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IN THE HIGH COURT OF THE COOK ISLANDS
HELD AT RAROTONGA
(CIVIL DIVISION)

OA No. 2/2014

IN THE MATTER	of the Income Tax Act 1997
BETWEEN	AIR RAROTONGA LIMITED of the Cook Islands, Company Appellant
AND	ANDREW JOHN HAIGH, Collector of Inland Revenue Respondent

Hearing date:	28, 29 & 30 December 2016, (CIT), 25 February 2017, 21 April 2017 (NZT)	
Decision:	24 July 2017 (NZT)	
Appearance:	G Clews & SJ Davies	for Appellant
	M Ruffin	for Respondent

JUDGMENT OF GRICE J
(Case Stated)

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Summary of Decision

Answers to Case Stated Questions

(a) Whether the Respondent was correct in disallowing the accounting provisions made for expected future expenditure on aircraft maintenance on the basis that the expenditure had not been incurred for the purposes of section 58 of the Income Tax Act 1997;

Answer: The Respondent was correct.

(b) Whether the Respondent was correct in capitalising and depreciating the C-Check costs under section 59(a) of the Income Tax Act 1997, and depreciating the asset under section 60(1) of the Income Tax Act 1997;

Answer: The Respondent was not correct.

And

(c) If the Appellant wishes to claim depreciation, should the rate be 100% under section 45 of the Income Tax Act 1997 instead of 10% on certain assets under section 60(1) of the Income Tax Act 1997.

Answer: The rate should be 100% under section 45 of the ITA.

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Introduction

1. The Collector of Inland Revenue is responsible for tax assessment and collection.[1] If a taxpayer objects to an assessment the Collector must consider the objection and if he disallows it he must give a notice of disallowance. If dissatisfied with the outcome, the taxpayer may then require the objection to be heard and determined by this court.[2]

2. This case concerns assessments of tax made by the Collector of Inland Revenue in relation to Air Rarotonga. Air Rarotonga objects to the tax treatment of costs associated with its aircraft. The objections relate to the five income years ended 31 December 2005, 2006, 2007, 2008 and 2009 respectively.[3]

3. Air Rarotonga is a company incorporated in the Cook Islands. It is the only local commercial airline and flies between the islands in the group. It is based in Rarotonga and employs 114 staff. It operated a fleet of 4 aircraft: 1 SAAB 340; 2 Embraer Bandeirante aircraft and 1 Cessna 172.

4. Air Rarotonga's objections relate to three main issues. The first and second concern the tax treatment of the costs of a periodic inspection and related work done on its SAAB aircraft known as a C-Check. The third objection relates to the depreciation allowed on the acquisition of a SAAB aircraft in 2000 and a Bandeirante aircraft in 2005.

5. To keep aging aircraft certified as airworthy and able to continue in service, regular or scheduled inspections, repairs and maintenance are required in addition to "for cause" work. The inspections and work are required on aging aircraft at various periods based on the number of completed flight hours.

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[1] Income Tax Act 1997 (ITA)
[2] Section 29(2) ITA
[3] The returns for these years were filed on 15 March 2011. These proceedings are brought by way of case stated under part IV of the ITA.

6. In its annual financial accounts, Air Rarotonga made provision each year for expected future costs of the inspections, repairs, and work required on its aircraft based on experience and costs. The work required in carrying out these operations could be anticipated based on known requirements for the aircraft and records of previous years' cycles of work.

7. Issues 1 & 2 in this case relate to the tax treatment of the financial provisions relating to the anticipated regular but significant inspection and related work for the SAAB C-Check.[4] The C-Check must be done at approximately every 4,000 flight hours and takes place after 2-3 years of flying.[5] The financial accounts made provisions for the upcoming expenditure spread over the years before a C-Check.

8. The Commissioner did not allow deductions for the provisions related to the C-Check in the relevant years. The Collector instead capitalised the expenditure outlaid on the C-Check in the year in which it was expended and allowed deductions by way of depreciation on the capitalised amount spread over the years leading to the next C-Check.[6]

9. The third issue relates to the depreciation allowed on the purchase price of the SAAB and a Bandeirante aircraft. The SAAB was purchased by Air Rarotonga

[4] Aircraft maintenance comprises day to day maintenance as well as a periodic invasive examination known as a "Corrosion, Fatigue and Structure Check". In the case of the SAAB this is known as the C-Check. The SAAB aircraft was the only plane that was subject to the C-Check. The C- Check involves specified inspections and work including replacement of componentry. Other significant checks and work would be done at the time of the C-Check to take advantage of the aircraft being out of service and in the workshop.

[5] Ms Thomson for the Collector refers to the C-Check being due after 4,000 landings. Mr Polley the expert on aircraft maintenance called by Air Rarotonga refers to 4,000 flight hours. There is no material difference for the purposes of this decision.

[6] Prior to the years the subject of the objections the C Check costs had been dealt with by way of provisioning the work over the period leading to the C Check. An additional issue arose during the hearing as to the method and calculations by the Collector to take account of deductions made for provisions pre 2005 by the Collector. I deal with the Collector's approach in more detail below.

in 2000 and the Bandeirante in 2005. Depreciation was allowed on the SAAB on acquisition.

10. Until 2005 Air Rarotonga applied a depreciation rate of 100% to its new aircraft and all its Cook Islands new assets. The Collector allowed this by allowing a rate of 100% applicable on the acquisition cost of certain assets new to the Cook Islands.[7]

11. In its 2005 financial accounts Air Rarotonga applied the 100% rate to certain assets qualifying for that rate but not to others. In particular, it applied a lower rate to the SAAB and the Bandeirante. The SAAB had been depreciated by 100% when it was acquired (2000). Air Rarotonga said it had not had the full benefit of the depreciation allowed on the SAAB due to an error made in the restructuring of the company shareholding in 2004. It had therefore lost the ability to offset past losses (including the depreciation) against future income. It also sought to depreciate the purchase price of a Bandeirante acquired in 2005. The Collector takes the position that the applicable depreciation rate on both aircraft is 100%.

12. The Collector issued amended notices of assessment for each of the 2005 to 2009 years after making adjustments relating to the treatment of the C-Check costs and the depreciation on the acquisition of the SAAB and Bandeirante.

13. Air Rarotonga objected to the Collector's assessments for those years. It took the three points of objection. These objections were disallowed by the Collector.[8]

Case stated

[7] Section 45 ITA.
[8] Other objections were allowed.

14. The questions for determination before me are set out in the Case Stated as follows:

    (a) Whether the Respondent was correct in disallowing the accounting provisions made for expected future expenditure on aircraft maintenance on the basis that the expenditure had not been incurred for the purposes of section 58 of the Income Tax Act 1997;

    (b) Whether the Respondent was correct in capitalising and depreciating the C-Check costs under section 59(a) of the Income Tax Act 1997, and depreciating the asset under section 60(1) of the Income Tax Act 1997; and

    (c) If the Appellant wishes to claim depreciation, should the rate be 100% under section 45 of the Income Tax Act 1997 instead of 10% on certain assets under section 60(1) of the Income Tax Act 1997.

15. Air Rarotonga posed the third question for determination in two parts. These are:

    (a) Whether annual 10% depreciation was able to be spread over a number of years rather than the 100% being taken in the year of purchase; and

    (b) Whether the acquisition of an aircraft in 2005 entitled Air Rarotonga to elect how to spread its depreciation on that aircraft rather than depreciating at 100% in the first year.

16. During the hearing, Air Rarotonga raised a subsidiary issue concerning statutory interpretation based on the Constitution. It says that if there is any ambiguity in the wording of the legislation a meaning which is most favourable to it should be adopted. This is because rights which are enshrined in the Constitution (including the provisions specifically relating to statutory

interpretation in Article 65(2)[9]) are to protect individuals' rights to property which are at stake in this case.

Approach to objection

17. The manner the Court must approach an objection is set out in the ITA as follows:[10]

> "29. Collector may amend assessment, or objection may be submitted to High Court - (1) The Collector shall consider every objection and may alter the assessment pursuant thereto.
>
> (2) If an objection is not allowed by the Collector, the objector may, within three months after the date on which notice of the disallowance is given to the objector by or on behalf of the Collector, by notice in writing to the Collector require that the objection be heard and determined by the High Court before a Judge thereof, and in that event the objection shall be heard and determined in the High Court and the High Court shall for the purpose of hearing and determining the objection, whatever the amount involved, have all the powers vested in it in its ordinary civil jurisdiction as if in an action between the objecting taxpayer and the Collector (emphasis added).
>
> "(3) If the Collector, after considering the objection, has allowed the objection in part and has reduced the assessment, the reduced assessment shall be the assessment to be dealt with by the High Court.

