Too Confident: Section 33 of the Income Tax Act and Its (Mis)trust in Judicial Precedent

Jonathan Muk, *Singapore Management University*
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An analysis is presented of Comptroller of Income Tax v. AQQ, in which the Court of Appeal held that a transaction which has a main purpose of tax avoidance will be regarded as tax avoidance, preferred the Australian approach in interpreting Singapore’s anti-avoidance provision and appeared to have lowered the standard of review over the Comptroller. As the Australian approach is itself inconsistently applied, the author asserts that the Court might have been overly confident in its reliance on Australian case law.

1. Introduction

Tax avoidance is the structuring of transactions in legal forms that result in different tax treatment than other economically equivalent transactions, in a manner that is unacceptable to the tax authorities.1 To combat this, general anti-avoidance rules (GAARs) are used by tax authorities in several common law countries.2 However, persistent concerns regarding the over-application of such provisions remain, and courts have struggled to achieve a consistent balance between the interests of allowing genuine commercial transactions while preventing the use of creative corporate structures to avoid tax.

Singapore’s general anti-abuse rule is found in section 33 of the Income Tax Act (ITA).3 The relevant portions read as follows:

(1) Where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly:
(a) to alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;
(b) to relieve any person from any liability to pay tax or to make a return under this Act; or
(c) to reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act, the Comptroller may, without prejudice to such validity as it may otherwise have, vary the arrangement and make such adjustments as he considers appropriate, including the computation or recomputation of gains or profits, or the imposition of liability to tax, so as to counteract any tax advantage obtained or obtainable by that person from or under that arrangement.4

(3) This section shall not apply to:

\[\ldots\]

(b) any arrangement carried out for bona fide commercial reasons and had not as one of its main purposes the avoidance or reduction of tax.

2. Significance of Comptroller of Income Tax v. AQQ

Section 33 was inspired and modelled after section 260 of the Australian Income Tax Assessment Act, 1936 (Cth) (Aust) and section 99 of the New Zealand Income Tax Act, 1976 (NZ) (the New Zealand Income Tax Act).6 In the words of the then Minister for Finance of Singapore, Dr Richard Tsu Tau Hu (Dr Hu):

I think we have in the process of drafting this legislation studied the anti-avoidance provisions of a number of countries before we finalised our draft, including countries such as Hong Kong, Australia and New Zealand.

\[\ldots\]

The problem faced by countries with a substantial international business community and by financial centres is similar in that the schemes of tax avoidance are now becoming so sophisticated and complex that most of them go undetected. They include very subtle schemes of transfer pricing, multiple company transactions, all of which are so difficult to trace that we believe substantial amounts of revenue are lost.7

The amendment was due to a need to combat tax avoidance schemes that were becoming more complex and specific to clients’ needs, hence being difficult to detect.8 To allay concerns that various members of Parliament had over the uncertainty of the application of section 33,9 Dr Hu also expressed his intentions for safeguards to prevent the overapplication of section 33. These were to be found in the judicial interpretations of similar legislation in other countries, of which New Zealand and Australia were specifically mentioned.10

In connection with this, the Inland Revenue Department issued a letter on 20 January 1988 which was intended to provide public guidance on the application of section 33.11 The letter mentioned certain specific examples that would not be caught under section 33, but in the end reiterated its reliance on Australian and New Zealand decisions as safeguards against over-application of section 33. Despite

* Justices’ Law Clerk, Supreme Court of Singapore.

8. Singapore Parliamentary Debates, supra n. 7, at cols. 365-360; see also Yoong, Send & Timms, supra n. 1, at 45.30.
9. Yoong, Send & Timms, supra n. 1, at 45.33.
11. Yoong, Send & Timms, supra n. 1, at 45.32.
these reassurances, Australia and New Zealand have divergent approaches in the application of their general anti-avoidance rules, and there does not appear to be a convincing yardstick by which schemes and transactions are adjudged to have a main purpose of tax avoidance.

In Comptroller of Income Tax v. AQQ, the Court of Appeal was faced with the issue of how Singapore should apply section 33, and had to choose between the Australian and New Zealand approaches to applying section 33. In this regard, two key findings made by Sundaresh Menon CJ made are as follows:

– to come within the statutory exception to tax avoidance in section 33(3)(b), the main purpose of the transaction must not be tax avoidance; and
– the New Zealand approach to interpreting the general anti-avoidance rule vis-à-vis other tax provisions is to be preferred over the Australian approach.

