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CIRCUMVENTING THE CONTROLLED FOREIGN COMPANY AND FOREIGN INVESTMENT FUND REGIMES IN AUSTRALIA AND NEW ZEALAND

by Philip B. Gurney

ABSTRACT: This paper reviews to what extent it has proven possible for taxpayers in Australia and New Zealand to circumvent the controlled foreign company ("CFC") and foreign investment fund ("FIF") taxation regimes. It identifies whether legitimate tax avoidance has been a realistic possibility in practice – perhaps using exotic legal entities in countries as geographically diverse as Liechtenstein and Samoa; or whether non-disclosure of offshore interests amounting to tax evasion has become more the norm under the self-assessment rules that now operate for taxpayers in each country. It considers various applicable sections in the Australian Income Tax Assessment Act 1936 (Cth) and the New Zealand Income Tax Act 1994 (N.Z); and in particular it examines the effectiveness of specific anti-avoidance rules in both jurisdictions as well as the impact of the general anti-avoidance provisions.

I INTRODUCTION

In the period from 1988 to 1993 both Australia and New Zealand legislated new tax rules aimed at taxing the income of their resident taxpayers derived from holding controlling interests in offshore companies ("controlled foreign companies") or non-controlling interests in various offshore investment vehicles ("foreign investment funds"). Essentially, a current year tax liability would thenceforth arise where the relevant taxable interest was found to exist, regardless of whether any dividend or remittance of income was actually received by the taxpayer from the offshore entity in the year in question. Complex provisions were introduced into the tax law of both countries to implement this new and draconian tax regime.

The purpose of this article is to review to what extent it has proven possible for taxpayers in Australia and New Zealand to circumvent the controlled foreign company ("CFC") and foreign investment fund ("FIF") taxation regimes. Likewise, the article seeks to identify whether legitimate tax avoidance has been a realistic possibility in practice or whether non-disclosure of offshore interests amounting to tax evasion has become the norm under the self-assessment rules that now operate in each country. As a general matter, research into tax avoidance methods often proves difficult as taxpayers and their advisors are likely to keep their actions highly confidential. Nevertheless, this author has found it possible to comment in this article on two distinct and unusual types of legal entities that are thought to assist in circumventing the CFC and FIF regimes. One of these is found in Liechtenstein, a principality in Europe; the other in Samoa, a sovereign nation in the South Pacific region. In the case of Samoa, reference is made to a particular website where any taxpayer can at present find candid advice on how to use a particular type of Samoan company to defeat the application of the Australian CFC rules.[1]

Moreover, it should be noted that under the Australian "accruals" taxation system, there are also "transferor trust" provisions aimed at taxing Australian residents on certain income. This includes, for example, income derived by non-resident discretionary trusts where the Australian resident has at any time transferred property or services to the trust. The New Zealand tax legislation does not contain identical taxation rules, but instead its "settlor" tax regime means that a New Zealand tax liability will apply to the trustee income of a trust having a non-resident trustee when a New Zealand resident settlor of the trust is found to exist.[2] It is beyond the scope of this article to take into account tax avoidance actions aimed at circumventing "transferor" or other trust taxation regimes.

II BACKGROUND AND NATURE OF CFC's AND FIF's

The definition of what type of company will be considered a CFC is similar under both the Australian legislation (Income Tax Assessment Act 1936 (Cth)) and the New Zealand law (Income Tax Act 1994). In summary, a CFC will arise under the law of both countries where one of the following control tests is satisfied:[3]

(a) a group of five or fewer residents have a controlling interest of over 50% in the foreign company;
(b) a single resident holds a controlling interest in the foreign company of at least 40% (but this is a presumption of control, and can be rebutted); or
(c) a group of five or fewer residents have actual control of the foreign company (e.g., the power to control the exercise of shareholder decision-making rights), regardless of their ownership percentages in the foreign company.

[1] International Company Services Limited *Samoa Creditor Controlled International Company* <http://www.icsl.com/pages/jurisdic/samcred.html> (at 10 December 2004).
[2] Commerce Clearing House *New Zealand Master Tax Guide 2004* (CCH, Auckland, 2004) para 25-010.
[3] Income Tax Assessment Act 1936 (Cth) s 340 and Income Tax Act 1994 s CG4(1).

Both countries allow an exemption from the CFC regime for companies that are resident in certain listed comparable tax jurisdictions – including Canada, Germany, Japan, the United Kingdom, the USA, and each other.[4] However, even in these instances a current year tax liability can arise under the CFC rules if the foreign company has benefited from a specified tax concession (or "tax preference" in the New Zealand terminology) in one of the listed countries.

As between Australia and New Zealand, a significant difference in the application of the CFC rules arises from the "active income" test applied under Australian law. This test provides an exemption from the accruals tax system where the foreign company in question derives at least 95 percent of its gross turnover from active income; or put another way, derives less than five percent of its gross turnover in the form of "tainted income". The latter term comprises passive income (e.g., dividends, rent and royalties) as well as tainted sales or services income that may arise, for instance, from transactions with an associate.[5] Under the New Zealand CFC regime, there is no such exemption for foreign companies that derive primarily active income – although such an exemption has been proposed and is under consideration. At least in this respect, New Zealand retains a purer system of tax law in relation to controlled foreign company legislation.

As regards FIF's, there are some differences in definition as between Australia and New Zealand. In the case of the former, an interest in a FIF is either a shareholding in a foreign company or an interest in a foreign trust (including a unit trust). In the case of New Zealand law, an interest in a FIF is either an interest in a foreign company (including a foreign unit trust) or an entitlement to benefit under a foreign superannuation fund or foreign life insurance policy.[6]

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[4] The "broad-exemption" listed countries under Australian law are at present the following: Canada, France, Germany, Japan, New Zealand, United Kingdom and United States of America. There are also 58 "Limited –Exemption" countries specified in the Australian legislation. See Income Tax Assessment Act 1936 (Cth) s 320 and ITR 36 reg 152J, Sch 10 (Cth).

[5] Commerce Clearing House *Australian Master Tax Guide 2004* (CCH, Sydney, 2004) para 21-180. A more detailed definition of these terms is contained therein.

There are, however, specific rules in Australia dealing with interests in a foreign life insurance policy (FLP). Both countries provide for a large number of exemptions from the definition of what constitutes a foreign investment fund and these will be considered in this article as necessary to understand any past strategies adopted to circumvent the FIF tax regime.

III THE IMPACT OF SELF-ASSESSMENT

In the case of Australia, the CFC and FIF rules clearly fall within the scope of the self-assessment regime. This means that the taxpayer has the prime responsibility for determining whether he/she must include income derived by a CFC/FIF in their tax return for any particular year. The key question, contained in the Income section of the Taxpack 2003 for individual taxpayers, is whether the taxpayer derived any "attributed foreign income". If the answer is affirmative, the taxpayer must then go to Question 18 in the Taxpack 2003 Supplement that poses the following questions:

> "Are you an Australian resident for tax purposes who:
> - had either a direct or indirect interest in a controlled foreign company…
> - had, or continues to have, an interest in a foreign investment fund or a foreign life assurance policy?"

If the taxpayer answers either of these questions in the affirmative, he/she is then advised in the text of the Taxpack 2003 Supplement that the CFC/FIF measures may apply to income or gains of foreign companies or trusts in which the taxpayer has a direct or indirect control interest (in the case of a CFC) or a non-controlling interest (in the case of a FIF). The taxpayer is further instructed to work out his/her attributed foreign income from the CFC, FIF, or FLP, as the case may be.

There are significant penalties in place for making false or misleading statements – including penalties that may be imposed by a court upon the successful prosecution of a

[6] See *New Zealand Master Tax Guide,* above n 2, para 26-092 for a more detailed description.

tax offence. Nevertheless, the fact that the taxpayer must in the first instance disclose the existence of any interest in an overseas CFC or FIF – as the taxpayer sees fit on the facts of the particular situation – does certainly give rise to opportunities for tax avoidance.

