Article on section HD 15

Section HD 15 of the Income Tax Act 2007 (ITA) is directed towards the recovery of income tax when there has been asset stripping of companies. The mischief that the section is directed towards is a company left with insufficient financial resources to discharge its income tax liability. There needs to be an arrangement in place, the purpose of which is to leave the company in a position where it cannot meet its tax liability.

Section 61 of the Goods and Services Tax Act 1985 (GST Act) imports the wording of section HD 15 into the GST Act for recovery of an unpaid GST lability from a company[1]. The section requires the wording of s HD 15 to be altered for the different context so when section 61 of the GST Act applies the phrase "the tax year" appearing in s HD 15 becomes the "taxable period".

The tax liability in question can be either an existing liability arising from returns the company has filed but not paid, or can arise in situations where Inland Revenue reassesses the company for more income tax than was returned. It is the latter situation in which the drafting of the section is problematic.

In this reassessing situation, there are two time bar provisions explicitly provided for in s HD 15. The first deals with the time in which the Commissioner must raise assessments against the company. This is contained in s HD 15(6), which empowers the Commissioner to make assessments "at any time after the liquidation…. as if the company had not been liquidated." The section also says that the time bar applies, which is a reference to s 108 and 108A of the TAA.

The second time bar is provided in section HD 15 (8) and is directed towards providing a time bar for the imposition of liability on the agent, be that a director or shareholder. It is set out below:

> *No liability arises under this section for a tax year in relation to which—*
>
> *(a) a company has provided returns within the time allowed by section 37 of the Tax Administration Act 1994 for providing returns for the tax year in which the company is liquidated; and*
>
> *(b) the Commissioner has not issued a notice of assessment of the company for the tax year before the end of 4 years following the end of the tax year in which the company is liquidated.*

Inland Revenue takes the view that the words "liquidation" and "liquidated" appearing in s HD 15(6) and (8) means the date on which the company is finally removed from the register at the end of the liquidation process rather than the date on which a liquidator is appointed. If that view is correct, the period of time over which Inland Revenue can reassess a company and a director and/or shareholder under s HD 15 is largely open ended and can exist for a lot longer than the normal 4 years following the end of the income tax year in which the return is filed.

This article suggests that Inland Revenue's interpretation is wrong and that the better view is that the words "liquidated" and "liquidation" refer here to the start of the liquidation process when the liquidator is appointed.

[1] For ease of reading I will use the word "tax" to cover both income tax and GST unless otherwise stated.

Firstly, liquidation is a Companies Act concept. In the Companies Act the word "liquidation" refers to a process. It commences on the date on which the liquidator is appointed: see the Companies Act s 241(5). The period is terminated when the conditions described in section 249 of the Companies Act are met.

The ordinary meaning of the words "liquidate" and "liquidation" are respectively:

> *Liquidate*[2] *– "ated" verb (earlier)…1 verb trans, determine and apportion by agreement or litigation... 5(a) ascertain and set out clearly the liabilities of (a company or firm) and arrange the apportioning of the assets; wind up..(b) go into liquidation.*
>
> *Liquidation – "..3 the action or process of winding up the affairs of a company etc; the state or condition of being wound up: esp in go into liquidation…"*

Therefore, the phrase "in which the company is liquidated" in s HD 15(8) can mean in ordinary English usage the year in which it is placed into the process of liquidation.

Secondly, the definition of the word "liquidation" in the Income Tax Act is an inclusive definition, so it expands the ordinary meaning of the word. Just because it expands the meaning to encompass the end of the process does not mean that the ordinary meaning of the word has changed or is excluded. All definitions in YA 1 are subject to the qualification "unless the context otherwise requires".

There are contextual indicators that support the earlier point. In this regard it is desirable that the phrase "the end of the tax year (GST period)" is interpreted in a way that gets the same outcome whether it is applying to a tax year or GST period. In this regard it is clear that in a GST context the phrase must refer to the date the company was placed in liquidation because otherwise it makes a nonsense of other provisions.

For example, pursuant to section 58 of the GST Act a liquidator is a specified agent of the company, and an agency period begins on the date of their appointment. The specified agent is treated as the registered person and the incapacitated person, which is the company in this instance, is not treated as carrying on the taxable activity. Therefore, the last return the company will make, as opposed to the return that will be made by the specified agent, will be for the period prior to their appointment as liquidator.