In arriving at its decision, it is respectfully submitted that the Court of Appeal might have been too confident about (i) the reliability of past judicial decisions in determining what is the main purpose of the transaction and (ii) about the New Zealand approach in interpreting the status of the general anti-avoidance rule in relation to other specific tax provisions, as it relied heavily on Parliamentary intention (which is not always easily determined).

3. Facts

AQQ involved a corporate restructuring scheme coupled with a financing scheme. The context of the schemes was the pre-2003 imputation system for corporate tax. Under that system, franked dividends carrying tax credits were paid up to parent companies by subsidiaries because income tax had been paid on the net profits of those subsidiaries. This enabled the parent company, in this case AQQ, to set off the tax credits against its gross tax liability if the tax credits were equal to 22% or 20% of the tax that had been paid by AQQ on its profits.12

AQQ was incorporated as part of a corporate restructuring exercise in the B Group. Under the restructuring, it acquired several subsidiaries for SGD 75 million. Together with the above corporate restructuring scheme, a financing scheme for SGD 225 million was effected as set out in the above Figure.

One of the main consequences of the financing scheme was that significant interest payments were generated and were payable to N Bank. AQQ could then deduct these payments from its gross profits and reduce its tax liabilities, enabling it to set those tax liabilities off against the tax credits that came with the franked dividends. AQQ thus sought to deduct the interest expense from the dividend income and also sought to claim the tax credits to reduce its tax liability. Initially, this substantially reduced its tax liability through tax refunds from the Comptroller. However, the Comptroller later formed the view that this amounted to tax avoidance and exercised its powers to disregard both the dividend income and interest expense so as to recoup the tax refunds.

AQQ then appealed to the Income Tax Board of Review (the Board). However, its appeal was dismissed, with the Board taking the view that the arrangement constituted tax avoidance under section 33, as it was not carried out for bona fide commercial reasons but rather had a main objective of avoiding or reducing tax. Dissatisfied, AQQ appealed to the High Court and later to the Court of Appeal.

12. AQQ CA, at 17.
4. Court of Appeal Proceedings

In AQQ’s appeal, it asserted that the trial judge erred in finding that the financing arrangement amounted to an agreement to avoid tax under section 33(1). It submitted first that the scheme did not attract the operation of section 33 because there was no tax liability after setting off any applicable tax credits from the assessed sum of tax, and it was impossible to avoid a liability that did not ultimately exist once the tax credits had been set off. Section 33 was not intended to apply to a scheme that had the objective of extracting tax credits – as opposed to reducing a specific tax liability.

Next, AQQ argued that even if section 33 was engaged, the operation of section 33(3)(b) was also attracted, and thus fell within the statutory exception. The trial judge erred by considering the financing arrangement apart from the corporate restructuring and should not have inferred that the two were done with a view to ensure the restructuring was carried out in a tax efficient manner and that its main purpose was the avoidance or reduction of tax.

Lastly, AQQ submitted that even if section 33 were engaged, the Australian approach to interpreting the operation of section 33 vis-à-vis other specific tax provisions should preclude the operation of section 33 vis-à-vis other specific tax provisions. This approach necessitated the ascertainment of Parliamentary intention as to whether a specific tax provision was intended to exclude the operation of section 33 by firstly stating affirmatively the operation of section 33 against other specific tax provisions. Nevertheless, it is submitted that even with this approach, it is difficult to apply section 33 fairly and consistently because of deficiencies inherent in the Australian and New Zealand cases as to firstly what constitutes a main objective and, secondly, ascertaining Parliamentary intention.

Applying this approach, on AQQ’s first argument, the Court of Appeal found that while the scheme was designed to extract tax credits, the interest expense was not properly incurred and had the effect of reducing AQQ’s tax liability, therefore engaging section 33.