Similarly, in New Zealand self-assessment as to income tax liability has been in place since the 2002/03 income year. In the case of the CFC and FIF regimes, this entails an obligation on the taxpayer to declare the existence and nature of any relevant interests. Again, the relevant question in the Individual Tax Return (IR3) is Question 16: "Did you receive any overseas income?" If the answer is affirmative, the taxpayer is referred to the Individual Return Guide for information on how to correctly disclose CFC or FIF interests and attribute income in the return. Similarly, companies must declare whether they have received overseas income in the IR 4 Corporate Tax Return and then refer to the company tax return guide for information on how to proceed. However, under International Tax Disclosure Exemption ITR14, previously issued by the Commissioner of Inland Revenue, a resident taxpayer is not obliged to disclose an interest in a foreign company (if it is not also an interest in a FIF) that does not constitute an income interest of 10 percent or greater. Such an interest is defined to include interests held by an associated person. An interest in a FIF must, however, be disclosed by a resident.[7]

Likewise, in Australia, a taxpayer is only required (under the Income Tax Assessment Act 1936 (Cth) s 361) to declare that he/she is an "attributable taxpayer" in relation to a CFC if the taxpayer "has a minimum 10% associate inclusive control interest in the CFC, or has a minimum 1% associate inclusive control interest in the CFC and is one of five or fewer Australian entities that control the CFC."[8]

In New Zealand, under Part XII of the Tax Administration Act 1994, the Inland Revenue Department may impose penal tax of up to treble the amount of deficient tax where the taxpayer has knowingly failed to disclose information – or has provided false information – in relation to interests in a CFC or FIF. In addition, the name of the offender may be

[7] See *New Zealand Master Tax Guide*, above n 2, para 26-120 for a discussion on the effect of this ruling.

published and additional tax for late payment may also be imposed. Where a tax offence has been the subject of a criminal prosecution in the courts, a fine of up to NZD$50,000 and/or a maximum prison term of two years may be imposed in the event of the taxpayer being convicted.

Even without the self-assessment rules that currently exist in Australia and New Zealand, it is still likely that taxpayers could succeed in defeating the application of the CFC/FIF rules. The tax authorities are required to issue assessments detailing the offshore interests from which the income is derived. As explained below, it will frequently be impossible for the revenue departments in either country to identify controlled foreign entities or other interests (including, for example, interests in a Hong Kong company held via nominees).

IV STRUCTURING AN INVESTMENT TO CIRCUMVENT THE CFC RULES

It has proven possible in practice for taxpayers to structure their offshore investments in such a way as will circumvent or at least moderate the impact of the CFC rules. From a New Zealand perspective, an example of such an approach has been to set up a subsidiary holding company in Australia – which is one of the approved "grey list" countries under the New Zealand CFC regime. These countries at present comprise Australia, the United Kingdom, Canada, Norway, the United States, Germany and Japan (as specified in Schedule 3 of the Income Tax Act 1994). They are considered to be countries that have tax systems similar to that of New Zealand. Originally, France was included in the grey list, but its system of tax is a territorial based one, and it was ultimately removed from the list on the basis that it lacked sufficient comparability to New Zealand. There is no attribution of income back to New Zealand shareholders in respect of a straightforward shareholding in a controlled subsidiary in Australia (a grey list country).

[8] See *Australian Master Tax Guide*, above n 5, para 21-140 for a further description of the meaning of these phrases.

Under s 23AH of the Income Tax Assessment Act 1936 (Cth), foreign branch income derived by an Australian company from a business carried on in a listed country "at or through a permanent establishment" is generally exempt from Australian tax.[9] This includes income from a branch in one of the seven "broad-exemption" listed countries, so long as the income is not what is referred to as "eligible designated concession income" (being income taxed at a very low rate under a tax concession).[10] The exemption also includes income from a branch in any of the other 58 "limited-exemption" listed countries, so long as the branch can pass an active income test. Moreover, the branch profits must have been subject to tax in the listed country in question.

Therefore, so long as it is the intention of the New Zealand taxpayer(s) to carry on a tax-paying and/or active business in one of the 65 listed countries as defined under the Australian CFC legislation, then the impact of the New Zealand CFC regime can be altogether circumvented by incorporating a holding company in Australia that, in turn, registers a branch in the third (listed) country jurisdiction where the actual business is to be transacted. This structure will achieve deferral of New Zealand income tax on offshore profits – so long as no dividend is declared and paid back to the New Zealand shareholders – whilst also avoiding any intermediate Australian tax on profits that are flowed through the Australian holding company.

The "loophole" described above may widen even further in the future given that the Australian Government, in its 2003/04 budget, announced that the exemption for foreign branch profits received by Australian companies will apply regardless of whether those branch profits relate to listed or unlisted countries.[11] However, no commencement date has so far been announced for this change. It should also be noted that the investment structure detailed above will not work in the reverse geographical direction, as New Zealand tax law does not provide an exemption from tax for branch profits derived from grey list countries. In the case of New Zealand, branch profits will be included in the total

[9] Income Tax Assessment Act 1936 (Cth) s 23AH(1)(b).
[10] See text at n 4 above.
[11] *Australian Master Tax Guide*, above n 5, para 21-280.

taxable income of the resident parent company, but a full tax credit will be given for foreign taxes paid on the earnings of the branch.

The intended application of the FIF rules in New Zealand may also be mitigated by investing via an intermediary vehicle in a grey list country. For instance, an investor resident in New Zealand might opt to use a unit trust managed in the UK or in Australia to access investment opportunities in non-grey list countries. Investing via such offshore managed funds will produce a significantly better tax outcome in New Zealand as compared to investing through a similar New Zealand entity. This is true for two reasons. Firstly, the offshore fund will be subject to low or nil tax in its home jurisdiction (i.e., United Kingdom or Australia). Secondly, an investment in such a fund will give rise to a very low tax liability in New Zealand due to its being resident in a grey list country.

The opportunity for tax avoidance in this area has been highlighted in a paper prepared in December 2003 by the Policy Advice Division of New Zealand's Inland Revenue Department.[12] This paper discusses the specific example of New Zealand resident investors buying units in an Australian unit trust that, in turn, uses the money to invest in New Zealand government bonds. Interest from the bonds is paid to the Australian unit trust, with only a two percent Approved Issuer Levy deducted within New Zealand (rather than the normal rate of withholding tax). At the Australian end, the income received by the unit trust is not taxed at all due to the fact that the receiving entity is taxed as a trust in that country rather than as a company. Likewise, the interest income was not sourced in Australia nor was it related to an Australian resident beneficiary. As noted in the policy paper, "the unit trust then distributes its income by way of non-taxable bonus issues so that the investor in New Zealand ends up holding more units in the entity" and "no New Zealand or Australian tax is payable at this stage."[13] The net result is that the New Zealand resident investors are able to receive New Zealand sourced income via the Australian unit trust virtually tax-free; whereas if they had invested either directly

[12] Inland Revenue Policy Advice Department & New Zealand Treasury *Taxation of Non-Controlled Offshore Investment in Equity* (2003) www.taxpolicy.ird.govt.nz/publications/files/offshoreinvis.pdf (at 10 December 2004).
[13] Ibid para 4-18.

or through a New Zealand based investment vehicle, they would have been subjected to full income tax in New Zealand on the interest income derived.

However, in a recent development the New Zealand Government has announced that the unit trust loophole described above is to be closed by amending the definition of "taxable bonus issue" in s OB1 of the Income Tax Act 1994.[14] As mentioned, New Zealand resident beneficiaries of offshore unit trusts can avoid paying tax on dividends by agreeing in advance that amounts vesting absolutely in them are to be re-invested in new units – which are then distributed as a tax-free bonus issue of new units to the investors. This opportunity is to be removed in the near future by including in the definition of "taxable bonus issue" the following new paragraph:[15]

> A bonus issue that is made by a unit trust to a unit trust holder under an arrangement or decision that the unit trust will make the bonus issue instead of causing a beneficial interest in money or property of the unit trust to vest absolutely in the unit holder.