[9] Art 65(2) Every enactment, and every provision thereof shall be deemed remedial, whether its immediate purpose is to direct the doing of anything that the enacting authority deems to be for the public good, or to prevent or punish the doing of anything it deems contrary to the public good, and shall accordingly receive such fair, large, and liberal construction and interpretation as will best ensure the attainment [[of the object]] of the enactment or provision thereof according to its true intent, meaning and spirit.
[10] Section 29 ITA

> 30. Hearing of objections by High Court - (1) The procedure for the institution, hearing, and determination of such proceedings in the High Court shall be in accordance with the ordinary practice of that Court.
>
> (2) No objection to an assessment of income tax shall be heard by a Judge in open Court.
>
> 31. Burden of proof on objector - On the hearing and determination of all objections to assessments of income tax the burden of proof shall be on the objector, and the Court may receive such evidence as it thinks fit, whether receivable in accordance with law in other proceedings or not (emphasis added).
>
> 32. Costs - On the determination of any objection the High Court may award against the Collector or against the objector such costs as it deems just (including interest on tax payable or received).
>
> 33. Court may confirm, cancel or alter the assessment – On the determination of any such objection the High Court may either confirm or cancel the assessment, or increase or reduce the amount thereof, and the assessment shall be altered by the Collector, if necessary, so as to conform to that determination (emphasis added)."

18. I now turn to the issues.

The C-Check

19. The first and second issues relate to the treatment by the Collector of the costs of the C-Check inspection and related work.

20. The Collector disallowed Air Rarotonga's annual deductions of amounts it had provisioned based on its estimates of future expenditure likely to be spent on the SAAB at the next C-Check. In the main these were expenses for work usually undertaken by Air Nelson in its workshops in New Zealand.

21. A C-Check is required after the SAAB has flown 4,000 hours. It involves a thorough inspection of the plane, replacement of various components and the undertaking of work required to bring it up to a standard of prescribed airworthiness. The plane cannot continue in service without satisfying the C-Check inspection. In summary the work is extensive and involves stripping down and dismantling the aircraft and invasive exploration for faults and fatigue as well as routine componentry replacement and other planned work. It takes some 5,000 man hours to complete. Detailed evidence was given as to the work involved.[11] I do not intend to set out the detail of that evidence but for the SAAB it included:
    - Taking it out of service for a period of approximately 11 weeks:
    - Flying it to Nelson to enable Air Nelson the contracted service provider to undertake the required inspection and work at its workshops;
    - A close examination of the aircraft using x ray equipment and a substantial dismantling of the aircraft.
    - Routine component replacement and servicing as well as work required where defects were discovered in inspection.

22. In addition to the C-Check other periodic inspections, procedures and work were scheduled for the SAAB. These included inspections and work at the expiration of a prescribed number of flight hours known as the A and B Checks.

23. The airworthiness regime for the SAAB is based on the aircraft manufacturer's requirements, international and national airworthiness notices and the requirements of the civil aviation and airport authorities. Updated notices and requirements are promulgated from time to time as fresh technical information emerges from accident investigations and as problems emerge in aging aircraft. These are incorporated into the aircraft maintenance requirements

[11] Mr Polley, is an aircraft maintenance and operations consultant who had undertaken work for Air Rarotonga and was familiar with its maintenance and airworthiness regime gave evidence as to the requirements. No issue was taken by the Collector about the nature or extent of the C-Check processes or the accuracy of the forecasting.

and checklists. Air Nelson maintained ongoing records of requirements for the SAAB and incorporated these into scheduled maintenance and work for it. Air Rarotonga fed the flight information and maintenance on its aircraft into the system. The computer-based system which maintained the information and scheduled the planning for inspections and maintenance on the aircraft was known as RAMIS.

24. Air Nelson agreed to ensure the currency of all the maintenance manuals and service information and new requirements. In some cases, these requirements would not apply to a particular aircraft due to its operating environment or other factors. Nevertheless, the requirement must be noted.[12]

25. A corrosion protection inspection (CPCP) is required in aging aircraft. The SAAB required this check around the four and six-year mark. If possible this check is scheduled to coincide with the C-Check. Invasive structural fatigue inspections required by the manufacturer at specified periods are often carried out at the time.

The contractual arrangements between Air Nelson and Air Rarotonga

26. The SAAB's C-Check inspection and related work must be carried out by approved aircraft engineers. Air Nelson was approved and it had the x-ray and other sophisticated equipment needed to carry out the C Check. At the end of the check, if the requisite work is carried out satisfactorily the aircraft is certified as airworthy.[13] The airline has responsibility for keeping the aircraft in a state of continued airworthiness and cannot contract out of this primary responsibility.

[12] For instance Mr Polley gave the hypothetical example of a requirement for defrosting equipment. This would not be needed in an aircraft flying in high temperatures such as the Cook Islands. The requirement and action or reason for it not being necessary would be noted.
[13] Evidence was given that Air Rarotonga now undertakes the C-Check work using workshops in Hamilton New Zealand as well as keeping the records. I do not take this into account as it post-dates the arrangements relevant to this case. Nevertheless it does illustrate there were options available to Air Rarotonga other than Air Nelson carrying out the work.

27. An Agreement for Provision of Maintenance Services for a SAAB 340 aircraft between Air Nelson Ltd and Air Rarotonga Ltd dated 8 June 2004 was produced. The Agreement was varied by a letter dated 14 October 2008.[14] The contractual documents between Air Nelson and Air Rarotonga specify the work to be done and the manner of charging. It does not bind Air Rarotonga to have the C-Check carried out by Air Nelson. However, if it did choose to do so Air Nelson agreed to perform the services on the terms and to the standards prescribed in the contract.

28. Under the agreement, Air Nelson agreed to perform specified aircraft maintenance including the C-Checks and associated work, structural and corrosion program inspections and associated rectification. The agreement provided (among other things):
    - Air Nelson will maintain an adequate engineering establishment to carry out its obligations in Nelson. The workshops in which the work is carried out must comply with the standards laid down by the Director of Civil Aviation, Civil Aviation Authority of New Zealand.
    - The contract is for a period of two years and thereafter may be terminated by six months' notice in writing by either party.
    - The agreement will be reviewed annually and Air Rarotonga may amend or delete contracted services if it decides to perform those or part of them itself.
    - The work must comply with the practice and standards laid down by the Director and as required by the SAAB manufacturer's documentation, the Customer's Operator Maintenance Manual and schedules and other requirements.
    - Agreed charge out rates for labour and allowances as well as the pricing for consumable materials, components and standing charges.

[14] This variation was not the subject of detailed evidence. It appears irrelevant in relation to the matters before the court.

- Requirements for notifying Air Rarotonga of the work required and for recording the maintenance and repairs carried out.
- Terms of payment.
- That Air Nelson keep records of the maintenance and repair work carried out.
- Air Rarotonga is not absolved from the final responsibility for ensuring the safe operation and airworthiness of the aircraft.

29. The agreement also covered matters such as the standard of work required, delegation of work, warranties and insurance and indemnities and the usual contractual terms.

30. The agreement noted that Air Nelson's services are crucial to Air Rarotonga not only in carrying out the C-Check inspection and related work, but in maintaining the airworthiness certification for the SAAB.

31. Furthermore Air Nelson supplied "Technical Services" support for the SAAB. It was responsible for the maintenance of the aircraft engine and components' records and receiving and entering them into the computerised maintenance and inventory control system, RAMIS. It also agreed to maintain records in RAMIS including flight logs and schedules of maintenance to be actioned by Air Rarotonga. The set or standing charges payable for the technical services and record keeping and monitoring work were specified in the agreement.

32. Air Nelson maintained the computer records and it advised Air Rarotonga when and what maintenance was required. When the C-Check and other larger scale inspections and maintenance were required it provided to Air Rarotonga the schedules of required work in advance. These records enabled Air Rarotonga to estimate future C-Check expenditure.

33. The work and amounts invoiced for the C-Check costs were produced. No issue was taken either with the amounts nor the fact they were incurred in the

production of income. The issue relates to the nature of the deductions and their timing and whether Air Rarotonga's provisions should be allowed or some other tax treatment should apply to the C-Check expenditure.

The First Issue – Whether the Provisions for Upcoming C-Check are Deductible

34. Air Rarotonga says its provisioning relating to the C-Check should be deductible. It says the provision is "necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income" for the income year in which the provision is recognised.[15]

35. Air Rarotonga says the provisions are based on reliable forecasts or estimates of the likely cost of the C-Check and associated work. These are reliable because of the meticulous recording of previous work, expenses and costs, experience of work likely to be required based on past experience, future planning and the review and adjustment of those costs from time to time to take into account changes in price Air Rarotonga said that in relation to the maintenance spend overall, while there were fluctuations between years, over a ten year period Air Rarotonga overspent its maintenance provisions by only about $42,000. No issue was taken with this evidence and I accept that the costs were able to be estimated with some accuracy for provisioning purposes.

36. Recognition of the provisions in the financial accounts enabled Air Rarotonga's management and board to take into account upcoming expenditure.

37. Air Rarotonga says that the provisions were properly made because:

[15] Section 58(b) ITA

(a) The SAAB was using up its airworthy certified flying hours as it moved toward the next C-Check and produced income for the business by providing flight services for paying customers.

(b) Air Rarotonga was under compliance obligations to meet the C-Check expenditure in order to ensure that the SAAB was airworthy and able to remain in service to enable the business to continue.