This implies that, for the purposes of section 61 and section HD 15 (8), the words "in which the company is liquidated" must be a reference to the date on which the liquidation commenced.

When the words "in which the company is liquidated" as they appear in section HD 15 (8) are read as meaning the date on which the liquidation commenced, then there are sensible time constraints within which an agent may be made liable for the tax of the company. Those constraints are broadly aligned with the ordinary four year time bar contained in section 108 and section 108A of the TAA.

As mentioned, the same interpretation of the phrase "in which the company is liquidated" should be used for both the GST and income tax assessments. The Tax Administration Act 1994 "TAA" is not as prescriptive as the GST Act in terms of delineating between the pre and post liquidation return position of the company, but there are nonetheless statutory clues. The first one is that s HD 15(8)(a) says that the protected tax year has to be one where the company has provided returns within the time allowed by s 37 of the TAA. Section 37 is the provision dealing with the normal routine filing of annual returns. That can be contrasted with section 44 which applies inter alia to companies in the course of being liquidated. It enables the Commissioner to request a special return for any stipulated period. The

[2] Shorter Oxford Dictionary.

reference to s 37 rather than s 44 implies that it is the final normal return filed by the company before the liquidator is appointed that is in scope.

Generally speaking, the Courts strive for a consistent interpretation. It would be an odd outcome if for GST purposes the s HD 15 time bar ran from the date the liquidator was appointed and for income tax purposes it ran from the date on which the company was struck off at the end of the liquation process. It is far harder for the Commissioner to support her late date interpretation when it comes to GST as opposed to income tax.

Thirdly, section HD 15 (7) deals with the mechanics of reassessing the company. It specifically requires the Commissioner to nominate the person or persons as having the tax obligations set out in the assessment of the company under s HD 15(6). That person or persons must be the shareholders and/or director and by virtue of the Commissioner's nomination are treated as agents of the company and have challenge rights.

Section HD 15(7) is explicitly linked to subsection 6 and subsection 6 explicitly incorporates the normal time bar provisions. The normal time bar provisions drive off the routine return and assessment cycle which must apply to the pre liquidation returns because the section as a whole is directed to arrangements which have a consequence of placing the company in liquidation. The fact of liquidation is the evidence that the arrangement meant that the tax could not be paid. The arrangement must precede that event.

For completeness it is important to set out Inland Revenue's reasoning. It is firstly that the word "liquidation" as defined in s YA 1 is capable of including the end of the whole process of liquidation. They say that the use of the past tense "liquidated" means that Parliament had the end of the liquidation process in mind.

One practical issue that arises with s HD 15 and reassessments is that Inland Revenue will typically send it to the liquidator. The liquidator will typically do nothing as the company will have no assets and the liquidator will not have the resources or motivation to investigate and oppose. Consequently, the liquidator normally does not challenge the assessment.

The follow on effect of that is that the director or shareholder who is assessed as an agent is often either too late or not allowed by Inland Revenue to dispute the assessment of the company. That means there is no ability to dispute the correctness of the reassessment but only the existence of the prohibited arrangement.

In the author's view of s HD 15(7) is intended to afford the director and/or shareholder the full challenge rights as to the correctness of the company's reassessment. This is because that section requires the Commissioner to dominate the persons who will have the tax obligation under the reassessment raised under s HD 15(6). The implication is that that person is the one who is the agent and the section provides notification and objection rights.

While the section refers only to the objection procedure, section 113 of the TAA would also engage and that section also requires notice to be given to the taxpayer affected. Here the taxpayer affected includes the director and/or shareholder. The director and/or shareholder would have challenge rights under s 89D and 89G of the TAA.

Interesting issues would arise should the Commissioner not notify the director and/or shareholder of the company's reassessment under s HD 15(7). There may be the option of Judicial Review as challenge rights vis-à-vis the correctness of the company's reassessment would have been denied the director or shareholder and hence the preconditions for review stipulated by the Supreme Court in *Tannadyce Investments Limited v CIR* (2001) 25 NZTC 20-103 would apply.

In conclusion there are strong contextual pointers in s HD 15 towards both time bars running from the end of the tax year or GST period in which the company was placed into liquidation, rather than from the end of the tax year or GST period in which the company was struck off the record.

These are just some of the myriad of interpretational issues s HD 15 raises and has raised in the past. It will be interesting to see if a case does make it to Court soon so that the scope of this section can be delineated more clearly.