Thus, new units vested in unit-holders under these circumstances will in future be treated the same as taxable dividends received by New Zealand residents. These changes will apply to unit trust investors worldwide, but the major impact is likely to be in relation to Australian unit trusts.[16]

As noted earlier, there are also a number of exemptions from the FIF rules – including, in the case of New Zealand, a *de minimus* rule that exempts taxpayers whose total cost of acquiring FIF interests is NZD$50,000 or less. There are further miscellaneous exemptions for employment related superannuation schemes, or life insurance policies taken out before a taxpayer becomes a New Zealand resident. Australia also exempts

[14] Office of the New Zealand Revenue Minister "Unit Trust Loophole to be Closed" (Media Release, 12 May 2004) www.cch.co.nz/tax/pssrels/trust-lphole.asp (at 10 December 2004).
[15] New Zealand House of Representatives *Supplementary Order Paper No. 210 Amending the Taxation (Annual Rates, Venture Capital and Miscellaneous Provisions) Bill* (11 May 2004) www.cch.co.nz/tax/leg/bills/billstoc.asp (at 10 December 2004).
[16] Ellen Read "Cullen Closes Australian Unit Trust Tax Loophole" *New Zealand Herald* (Auckland, New Zealand, 13 May 2004) C3. It was reported that New Zealanders have about NZ$3 billion in Australian unit

contributions to an employer-sponsored superannuation fund from the scope of the FIF rules. Under Division 11 of Part XI of the Income Tax Assessment Act 1936 (Cth) an exemption is provided for an interest in a non-resident employer-sponsored superannuation fund subject to some conditions.

In addition, there are other possible avenues by which an Australian taxpayer might structure their investment so as to circumvent the effect of the Australian CFC regime. One such approach might be for the Australian taxpayer to incorporate an offshore holding company in Singapore – a limited-exemption listed country but without making use of the Singapore tax incentive available for "Operational Headquarter Companies". The intention would be to ensure that active income received by the Singapore subsidiary would not be subject to accruals taxation in Australia. Under the Australian legislation, only "tainted" income derived by CFC's resident in "unlisted" and "limited-exemption listed" countries is taxable in Australia. The term "tainted income" refers to such items as dividends, rent and royalties, certain interest receipts, and certain sales or services income from dealings with associates. Furthermore, in situations where the Singapore CFC was likely to derive more than five percent of its gross turnover in the form of tainted income from offshore (thus falling outside the existing *de minimus* exemption), it might well be possible for the Singapore subsidiary to delay booking such income into its profit and loss account. Thereby, the income could be left outside Singapore for a period of time, so as to remain within the active income exemption for Australian CFC purposes.

The taxation law of Singapore itself provides that foreign source income derived by a resident of Singapore (individual or corporate) is only taxable in that country if it is physically received in Singapore. Accordingly, there is ample opportunity for deferring Singapore tax on offshore income by leaving it outside Singapore for whatever period of time may be convenient to the ultimate shareholder(s). The relevant provision is found in s 10 of Singapore's Income Tax Act that provides, *inter alia*:

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trusts that do not make a cash payout, but instead reinvest dividends as new units. Closing the loophole will earn the Government between NZ$25 million and NZ$30 million in tax revenue.

> [A]ny income derived from outside Singapore which is (a) remitted to, transmitted or brought into Singapore; or (b) applied to satisfy a debt incurred in respect of a trade or business carried on in Singapore; or (c) applied to purchase any movable property which is brought into Singapore, is treated as income received in Singapore.

A Possible Utilization of Tax Havens

It would be reasonable to assume that "the use of tax havens to secure benefits for taxpayers resident in Australia (and New Zealand) has become far less common as a result of the controlled foreign company (CFC) measures."[17] The incorporation of a controlled entity in any well-known tax haven is very likely to attract the attention of the tax authorities in the event of an audit, should the appropriate disclosure not have been made under the self-assessment regimes now operating in both Australia and New Zealand. The subsequent enactment in 1993 of the foreign investment fund measures in Australia would, on the face of it, have acted as a further disincentive for taxpayers in that country to invest in a tax haven.[18] As noted earlier, the effect of the FIF rules is to tax Australian and New Zealand residents on increases in value of their non-controlling interests in foreign companies, foreign life policies and, in the case of Australia only, foreign trusts.

As an aside, it is interesting to note that the list of limited-exemption countries for the purposes of the accruals taxation system in Australia includes both Malaysia and Samoa. These countries are therefore considered to have tax systems that are similar to Australia's, but not closely comparable. The state of Malaysia includes an island called Labuan (located near to Brunei). Labuan became a tax haven in its own right after the International Offshore Company (IOFC) regime was established there in 1990. No Malaysian governmental approval is required to establish an offshore company, except where it intends to engage in banking, insurance and corporate management services. Under the IOFC regime, offshore companies incorporated in Labuan have the option of paying corporate tax either as a fixed administrative fee of RM20,000 per annum

[17] *Australian Master Tax Guide*, above n 5, para 31-580.

(equivalent to approximately USD$5,260) or at the low rate of three percent on audited net profits derived from offshore trading activities (which often includes re-invoicing activity). Where payment of the annual fee is chosen, there is no need to file annual accounts with the Labuan authorities. Income from offshore non-trading activity (such as share investment) is entirely tax exempt and there is also no dividend withholding tax on remittances from Malaysia. Other requirements are that the offshore company in Labuan must be beneficially owned by non-residents and not carry on business with Malaysians.

Unlike the position in Hong Kong (as discussed below), the beneficial ownership of a Labuan offshore company must be disclosed upon its formation to the trust company in Labuan which is to act as its agent and provide a registered office address – but this information is not available to the general public. Unlike Hong Kong also, shelf companies are not available. In addition, Malaysia is a party to double tax treaties with both Australia and New Zealand that contain information sharing provisions. Moreover, the Australian CFC provisions would apply to a company set up in Labuan in any event, given that Malaysia is a limited-exemption listed country, if it was to derive less than 95 percent of its income from genuine business activities (i.e., the “active income” test). The New Zealand CFC provisions would also apply to a Labuan offshore company.

Leaving aside the CFC rules in Australia and New Zealand, a major benefit of establishing a company in Labuan is that Malaysia’s double tax treaties will generally apply to reduce the rates of withholding tax on inward receipts of dividends, interest and royalties from other jurisdictions. However, it should be noted that some countries – such as the Netherlands, Sweden and the United Kingdom – have specifically denied tax treaty benefits to Labuan offshore companies. One commentator has also mentioned that some taxpayers use Labuan as a “conduit haven” to avoid creating a permanent establishment in a non-treaty country where the business presence is likely to be minimal.[19] The example given is that a “Labuan intermediary company can avoid a representative office

[18] Ibid.
[19] Roy Rohatgi *Basic International Taxation* (Kluwer Law, The Hague, 2002) 278.

being treated as a permanent establishment in China" due to the operation of the double tax treaty between Malaysia and China.[20]

The inclusion of Samoa in the Australian list of limited-exemption countries is perhaps a surprise, given that Samoa was one of 35 tax havens identified by the Organisation for Economic Co-operation and Development (OECD) in June 2000 as being responsible for harmful tax practices. At the time, the OECD threatened to impose various sanctions on those tax havens that failed to co-operate in improving transparency, fairness, and the elimination of harmful features of their tax regimes by the end of 2005. Subsequently, a black list of non co-operating tax havens was published in April 2002.

In May 2003, Vanuatu became the first country to be removed from the OECD's blacklist after committing itself to improving the "transparency of its tax and regulatory systems and to establishing effective exchange of information for tax matters with OECD countries by 31 December 2005."[21] More recently, on 22 March 2004, the OECD reported that only five jurisdictions remained on its list of unco-operative tax havens – and Samoa was not one of these five.[22] As will be seen below, Samoa still offers a novel form of legal entity structure that appears to fall outside the definition of a "controlled foreign company" for purposes of the CFC regimes in both Australia and New Zealand.