(c) These obligations were imposed as a result of the airworthiness requirements which Air Rarotonga had to meet.[16]

(d) The maintenance was required to keep an aircraft in a state of constant airworthiness including the costs of the C-Checks.

(e) The SAAB was operated in the context of a commercial airline and enduring business which depended on deploying airworthy aircraft. To operate this business model, the airline was obliged to undertake the C-Check on the SAAB.

38. Counsel for Air Rarotonga accepted that there was no obligation to engage Air Nelson to perform the cost of the C-Check work under the agreement. It could have chosen to do the work itself or have the work done elsewhere.

39. The Collector disallowed the deductions for the provisions for the C-Check and related work. He capitalised and depreciated the C-Check expenditure over future years. That tax treatment is the subject of the 2nd issue which is dealt with below.

What is Deductible?

[16] The combined effect of the Civil Aviation regulations, manufacturers specifications and requirements for the aircraft as well as the standing arrangements with Air Nelson

40. The starting point is that income tax is imposed on income derived by a person in the Cook Islands.[17] Assessable income includes "profits or gains derived from any business"[18] Deductions which may be made in calculating assessable income are specified in the ITA.[19] The Act provides:

> "58. Expenditure or loss incurred in the production of assessable income - In calculating the assessable income of any taxpayer, any expenditure or loss may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred, to the extent the expenditure or loss is -
> (a) incurred in gaining or producing the assessable income for any income year; or
> (b) necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year."

41. The New Zealand legislation is to similar effect, although the language has been simplified. It provides:

> "**DA 1 General permission**
> *Nexus with income*
> (1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—
> (a) incurred by them in deriving—
> (i) their assessable income; or
> (ii) their excluded income; or
> (iii) a combination of their assessable income and excluded income; or
> (b) incurred by them in the course of carrying on a business for the purpose of deriving—
> (i) their assessable income; or
> (ii) their excluded income; or

[17] Section 39(2), ITA.
[18] Section 46(1)(a) ibid.
[19] Section 57 & 58 ibid.

(iii) a combination of their assessable income and excluded income.[20]

42. Certain deductions are not permitted under the ITA. In particular there is a limitation on deductions for capital expenditure.[21]

> "59. Certain deductions not permitted - Notwithstanding anything to the contrary in section 58, in calculating the assessable income derived by any person no deduction, except as expressly provided in this Act, shall be made in respect of any of the following sums or matters -
> (a) investment, expenditure, loss or withdrawal of capital; money used or intended to be used as capital; money used in the improvement of premises occupied; or interest which might have been made on any such capital or money if laid out at interest
> ...."

Any deduction for repairs is limited to the amount usually expended in any year for those purposes, except as expressly provided in the ITA.[22]

> "60. Deductions for repair, maintenance and depreciation -
> (1) Notwithstanding anything to the contrary in section 58, in calculating the assessable income derived by any person from any source no deduction shall, except as expressly provided in this Act, be made in respect of any of the following sums or matters: namely, the repair of premises, or the repair of plant, machinery, or equipment used in the production of income beyond the amount usually expended in any year for those purposes:
> Provided that in cases where depreciation of any asset, whether caused by fair wear and tear or by the fact of such asset becoming obsolete or useless, cannot be made good by repair, the Collector may allow such deduction as the Collector thinks just; …"

[20] Section DA 1, Income Tax Act 2007
[21] Section 59 ibid.
[22] Section 60 ibid.

43. If an expense is not subject to a timing regime it must be allocated to the income year in which it was incurred. Whether and when provisions are "incurred" and deductible has been considered in a number of cases.

44. In the Privy Council decision *CIR v Mitsubishi Motors NZ Limited*, the issue was whether an accounting provision for the likely cost of warranty claims on motor vehicles manufactured could be deducted in the same year as the income from the sale of the cars.[23] The work required under the warranty for these vehicles might not be carried out until in a later year.[24] The High Court (NZ) had accepted that the anticipated cost of the total annual warranty liability for the cars manufactured in the year of provision could be established. The percentage of vehicles which would have defects and the total cost to remedy these defects in a given year could be predicted with some accuracy based on previous experience. A warranty from Mitsubishi attached to each vehicle manufactured and contractually bound it to pay the costs of any work or parts claimed by buyers in the terms set out in the warranty.[25] The Privy Council upheld the High Court and the Court of Appeal and allowed the deductions. It agreed that the accounting provisions that Mitsubishi had applied were deductible in the year of manufacture.

45. In reaching this conclusion their Lordships noted:
    - The issue of whether the warranty costs were incurred in the year of manufacture was primarily a matter of construction. An analysis of the warranty wording satisfied them that under the warranty a clear liability was incurred by Mitsubishi at the time of sale of the vehicle for latent defects.
    - The liability was contingent upon a qualifying defect appearing and being notified during the warranty period. Nevertheless for 63% of cars a defect

[23] *CIR v Mitsubishi Motors NZ Limited* [1995] 3 NZLR 513 (PC).
[24] Liability for the defect was dependent upon the manifestation and notification of the defect within a 12 month period. Not all cars would be defective but there was a percentage of cars which would have defects.
[25] The warranties were issued by dealers but Mitsubishi bore the cost of remedy and the Court accepted that the taxpayer was liable.

was a matter of existing fact and not a future contingency. The contingency that the owner would not make a claim for remedy was minimal. The expenditure which had been estimated could be said, as a matter of law, to be definitively committed.

- The legal obligation to make a payment in the future could be said to have accrued on sale and the merely theoretical contingencies could be disregarded.
- Evidence of accounting practice accepted by the High Court left no doubt that the proper treatment of the outstanding warranty liabilities as part of the cost of the vehicle sales should be matched against the corresponding year's revenues.
- The New Zealand legislation differed from the corresponding Australian legislation which took a more jurisprudential approach. It was less aligned with commercial reality than the New Zealand legislative approach.
- Their Lordships noted that prima facie the income and expenditure should be related to each in accordance with normal accounting principles. However their Lordships did not adopt the suggestion that all items of expenditure or loss recognised using normal accounting principles should also be tax deductible.

46. More recently the New Zealand Taxation Review Authority in *Case Y17* considered whether an estimate made for accounting fees for compliance work for the current financial year but yet to be performed invoiced or paid were deductible in that year.[26]

47. The Authority summarised the principles relating to "incurred" as follows:

> "[24] …It is also settled law that principles relating to "incurred" are:
> i) Expenditure will be incurred in an income year even though there has been no actual disbursement if, in that year, the taxpayer is definitively committed to the expenditure;

[26] *Case Y17* (2008) 23 NZTC 13,171 (NZ TRA Barber DCJ)

ii) A taxpayer is definitively committed to an expenditure if a legal obligation to make payment in the future can be said to have accrued;
iii) In determining whether expenditure is incurred, in the case where the expenditure is subject to a contingency, merely theoretical contingencies can be disregarded;
iv) Where the expenditure arises under an agreement, it is fundamental to analyse the nature of the obligation as set out in the agreement in determining whether expenditure is incurred;
v) "Necessarily incurred" relates to the degree of connection with the business, rather than whether the expenditure is necessary.

[25] There is much case law on the meaning of incurred…
As noted by the Court of Appeal in *CIR v Banks* (1978) 3 NZTC 61 236:
However, this is not an area of the law where it is possible to devise a judicial formula which, as a substitute for the statutory language, could be applied in all cases and, in the end, a decision in a particular case must be reached on the application of the statutory language to its particular circumstances. [61,241].
The Court of Appeal went on to find that:
The statutory requirement is that the expenditure be "incurred in gaining or producing the assessable income". That has to be judged at the time that the taxpayer became definitively committed to the expenditure for which deduction is sought. [61,241].

[26] Lord Hoffman, in the Privy Council in *CIR v Mitsubishi Motors New Zealand Ltd* (supra), held the test to be:
The question is rather whether, in the light of all the surrounding circumstances, a legal obligation to make a payment in the future can be said to have accrued. For this purpose, merely theoretical contingencies can be disregarded.

[27] The Courts have used the term "definitively committed" for expenditure to be "incurred" in a number of cases; *FC of T v La*u [1984 ATC 4929], *FC of T v Raymor* (NZW) Pty Ltd [90 ATC 4461], *C of IR v Lyndale Motors (1972) Ltd* [1991 2 NZLR 379.

