IN THE SUPREME COURT OF NEW ZEALAND

SC 14/2014
[2014] NZSC 68

BETWEEN	SOVEREIGN ASSURANCE COMPANY LIMITED First Applicant
	ASB BANK LIMITED Second Applicant
	SOVEREIGN SERVICES LIMITED Third Applicant
	CBA ASSET FINANCE (NZ) LIMITED Fourth Applicant
	CBA FUNDING (NZ) LIMITED Fifth Applicant
	CBA DAIRY LEASING LIMITED Sixth Applicant
AND	COMMISSIONER OF INLAND REVENUE Respondent

Court: Elias CJ, William Young and Arnold JJ

Counsel: L M McKay and M McKay for Applicants
D J Goddard QC and H W Ebersohn for Respondent

Judgment: 10 June 2014

JUDGMENT OF THE COURT

The application for leave to appeal is dismissed.

REASONS

[1] Sovereign Assurance Co Ltd (Sovereign) seeks leave to appeal from a judgment of the Court of Appeal[1] dismissing an appeal from a judgment delivered by Dobson J[2] in which he rejected Sovereign's challenge to income tax assessments which involved the reversal of Sovereign's treatment of its receipt and later repayment of refundable commissions paid to it by reinsurers in relation to life insurance policies.

[2] Sovereign commenced business in the late 1980s and at that time, or shortly afterwards, it entered into reinsurance arrangements. The arrangements in issue in the proceedings took effect from 1 April 1992 and had two key features:

(a) reinsurance of mortality risk; and

(b) refundable commissions paid to Sovereign by the reinsurers.

[3] The refundable commissions provided financing for Sovereign in the early stages of its business. They were calculated by reference to the initial premiums and were refundable with interest from future premiums. This was pursuant to arrangements which did not impose on Sovereign an absolute liability to repay but which practically assured that the commissions would be refunded with interest.

[4] Sovereign treated the commissions as taxable income when received and the commission repayments as deductible when made. The Commissioner's approach under the accruals regime was to treat the commission repayments as deductible only to the extent that they exceeded the commissions received by Sovereign and to spread the deductibility over the terms of the commission arrangements. So in issue is a question of timing which in normal circumstances would have no practical ramifications. In this case, however, Sovereign was taken over by ASB Bank in December 1998 and it cannot carry forward tax losses incurred before then. On the basis of the reversal of its tax treatment of the refundable commission arrangements,

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1 *Sovereign Assurance Co Ltd v Commissioner of Inland Revenue* [2013] NZCA 652 [*Sovereign* (CA)].

2 *Sovereign Assurance Co Ltd v Commissioner of Inland Revenue* [2012] NZHC 1760.

Sovereign has incurred losses before 2000 which it cannot use to shelter the increased income resulting from the Commissioner's refusal to allow deductions for repayments made from 2000. The core tax involved is around $47.5m and, with use of money charges, the total amount at stake is around $90m.

[5] The case narrowed in scope considerably after the High Court judgment. What is now in issue can be shortly stated.

[6] It is now common ground that the reinsurance treaties fell within the definition of "financial arrangement" for the purposes of s EH 14(b) of the Income Tax Act 1994 but with the mortality risk reinsurance provisions excepted. This means that s EH 10 applies:

> **EH 10 Relationship with rest of Act**
>
> *Qualified accruals rules override*
>
> (1) Notwithstanding any other provision in this Act, gross income or expenditure in an income year in respect of a financial arrangement under the qualified accruals rules shall be calculated under those rules.
>
> …
>
> *Property transfer price*
>
> (2) Where
>
> (a) property is transferred under a financial arrangement, and
>
> (b) the property or the consideration given for the property is relevant under any provision of this Act other than the qualified accruals rules for the purpose of determining any amount of gross income or allowable deduction of a person,
>
> the property shall be treated for the purpose of that provision as having been transferred under the financial arrangement for an amount equal to the acquisition price of the property.

[7] The Court of Appeal judgment records at [57] an argument from Sovereign to the effect that it could rely on s EH 10(2) on the basis that the commission arrangements involved a sale of property (akin to the factoring of debts). In the leave submissions, Sovereign denies advancing that submission but the respondent maintains that the submission was advanced and gives examples from what was said

in the Court of Appeal as indicating that Sovereign was seeking to rely on s EH 10(2). We do not need to resolve this. It is sufficient to say that Sovereign is not now seeking to rely on s EH 10(2).

[8] It is common ground that if the accruals regime applies to the refundable commission transactions as a whole, then the Commissioner's assessments are correct. Sovereign's position is that:

(a) The accruals regime applies only to the deferral element of a transaction. The example given is of services to the value of $100 being provided for $110, the extra $10 reflecting an agreement by the supplier not to demand payment for a year. Sovereign says that in such a case the $100 is assessable on ordinary principles and the accruals regime applies only to the $10.

(b) On the application of ordinary principles, Sovereign's tax treatment of the refundable commission arrangements was correct.

[9] Both Dobson J and the Court of Appeal rejected Sovereign's contention as to the limited application of the accruals regime. As well, Dobson J held that in accordance with ordinary principles, the refundable commissions were not income and that accordingly the repayments were not deductible. Two members of the Court of Appeal panel reached the same conclusion. In part, this was because they treated them as loans (see [122]–[124] of the Court of Appeal decision) but their conclusion was also based on the premise that the refundable commissions could not be "counted as gains completely made" (an expression which comes from an Australian case).[3] In this latter respect their conclusions were to the same effect as those of Dobson J.

[10] It follows that if the legal arguments which Sovereign wishes to advance as to the displacement of the accruals regimes and the categorisation of the arrangements as loans were to succeed, Sovereign still faces the hurdle of findings on the capital/revenue issue. These findings could be categorised as being factual but even

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3 *Sovereign* (CA), above n 1, at [119].

if they are not, we see no good reason for allowing a second appeal. The relevant principles are well established, if not always easy to apply. The question raised by the case is thus one of application rather than principle and there is no appearance of a miscarriage of justice.

[11] Accordingly, the application for leave to appeal is dismissed.

Solicitors:
Bell Gully, Auckland for Applicants
Crown Law Office, Wellington for Respondent