On the taxpayer’s second argument, the Court of Appeal held that the bona fide commercial reasons for a particular step in the arrangement should ordinarily be construed within the context of the entire economic and commercial reality of the arrangement. The Court was satisfied that the corporate restructuring and financing arrangement schemes were not commercial transactions under which tax avoidance or reduction was incidental to AQQ’s real object, and it was clear that its express intention was to obtain a tax benefit in the form of a reduction in its tax liability to secure the release of tax credits. Thus, one of its main objects was to reduce its tax liability for dividend income from its subsidiaries. Accordingly, AQQ did not fall within the statutory exception in section 33(3)(b).

On the taxpayer’s last argument, the Court agreed with the Comptroller and adopted the New Zealand scheme-and-purpose approach to interpreting section 33 vis-à-vis other specific tax provisions. This approach necessitated the ascertainment of Parliamentary intention as to whether a specific tax provision was intended to exclude the operation of section 33 by considering the scheme and purposes of the ITA as a whole and any specific tax provisions relied on by the taxpayer. It provided a conceptual methodology that enabled the Court to analyse tax policy and principle to determine whether a taxpayer is entitled to use a specific tax provision to show that section 33 should not apply.

5. A Clearer but More Difficult Path Moving Forward

It is submitted that AQQ has clarified the application of section 33 by firstly stating affirmatively the operation of the main tax avoidance limb in section 33(1) against the statutory exception in section 33(3)(b), and, secondly, the adoption of the scheme-and-purpose in construing section 33 against other specific tax provisions. Nevertheless, it is submitted that even with this approach, it is difficult to apply section 33 fairly and consistently because of deficiencies inherent in the Australian and New Zealand cases as to firstly what constitutes a main objective and, secondly, ascertaining Parliamentary intention.
5.1. Application of section 33(3)(b)

In AQQ the Court of Appeal affirmed the trial judge’s interpretation of ‘purpose’ as being concerned with the taxpayer’s subjective intentions of the end to be achieved in carrying out the transaction.\(^\text{27}\) It held that this was more in line with the tenor and intention of section 33(3)(b),\(^\text{28}\) which sought to prevent an overly inclusive application of section 33(1) that potentially could catch any arrangement that has an objective ascertainable purpose of reducing or avoiding tax. Thus, the two limbs in section 33(3)(b) were to be applied subjectively, as opposed to the objective application of section 33(1), to counteract the overapplication of section 33(1).

It is observed that the application of section 33(3)(b) was a highly fact-sensitive one. In particular, specific reference was made to (i) the public announcement by B Group on the Kuala Lumpur Stock Exchange that the fixed-rate notes were not intended to affect its consolidated borrowing position,\(^\text{29}\) (ii) the admission by its Chief Financial Officer (CFO) that there was no coincidence that B Group was able to purchase the fixed-rate notes on the same day because it had the money to buy back their bonds from internal funds\(^\text{30}\) and (iii) that there was no good explanation for the financing arrangement going through N Bank entities in two different jurisdictions.\(^\text{31}\) For these reasons, the Court held that the financial arrangement was not bona fide and had tax avoidance as one of its main purposes. Therefore, AQQ fell outside of section 33(3)(b).

Prima facie, the application of section 33(3)(b) does not appear to be contentious – the circuitous nature of the fund transfer arrangement entitling N Bank to merely a 0.01% spread was highly indicative of the intentions of B Group to avoid tax. However, others have observed that the task of distinguishing between which purpose is the main or incidental one is often a subjective exercise.\(^\text{32}\) Commentators have observed that Australian and New Zealand authorities are inconsistent (and, in many cases, resulted in split decisions) on this matter, such that it would be premature to state affirmatively whether tax avoidance would be a main purpose of a transaction.\(^\text{33}\) For instance a more borderline case could arise on the facts of Andermatt Investments Pte Ltd v. Comptroller of Income Tax.\(^\text{34}\) While that case concerned the application of section 14 of the ITA and the Stamp Duties Act (the SDA),\(^\text{35}\) the facts are relevant for the purposes of discussing tax avoidance.

