax treatment. The second is that we tax income on an individual basis. The third is that all individuals are subject to a progressive rate structure.

It is difficult to conceive of a tax structure which contains a more effective recipe for income splitting. Yet, the Task Force reported:[11]

> As a result of changes made to the Income Tax Act in 1968 dealing specifically with the taxation of trusts and in 1974 dealing with tax avoidance in general, the attractiveness of family trusts solely for tax avoidance purposes has largely diminished.

On the basis of the arithmetic set out above, my response can only be that one cannot believe everything one reads.

11 Supra n.6, 53.

E. Summary

Each of the examples I have discussed has focused on the effect of tax preferences. The preferences result from legislative action or inaction. The farm-based incentives depend upon taxpayers being "tax motivated". The Task Force saw no objection to that in conceptual terms. The effect of that type of incentive has to be seen in its full perspective. Few can argue, for example, that kiwifruit in particular has not been an agricultural success story to date. On that basis or assumption, namely that the incentives have worked, few can take issue. But the point is that those incentives are provided for in a quite uncontrolled way in terms of budgeting for government expenditure. They are totally subversive of the tax base in terms of taxpayer equities.

Turning now to fringe benefits, the argument presented by the Task Force depends on notions which are entirely independent of perceptions of "tax avoidance", notwithstanding the language used by the Task Force to criticise the artificially narrow tax base which fringe benefits reflect. In my view, we should accept the Task Force's recommendation, regardless of whether fringe benefits are sought in order to avoid tax or for any other reason whatsoever. The reality of fringe benefits is that they are part and parcel of the remuneration package. They are income. The tax system's failure so to treat them is indefensible.

Equally clearly, I submit, the present treatment of trusts as income splitting devices for tax purposes cannot be justified while we tax individuals on their earnings. Income splitting through trusts is a tax preference. There is absolutely no doubt that the growth of trusts over the past fifteen years is dominated by tax inspired income splitting.

Of the examples I have chosen, I find the one person superannuation scheme situation described the most difficult. In contrast, the Task Force had a simple, "tax avoidance" oriented, approach. The difficulty is caused by the facts that, on the one hand we should not tolerate exactly the same individual deriving exempt income (at age 60) by the use of such a scheme, whereas such income arising from precisely the same source and set of transactions is taxable in any other circumstances. On the other hand, the people who are using such schemes are, in many cases, denied the same superannuation subsidies available to employees from the tax system.

The dilemma is resolved, in my view, by concentrating on what we are seeking to do with private superannuation schemes, as distinct from that provided by national superannuation. When looked at from that perspective, the solutions with respect to exemptions become much clearer. Superannuation can then be seen for what it is: another form of saving. Why should the tax system subsidise some savers and not all? As the Task Force itself recognised, the tax policy towards all forms of savings is untrammeled by discernible principle or cohesion.

The economic case for the incentives we have in our Act is not altogether clear. We have no way of measuring the effect because much of the government expenditure, through the tax system, is disguised. A form of tax expenditure budget would soon make the government account for this area. It may be that such incentives are extremely effective and efficient.

If that judgment is made, the further question is whether the tax system is the place to provide them. We know from experience that special preferences to a particular group in the community are examined closely by other taxpayers and their advisers. Export incentives are an obvious case, but farm incentives such as livestock standard values, bailments, and capital allowances are equally important. If we provide for them through the tax system, we have first to consider their effect in terms of taxpayer equities. Secondly, we have to consider the *Cridlands* of the world.

V. GENERAL AVOIDANCE LEGISLATION

In *Cridland's* case, the High Court of Australia commenced its judgment, rejecting the Federal Commissioner's reliance on the general avoidance provision, section 260, by saying:[12]

> Although the very restricted operation conceded to s. 260 by the course of judicial decision and the generality of the language in which the section is expressed stand in high contrast, the construction of the section is now settled. It is therefore a source of some surprise that it continues to be relied upon when its defects and deficiencies have been apparent for so long. More than 20 years ago Kitto J. said in *F.C.T.* v. *Newton* (1956) 96 C.L.R. 577, 596:
>
> > "Section 260 is a difficult provision, inherited from earlier legislation, and long overdue for reform by someone who will take the trouble to analyse his ideas and define his intentions with precision before putting pen to paper."
>
> This message, despite its clarity, seems not to have reached its intended destination.

In the New Zealand Court of Appeal, with reference to section 108 of the 1954 Act, McCarthy P. said in *Gerard* v. *C.I.R.*:[13]

> It cannot be given a literal application, for that would, the Commissioner has always agreed, result in the avoidance of transactions which were obviously not aimed at by the section.

The Court felt compelled to read down the language of section 108 so that, in broad terms, its application was limited to the alteration, for tax purposes, of existing family business structures. Of itself, such a restriction flies in the face of horizontal equity. Why should a taxpayer which changes its business arrangements to secure tax benefits be guilty of "tax avoidance" whereas a new business, with a new source untainted by previous activity, is not? The difference in treatment cannot be defended in terms of "avoidance" notions.

Since enactment in 1974, our new section 99 has yet to see the judicial light of day. Judging from his present statements, the Commissioner sees hope for revival of general anti-avoidance cases. For myself, I think many of the cases in contemplation may fail. The vices which the Commissioner is now confronting are inherent in the structure of the Act itself. They are structural inequities. No amount of section 99 type patchwork will close those; only a coherent tax policy can be effective to ensure that horizontal equity in the tax system is maintained.

12 Supra n.9, 172.

13 [1974] 2 N.Z.L.R. 279, 280.

Tax incentives are inherently motive oriented. The direction of anti-avoidance legislation against such motive oriented provisions is a nonsense. It forces the courts to read down the express language Parliament uses because it does not mean what it says. As soon as that process commences, the vices of uncertainty, selectivity and discretion are imported.

Tax planning and tax minimisation are facts of life. I am not arguing that "motive" should always be irrelevant for tax purposes; what I am saying is that avoidance legislation being applied to preferences is a contradiction in terms. For these reasons, I consider that section 99 fails to address the real essence of the choice principle. It is because I do not know how to address that principle or doctrine in a coherent fashion by general anti-avoidance provisions, that I have argued that we should first look to the choices presented. So long as the choices are presented, and provide tax preferences, section 99 cannot be effective.

VI. CONCLUSION

This paper attempts an almost purely negative analysis of our tax legislation. Its main argument is that that legislation lacks a coherent and consistent body of policy and principles. The starting place for a sound tax system is the recognition of the fact that people will try to minimise tax payable by them. Equally, we ought to frame our tax system around the proposition that paying tax should not be optional. On either basis, our Income Tax Act 1976 is a disgrace. The disgrace is that for some sections of the community, tax is an option. For some, tax is not only optional, but it also provides the opportunity to "double dip" by, for example, using income deductions to convert investments to untaxed capital gains.

I have attempted to single out some of the major structural inequities in our system. The ability to treat tax as optional through "fringe benefits" is unacceptable; for so long as we treat the individual as the taxable unit, income splitting through trusts or any other restricted form of tax preference is just as bad. My conclusion is that the New Zealand tax law is fundamentally flawed by:

(a) An inadequate tax base definition;

(b) The provision of incentives and preferences without regard to taxpayer equities;

(c) Attempts to focus on whether a transaction is "tax motivated" when the real question is whether the transaction itself should be taxed in a certain way.

I regret that the Task Force failed to focus its attention in this way, because its proposals are insufficient to cure the structural defects. To achieve real tax reform, we simply have to clean up our Act.