The principality of Liechtenstein – which does remain on the OECD blacklist – offers a form of legal entity called the *Anstalt* (translated as the "Establishment"). This has been described as being "half-way between the corporation and the foundation."[23] As will also be seen below, there is good reason to take the view that the *Anstalt* also falls outside the definition of a CFC and it is therefore an effective legal entity for achieving tax deferral on offshore income beneficially owned by a resident taxpayer in either Australia or New Zealand.

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[20] Ibid.
[21] Larry Schlessinger *Success for OECD in Tax Havens Battle* (20 May 2003) Financial Director http://www.financialdirector.co.uk/News/1133556 (at 10 December 2004).
[22] The five countries are Andorra, Liberia, Liechtenstein, the Marshall Islands and Monaco.

One location that was presumably never in danger of being placed on the OECD tax haven blacklist was Hong Kong (although nearby Macau apparently was considered for inclusion but succeeded in passing OECD tests).[24] In fact, Hong Kong "is not a tax haven in the true sense of that term" and many operations have been set up there "which avoid the suspicion and adverse discriminatory treatment with which such operations in pure tax havens are often treated by the tax officials of high tax rate countries."[25] Based on this author's previous work experience in Hong Kong, it is quite evident that many companies have been incorporated in Hong Kong with the deliberate intent of escaping the CFC net in Australia and New Zealand through nothing more sophisticated than the simple non-disclosure of CFC interests. This can be achieved quite readily by purchasing a shelf company and transferring the existing shareholding and directorships into the names of nominees – often provided by company secretarial operations in Hong Kong for a fee. In this situation, Declarations of Trust are executed but not filed in the Companies Registry record.[26]

In Hong Kong, there is no legal obligation to disclose the beneficial ownership of companies to either the Companies Registry or to any other governmental authority (including the Inland Revenue Department). Moreover, Hong Kong has entered into only one comprehensive double tax treaty to date and therefore has minimal information sharing obligations at the present time.[27] It would be extremely difficult in practice for the tax authorities in Australia or New Zealand to identify beneficial controlling interests in companies in Hong Kong where nominee arrangements have been utilised. Therefore, the deliberate failure by a taxpayer in Australia or New Zealand to disclose the existence of interests in a Hong Kong CFC under these circumstances is very likely to remain undetected.

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[23] John Walters *Grundy's Tax Havens: A World Survey* (4th ed, Sweet & Maxwell, London, 1983) 141.
[24] Ben Griffiths *OECD Names and Shames 35 Tax Havens* (26 June 2000) Accountancy Age http://www.accountancyage.com/News/1113769 (at 10 December 2004).
[25] *Walters*, above n 23, 99.
[26] Nevertheless, under Income Tax Act 1994 s CG3 it is clearly stated that interests held by a nominee will nevertheless subject a New Zealand taxpayer to a tax liability. For the purposes of the international tax regime, a nominee includes a bare trustee (but not a discretionary trustee); and it also includes a person who has entered into an arrangement with the New Zealand taxpayer regarding the holding or exercising of any rights or powers.
[27] A comprehensive double tax treaty with Belgium was signed in December 2003.

The definition of a CFC under both Australian and New Zealand law includes the situation where the taxpayer has actual control of the offshore company irrespective of shareholding interests. The definition of control includes interests held by "associates", such as a trustee.[28] Hence, the execution of Declarations of Trust referred to above in relation to Hong Kong nominee companies would suffice to bring about a "controlled" foreign company situation under the CFC regimes of both countries.

B The Liechtenstein Anstalt

One possible way to own assets and make investments through a controlled foreign entity, whilst avoiding the application of both the Australian or New Zealand CFC and FIF legislation, is to utilize an entity that does not fit into the definition of a "company" or a "trust" for CFC/FIF purposes. It is probable that the Liechtenstein *Anstalt* has already been used for exactly this type of purpose by taxpayers resident in Australia. The *Anstalt* is generally set up as a foundation without shares and functions in a similar manner to a company, but with beneficiaries rather than shareholders. Since the beneficiaries do not have to be specified by name, a high level of confidentiality is assured. Whilst an *Anstalt* must have a Board of Directors consisting of one or several persons (of whom one must be domiciled in Liechtenstein), the ultimate control over the *Anstalt* rests with its founder or his legal successor. It is the founder who has the power to "change the bylaws, appoint and remove directors, and decide the beneficiaries and their rights."[29] Moreover, the founder may include in the articles of incorporation any special or general provisions with respect to the allotment of net profits.

It is important to note that the founder of an *Anstalt* can be resident anywhere in the world, which potentially makes this entity a valuable vehicle for circumventing the

[28] See Income Tax Assessment Act 1936 (Cth) s 340 and s CG4(1). See also Income Tax Act 1994 s OD8(3).
[29] *Rohatgi*, above n 19, 267.

CFC/FIF regimes in Australia, New Zealand or any other tax jurisdiction. One commentator summarizes the setup procedure as follows: [30]

> The law provides that individuals, firms, juridical persons or communities, whether entered in the Official Register or not, may found establishments and may also act as directors of establishments. Only one founder is required. The law does not set any requirements as to the founder's nationality or domicile. This means that anybody who fulfils the legal requirements and complies with the provisions of the law may found an establishment in Liechtenstein. An establishment may also be set up through power of attorney and, of course, by a fiduciary on behalf of third persons.

Where the *Anstalt* is used purely as a holding vehicle to own and manage investments outside Liechtenstein, there is no need for its accounts to be audited or for annual accounts to be filed. Moreover, it will not be liable to pay any tax on its profits in Liechtenstein; nor any withholding (or coupon) tax on dividend distributions, having been formed without shares. There is, however, a minimum tax liability of SF1,000 per annum in respect of tax levied on the *Anstalt's* capital base.

Given the manner in which the self-assessment regimes operate in Australia and New Zealand, a resident taxpayer with an interest in an *Anstalt* will at some point in his/her tax return be asked whether he/she has an interest in a controlled foreign company. Since the *Anstalt* is not a company, nor a trust, nor an unincorporated association or body of persons as variously referred to in the Australian and New Zealand CFC/FIF legislation, it appears that the taxpayer may legitimately answer this threshold question in the negative. This allows for successful circumvention of the CFC/FIF regime. It is noted, however, that the cost of setting up and operating an *Anstalt* in Liechtenstein is likely to be quite high and therefore this approach will only be of value to a resident investor having substantial offshore investments in the millions of dollars.

C The Samoan Creditor Controlled International Company

[30] *Walters*, above n 23, 142.

A further unusual type of legal entity promoted as a means of circumventing the Australian CFC rules is the Samoan Creditor Controlled International Company ("CCIC"). Such a "company" can be set up in Samoa without either shareholders or share capital. Instead, the ownership of this type of entity is vested in the holder(s) of bearer debentures. All the rights that normally pertain to shareholders are exercised by the bearer debenture holder(s). It is also possible to allot a non-voting redeemable preference share to a non-resident of Australia if this is thought to be desirable to give credibility to the use of the word "company".

A CCIC is not required to pay any taxes in Samoa. At least one director must be appointed and this can be a corporate director. Confidentiality is assured in this respect, as details of directors do not appear on the public record. An annual return must be lodged, but no accounts need be filed. In addition, a registered office address must be maintained within Samoa and a Samoan resident must be appointed as secretary and agent.