In Andermatt Investments, Wan Holdings Pte Ltd (Wan Remaja) developed and owned a property in Jalan Remaja. The directors incorporated Andermatt Investments Pte Ltd, an investment holding company, to own and lease out the Jalan Remaja property, and it did so by buying the entire share capital of Wan Holdings (as opposed to the property itself). While it was not mentioned why the transaction was effected in such a manner,\(^\text{36}\) the Court found that there would be significant savings in stamp duty.\(^\text{37}\)

This was also the case in UOL Development (Novena) Pte Ltd v. Commissioner of Stamp Duties,\(^\text{38}\) which concerned the acquisition of 53 properties on an en bloc basis via 53 separate contracts to achieve savings in stamp duty. The Court held that there was no sound commercial basis for this arrangement and that it was a contrived one designed to reduce or avoid tax liability.\(^\text{39}\) Assuming that the transaction resulted in significant income tax savings and not stamp duties, would tax avoidance be a main purpose of the transaction under section 33 on the basis that it achieved little or no commercial value, as appears to be the case in UOL Development?\(^\text{40}\)

It is submitted that the distinction is difficult to draw because there was no authoritative test laid down so that taxpayers can know with sufficient certainty the line between tax avoidance and tax mitigation – a distinction drawn by Lord Templeman.\(^\text{41}\) The Court of Appeal commented that this distinction meant that conceptually, there were circumstances in which a reduction of tax liability was permitted, and there were circumstances where it would be barred by section 33.\(^\text{42}\) The Court went on to hold that AQQ had not incurred a real loan, as there was no economic cost to it.\(^\text{43}\) However, this then leads to the further question as to what is a real loan – would the ‘realness’ of the loan depend on the financial transaction seen in its entirety, as appears to be the case in AQQ, or would it depend on an analysis similar to the ‘economic burden’ approach in Peterson v. Commissioner of Inland Revenue?\(^\text{44}\) Such a distinction was criticized by Lord Hoffman as unhelpful and other cases and textbooks have also commented that it is unhelpful to introduce elements of moral judgment in making any such distinctions.\(^\text{45}\)

While Peterson was cited in AQQ, there was no explicit endorsement of the ‘economic burden’ test as the touch-
stone of tax avoidance. It was observed that a factor which the Court of Appeal considered was AQQ’s lack of justification for why the loan needed to be effected through N Bank entities in two jurisdictions.46 Could one of the factors in determining the “realness” of a loan also be whether the loan was taken in the least convoluted manner, as appears to be the case in Peate v. Commissioner of Taxation?47 Is Peate then consistent with Mobil Oil Australia Ltd v. Commissioner of Taxation,48 in which a complicated loan and repayment financing arrangement which could have been achieved with a simpler arrangement but with higher tax obligations, was allowed?49 Similarly, in Europa Oil (NZ) Ltd v. Commissioner of Inland Revenue, a similar convoluted arrangement for oil sales which could also be achieved in a less convoluted manner, was held not to be tax avoidance.50 Such decisions might seem surprising, but there are indeed many of them, and they are the basis on which the safeguards against the overapplication of section 33 is to be built.

The distinctions and changes in positions taken in and between the cases have been described as “logic defying”,51 and the selected examples testify thereto. It is suggested that with the position still unclear and the unconvincing explanation given by the “economic burden” and “least convoluted transaction” approach, Singapore courts should approach Australian and New Zealand cases with caution in applying section 33.

In summary, there does not appear as yet to be any clear guidelines for the determination of what is a main or incidental purpose. Perhaps there cannot be one and it is impossible for a meaningful dichotomy to be achieved between a transaction with a bona fide commercial purpose and the main purpose of tax avoidance.52 After all, would no tax savings be part and parcel of a genuine commercial decision?53 If this is true, then it is submitted that on the American Legal Realist’s “bad-man view of the law”,54 this, without more, would leave the taxpayer at the mercy of a judge’s idiosyncrasies and – more practically – reduces the confidence that businesses and taxpayers have as regards the certainty of the application of section 33(3)(b).55

5.2. Adoption of the scheme-and-purpose approach

The next significant development is the express adoption of the New Zealand scheme-and-purpose approach over the Australian choice approach in considering section 33(3)(b) against other more specific provisions in the ITA.56 The trial judge was overruled, and the Court held that section 33(3)(b) was not the only legislative safeguard against the overapplication of section 33(1) – the approach was inconsistent with Parliament’s intention that Australian and New Zealand case law would adequately safeguard the right of taxpayers to rely on these incentives.57 Moreover, adopting the scheme-and-purpose approach safeguard is also significant because section 33 does not expressly allow the application of tax incentive schemes in the ITA.58 The scheme-and-purpose approach would protect the taxpayer’s right to specific tax incentives under the ITA.