> [28] As noted by the High Court in *Lyndale Motors (1972) Ltd*, the (then) leading New Zealand case on the point was the Court of Appeal in *C of IR v Glen Eden Metal Spinners Limited* (1990) 12 NZTC 7270. Richardson J noted that:
>
> The legal principles are clear. An expenditure is incurred in an income year although there has been no actual disbursement if in that year the taxpayer is definitely committed to that expenditure (*King v C of IR*). There must be an ascertained liability but it is not necessary to constitute a definitive commitment that the liability is indefeasible: the taxpayer is equally committed whether or not its present liability may subsequently be diminished or avoided by the actions of others. (7271)
>
> [29] In *King v C IR* (1995) 17 NZTC 12, 122, Wild CJ cited with approval the High Court of Australia in both *FC of T v James Flood Pty Ltd* (1953) 88 CLR 492 and *NZ Flax Investments Ltd v FCT* 61 CLR 179. Wild CJ quoted from *James Flood Pty Ltd*:
>
> …"Incurred" does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon. It is unsafe to attempt exhaustive definitions of a conception intended to have such a various or multifarious application. But it does not include a loss or expenditure which is no more than impending, threatened, or expected.
>
> …"

48. In *Case Y17* the issue was whether a deduction for estimated accounting costs should be allowed. The accounting work was not carried out in the year in which the deduction was claimed by the disputant company. The relevant work and invoicing was done in the following year. The disputant had entered into an agreement with its chartered accountants which was a "continuing appointment to provide accounting services." The billing arrangement was to "bill as the work was performed". In the 2003 year the disputant accrued the sum of $2,285.00 as being "estimate of 2003 fees" and claimed a deduction for that amount in its 2003 income tax return. It was accepted that the relevant accounting services were performed and invoiced in the 2004 income year.

49. The disputant argued that it had a definite commitment or existing obligation to pay the fees in 2003 due to its statutory obligation to prepare financial statements, to prepare and file returns of income and to file them with Inland Revenue.

50. The disputant could make a reasonable estimate of the compliance costs based on it having an established relationship with the accountants which enabled it to predict the likely fees. The company also said that the work was partially completed during the 2003 income year and that comparisons were available with entities of a similar size and nature. The agreement between the company and the accountant did not give rise to expenditure for the work yet to be undertaken by it. The disputant said that its obligations arose on the first day of trading in any income year as it became liable to file a return at the end of that income year. The company said reporting and tax returns were mandatory by law requiring it to comply in order to keep the business going.

51. The Authority said whether expenditure is deductible must be judged at the time the expenditure is incurred and must have a nexus with an income earning process.[27] It noted that deduction was not permitted in any year other than the year it is incurred and an election not to deduct in that year means that the opportunity to deduct is lost.[28]

52. The Authority concluded that while the disputant had a statutory obligation to prepare financial accounts and returns, it did not have a statutory obligation to use or to pay the accountants. The contractual obligation was to pay the accountants for work after it was performed and invoiced. The Authority noted that the disputant could have ceased using those accountants and done the

[27] See [32].
[28] Ibid. His Honour noted that it was commercial practice for any oversight in making deductions to be remedied by reopening the year of the oversight with the approval of the Inland Revenue Department.

work itself or used other providers. The only obligation on it would be for unpaid invoices for work already performed.

53. The Authority distinguished *Mitsubishi* where the taxpayer was contractually bound under the warranty to remedy the fault in the vehicle. On the contrary, the accounting firm in *Case Y17* had no enforceable rights against the disputant for any services not yet performed and there was no definite commitment for expenditure for the accountants' fees to complete the financial statements and returns of income. The legal obligation to pay only arose upon the performance of the work and the rendering of the invoice.[29] The Authority was of the view that in order to incur the accounting fees the disputant must be "definitively committed to them." To deduct fees in an earlier year for work done in a later year was as a matter of law a wrong practice.[30] His Honour said:

> "[47]…This is consistent with the Privy Council in *Mitsubishi Motors NZ Ltd* at 12,356:
> The question of what income can be treated as "derived" during an accounting year is, unlike the question of deductions, a matter governed by normal accounting principles.
>
> And the Court of Appeal in the same case at 11,103:
> Accounting principles applicable for financial reporting purposes and good commercial practice cannot be substituted for the statutory test of deductibility but they may assist "in ascertaining the true nature and incidence of the item as a step towards determining whether it answers the test" (*James Flood Pty Limited* at pp 506-507)."

54. The Authority held that:

(a) a deduction was sought for a cost to be incurred;

[29] At [46].
[30] At [47].

(b) the disputant did not owe anything to its accountants for work not yet performed;

(c) there was no contractually enforceable obligation on the accountants to complete the anticipated accountancy work for which the estimate had been calculated; and

(d) even if there had been an obligation on the accountants to perform the work in the future he did not see the *Mitsubishi* or *Bisley* cases as being "particularly helpful".[31] The Authority said:

> "[51]…. It seems to me to be basic that if a taxpayer seeks to deduct accountancy fees in a particular year, then as a general rule that service needs to have been provided in that particular year. Possibly, there is merit in the argument that a pre-commitment on a commercial basis for services to be provided after the end of the revenue year in question creates a debt incurred in the earlier year and, therefore, deductible in that year."

55. I now turn to the present case.

Conclusion on the First Issue

56. Their Lordships in *Mitsubishi* said:

> "...the question of whether the expenditure has been "incurred" involves characterising the nature of the legal relationship between the taxpayer and the person to whom the obligation is owed. On one view, it requires one to decide as a matter of construction whether the obligation is contingent or vested but defeasible..."[32]

[31] At [51].
[32] *CIR v Mitsubishi Motors New Zealand Ltd* [1995] 3 NZLR 513 at 517.

57. Air Rarotonga submitted that it was obliged to have the C-Check done. It said that any uncertainty over whether it would have the work done, because it may not continue to use the SAAB in its business, was a remote contingency and therefore did not detract from the obligation.

58. Counsel for Air Rarotonga accepted that the contract with Air Nelson did not impose an obligation to pay for the cost of the C-Check until the work was completed and invoiced. Air Rarotonga said it needed to have the C-Check work done by Air Nelson in order to keep the aircraft certified. However this was not a contractual obligation, nor any direct legal obligation, to a third party. Air Rarotonga could have done the work itself or terminated the contract with Air Nelson and had it done elsewhere. It was Air Rarotonga's choice to have the inspection and work done by Air Nelson or done at all. Therefore any obligations that require Air Rarotonga to incur the C-Check costs were not legal obligations but rather choices it made to first to use Air Nelson to undertake the work and secondly to pursue a business plan which retained the SAAB in service.

59. The compliance obligations that Air Rarotonga points to as necessitating it to have the work done by Air Nelson are not of the same nature as the direct legal obligations on Mitsubishi. Air Rarotonga's submission is similar to the taxpayer's[33] argument in *Case Y17*. In that case the purported obligation to incur the accountants' fees to prepare the disputant's financial accounts and tax returns arose not from a contractual or other direct legal obligation to a third party but rather due to its legal compliance requirements.[34] The disputant was not contractually bound to pay the accountants' fees for the work provisioned. It had a choice both as to whether it complied and secondly whether it used the relevant accountant to carry out the work.

[33] Called the "Disputant" in the Taxation Reveiw Authority.
[34] The taxpayer said it was legally obliged to undertake the preparation of the accounts and tax return from the start of the relevant financial year in which it earned the income although the work and invoicing did not occur until the following year.

60. In *Mitsubishi* the liability was dependent upon the manifestation and notification of the latent defect within the 12 month period. The Board was of the view that the legal obligation to make a payment in the future accrued on manufacture of the vehicle. The contingency was not that the underlying liability might not occur but rather that the owner might not claim. The contingency or defeasibility was the slight chance that the owner of a car with a latent defect which became apparent in the warranty period would not claim under the contractual warranty. Lord Hoffman said:

> "...Since these defects were by definition likely to show themselves within the warranty period, their Lordships consider that the contingency that the owners might be content not to require remedial work would be real only in the case of the most trivial defect. It would not make any material difference to the accuracy of the estimated amount of expenditure to which the taxpayer could be said, as a matter of law, to be definitely committed..."[35]

61. Air Rarotonga was not committed to the expenditure for the C-Check in the sense that an obligation to pay existed or had accrued. In the years in which it made the provisions it was not under any "definitive commitment" to pay the cost of the C-Check to Air Nelson. Whether the costs were incurred was down to a choice made by Air Rarotonga and not a contingency.

62. Air Rarotonga says it was obliged to undertake the C-Check in order to keep the business as a going concern. That was a business decision entirely within its discretion and not an obligation owed to a third party. For instance it might sell the aircraft and buy another or choose not to replace it. If it did have the work done it need not have it done by Air Nelson. The contract has provisions for termination and also for Air Rarotonga to do the work itself. The obligation to pay Air Nelson only arose when the work was done and the cost was invoiced.

[35] *Mitsubishi* at 519:

63. Air Rarotonga says that the costs of the C-Check were able to be estimated with a degree of accuracy in a similar vein to the ability of Mitsubishi to predict with reasonable accuracy the cost to remedy defects in vehicles in any particular year. This does not advance Air Rarotonga's argument that the costs were incurred in the legal sense but rather shows that it could estimate the likely costs with accuracy.

64. Finally Air Rarotonga said that it was following normal accounting treatment to enter provisions for upcoming maintenance (and by implication C-Check) costs and therefore the provisions should be allowed.[36] On this point I observe that there was no specific evidence that work in the nature of a C-Check should be provisioned in advance as a matter of normal accounting practice. Mr O'Meara said it was appropriate in his experience. Ms Thomson for the Collector disagreed. However, even accepting that the provisions made in relation to the C-Check did follow normal accounting treatment I am of the view that this is not determinative. I do not consider that in this case the accounting treatment assists me. While what is normal accounting treatment may assist in certain cases, in this case the legal position is clear. The provisions do not meet the legal requirements for deduction.