Various financial/tax advisors in Hong Kong and elsewhere have marketed the CCIC as an entity that enables Australian residents to avoid the accruals taxation regime embodied in the CFC legislation. These advisors include "International Company Services Limited" which maintains a website accessible to the general public.[31] The tax avoidance argument – as promulgated over the website – goes along the following lines. Under the Australian CFC legislation, a CFC only exists if it is controlled by Australian residents – but the word "controlled" is not actually defined in the Income Tax Assessment Act 1936 (Cth). It can be inferred, however, that control must vest in Australian shareholders for a CFC to exist. This being the case, a CCIC cannot be a CFC for Australian tax purposes as the Australian residents who invest in it merely hold bearer debentures and the sole shareholder in the CCIC, if any at all, will not be a resident of Australia. Therefore, according to International Company Services Limited: "none of the provisions of Part X [of the Income Tax Assessment Act 1936 (Cth)] apply to an Australian resident

[31] *International Company Services Ltd*, above n 1.

debenture holder and no attribution of income occurs [in Australia]".[32] In addition, "there are no reporting requirements as the debenture holder is not an attributable taxpayer."[33]

However, an alternative argument is that the de facto control test in s 340(c) of the Income Tax Assessment Act 1936 (Cth) does not require that "control" must reside in the hands of a shareholder; thus, a Samoan CCIC that is effectively controlled by an Australian resident debenture holder is nevertheless a CFC within the meaning of Part X of the Income Tax Assessment Act 1936 (Cth). If this alternative argument is correct, then the attributable income of the Australian resident must be calculated so as to enable the latter to be subjected to accruals taxation. It is at this point, say International Company Services Limited (and other financial advisors), that the provisions of Part X of the Income Tax Assessment Act 1936 (Cth) are defective. According to International Company Services Limited: [34]

> In normal situations an Australian resident's attributable interest in a CFC is the same as his Direct Control Interest under section 356. Where however the subjective de facto control test applies under section 340 (c) the resident is deemed, pursuant to section 350 (6), to have a direct control interest of 100%, but his attribution percentage is calculated in accordance with his actual interest in the CFC as established under section 356 (1). This section specifically limits attribution interests to shareholders and share capital. So under the second (alternative) view, all of the provisions of Part X of the Act apply to CCIC's except the final step. There is no attribution interest held by the Australian resident in the CFC and therefore no attribution is possible. Part X of the Act is aborted and no accruals taxation applies.

Therefore, it is concluded that whichever way the control test in the Australian CFC legislation is interpreted, no attribution of income to an Australian resident debenture holder in a CCIC can arise. Accordingly, a CCIC is an effective entity to achieve tax deferral in Australia and to avoid the impact of the CFC regime. In addition, it should also succeed in avoiding the application of the Australian FIF rules, particularly if no shares are issued in the CCIC (so that it falls outside the definition of a foreign company

[32] Ibid.
[33] Ibid.
[34] Ibid.

for purposes of the FIF rules). It is not known how extensively tax planners have used Samoan CCIC's for this purpose, but the entity has certainly been extensively marketed. The fact that Samoa is included in the Australian list of limited-exemption countries for CFC purposes is also likely to be a comfort to any Australian resident taxpayer who must file a tax return under the self-assessment system, whilst having an interest as a bearer debenture holder in a Samoan CCIC.

V RELEVANT CASE LAW IN NEW ZEALAND

The only reported decision of any significance in relation to the use of CFCs or FIFs in tax avoidance arrangements is *Commissioner of Inland Revenue v BNZ Investments Ltd* heard in the High Court at Wellington in 2000 and subsequently appealed by the Commissioner to the Court of Appeal in 2001.[35] The taxpayer in this case – BNZ Investments ("BNZ") – made a number of redeemable preference share ("RPS") investments in entities provided by a company called Capital Markets Ltd ("CML"). The latter then utilised these funds for various offshore downstream transactions – making use of some special purpose companies in tax haven jurisdictions. Details of these transactions were not necessarily known to BNZ. However, these transactions resulted in the earning of interest income by CML. The latter ultimately repatriated this income to BNZ in the form of tax exempt dividends and the quantum of the dividends was set at such a rate as would share the benefit of the tax advantages between the taxpayer and CML. The net result was that BNZ received a greater tax-free return on its initial investment than it otherwise would have.

It is noted that the facts in the *BNZ* case are similar to those in the earlier case of *New Zealand Wool Board v Commissioner of Inland Revenue* in which the taxpayer was a statutory board with obligations to New Zealand woolgrowers.[36] In 1988, the Wool Board invested NZD$100 million in tax-free redeemable preference shares. Dividends received from this investment were treated as tax exempt under s 63 of the (then applicable)

[35] *Commissioner of Inland Revenue v BNZ Investments Ltd* [2002] 1 NZLR 450 (CA).
[36] *New Zealand Wool Board v Commissioner of Inland Revenue* [1997] 2 NZLR 6 (CA).

Income Tax Act 1976. The invested money was used in arrangements involving convertible notes and the passage of funds through conduits and entities in the Cook Islands (called the "MCN scheme"). The proceedings in this case dealt with the powers of the Commissioner to amend an assessment and the grounds upon which he might do so. It did not involve the application of the CFC regime, as the latter had not yet been legislated for at the time of the original Wool Board investment. However, after the original assessment had been issued by the Commissioner to the taxpayer, the MCN scheme became the subject of a well-known Commission of Inquiry in New Zealand – termed the "Winebox Inquiry" – the result of which caused the Commissioner to conclude that the MCN scheme ran counter to the general tax avoidance provisions in the law. Consequently, he amended his assessment to the Wool Board to include the dividends it had received from the redeemable preference share investment as taxable income and the Court of Appeal ultimately confirmed that he had acted properly in doing so. The significance of this case in the context of this article is that it forms part of the background to the introduction of the CFC and FIF regimes in New Zealand, together with the Winebox Inquiry itself.

In the subsequent *BNZ* case, the Commissioner contended in the High Court that all of the RPS investments made by the taxpayer company were part and parcel of an overall arrangement aimed at "the avoidance of liability to pay income tax on the interest earned and to share the benefit of the savings from the avoidance of tax."[37] Therefore, the Commissioner sought to treat the earnings of BNZ from the RPS investments as taxable receipts and invoked the general anti-avoidance provisions in (then applicable) s 99 of the Income Tax Act 1976 to achieve this result. For its part, the taxpayer company argued that tax avoidance was merely an incidental purpose of the downstream arrangements. According to the argument, s 99 was inapplicable to the transactions in question because the downstream transactions fell within categories recognized by tax legislation and were effective in their own terms.[38]

[37] *BNZ Investments Ltd v Commissioner of Inland Revenue* (2000) 19 NZTC 15, 732 (HC).
[38] Ibid.

In the course of his submissions to the High Court, the Commissioner argued that the investment structures set up in the case involved a "deliberate manipulation of the arbitrary distinction between debt and equity, deliberate avoidance of the new CFC tax regime, and an attempt to design around the accrual rules."[39] He further argued that all of the transactions in issue used overseas companies that were not majority owned by New Zealand residents; that they had (implicitly) been designed this way to avoid the impact of the CFC provisions; and that this intention to frustrate the legislative purpose (i.e., the CFC accrual rules) was relevant to the argument of general tax avoidance and s 99 of the Income Tax Act 1976.[40]

However, in his judgment in favour of the taxpayer company, Justice McGechan determined that the Commissioner "does not have the power, except in cases specially provided for by New Zealand legislation for New Zealand tax purposes, to re-characterize transactions occurring abroad as something else."[41] As such, the court held that s 99 of the Income Tax Act 1976 (the general anti-avoidance provision) was inapplicable in this case because the taxpayer was not a party to an arrangement within the relevant provision.[42]

Furthermore, on appeal it was reiterated that s 99 was not intended to "override all other provisions of the Income Tax Act 1976 so as to deprive the taxpaying community of structural choices, economic incentives, exemptions and allowances provided by the Act."[43] In the event, the Court of Appeal affirmed the High Court's decision in favour of BNZ and dismissed the appeal by the Commissioner. The latter has, however, appealed the decision to the Privy Council and the appeal is likely to be heard in the second half of 2004.

