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# A conceptual challenge: the “common voting interests” and “control by any other means” tests for associated persons



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By Emma Marr and Matthew Scoltock

*Concepts 124 Ltd v Commissioner of Inland Revenue*<sup>1</sup> is a curious judgment that potentially has alarming implications for entities owned by the same corporate trustee. The High Court has effectively found that two companies owned by the same corporate shareholder – acting as the trustee of two different and wholly unrelated trusts – can be “associated persons” for GST purposes on the basis of common voting interests. Given the long reach of the land taxing provisions to associated (“tainted”) entities, without remedial legislative intervention the judgment could radically impact on the tax treatment of entities currently holding land on capital account.

The Court also found association on the alternative ground of “control by any other means whatsoever”, but in doing so does not appear to have considered a line of relevant case law authority, and has not provided clear guidance on precisely what that test encompasses.

## The facts

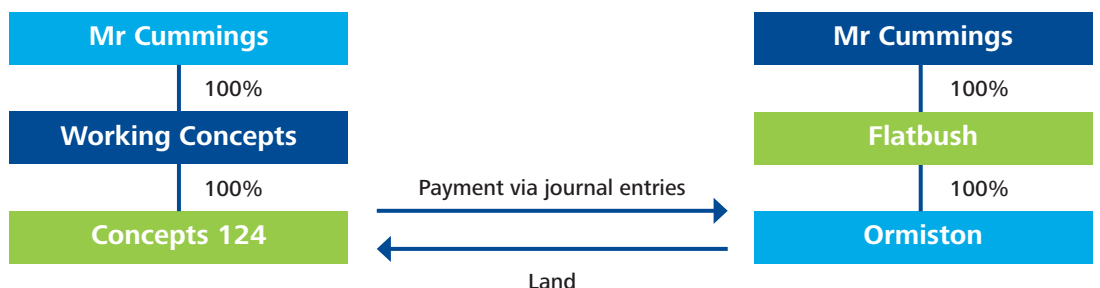
The facts involved a Mr Cummings who, through his company Concepts 124 Ltd (Concepts 124), purchased a block of land from Ormiston Residential Ltd (Ormiston)

in 2008. The purchase price of \$8,034,750, which was nearly 10-fold more than Ormiston had paid for the same land four years earlier, was payable in 18 instalments. Between July 2008 and October 2009, 17 instalments of the purchase price were paid by Concepts 124 via journal entries, amounting to \$7,191,000. As Ormiston was not GST registered, it had no liability to account for GST in respect of the instalments paid by Concepts 124. Concepts 124, however, was GST registered. An asymmetry therefore arose, as Concepts 124 was entitled to claim GST input credits equal to one-ninth of the purchase price paid at that point, or \$799,000.

A diagram depicting the ownership structure in respect of Concepts 124 and Ormiston is set out below. On the face of it, Mr Cummings owned 100% of both Concepts 124 and Ormiston via intermediate holdings companies, Working Concepts Ltd and Flatbush Holdings Ltd (Flatbush). Mr Cummings was the sole director of all of the corporate entities.

Flatbush held the shares in Ormiston as to 75% on trust for the Flatbush Holdings Trust – of which Mr Cummings had the sole power of appointment and removal of all trustees – and 25% for Mr Cummings personally.

<sup>1</sup>[2014] NZHC 2140.





### The issue and applicable legislative framework

The key question was whether Concepts 124 and Ormiston were associated persons, which would have limited the GST input credit claimable by Concepts 124 to the lowest of:

- a. The GST component of the original cost of the block of land to Ormiston (which was \$94,111.12);
- b. One-ninth of the purchase price payable by Concepts 124 to Ormiston; or
- c. One-ninth of the open market value of the block of land.

Based on the facts of the case, Justice Clifford considered that Concepts 124 and Ormiston could only have been associated if a person or group of people:

- a. held at least 50% of the voting interests in both companies (the voting interests test); or
- b. had control of both companies “by any other means whatsoever”.

### The voting interests test

The Commissioner of Inland Revenue (Commissioner) and Concepts 124 agreed that – as had been widely accepted up to that point in time – there was no commonality of

voting interests where shares in different companies were held by the same person but in separate capacities. While ultimate ownership of both Concepts 124 and Ormiston vested in Mr Cummings as a matter of legal title, the shares in Ormiston were held by Flatbush in a trustee capacity. As ownership for tax purposes of Ormiston could only be traced through to Mr Cummings as to 25% given the distinct personal and trustee capacities in which Flatbush held the shares in Ormiston, the Commissioner and Concepts 124 had agreed that the voting interests test was not satisfied. This is consistent with the Commissioner’s published view on whether, in the context of the “associated persons” test in the GST legislation, a person acting in their capacity as a trustee of a trust is acting in a different capacity from when they are acting in their personal capacity<sup>2</sup>.

Interestingly, Justice Clifford disagreed, and took an approach at odds with this. After traversing the legislative history in some detail, Justice Clifford concluded that common legal ownership of different companies is sufficient on its own to establish association on the basis of common voting interests. His Honour concluded that “where...control is being determined, there is no reason not to attribute control to the (personal) shareholders of a company that holds shares in another company on trust”. Justice Clifford was ultimately of the view that a distinction based on separate personal and trustee capacities was neither rational nor grounded in the legislative history. >>

<sup>2</sup> Refer to “QB 07/03 Trustees in the context of the Goods and Services Tax Act 1985: does a separate trustee capacity and personal capacity exist and do separate trustee capacities exist for trustees of multiple trusts?”, in which the Commissioner states that: “Case law also recognises that a person’s capacity as a trustee of a particular trust is separate from their capacity as a trustee of any other trust (*Fraser v Murdoch* (1880-81) LR 6 App Cas 855; *Commissioner of Taxes v Trustees of Joseph (deceased)* (1908) 2 NZLR 1085; 10 GLR 556; Case 98 (1951) 1 CTBR (NS) 423).”