This point is significant because the Court of Appeal reasserted its authority in protecting the rights of taxpayers to use tax incentives on the basis of Parliament’s intention when enacting section 33. The Court relied on the majority’s approach in Ben Nevis Forestry Ventures Limited et al. v. Commissioner of Inland Revenue59 because it provided a conceptual methodology that combined tax policy and principle in answering the question as to whether a taxpayer was entitled to use a specific provision in the ITA in reducing tax liability. The Australian choice principle was found to place specific provisions above the general anti-avoidance provision, rendering the latter nearly useless.60 Moreover, the choice principle had become obsolete in Australia.61

On that basis, the Court held that AQQ could not use sections 10(1)(d), 14(1)(a)(i), 44, 44A and 46 (sections in the Income Tax Act pertaining to deducting interest payments) to deduct interest expense on its chargeable income.62 While the financing arrangement fulfilled the letter of the law, it did not fulfil its spirit. The deductions were not properly made, especially where no economic cost was incurred by the B Group.63 That was considered not to be Parliament’s intention.

46. AQQ CA, at 87.
47. NZ: PC, 1967, 1 AC 308.
49. This observation was also made by Michael Littlewood in Littlewood, supra n. 33, at 191.
50. Littlewood, supra n. 33, at 196.
51. H. Telfer, General Anti-Tax Avoidance Provisions: The Singapore Position and Australasian Comparisons, 32 Malaya L. R. 311 (1990) (General Anti-Tax Avoidance Provisions: The Singapore Position and Australasian Comparisons), at 318. Telfer mentions the ‘safeguards’ that the Singapore Parliament sought to rely on. He then highlights the enormous changes undergone by Australian and New Zealand interpretations of tax avoidance over the years. In New Zealand, there were decisions initially which entitled taxpayers to split income until NZ: CA, 1967, Ehringer v. CIR, NZLR 161 held that it was tax avoidance. This was later reversed by NZ: CA, 1974, CIR v. Gerard, 1 NZTC 61, at 151; NZ: CA, 1974, Louder v. CIR, 1 NZTC 61, at 132. Similar shifts were seen in the Australian position as well.
52. This view finds support from Littlewood, supra n. 33, at 200.
53. J. Freeman, Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle, 4 Brit. Tax Rev. 332 (2004), at 345. While Freeman supports the enactment of a general anti-tax avoidance provision, she makes the very valid point that many taxpayers realize that their engineered schemes may be entered into solely for tax purposes and would seem to be perfectly natural and reasonable commercial activity to them. See also N. Orow, Structured Finance and the Operation of General Anti-Avoidance Rules, 4 Brit. Tax Rev. 410 (2004), at 410, 425 (observing that the notion of purpose is open-ended and requires a distinction to be made where there is no conceptual or real difference). In Canada, the United States and Australia, it is generally accepted that there is no necessary dichotomy between commercial and tax avoidance purposes.
55. Orow, supra n. 53, at 411.
56. AQQ CA, at 106.
57. AQQ CA, at 95 (referring to Richard Tsu Tau Hu’s speech before Parliament, expressly contemplating that Australian and New Zealand cases be used as adequate safeguards through purposeful interpretation).
58. AQQ CA, at 95.
60. AQQ CA, at 89.
62. AQQ CA, at 113.
63. Id.
The adoption of the New Zealand scheme-and-purpose approach therefore makes good sense, especially in light of its greatest similarity with the corresponding New Zealand provision and the above-mentioned consequences of adopting the “choice” principle. However, two ensuing problems arise.

5.2.1. Difficulty in determining Parliament’s intention where tax provisions are concerned

The first difficulty is that lawyers and accountants would then have to deduce Parliamentary intention in using a specific tax provision. This is not always an easy task, and was in fact acknowledged by the Court of Appeal in its decision. It has also been commented that:

[i]t is difficult to discern any coherent policy in a specific provision, regime or indeed the Income Tax Act as a whole. This problem is exacerbated where different tax regimes are applied to a complex set of composite commercial arrangements.

Such a difficulty is exacerbated by the very nature of tax law, as tax obligations are a creature of statute and the considerations giving rise to these obligations are multi-faceted. Indeed, such a difficulty could arise in relation to income tax treaties. In section 49 of the ITA, the Minister is empowered to declare income tax treaties with other countries valid. If this is done, the ITA provisions will cease to be of effect, including section 33.