65. Their Lordships in *Mitsubish*i noted that it was not without attraction to take an approach which allowed that all items of expenditure or loss were deductible using normal accounting principles. However that approach was contrary to the weight of authority in New Zealand. The Privy Council would not undertake such a revisionist approach without a thorough inquiry into the possible repercussions on other parts of the legislation and established commercial practices.

[36] Nor was I satisfied on the evidence that it was usual commercial practice. There was evidence from Mr O'Meara the accountant from Air Rarotonga but no evidence as to the industry approach. The Collector's evidence was to the contrary.

66. Therefore the Collector was correct in not allowing the deduction of the C-Check provisions. The next issue relates to the treatment that the Collector adopted for the C-Check expenditure.

The Second Issue – Repairs and Maintenance or Capital Expenditure for the C-Check

67. In the alternative, Air Rarotonga says that the relevant expenditure should be deductible in the year in which the work is done and paid for. Thus the C-Check expenditure should be treated as a repair and maintenance item and so on the revenue account and not capital.

68. The Collector capitalised the C-Check expenditure and spread the depreciation over the years following the C-Check.

69. Whether the C-Check is treated as capital expenditure or as repairs and maintenance is central to this issue. This distinction has been the subject of a number of cases. Principles have emerged but each case turns on its facts.

70. In *Poverty Bay Electric Power Board v CIR* the Court of Appeal (NZ) agreed with the finding of the High Court that the replacement of the network for electricity reticulation within Gisborne City was an item of capital work.[37] The overhead lines had been replaced by underground wiring. The work was substantial and created an asset that was clearly superior to that which had existed before. The Court held that the work was more than repairs and maintenance as it created a capital improvement that was intended to have an enduring benefit. The new network was physically larger, had greater capacity and operated more efficiently. The taxpayer argued the expenditure could be apportioned part as to repairs and part as to capital. The Court rejected this

[37] *Poverty Bay Electric Power Board v CIR* (1999) 19 NZTC 15,001

argument, finding that in reality, no amount could be said to have been spent on repairs as the old lines were removed and scrapped.

71. In *Auckland Gas Co v CIR* the issue was whether the cost of work that the company regarded as progressive repairs to its pipe network was revenue and therefore deductible expenditure or whether it was capital expenditure that could not be deducted due to the capital limitation.[38] The Privy Council upheld the decision that it was capital expenditure.

72. In *Auckland Gas Co*, the taxpayer owned an existing system of metal pipes for reticulating gas to its customers. The pipes were old and leaked. Ultimately the leaks were progressively fixed by inserting polythene pipes in the old pipes where the leaks had occurred. The gas was then reticulated in the new polythene pipe sealed off from the leaky metal pipe which was retained as an outer shell. In time and progressively the polythene piping was inserted through the whole network of pipes which made up the gas distribution system. It was accepted that the expenditure would be a revenue item if the work constituted "repair" as distinct from "replacement."

73. Their Lordships set out a two-stage test to assist in determining whether the work amounted to repair (revenue account) or replacement (capital account).
    i. First the asset must be identified. The relevant asset was the Auckland gas pipe network. It made up the Auckland gas distribution system.

    ii. Secondly the effect of the work on the character of that asset must be considered. If the replaced part is so different from the original part that the character of the asset has changed it might be an indication that the asset has been replaced rather than repaired. A repair will return the asset to its previous condition without changing its character. However that the replacement part is better than the original due to improvements in technology does not of itself mean that the work is a replacement.

[38] *Auckland Gas Co v CIR* (1997) 18 NZTC 13,408 (PC)

74. The old gas pipes no longer carried out their function of carrying gas. They were merely providing support for the new polythene pipes. The character of the original gas distribution system had changed and been upgraded. The nature and extent of the work undertaken on the network of pipes was determinative of the character. It went beyond a repair and constituted a replacement of a significant portion of the gas distribution network. The cost of the work was not deductible repair expenditure but rather capital expenditure.

75. A crucial point was that the new system was a vast improvement on the old. If the old metal pipe system had been fixed by fixing faulty joints and corrosion the work would be in the nature of repair. But here the old mains system was effectively abandoned as a conveyor of gas and relegated to the role of housing the new polythene pipeline. Had the polythene pipes been placed beside the old mains there would have been no argument but that they were a new system. The Lordships were of the view that placing the new pipes within the old did not make a material difference to the fact it was a new system.

76. In this case Air Rarotonga was required to follow a programme of scheduled inspection and maintenance. Without meeting the maintenance and inspection requirements on its aircraft the company could not continue its airline business. The C-Check work including the replacement of aging componentry required by the scheduled regime did not extend the aircraft's finite life, but rather allowed it to continue to achieve its flying certification.

77. The C-Check work was invasive and significant compared to other items of scheduled maintenance and inspections but it did not change the character of the plane nor replace it with something else. According to Air Rarotonga the nature of the aircraft did not change nor was it renewed. It may have gained some technical improvement due to advances in technology of replacement components but this was incidental to the maintenance and repair content of

the scheduled work.[39] There was no evidence of any relevant technical improvements as a result of the C-Check work.

78. I now turn to the application of the *Auckland Gas Co* two-stage test to this case. The identification of the asset is the first stage. This is the SAAB aircraft. It is able to be operated alone and sold or otherwise dealt with separately. It is the sum of its components but these are not assets for the purposes of the legal tests. The aircraft is a discrete item and stands alone. It is part of the larger fleet and so delivers the services needed by the airline to continue in business

79. The second part of the test looks at the effect of the work on the character of the asset. The aircraft was stripped down to its chassis. It was repaired and serviced. Some of the replacement components may have been improvements on the old due to advances in technology. But there was no evidence that the improvements were so significant as to make it a vastly improved aeroplane or change its character or increase its life span. The finite operational life of the aircraft was 90,000 landings or 60,000 flight hours.

80. I now go on to consider other indicators that have assisted the Courts in considering the nature of the C-Check work.

81. In *Sun Newspapers Ltd v FCT* the High Court of Australia pointed to three indicators.[40] First, the character of the advantage sought and its lasting qualities. Secondly, the manner in which the advantage was to be used, relied upon or enjoyed and in this consideration recurrence may be relevant. Finally, the means adopted to obtain it. For instance, a periodic or regular payment

[39] The Privy Council in *Auckland Gas Co*, used the analogy of the fact that generally the replacement of the battery in a car and would not usually be an item of capital, but rather repair. The car has been put into working condition again and improvements in technology of the replacement part means the car may last longer or function better, nevertheless that of itself does not change the nature of the vehicle.
[40] *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337

commensurate with its use may indicate revenue while a once and for all payment to secure enjoyment in the future may indicate a capital item.

82. Whether the cost of the work is a once and for all expenditure or is a regular item of expense is a consideration which is relevant here. The C-Check was a regular check due every 4,000 flight hours. Its periodic nature supports it being a revenue expense.

83. During argument, an analogy was drawn between the certification for airworthiness with warrants of fitness which are required for motor vehicles in various jurisdictions. In the case of motor vehicles, a warrant is issued on satisfying the requirements of an annual test of vehicle safety, and roadworthiness.

84. The comparison is sound despite the significant work required for the C-Check. The completion of the C-Check does not result in a new aircraft but rather an aircraft which is certified as airworthy and so able to continue in service for the period until the next C-Check is due.

85. Another factor referred to in some cases is the financing of the work. In this case there is no evidence of whether the expenditure on the C-Check came from fixed capital or working capital although counsel for the Collector did ask about this.[41]

86. Counsel were unable to find any tax cases dealing with C-Checks specifically. They referred to a number of decisions from the United States. Counsel for the Collector referred to *FedEx Corp v US* which involved aircraft maintenance. In that case when considering whether the maintenance was capital the court considered whether the expenditure increased the value of the asset,

[41] In any event it is not a definitive indicator as with the prevalence of revolving credit facilities, the difference is less significant than it may have been in the past.

prolonged its useful life or adapted it to a new use.[42] Notwithstanding the high cost relative to the value of the engines being repaired the court concluded that the heavy overhaul of the engine did not increase the value, prolong its life or adapt it to a new use. They were incidental to the maintenance and so deductible expenditure. This reasoning provides useful guidance for this case.