As the decision presently stands, obiter comments by Justice McGechan appear to substantiate the view that arrangements may legitimately be put in place to structure

[39] Ibid para 94.
[40] Ibid para 99.
[41] Ibid headnote para 6.
[42] Ibid headnote para 1.
[43] *BNZ* (CA), above n35, 464.

offshore investment holdings so that they fall outside the technical ambit or scope of the CFC and FIF rules. Moreover, such "structural choices" are unobjectionable in terms of the general anti-avoidance provision contained (at that time) in s 99 of the Income Tax Act 1976.[44]

If this reading of the *BNZ* decision is correct, this would give further comfort to taxpayers in New Zealand (and perhaps Australia) that choose to use an obscure legal entity such as the Liechtenstein *Anstalt* or Samoan CCIC in order to hold offshore investments or assets whilst technically avoiding the application of the CFC and/or FIF legislation.

Turning to criminal case law in New Zealand, a review of all relevant databases has failed to disclose any prosecutions for tax evasion offences based on actions aimed at circumventing the CFC or FIF provisions. Presumably, if any prosecutions of this sort have been considered by the tax authorities in the decade or so since the CFC/FIF rules came into existence, the taxpayers in question would no doubt have been motivated to reach a prompt settlement with the Inland Revenue Department. Unfortunately, for reasons of taxpayer confidentiality, it is not possible to access records of any such discussions.

VI RELEVANT CASE LAW IN AUSTRALIA

The application of the CFC and FIF rules under Part X of the Income Tax Assessment Act 1936 (Cth) has been considered in one major Australian case. This is *Dismin Investments Pty Ltd v Commissioner of Taxation* heard at first instance in 2000 and then on appeal to the full Federal Court in 2001.[45] The interesting facts in this case demonstrate how a controlled foreign company scenario might arise. Australian company Dismin Investments Pty Ltd ("Dismin") was the owner of Mindis NV, a company incorporated in the Netherlands Antilles. Mindis NV owned Mindis BV ("MBV"), and

[44] Ibid.
[45] *Dismin Investments Pty Ltd v Commissioner of Taxation* (2001) 47 ATR 292 (FCA).

the latter was a company incorporated in the Netherlands. MBV itself owned FBG Canadian Investments Inc, and the latter in turn owned Carling O'Keefe Breweries of Canada Ltd ("Carling").

A fact not in dispute was that MBV was a controlled foreign company in relation to Dismin, for the purposes of Part X of the Income Tax Assessment Act 1936 (Cth). In addition, MBV was a resident of a listed country (the Netherlands) for the purposes of the Australian CFC rules and Dismin was an "attributable taxpayer" in relation to MBV, meaning that its assessable income in any Australian tax year had to include its share of MBV's attributable income. Such attributable income was the amount that would have been its taxable income in Australia if it were assumed to be an Australian resident taxpayer.

In 1989, Carling and the Molson Companies Ltd ("Molson") formed a partnership called the Molson Partnership to carry on a brewing business in North America. However, in 1993 each of the partners sold a 10 percent interest in the Molson Partnership to Miller Brewing Inc of the United States. This sale was achieved through a complex series of steps that included, at one point, the transfer of certain shares held by MBV in its now restructured Canadian brewing subsidiary to a newly created entity in Canada called Ontario Company in consideration of the issue by the latter entity of 1000 shares in itself to MBV. The trial judge in the hearing at first instance determined that MBV had made a gain or profit of a capital nature within the meaning of reg 152(B)(1) of the Income Tax Regulations 1936 (Cth). Therefore, it followed from that (in the submission of the Commissioner of Taxation) that the share transfers gave rise to assessable income that should be attributed to Dismin in Australia under the provisions of Part X of the Income Tax Assessment Act 1936 (Cth) – bearing in mind that capital gains are taxable as ordinary income in that country. No doubt this would have been the result of the case had the Commissioner argued the case on a consistent basis throughout. Instead, at the appeal stage, he sought to change his legal argument that resulted in evidential problems being created for the taxpayer company.[46] For this reason, judgment was ultimately given in favour of the taxpayer company on appeal.

This case does nothing to rebut the underlying thesis of this article; namely, the application of the CFC and FIF rules can be readily circumvented by astute tax planning. It was never in dispute that MBV was anything other than an offshore subsidiary company controlled by Dismin and thus a CFC for Australian tax purposes. Had MBV been set up so that it was not controlled by an Australian resident – as in the *BNZ* case – or had an intermediary holding entity such as a Liechtenstein *Anstalt* been inserted at the MBV level, then the arguments as to application of the Australian CFC rules would in all likelihood not have arisen.

There also appear to have been no criminal prosecutions in Australia for tax evasion actions aimed at circumventing the CFC or FIF accrual regimes.

VII THE EFFECT OF ANTI-AVOIDANCE MEASURES?

A Specific Anti-Avoidance Measures in New Zealand

In the case of New Zealand, it is necessary to bear in mind that Part G of the Income Tax Act 1994 contains provisions that are specifically intended to counter tax avoidance arrangements involving the international tax regime – including the controlled foreign company and foreign investment fund measures. The relevant legislative provision is s GC7 of the Act:

> Where in relation to any foreign company any two or more persons resident in New Zealand have entered into an arrangement by which any control interests in that foreign company are held by any other person or persons, which arrangement has the purpose of preventing the foreign company from being a controlled

[46] The Commissioner changed his argument because the reasons for the decision at first instance might have had unintended consequences and cast the revenue net wider than it had been understood to cover.

> foreign company, those control interests shall be deemed to be held by those persons resident in New Zealand divided equally among them.

It has already been noted that a New Zealand resident may be subject to tax in respect of interests held by a nominee. Section GC7 appears to achieve a similar result. Presumably, the major problem confronting the Commissioner of Inland Revenue in enforcing this section might be an evidential one – that is to say, being able to prove that an arrangement to "conceal" control interests in reality existed. This might be even more problematic for the Commissioner where the person allegedly holding the control interests is an overseas party. Section GC8 of the Income Tax Act 1994 provides:

> For the purposes of section CG7, where and to the extent that –
>
> (a) Any controlled foreign company enters into any loan or other arrangement (including a security arrangement) with any other person; and
> (b) The arrangement does not directly result in any person having any attributed repatriation in respect of the controlled foreign company; and
> (c) Where, having regard to any connection between the parties to the loan or arrangement or to any other relevant circumstances, the parties were dealing with each other in relation to the loan or arrangement in a manner that has the purpose or effect of –
>
>> (i) Directly or indirectly, enabling any person (whether or not the person referred to in paragraph (a), and referred to in this paragraph as the "investor") to enter into a loan or other arrangement (in this section referred to as the "related arrangement"), which, if entered into by the controlled foreign company, would have resulted in a person having attributed repatriation in respect of the controlled foreign company; and
>> (ii) Defeating the intent and application of section CG8,
>
> the related arrangement shall be deemed to have been entered into by the controlled foreign company and not by the investor.

Essentially, this section means that an attributed repatriation to a New Zealand resident can still arise under the CFC rules, even though "financial arrangements are routed via intermediary parties."[47] Presumably, back-to-back loans aimed at benefiting a New Zealand resident taxpayer at the expense of his/her offshore CFC would result in

[47] *New Zealand Master Tax Guide*, above n 2, para 33-144.

attributed taxable income in New Zealand under this provision. The excerpted section referred to above defines in detail how attributed repatriations from CFC's are to be calculated for tax.