Should transactions be structured with an income tax treaty country as an intermediary, section 33 appears to be inapplicable. While income tax treaties do contain provisions for a mutual agreement procedure, under which tax avoidance issues can be resolved with the cooperation of the authorities of the relevant contracting state, this power is limited to the extent that the authorities in the relevant contracting state cooperate. The inapplicability of section 33 to prevent tax avoidance in a world where tax avoidance schemes are becoming increasingly complex and are becoming ‘tailor-made’ to suit specific clients would therefore drastically reduce its effectiveness. It is questionable whether the above analysis is reflective of Parliamentary intention.

Furthermore, there was no express statement from Parliament as to the operation of section 33 against other tax provisions when it was enacted, and the effect of section 33 vis-à-vis the existing provisions has been questioned. This question was seemingly answered in Commissioner of Inland Revenue v. Challenge Corporation Ltd. In Challenge, the taxpayer had bought all the shares in a loss-making company, Perth, to set off its own income against the losses and reduce its own tax liability. The Commissioner sought to rely on the general anti-avoidance rule found in section 99 of the New Zealand Income Tax Act to deny the taxpayer the benefit of such an arrangement. The Commissioner’s position was upheld.

It was contended by the taxpayer that the wording of section 191 of the New Zealand Income Tax Act allowed a loss incurred by a company within a group of companies to be set off against the assessable income of another company in the group, and therefore section 99 of the same Act would not apply thereto. However, Lord Templeman relied on legislative history in dealing with this argument, and held that an express exclusion of section 191 of the New Zealand Income Tax Act would be needed for section 99 of the same Act to be excluded.

On the above basis, Wee Liang Tan commented that section 33 subjected all other antecedent provisions in the ITA to it. This sounds correct, but the difficulty in ascertaining Parliamentary intention can be seen in the dissent of Lord Oliver, where he took the view that section 99 of the New Zealand Income Tax Act did not apply to provisions which entitled taxpayers to structure their affairs and claim deductions. An implied limitation was recognized where its operation was subject to the other provisions of the Act. Thus, the ascertainment of Parliamentary intention is not easy and could result in future inconsistencies, especially with reference to Australian and New Zealand case law.

5.2.2. Arbitrariness of the scheme-and-purpose approach

Besides the difficulty in assessing Parliamentary intention, the application of the scheme-and-purpose approach might also be arbitrary. This potential outcome is illustrated in the Privy Council’s divergent findings in Inland Revenue Commission v. Europa Oil (NZ) Ltd (the first Europa case) and Europa (NZ) Oil Ltd v. Commissioner of Inland Revenue (second Europa case).

Both cases concerned the sale of oil in a circuitous manner via three companies. In the first Europa case, Pan Eastern was incorporated, with Gulf (a firm providing Middle Eastern oil) and Europa as equal owners. Gulf sold oil to Pan Eastern for Europa’s petrol production. Pan Eastern paid Gulf to refine the oil into petrol, which was then sold back to Gulf. Although these were paper transactions, Pan Eastern earned a profit which was distributed to Europa which distribution was tax exempt at that time.

The Commissioner found that Europa had sought to avoid tax, and the Commissioner’s determination was upheld.

65. AQQ CA, at 109.
69. Telfer, supra n. 51, at 320.
70. See e.g. Agreement between the Government of the Republic of Singapore and the Government of the Republic of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (19 Aug. 1995), art. 25 (entered into force 7 June 1996), Treaties IBFD.
71. Singapore Parliamentary Debates, supra n. 7, at cols. 358-359.
72. Tan, supra n. 63, at 101.
73. NZ PC, 1987, 1 AC 155, cited in Tan, supra n. 63 at 101.
74. Challenge, at 165.
75. Tan, supra n. 63, at 101.
76. Challenge, at 172.
77. Challenge, at 171.
78. NZ PC, 1971, AC 760.
79. NZ PC, 1976, NZLR 546.
by the Privy Council in a split 3-2 decision, where it was held that section 111 of the Land and Income Tax Act, 1954 (New Zealand) permitted the Commissioner to limit the deductibility of Europa’s expenditure to Pan Eastern. On this basis, it was unnecessary to consider the application of section 108 of the Land and Income Tax Act, 1954 (the predecessor to section 99 of the Income Tax Act, 1979 (New Zealand)).