87. Ms Thomson for the Collector in support of his approach researched the accounting treatment of aircraft overhauls in other jurisdictions. She said she considered material from the United States and the United Kingdom as well as tax textbooks. She did not elaborate on the latter. Primarily she relied on three publications. The first was an IATA[43] (in association with KPMG) Airline Disclosure Guide – Airline Acquisition Cost and Depreciation.[44] This is a document compiled by the IATA Industry Accounting Group (IAWG) made up of finance representatives from IATA member airlines. The publication notes that the group's mandate is to promote consistency in the application of International Financial Reporting Standards (IFRS) and to lobby accounting standard setters to take into consideration the interests of airlines globally. It specifically notes that it is not a guide to best practice.[45] It says that the relevant international standard prohibits recognition of a provision for future operating losses and future expenditure that can be avoided. This includes the cost of future maintenance of owned assets as the provision can be avoided by either not flying or by selling the aircraft. It also notes that major inspections and overhauls are identified and accounted for as an asset under the standard if that component is used over more than one reporting period. The costs of the maintenance event are to be capitalised and depreciated over the period until the next overhaul is performed. The component accounting for overhaul costs is said to be intended for use only for major expenditure that occurs at regular intervals over the life of the asset. Costs associated with

[42] FedEx Corp v US291 F Supp 2d 699 (2003)
[43] International Air Transport Association.
[44] Copyright 2016
[45] Ibid at 5

routine repairs and maintenance are expensed as they are incurred.[46]

88. The schedule to the publication states that the practices of various international airlines are the sources relied upon. It lists the rates of depreciation and the useful life and residual values ascribed to various components by a number of large international airlines. It does not purport to deal with taxation requirements. There are no New Zealand or Pacific airlines listed.[47]

89. A further publication produced by Ms Thomson was a KPMG Australia publication headed "Components of Aircraft Acquisition Cost, Associated Depreciation and Impairment Testing in the Global Airline Industry"[48]. The principle objective of this publication is to outline accounting considerations in relation to components of aircraft costs, associated depreciation and impairment testing under IFRIS.

90. The third document that Ms Thomson refers to is the Regulatory Impact Statement published by the New Zealand Inland Revenue Department (NZ IRD) dated 21 August 2015.[49] I go into more detail about the relevant points made in that publication below. In summary, the publication expressly notes that on the basis of the then current NZ legislation the correct legal approach to the major overhaul work on aircraft was to allow deductions for the work in the year of expenditure. It rejected the earlier practice of provisioning. That approach was incorrect and authorisation for it had been wrong in law and since been withdrawn, it said. It also indicated that the capitalisation of the relevant expenditure and spreading depreciation over the period until the next regular overhaul or work was the preferred economic option but was not the

[46] Ibid p 7
[47] The Collector produced a set of published financial accounts for Air New Zealand.These provided no assistance as the tax treatment was not referred to and the overhaul expenses were aggregated.
[48] Copyright 2007
[49] Regulatory Impact Statement on aircraft overhaul expenses: deductibility and timing issued by the New Zealand Inland Revenue Department for consultation]:
http://taxpolicy.ird.govt.nz/publications/2016-ris-archcrm-bill/aircraft-overhaul-expenses

correct legal approach. This better aligned the economic income with the taking of the depreciation. However, to use that method required a law change. The law change has now been implemented in New Zealand.

91. Ms Thomson says she found it clear from those documents that the C-Check overhaul is to be regarded as a separate component with a useful life from overhaul to overhaul.[50] Therefore she concluded the correct approach was to capitalise the expenditure and depreciate it forward until the next C-Check. She was heavily influenced by the accounting treatment of aircraft major overhauls under the International Accounting Standards and the preferred (but not at that stage legal) approach in New Zealand. She did not consider the legal tests in any depth nor did she appear to consider the point made in the NZ IRD publication that the legislation in New Zealand required a law change to permit the application of the tax treatment that she applied to the C-Check expenditure.

92. Ms Thomson agreed that she had likely relied on an earlier NZ IRD publication titled "Interpretation Statement: IS 12/03. Income Tax Deductibility of Repairs and Maintenance Expenditure – General Principles". It was published in 2012. She had used language similar to that in the publication in her disallowance of the objection.[51] Her focus was on the passages in the publication noting that the greater the size, importance and cost of the work the more likely it was to be capital. Nevertheless she acknowledged the legal categorisation between repairs and maintenance and capital was much more complicated than that. She said she had considered not only to the cost but the extent of the work. She also referred to the C-Check as an "overhaul" in her letter which is the word used in the international accounting treatment publications. She made a distinction between work to meet legislative requirements and work to repair something obviously damaged such as a broken wing. Under cross

[50] I note that the IATA and NZ IRD documents both post-dated Ms Thomson's disallowance of the objection on 21 September 2012.
[51] Letter dated 21 September 2012 from Ms Thomson to Mr O'Meara

examination Ms Thomson indicated she thought there was an Australian case where a legislative requirement concerning asbestos was held not to be a repair. However that point was not pursued nor was the case produced.

93. Mr Polley, an expert, gave detailed evidence on the technical aspects of the C-Check and the SAAB maintenance schedule. This was not challenged. His view was that the C-Check was maintenance work from a technical point of view. It did not renew nor change the aircraft but rather kept it certified to fly. He said the concept of a maintained working life was central to the sale and valuation of aircraft. Ms Thomson for the Collector did not have the benefit of such technical information at the time she considered the matter.

94. While the size and complexity of the work is a factor to consider it is not determinative. The utility company cases focussed on the asset and whether it had changed in character. In this case the SAAB did not change in character nor was it improved in any significant manner.

95. Ms Thomson accepted the analogy of a warrant of fitness and that the work required on that was generally in the nature of repairs and maintenance. Nevertheless the scale and cost appeared to influence her unduly in concluding that the work was capital in nature.

96. Ms Thomson acknowledged that the way international accounting standards dealt with aircraft overhaul work was not determinative as to the tax treatment of the costs of those overhauls in different jurisdictions.

97. At the end of the day it is a matter of fact and degree. While the C-Check work was substantial, it merely secured airworthy certification for the aircraft. The aircraft is maintained and repaired to the extent that it can be certified to continue to undertake its work. Proportionally the checks relating to the smaller and less sophisticated planes were likely as significant to the C-Check was to the SAAB. They are all designed to ensure continued airworthiness and must be thorough for the protection of the customers. I am of the view that

Ms Thomson's distinction between repairs and maintenance carried out to meet compliance requirements and those carried out to repair something obviously broken is not a relevant consideration here.

The New Zealand Position

98. The NZ IRD Statement Ms Thomson produced was published on 21 August 2015. The proposal (for the use of the capitalization method) and the various options set out had been the subject of earlier targeted consultation by the NZ IRD. It recorded that the submitters from the industry considered that the cost of the aircraft engine overhauls was a major expense and that economically the cost related to income earned over the years from one overhaul to the next overhaul but it was not material relative to the value of the aircraft.[52] The Statement also recommended that for a non-engine overhaul which amounted to a significant cost relative to the value of the aircraft, the proposed capitalisation and spreading over years to the next overhaul should also apply. Otherwise non-engine overhauls were deductible as repairs and maintenance. The C-Check appears to be a similar undertaking to the aircraft overhauls referred to in the Statement. The NZ IRD position thus provides some confirmation that under similarly-worded tax provisions the C-Check type inspection and related costs are to be treated as incurred at the time of expenditure and must be treated as repairs and maintenance.

99. The NZ IRD Statement gives five options for the treatment of depreciation of aircraft overhaul expenditure. These include deduction in the year of expenditure, depreciation and spreading from overhaul to overhaul (forward spreading) and the provisioning method as used by Air Rarotonga. It notes that 60% of operators used the provisioning method that Air Rarotonga favours. This was previously allowed by a Technical Ruling issued by the NZ IRD which was withdrawn on the basis it was wrong. Forty percent deduct in

[52] The extent of the overhauls under consideration are set out in the publication. Ibid page 2-3/16: http://taxpolicy.ird.govt.nz/publications/2016-ris-archcrm-bill/aircraft-overhaul-expenses.

the year of work and expenditure. This was the method that the NZ IRD regarded as the only one available under the legislation. It is the alternative option that Air Rarotonga puts forward here. The paper reads:[53]

> "25. Five options (including the status quo) are considered in this RIS for addressing the problem. They are:
>
> - Option 1: As incurred method. The general deductibility and timing rules of the Income Tax Act 2007 are applied to determine deductibility and timing of aircraft overhaul expenses.
> - Option 2: Spreading method. The deductible costs for an overhaul of an aircraft (for example, an engine) are spread forward over the period from the time of the overhaul to the next overhaul, on a usage basis (time in service). Within this option, we considered three possible transitional approaches.
> - Option 3: IFRS method. The accounting treatment of overhaul costs under generally accepted financial accounting practice (IFRS) would be acceptable for income tax purposes. For owned assets, this method is similar to the spreading method but for assets treated as operating leases for IFRS purposes, this method is similar to the provisioning accounting method.
> - Option 4: Provisioning accounting method. Legislation would authorise the provisioning tax accounting practice to allow deductions for provisions for future expenses.
> - Option 5: Equalisation method. This method is based on the provisioning accounting practice. An aircraft operator makes tax deductible cash deposits into an aircraft overhaul account administered by the Commissioner of Inland Revenue. Withdrawals from the account would be offset against the cost of the actual overhaul.