Accordingly, Justice Clifford found that Concepts 124 and Ormiston were associated persons for GST purposes, meaning that Concepts 124's GST input credit was limited as described above.

### Our thoughts

It is questionable whether this outcome was driven by the fact that, in reality, Mr Cummings was "running the show". When viewed in that light, a conclusion that Concepts 124 could nevertheless claim GST input credits based on a purchase price that was significantly higher than Ormiston's original acquisition cost, and that was effected via journal entries, perhaps did not seem appropriate. In addition, a finding that Concepts 124 and Ormiston were not associated due to an ownership structure involving distinct personal and trustee shareholder capacities may have set a precedent for similar claims by other taxpayers, with equally (or more) material fiscal consequences.

But here's the problem. Disregarding personal and trustee capacities – that is, effectively saying that the only question is what name is on the share register – would mean that every company whose shares are held by the same corporate trustee would, strictly speaking, be associated. So two companies beneficially owned by people who have never met, have nothing to do

with each other and who are linked solely because of the identity of a common corporate trustee (which will clearly hold both companies in distinct, wholly unrelated capacities) would be associated on that basis. What if, for example, one of those companies happens to be a property developer, while the other invests in property on capital account for long-term rental yield? Any gains derived by the property investor could, by virtue of its association with the property developer, be treated as taxable due to the tainting rules.

So, what's the fix? *Concepts 124* is, after all, the law. What's more, we understand that no appeal from the High Court's judgment has been filed. So the only real way to correct what must be viewed as an anomalous outcome is through a carefully drafted remedial legislative amendment that draws an appropriate distinction between personal and trustee capacities when ascertaining association. Given the potential outcome where no association is established on black letter law grounds (refer above, in a GST input credit context), perhaps consideration will need to be given to a targeted specific anti-avoidance rule or appropriate published guidance regarding the application of the general anti-avoidance rule in an associated persons context (although it is noted that the Commissioner's Interpretation Statement on section BG 1 of the Income Tax Act 2007 already addresses this to some extent).

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## Little guidance on the meaning of “control by any other means whatsoever” can be gleaned from the section of Justice Clifford’s judgment dealing with this test.

The outcome certainly warrants urgent attention from policy officials to re-establish certainty in this area and identify an appropriate remedial solution.

### Control by any other means whatsoever

Perhaps in case an appeal eventuated, Justice Clifford also found that Mr Cummings had control of both Concepts 124 and Ormiston by “any other means whatsoever”. Unfortunately, his Honour offered little reasoning to support his conclusion. Justice Clifford stated that:

*“I do not think that the section requires the “any other means whatsoever” to be the same means for each of the two companies in question. By my assessment, that would be an overly strained interpretation of the provision, and one not required to give it efficacy. The “any other means whatsoever” by which Mr Cummings controlled each of Concepts 124 and Ormiston is, in this context, the combination of Mr Cummings’ voting interests in Concepts 124 and of his ownership and control of Flatbush, and his power of appointment and removal of trustees under the FBH [Flatbush Holdings] Trust Deed.”*

### Our thoughts

Little guidance on the meaning of “control by any other means whatsoever” can be gleaned from the section of Justice Clifford’s judgment dealing with this test. As an initial observation, his Honour’s conclusion appears to be contrary to his statement earlier in the judgment, where he found that:

*“...if I had agreed with the approach taken by the Commissioner, I would also have agreed with Concepts 124 that, here, the control the Commissioner pointed to, based on share ownership, would not be a means of control “by any other means whatsoever”.*

If control based on share ownership should not properly be regarded as “any other means” for the purposes of the test, then it is hard to understand why a combination of factors including voting interests could have been relevant to Justice Clifford’s finding that Mr Cummings controlled both Concepts 124 and Ormiston by any “other” means whatsoever.

Unfortunately, Justice Clifford’s reasoning is unlikely to provide meaningful guidance in relation to this test of association. Perhaps given the context in which this alternative finding was made, his Honour’s judgment does not set out any clear “test” or “rule” as to how “control by any other means whatsoever” should ordinarily be ascertained. His analysis does appear limited to *Concepts 124*’s particular facts, and does not clearly articulate the exact “combination” of factors that would necessarily constitute “any other means”.

His Honour’s approach is also inconsistent with – and does not appear to appropriately take into account – well-established and significantly persuasive case law authority that had settled the meaning of control by any other means in this context, such as *British American Tobacco Company Ltd v IRC* [1943] AC 335 (HL). That meaning has been accepted by the Commissioner (*Tax Information Bulletin* Vol. 2 No. 3, Appendix D (October 1990)), and the Commissioner’s policy officials have stated that that case law provides the appropriate guidance (Officials’ Report on the Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill).

The “control by any other means whatsoever” test arguably therefore remains somewhat elusive in terms of how it should be considered or applied on a more generic basis, and where facts are not identical to those in *Concepts 124*.