In the second Europa case, the arrangements were slightly changed. Europa did not acquire petrol directly from Gulf, but from an intermediary, Europa Refining, which bought the petrol from Gulf and then sold it to Europa. This was so that there was no contractual relationship between Europa’s payments and the dividends received later from Pan Eastern. The Commissioner argued that the incorporation of Europa Refining should make no difference in light of the earlier finding of tax avoidance.

In this later decision, the Privy Council found for Europa in a 4-1 decision. Here, it was held that the expenditure was deductible in full and the general anti-avoidance rule did not apply – it did not operate to strike down ordinary business or commercial transactions. As Europa’s main object was to purchase petrol, the manner of its transactions did not amount to tax avoidance.

Based on the above, one can observe the difficulty in ascertaining Parliamentary intention. Both decisions involved split courts, and the acceptance of the transaction in the second Europa case as “ordinary” is one which seems rather contrived.80 Indeed, section 33 has been criticized as making things uncertain because of the inconsistency in Australian and New Zealand decisions.81 Therefore, while the scheme-and-purpose approach is preferable to the choice approach, ipso facto, it is not enough and hinges very much on the judge’s ability to read section 33 in its correct light vis-à-vis other tax provisions. Given the piecemeal approach and changing tax policies in the development of the ITA, together with seemingly inconsistent Australian and New Zealand case law, it is humbly submitted that ascertaining Parliamentary intention is no mean feat and could lead to perceived inconsistent decisions, as is the case in Australia and New Zealand.

5.3. Lower standard of review over the Comptroller’s findings

The last significant point regarding AQQ is that the Court of Appeal seemingly reduced the level of scrutiny that the Court could undertake over the Comptroller’s findings. Under section 33(1), the Comptroller is empowered to “disregard or vary the arrangement and make such adjustments as he considers appropriate […] so as to counteract any tax advantage.” The Court held that the standard of review over the Comptroller’s findings did not mean a full and unconstrained consideration of the merits, and thus did not warrant the substitution by a judge of his views over those of the Comptroller.82 The Comptroller was entitled to act fairly and reasonably, and was entitled to apply any practical yardsticks that may enable it to practically exercise this discretionary power.83

As a result, the in-depth assessment by the trial judge of the Comptroller’s treatment of the financing arrangement was overturned by the Court, and the Comptroller’s findings were left undisturbed. This constitutes a potential source of worry – at least when the Comptroller overapplies section 33(1).

The powers of the Comptroller under section 33 have been acknowledged to be broad.84 AQQ held that the Comptroller is not bound to exercise its power in any particular way, but identified three practical yardsticks by which the Comptroller could exercise its powers.85 Quoting Menon CJ, these are:

- the tax liability that arises from the inclusion of income sought to be excluded or the disallowance of a deduction sought to be claimed;
- the hypothetical tax liability on the economic and commercial basis of what would likely have happened if the taxpayer had not entered into the arrangement constituting tax avoidance; and
- the tax liability if the arrangement simply had not taken place.

The Comptroller was entitled to take a holistic and broad view of the transaction instead of counteracting each advantage specifically.86 As long as the Comptroller acted fairly and reasonably, the Court would not disturb the findings unless they were arbitrary, unreasonable or beyond the Comptroller’s powers.

First, the fair-and-reasonable standard means that the Comptroller’s discretion is less likely to be disturbed. Yet, it has been recognized that – in theory – this discretionary power means that the Comptroller can increase the income of taxpayers to whatever it subjectively regards as appropriate once a tax avoidance arrangement is found, even if the taxpayer is merely indirectly affected by that arrangement.87

There is thus a concern, as it remains unclear as to what is the exact standard that the Comptroller is held to – the Court of Appeal reserved the use of the phrase Wednesbury unreasonableness in ascertaining this standard.88 Yet cited JD Ltd v. Comptroller of Income Tax89 for its proposition that the Comptroller was entitled to act in good faith and in the interests of good administration.90 The Court also cited Woo Bih Li J in Ling Uk Choon et al. v. Public Accountants Board91 for the proposition that while the Court was not confined to just determining whether the rules of natural justice had been observed, a full rehearing on the merits might not be the norm.