Moreover, s GC9 of the Income Tax Act 1994 deals with variations in control or income interests in foreign companies. The section is too lengthy to excerpt, however, it is essentially intended to nullify "attempts by taxpayers to manipulate their control interests and income interests in controlled foreign companies by successive variations to those interests before and after a quarterly measurement day."[48]

Finally, the last relevant provision is s GC10 of the Income Tax Act 1994 that provides:

> Notwithstanding section CG3(e) and section CG 20(2), where –
>
> > (a) An income interest in a foreign company or an interest in a foreign investment fund is transferred from one person to an associated person on one or more occasions; and
> > (b) The associated persons enter into an arrangement with respect to making or not making –
> >
> > (i) The election referred to in section CG 3(e); or
> > (ii) The election referred to in section CG 20(2);or
> > (iii) Any combination of 2 or more such elections; and
> >
> > (c) The arrangement has an effect of defeating the intent and application of the international tax rules,
>
> the Commissioner may deem any one or more of such elections to have been made or not made to the extent appropriate to prevent the arrangement having such effect.

This section is quite self-explanatory. The elections referred to relate to the measurement of ownership interests in CFC's and FIF's.

It should be noted that—unlike New Zealand—the Australian legislation does not specify separate anti-avoidance measures in relation to the accruals taxation system. Instead, it builds such controls into the CFC/FIF rules themselves. When planning or arranging structures intended to circumvent the application of the CFC/FIF rules in either country, care should obviously be exercised to avoid contravening any of the specific anti-avoidance provisions of the type referred to above.

B General Anti-Avoidance Provisions in Both Countries

In addition to the specific anti-avoidance measures outlined above, New Zealand also has general anti-avoidance rules primarily found in ss BB3, BG1 and GB1 of the Income Tax Act 1994. Likewise, Australian law also contains general income tax anti-avoidance provisions within Part IVA of the Income Tax Assessment Act 1936 (Cth). When considering to what extent it may be possible to circumvent the application of the CFC and FIF rules in either country, regard must be had to the possible application of these general anti-avoidance provisions.

Under the New Zealand legislation, s BG1 of the Income Tax Act 1994 simply states that "a tax avoidance arrangement is void as against the Commissioner for income tax purposes." The key phrase "tax avoidance arrangement" is further defined in s OB1 of the Act in the following terms:

> Tax avoidance arrangement means an arrangement whether entered into by the person affected by the arrangement or by another person, that directly or indirectly:
>
> (a) Has tax avoidance as its purpose or effect; or
> (b) Has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the purpose or effect is not merely incidental.

Where a tax avoidance arrangement has been identified by the Commissioner, the latter may counteract any tax advantages obtained by the taxpayer pursuant to the arrangement by re-calculating taxable income as provided for in s GB1 of the Income Tax Act 1994.

[48] Ibid.

Thus, if a resident taxpayer was to make arrangements to hold offshore assets or investments through a Liechtenstein *Anstalt* structure (or a Samoan CCIC) and the purpose of the arrangements was primarily to avoid a tax liability under the CFC rules, might the general anti-avoidance provisions apply? This might allow the Commissioner to re-categorize and tax accrued offshore income. This is certainly possible, but given the manner in which the self-assessment regime operates (as discussed previously) it is difficult to see how such offshore arrangements (e.g., utilizing an *Anstalt*) would ever come to the attention of the Commissioner. However, it is worth noting the comments of the trial judge at first instance in the *BNZ* case. These were to the effect that the Commissioner was not precluded from concluding that what occurred abroad could have a purpose or effect of tax avoidance in New Zealand.[49] As such, what had been done abroad could still be part of an "arrangement" with the purpose or effect of tax avoidance.[50]

On the other hand, it appears to be settled law that a taxpayer will not be in breach of the general anti-avoidance provisions if he/she does no more than take advantage of specific exemptions, benefits, or allowances written into the body of tax law. Authority for this proposition is to be found in the Australian case of *Cridland v Federal Commissioner of Taxation* in which the taxpayer became a beneficiary of a trust in which the trustees were carrying on business as primary producers.[51] The Australian Income Tax Assessment Act 1936 (Cth) provides that a beneficiary of such a trust is deemed to be carrying on the business of the trustees, with the consequence that the taxpayer became entitled to certain concessions available to primary producers, and so reduced his tax liability. It was held that the Australian anti-avoidance provision (then s 260 of the Act) did not apply. This is because an arrangement – the purpose or effect of which is to qualify a taxpayer for taxation concessions specifically provided by the Act – is not an arrangement having the purpose or effect of tax avoidance.

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[49] *BNZ* (HC), above n 37.
[50] Ibid.

Bearing this point in mind, it is worth noting that there are a number of specified exemptions from the application of the CFC and FIF rules in New Zealand and properly meeting the requirements for any of these exemptions should rule out any possibility of the general anti-avoidance provisions becoming applicable. In fact, a detailed review of all available case law in New Zealand does not disclose any instances where these provisions have been applied against a taxpayer for breaching the CFC or FIF regimes.
Accordingly, it is worth detailing the existing exemptions from the operation of the CFC and FIF regimes. In the case of the former, the most significant exemption is for controlled companies established in certain specified foreign countries – namely, Australia, the United Kingdom, Canada, Norway, the United States, Germany and Japan[52]. This is subject, however, to the requirement that the company in question be liable to income tax in the particular foreign country by reason of its domicile, residence, place of incorporation, or place of management there. Other miscellaneous exemptions from the CFC rules arise where the taxpayer holds an income interest of less than 10 percent,[53] or where a CFC acquires shares in a further foreign subsidiary carrying on substantially the same business as itself.[54] In the case of the FIF rules, there is a longer list of exemptions under New Zealand law.[55] These include: (1) interests in certain funds located in the same seven countries as are exempted for purposes of the CFC rules; (2) an interest in an employment-related foreign superannuation scheme; (3) interests held by an individual whose aggregate cost does not exceed NZD$50,000; (4) certain historical interests where foreign exchange controls prevent the taxpayer from accessing the moneys invested; or (5) where the interest is a qualifying foreign private annuity. Under certain circumstances, income received by way of a death benefit under a life insurance policy will also not be treated as FIF income.[56]

As mentioned at the outset of this discussion, Australia also has general anti-avoidance provisions that are contained in Part IVA ss 177A-F of the Income Tax Assessment Act

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[51] *Cridland v Federal Commissioner of Taxation* (1977) 140 CLR 330.
[52] Income Tax Act 1994 s CG13.
[53] Ibid s CG6. However, the taxpayer may still be caught under the FIF rules.
[54] Ibid s CG8(7).
[55] Ibid s CG15(2).
[56] Ibid s CG16(7) .

1936 (Cth). These provisions are aimed at counteracting schemes under which the taxpayer has obtained a tax benefit and where such an outcome was the sole or dominant purpose for making the arrangements. There is a considerable body of case law in Australia dealing with key issues such as whether a tax benefit had been obtained and whether this was the dominant purpose of the scheme in question. One of the ways in which a tax benefit might arise is if "an amount is not included in the taxpayer's assessable income which would have been, or might reasonably be expected to have been, included if the scheme had not been carried out."[57] As in the case of the New Zealand general anti-avoidance provisions, it is theoretically possible that this provision could operate to defeat the use of an entity such as the Liechtenstein *Anstalt*. This might occur where, for example, arrangements have been put in place to use such an entity to avoid the operation of the CFC rules in Australia and thus to exclude from the taxpayer's assessable income the sort of accrual income that might otherwise be attributed. Again, however, it is difficult to see how the existence of such a scheme or arrangement would come to the attention of the tax authorities in Australia given the manner in which the self-assessment regime operates. If the taxpayer feels comfortable enough to answer in the negative the question posed in the annual tax return as to whether he/she has a direct or indirect interest in a controlled foreign company, then that should be the end of the matter (unless perhaps a detailed tax audit should subsequently ensue).