[53]Regulatory Impact Statement on aircraft overhaul expenses: deductibility and timing issued by the New Zealand Inland Revenue Department for consultation Page 6/16 para [25]: http://taxpolicy.ird.govt.nz/publications/2016-ris-archcrm-bill/aircraft-overhaul-expenses

> 26. All options other than option 1 (the status quo) would require amendments to the Income Tax Act 2007. This is discussed later in this RIS under the section "Implementation".
>
> 27. As an integrity measure, options 1, 2, and 3 also propose a claw-back of past provisions to ensure that a taxpayer would not have two deductions for the same expense. Under this accounting practice, the accumulated provision for future expenses is always reversed (netted off) against the actual expense when it is incurred. Options 1, 2, and 3 propose stopping provisioning, and therefore, it would be necessary to ensure that past deductible provisions were reversed against the actual overhaul expenses to give the same effect and ensure a second deduction is not allowed for that future overhaul expense.
>
> 28. Option 5 would require the Commissioner of Inland Revenue to establish a system to receive and pay out deposits.
>
> 29. If the Government decides not to pursue a legislative solution, taxpayers will be obliged to apply the current deductibility and timing rules (Option 1)."

100. The amendments to put in place option 2 (capitalization method) were enacted and came into force after the hearing of this matter.[54]

101. As it is apparent, I have made some findings in the course of discussing the facts and applicable law. Considering all the relevant factors, I conclude that the Collector was wrong in treating the expenditure on the C-check as capital. The C-Check related expenditure is in the nature of repairs and maintenance and deductible in the year in which it is incurred, being the year in which the work was done and paid for.

54 On 30 March 2017, the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Act 2017 (CHC Act) received royal assent.

Adjustment to take into account double deductions (provisions to year end 2004)

102. I now turn to the adjustment made by the Collector to take into account the deductions for the C-Check costs previously taken by Air Rarotonga in the years prior to 2005. This matter is not before me in the questions for determination. It arose as an issue late in the hearing.

103. In the event given my conclusion that the Collector was incorrect in his treatment of the C-Check costs, the amount of the adjustment will require further consideration by the Collector.

104. Ms Thomson made an adjustment to enable her to move the tax accounts from the provision method to the new method which involved capitalising the C-Check expenditure and spreading it over the years to the next C-Check (the capitalisation method). This was to avoid deducting the expenditure twice, first as part of the earlier provision and second as depreciation in the capitalisation method.

105. Air Rarotonga submits that:

    i. There is no legal basis for the adjustment. It says there is no statutory provision which allows this adjustment nor is there any principle of law that permits the Collector to make the adjustment.

    ii. The ITA does not contain any provision that expressly disallows instances of multiple deductions for the same expenditure.[55]

    iii. Therefore whether or not there is a doubling up of the deductions allowed for the C-Check costs the consequences lie with the Collector by introducing a change in treatment.

[55] See for instance s BD 4(5) of the Income Tax Act 2007 (NZ)

106. The Collector cannot point to any statutory provision which expressly prohibits multiple deductions for the same item of expenditure in different years. He says that the 2004 year is out of time for objection and it cannot be reopened, therefore, once a deduction has been made on account of the C-Check by way of provision it cannot be deducted again. The deduction, he says, is spent and cannot be "incurred" twice.

107. In my view, the Collector does not require an express statutory provision prohibiting double deductions in order for him to take into account previous years' deductions which represent the same expenditure made in 2005. In fact, and in law the deduction has been allowed only because it has been incurred. It cannot be incurred twice. Regardless of the introduction of the capitalization method the provisions had been incurred and so deducted already in earlier years. This is supported by the approach in the New Zealand decisions of *Anzamco Ltd v CIR*[56] and *BASF New Zealand Ltd v CIR*[57],both decided under the previous New Zealand legislation which in relation to the relevant provisions was very similar to the ITA. In *Anzamco* Barker J took the view that the scheme of the then Income Tax Act (NZ) was such that there was no ability to deduct the same expenditure twice. In *BASF* the Court of Appeal refused to permit a double deduction. The Court's underlying approach was that double deductions were not permitted under the general scheme of the legislation unless there was an indication to the contrary or a discernible policy consideration for doing so. In *BASF* Richardson P also pointed out that a double deduction was inconsistent with the true and fair view requirements of the Companies Act 1955 (NZ) relating to the preparation of accounts for financial reporting purposes. This is presently in force in the Cook Islands and so equally a relevant consideration.[58] This requirement is

> "s.153(1) Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial

[56] *Anzamco Ltd(in liq) v Commissioner of Inland Revenue* (1993) 6NZTC 61,541
[57] *BASF New Zealand Ltd v Commissioner of Inland Revenue* (1997) 18 NZTC 13,322
[58] By virtue of the Cook Islands Companies Act 1970-71 s.53.

> year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year."

108. The President noted that it was well settled "…*that generally accepted accounting principles and ordinary commercial practices are to be applied in the computation of income for tax purposes so far as the statutory language permits.*"[59] The financial statements of Air Rarotonga were based on provisioning which did not contemplate double deductions.

109. Air Rarotonga sought to distinguish those cases and pointed to *AMP Life Ltd v CIR*[60] where the High Court rejected the Commissioner's argument that double deduction should not be allowed. However that Court said that the case was not one involving double deductions. It involved two separate entities (in a group) and importantly two different losses. McGechan J said:

> "[79] I do not regard *BASF New Zealand Ltd* v *C of IR* (1997) 18 NZTC 13,322 or *Anzamco Ltd (in liq)* v *C of IR* (1983) 6 NZTC 61,541 as of direct assistance. …. The cases are useful in reinforcing the unlikelihood of Parliamentary intention to allow double deductions for a single item, but do not assist beyond that point."

110. In this case the deductions in the provisions and in the 2005 expenditure are for the same thing and so would be "incurred" twice by the same entity. Furthermore, both deductions have been and will be taken under the same statutory provision.

111. In determining the quantum of what has been incurred in 2005 and beyond the Collector must take into account what has already been incurred and deducted and cannot allow a result which amounts to a double deduction for that amount.

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[59] Ibid at [13,330]
[60] *AMP Life Ltd v CIR* (2000) 19 NZTC 15,940

112. The legislation in New Zealand and Australia that expressly prohibits multiple deductions puts this matter beyond doubt. However in my view, even without an express prohibition against double deductions, an amount that has been incurred cannot be incurred again.

113. Air Rarotonga had a fall-back position. It said that even if there could be an adjustment made by the Collector it could only be limited to the C-Check provisions and not for other provisions relating to different maintenance and repairs at year end 2004. I now consider that issue.

114. Ms Thomson used the sum of $710,992 as the provision amount to be taken into account as an adjustment when applying the capitalization method in her reassessment. She had taken this from the information supplied by Air Rarotonga.[61]

115. The actual cost of the C-Check in 2005 was $655,000.[62] She used this as the actual expenditure figure for 2005 and as the starting figure for her value for depreciation.

116. The figure of $710,922.00 was made up of various repair and maintenance provisions and included a credit of $304.[63]

117. Mr O'Meara accepted under cross examination that there was an element of double counting if the actual expenditure was allowed in 2005 when it had also

[61] Letter dated 21 September 2012 from Ms Thomson to the Chief Executive Officer, Air Rarotonga Ltd. This was headed "Objection and Reassessment of 2005-2009 Company Tax Assessments" and advised of the reasons for the assessment and enclosed working papers as a series of schedules setting out the adjustments in detail.

[62] The costs of the C-Checks were provided to Ms Thomson by Mr O'Meara by email on 29 November 2011. They were: "$1.000mil" in 2000; "$650k" in 2003; $655K in 2005; $743k in 2007 and $1.932 mil in 2010.

[63] In calculations done and produced by Ms Thomson this $304.00 was described as "SAAB Ccheck Struc Fat Accrual"). In calculations done and produced by Mr O'Maera this was described as "Balance of SAAB overhaul". For ease of description I have referred to the $304.00 as a credit balance in the provision balance for 2004 whereas the $710,922.00 is a provision debit balance.

been provisioned in previous years. He was unable to provide a precise breakdown of the attribution in the provisions which might be double deducted. He maintained that the only amount which related to the C-Check was the $304.00.

118. The difference between Ms Thomson and Mr O'Meara is whether it is appropriate to start with the provision for expenditure set out in the Air Rarotonga accounts closing provision balance as at 31 December 2004 for future maintenance for the four aircraft ($710,922) and from there make adjustments or just take the credit of $304.00 that Mr O'Meara says is the only amount that is attributable to the C-Check provisions accrued to the end of the 2004 year.[64]

119. As I have indicated,the appropriate adjustment amount now requires further consideration by the Collector. I am not in a position to determine the amount of the adjustment.

The Third Issue – Depreciation Rate on the SAAB and Bandeirante

120. The first question is whether either or both Collector and Air Rarotonga are bound to depreciate the SAAB and the Bandeirante at a rate of 100% in the first year following these acquisitions. This has two aspects. The first relates to whether the Collector should have considered a deduction at a rate other than 100%. The second relates to whether Air Rarotonga could select a depreciation rate other than 100%.

[64] The estimated cost of the C-Check presumably having been provisioned and so incurred by spreading the total over the years from the previous C-Check to the end of the 2004 financial year.