80. Littlewood, supra n. 33, at 196.
81. Tan, supra n. 63, at 106.
82. AQQ CA, at 119.
83. AQQ CA, at 127.
84. Tan, supra n. 63, at 83.
85. AQQ CA, at 126-127.
86. AQQ CA, at 127.
87. Telfer, supra n. 51, at 316.
88. AQQ CA, at 121.
89. SG: CA, 2006, 1 SLR(R) 484.
90. AQQ CA, at 118.
91. SG: HC, 2004, 3 SLR(R) 517.
However, *JD Ltd.* concerned the Comptroller’s use of a particular formula in determining whether interest expense was deductible against dividend income generated, and the Court judged the validity of these expenses by the standard of *Wednesbury* unreasonableness. As such, it is unclear whether a new standard is being prescribed by the Court of Appeal. If there is, it is questionable whether such a standard can ensure that the Comptroller acts “according to the rules of reason and justice, not according to private opinion; according to law and not humour.”

Next, the fair-and-reasonable standard also assumes that there is a satisfactory standard for determining what is tax avoidance as opposed to normal commercial transactions – how would the Court otherwise decide that the Comptroller had acted in an arbitrary or unreasonable manner? There are no current guidelines to delineate the two, and therefore this appears to be of concern, given the inconsistency of the Australian and New Zealand decisions that appear to be the basis for safeguards against the wrongful application of section 33.

Using *AQQ* as an illustration, the trial judge undertook a detailed examination of whether the Comptroller erroneously disregarded the tax credits attached to the franked dividends together with the artificial generation of interest, and held that while the Comptroller had acted fairly and reasonably in disregarding the interest expense, it did not in disregarding the tax credits. However, the Court of Appeal disagreed with this approach, preferring the holistic and broad approach in assessing the Comptroller’s fairness and reasonableness. In the absence of proper guidance as to what constitutes tax avoidance, a more detailed level of scrutiny might be preferred to ensure the fairness, reasonableness and consistency of the Comptroller’s findings.

### 6. Conclusion

*AQQ* has significantly clarified the application of section 33. However, many questions remain. Among some of the more significant of these are (i) what is the touchstone by which tax avoidance is said to be a main objective of a transaction, (ii) how will Parliamentary intention be ascertained under the New Zealand scheme-and-purpose approach and (iii) how can there be adequate safeguards against the arbitrary application of section 33.

Beyond *AQQ*, section 33 could benefit from better drafting so that only transactions which are effected with the sole purpose of reducing or avoiding tax will be disregarded. This is certainly a position worth exploring in light of the point that Professor Judith Freeman makes that morality can play only a limited role in defining taxpayer responsibility and must be backed up by law, albeit in the context of supporting the enactment of a general anti-avoidance rule in the United Kingdom. Address on the above-mentioned questions is thus needed.

Nevertheless, *AQQ* is still a decision to be lauded for its definitive take on implementing section 33. This will greatly aid lawyers and accountants in advising clients on their tax positions, even if, in the author’s opinion, the reliance on Australian and New Zealand cases remains overly positive.

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92. *JD Ltd.*, at 50.
94. Orow, *supra* n. 53, at 421 (commenting that the notion of tax advantage presupposes the existence of some benchmark or standard by reference to which tax liability that should have arisen could be determined). This implies a comparison between tax consequences of the actual arrangement with other hypothetical arrangements which does not exist in fact but would have resulted in higher tax liability.
95. Telfer, *supra* n. 51, at 203. See also Orow, *supra* n. 53, at 411 (features of tax-avoiding transactions include (i) the extent to which the transaction was influenced or actuated by the proscribed taxation purpose, (ii) whether the transaction was artificial and/or contrived, (iii) whether the transaction sought to exploit statutory loopholes or weaknesses and (iv) whether the transaction lacked economic reality).
96. *AQQ CA*, at 127.
97. In *JD Ltd.*, at 50, the Court of Appeal upheld the Comptroller’s use of a “logical mathematical method” in considering the deductibility of interest expense. In the present author’s opinion, in *AQQ*, the Comptroller’s disregard of tax credits does not seem to cohere with such a standard.
98. Hee, *supra* n. 32, at 69.