The Australian general anti-avoidance provisions are further limited by the requirement of finding that at least one person who entered into or carried out the scheme did so for the dominant purpose of obtaining a tax benefit.[58] No such requirement is to be found in the New Zealand legislation, which is therefore more extensive in this respect. However, it is interesting to note that where an Australian taxpayer has entered into a scheme on the advice of professional advisers for the purpose of obtaining a tax benefit, the intent or purpose of those advisers may be attributed to the taxpayer. It is no defence that the taxpayer is either innocent or ignorant.[59] This might potentially be the scenario where a

[57] Income Tax Assessment Act 1936 (Cth) s 177C(1)(a).
[58] Ibid s 177A(5) and s 177D.
[59] *Federal Commissioner of Taxation v Consolidated Press Holdings Ltd* (2001) 207 CLR 235.

resident taxpayer has set up a Liechtenstein *Anstalt* or Samoan CCIC to hold offshore investments and/or assets on the advice of financial advisors.

Where it is concluded that a scheme has been entered into for the dominant purpose of obtaining a tax benefit, the Commissioner of Taxation has the power to cancel the tax benefit. If the tax benefit obtained has involved an amount not being included in assessable income, then the Commissioner may determine that the whole or part of that amount is assessable and take action to enforce the re-assessment. However, when considering this possibility in the context of schemes intended to circumvent the CFC and FIF rules, it is necessary to bear in mind that there are also a number of specified exemptions from those rules written into the Australian legislation.

Apart from the exemption for CFC's resident in the seven broad-exemption listed countries, Australia also exempts CFC's that pass the active income test. As noted by one commentator, this exemption "is particularly important for Australian enterprises engaging in genuine business activities in limited–exemption listed or unlisted countries."[60] It is possible that New Zealand will also legislate an "active income" exemption into its CFC regime in the future.

For a CFC resident in one of the broad-exemption listed countries, Australia also permits a *de minimus* exemption. In these cases, income that would otherwise be caught under the accrual regime is exempted if the CFC in question has a gross turnover of less than AUD$1 million and such income does not exceed five percent of gross turnover; or alternatively, it has gross turnover of more than AUD$1 million but such income does not exceed AUD$50,000 in aggregate.

There are also provisions in the Australian legislation to avoid double taxation. Thus, a dividend paid by a CFC to an Australian shareholder out of profits that have already been taxed in Australia under the accruals rules will be exempt from further taxation.[61]

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[60] *Australian Master Tax Guide*, above n 5, para 21-180.
[61] Income Tax Assessment Act 1936 (Cth) s 23AJ.

As regards the Australian FIF rules (effective 1 January 1993) there are a large number of exemptions written into the law. First and foremost, the FIF rules will obviously not apply when the CFC rules operate anyway with regard to an interest in an overseas entity. Secondly, where a foreign company is principally engaged in activities that qualify it for the active business exemption, a resident shareholder in such a company is not subject to FIF taxation. However, there is a long list of activities that will not give rise to the active business exemption in this context. These include: (1) banking and the provision of finance; (2) financial intermediary services; (3) investment in "tainted assets" or "tainted commodity investments"; (4) the life insurance business; (5) management of funds; (6) the general insurance business; and (7) activities in connection with real estate other than construction activities.[62]

There are also specified exemptions for interests in various FIF's in the USA including an unconditional exemption for an interest in an entity treated as a corporation in the USA and subjected to tax on its worldwide income in terms of the US Internal Revenue Code.

Other significant exemptions from the operation of the Australian FIF rules include: (1) where the value of the interests held by an individual do not exceed AUD$50,000; (2) where an individual has an interest in a FIF which is an employer-sponsored superannuation fund; (3) where an interest in a FIF forms part of the taxpayer's trading stock, accounted for at market value; and (4) where the value of the taxpayer's non-exempt FIF interests do not exceed five percent of the total value of all of the taxpayer's FIF interests.[63] However, as of 1 July 2004, the last rule – often referred to as the "balanced portfolio exemption" – is to be further relaxed.[64] From that date, the threshold figure for managed funds is to increase from five percent to ten percent, with a complete

[62] Ibid ss 495-501.
[63] See Income Tax Assessment Act 1936 (Cth) s 515, 519, 521 and 525, respectively.
[64] New International Tax Arrangements Bill 2003 (Cth).

exemption from the FIF rules for complying superannuation funds. This change followed lobbying from the fund management industry. As one commentator notes: [65]

> [M]anagers often reviewed their portfolios before year-end to ensure that they were below the five per cent level, but then there could be a late move in the market that ruined all of their planning. There were also risks that they had wrongly categorized the investments, so that their non-exempt foreign investments actually exceeded the five per cent threshold.

This change means that the risks of managed funds paying tax on income they have not received has been significantly reduced. Nevertheless, under general FIF rules the possibility remains that Australian investors may be taxed on offshore portfolio investments even though they are not entitled to receive dividends or distributions from the investment. As such, they may not have the cash on hand to actually pay the tax. The same situation may also arise in New Zealand.

Meeting the requirements of any of the specified exemptions outlined above should avoid any risk of having the general anti-avoidance provisions applied in either Australia or New Zealand. In fact, a full review of case law in both countries fails to reveal any instances in which the general anti-avoidance provisions have been successfully utilized to counter attempts to plan around or to circumvent the CFC or FIF rules. On the contrary, as seen in the *BNZ* case, a New Zealand court of first instance has implicitly approved offshore structures set up in a manner that would avoid the application of the CFC regime.

VIII CONCLUSION

The foregoing historical review of tax planning strategies suggests that the sheer complexity of the rules greatly assists in creating structures that fall outside the defined scope of the CFC/FIF regimes. For instance, because the CFC rules in both countries contain technical definitions of what constitutes a company, it has been possible in

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[65] Deloitte Touche Tohmatsu *Budget Changes Cut Red Tape for Fund Managers* (14 May 2003) Deloitte Touche Tohmatsu http://www.deloitte.com (at 10 December 2004).

practice for investments to be placed into the ownership of an entity such as a Liechtenstein *Anstalt* or a Samoan CCIC on the basis that these particular entities fall outside the definition of a "company".

Once the taxpayer is satisfied that such an objective has been achieved, then the taxpayer may in all good conscience declare on his/her tax return that he/she has not held any interest in a CFC or FIF during the fiscal year in question. The absence of anti-avoidance case law in either country strongly suggests that legitimate tax avoidance has indeed been realistically possible in this area and such avoidance has in some cases been assisted by the self-assessment regimes. This means that some taxpayers have probably felt comfortable taking an aggressive approach to the completion of their tax returns.

This conclusion is further strengthened by the complete absence of any tax evasion prosecutions in either country in relation to actions taken to circumvent the effect of the CFC or FIF rules. If the likely non-disclosure of interests in CFC's and FIF's has failed to generate even one successful tax evasion prosecution, then it must be concluded that legitimate tax avoidance has indeed been eminently possible. Likewise, the tax authorities in both countries have proven unable to police their international tax regimes beyond accepting at face value the declarations made by taxpayers on their annual returns. On the other hand, there may well have been confidential settlements between taxpayers and the revenue authorities in both countries when offshore interests have come to light.

Finally, can any action be taken by the tax authorities to clamp down on tax avoidance in the international tax regime area? One obvious step would be to amend the law in both countries so as to specify that interests in a Liechtenstein *Anstalt* or a Samoan CCIC are to be treated as interests in a CFC or FIF. This would seem quite logical given that the Samoan CCIC is being promoted over the internet as a vehicle to escape the application of the Australian CFC rules. However, there may be further unique legal entities in other jurisdictions that have so far escaped attention and these would remain unaffected if this very specific approach were to be adopted. A more efficacious approach might be for the tax authorities to state publicly that investing offshore via such exotic entities will likely trigger an investigation. The basis for the investigation might be that using such holding vehicles constitutes an “arrangement” or “scheme” running contrary to the general anti-avoidance provisions in force in each jurisdiction. Undoubtedly, this would trigger a loss of interest in the use of such entities.

Beyond that, the best course of action for the tax authorities is to change direction altogether and define CFC’s or FIF’s by reference to the subjective intent of the taxpayer, rather than rely on overly technical definitions as to what constitutes a company, fund, or other targeted investment vehicle. This approach should serve just as well in “preparing the battlefield” for deployment of the general anti-avoidance weapon.