121. Section 45(1) of the ITA allowed a rate of 100% depreciation on certain assets acquired and brought into the Cook Islands. It was enacted to encourage investment in the Cook Islands.[65]

122. The Collector allowed depreciation of 100% on the SAAB acquisition in 2000. No issue was raised by Air Rarotonga at the time.[66] It did not have sufficient income to benefit from the losses resulting from the depreciation immediately, therefore it carried them forward to subsequent tax years.

123. In 2004 there was a change in shareholding in Air Rarotonga which resulted in it being unable to carry forward further losses into subsequent years.[67]

124. Air Rarotonga says the breach in the continuity of ownership occurred due to inadvertence. The changes were made as part of an arrangement to allow one of the original owners to dispose of his shares and tax implications were overlooked. It says that the tax benefit intended by the 100% depreciation rate therefore "miscarried" as Air Rarotonga had lost the benefit of it by inadvertence.

125. Air Rarotonga has objected to the depreciation allowed by the Commissioner in each of the five income years ended 31 December 2005 to 31 December 2009. It seeks to claim depreciation on the SAAB and the Bandeirante (which was purchased in 2005) at the rate of 10% per annum in each of the relevant years. This would enable Air Rarotonga to gain the benefit of some depreciation on the SAAB over the years following the loss of continuity.

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[65] Air Rarotonga referred to some relevant excerpts from Hansard which indicates the depreciation provision was an incentive to invest in the country.

[66] The time limits for objection relating to the 2004 and earlier years had elapsed when the present objections were lodged.

[67] The change contravened the requirement to maintain continuity in ownership and so Air Rarotonga lost its ability to carry forward its losses.

126. Air Rarotonga says that the Collector has a discretion to allow such depreciation deduction as "the Collector thinks just" on the SAAB and the Bandeirante. This is despite depreciation on the SAAB having been allowed at 100% when purchased. Air Rarotonga says that this discretion entitles it to seek to depreciate both aircraft at 10% per annum or other rate as is determined just. It says the Collector failed to exercise his discretion or turn his mind to considering and determining the depreciation issue. He is therefore in breach of his obligation to consider whether it was "just" to allow an alternative depreciation rate.

127. During his argument counsel for Air Rarotonga noted the argument was akin to one of judicial review of the Collector's decision based on a failure to consider the amount of the deduction.

128. The principles of interpretation applied in the interpretation of tax statutes, are the same as applied in any the interpretation of any statute. In summary, these are:[68]

- Words are to be given their ordinary meaning.
- There must be a strong and sufficient reason before words can be given some other meaning than they are capable of bearing in a particular context;
- If the words are capable of more than one meaning and the object of the legislation is clear, then the words must be given such "fair large and liberal construction" as will best ensure the attainment of the object of the Act;[69]
- Moral precepts are not applicable to revenue statutes, there is no room for intendment or presumption, and there is no equity about a tax;
- One should start with the premise that the legislature would not have intended absurdity or injustice;

[68] Elliffe & Marr, Lexis Nexis Key Cases, Tax, Wellington, Lexis Nexis NZ Ltd 2013 at 108 summarising the principles of statutory interpretation from *Mangin v Commissioner of Inland Revenue* [1971] NZLR 591 (PC) and *Alcan New Zealand Ltd v Commissioner of Inland Revenue* [1993] 3 NZLR 495.(HC) (1994) 3NZLR 439 (CA).
[69] Article 65(2) of the Constitution.

- The true meaning must be consonant with the words used, having regard to their context in the Act as a whole, and to the purpose of the legislation to the extent that this is discernible.

129. The argument that the Collector can exercise his discretion is based on the wording of Section 60 (1):

> "Notwithstanding anything to the contrary in section 58, in calculating the assessable income derived by any person from any source no deduction shall, except as expressly provided in this Act, be made in respect of any of the following sums or matters: namely, the repair of premises, or the repair of plant, machinery, or equipment used in the production of income beyond the amount usually expended in any year for those purposes:
>
> Provided further that where the Collector is satisfied that any repairs of such asset do not increase the capital value of the asset, or that the repairs increase that value by an amount less than the cost of the repairs or alterations, the Collector may allow such deduction as **the Collector thinks just**.
>
> Provided further that where the Collector is satisfied that any repairs of any such asset do not increase the capital value of the asset, or that the repairs increase that value by an amount less than the cost of the repairs or alterations, the Collector may allow such deduction as **the Collector thinks just**
> …"
> (Emphasis added)
> .

130. Section 45 sets out the special provision which the Collector says binds him to apply a rate of 100% depreciation on the SAAB and Bandeirante:

> "(1) Notwithstanding the actual useful life of the asset, in calculating the deduction which the Collector allows under the first proviso to

> section 60(1) on account of depreciation of an asset used in the production of income, the annual rate of depreciation will be one hundred per cent (100%) if the asset is acquired by the taxpayer on or after 1 April 1997 and has not been used or held for use in the Cook Islands, other than as trading stock, by any person before the date upon which the taxpayer acquired it."

131. The Collector says that under s 60 he must calculate the depreciation for the SAAB and Bandeirante at the annual rate of 100%. The depreciation rate provision in s 45(1) is clear, he says and he applied it to allow depreciation on the two aircraft at 100%.

132. In addition, the Collector says, the depreciation on the SAAB was recognised and taken in 2000. That it was not able to be used by Air Rarotonga as effectively as it might is not a relevant consideration. First, he says that the time for any objection to the relevant year in which the deduction was made has elapsed. Secondly there is a prohibition on allowing losses to be carried forward unless the shareholders on the balance date of the company for the year to which the loss claimed is to be carried forward were substantially the same as the shareholders on the balance date of the company for the year in which the loss was incurred.[70] In this case they were not. The Collector could not override this express prohibition without a clear provision allowing him to do so. To allow the Collector to reconsider the depreciation rate or amount

70 ITA s69. Losses incurred may be set off against future profits –" …(3) Notwithstanding anything in the foregoing provisions of this section, if in respect of any year of assessment any taxpayer, being a company, claims to carry forward any loss made by it in any former income year, the claim shall not he allowed unless the Collector is satisfied that the shareholders of the company on the balance date of the company for the year to which the loss claimed is to be carried forward were substantially the same as the shareholders of the company on the balance date of the company for the year in which the loss was incurred.
(4) For the purposes of subsection (3), the shareholders of a company at any date shall not be deemed to be substantially the same as the shareholders on any other date unless, on both such dates, not less than 40 percent of the paid-up capital of the company was held by or on behalf of the same persons, nor unless, on both such dates, not less than 40 per cent in nominal value of the allotted shares in such company were held by or on behalf of the same persons."

would amount to a back-door reassessment, permitting an objection out of time and override a direct prohibition.

133. There was no further depreciation to be deducted on the SAAB. The depreciation deduction at 100% of the cost of the asset effectively wrote the asset down to a tax book value of zero. Ms Thomson made the point as follows:

> "The intention of the investment scheme was not to depreciate an asset beyond its cost, rather to deduct the cost of the asset in the year of purchase. A tax deduction cannot be made for an amount in excess of the assets (sic) cost."[71]

134. In my view the provisions of s 45 are not ambiguous. The ordinary meaning is the Collector must allow a deduction equivalent to a rate of 100% on assets acquired new in the Cook Islands. It is an express provision of the Act which the Collector must apply in assessing a deduction under s 60(1). The Collector is required to calculate the deduction for depreciation under s 60(1) at a rate of 100%. The wording is unambiguous - the depreciation "will" be applied at the rate of 100%.

135. This interpretation is reinforced by the specific reference in s 45 to the annual depreciation rate of 100% for the purposes of the first proviso to s 60(1).[72] This specific reference to the rate overrides the general provisions in s 60 allowing the Commissioner a discretion to fix the depreciation as he "thinks just".

136. My conclusion is that the Collector was correct and obliged by the legislation to apply the 100% depreciation rate for the two aircraft. Additionally, in relation to the SAAB the depreciation was recognised in the year of acquisition and has been taken. That cannot be reopened.

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[71] Letter dated 9/4/14 from Sally Thomson to Kerry O'Meara. I note that the letter is marked "without prejudice". The reason for this is not apparent as it contains no offer nor is it part of a negotiation but is rather reasons for disallowing the objection.

[72] The second proviso in s 60(1) applies to repairs.

137. The second aspect of Air Rarotonga's submission under this head is that it says that the rate was in the nature of a special and favourable depreciation rate. As such it did not detract from Air Rarotonga's right to make a choice and instead seek a "just" annual deduction.

138. This argument turns on whether Air Rarotonga was bound to accept the 100% rate or it could ask for the Collector to apply a different rate.

139. In view of my interpretation of the statutory provisions, the Collector is bound to apply the 100% depreciation rate. I have concluded that he had no discretion to decide to allow a deduction not based on that rate. If the Collector must apply the 100% rate it follows that he can never allow a deduction other than one based on that rate. Therefore, as the Collector's assessment is correctly based on the 100% depreciation rate Air Rarotonga has no basis for objection. It must take the prescribed rate. If it was entitled to choose to seek another rate it follows the Collector must be able to apply another rate and he cannot.

140. Therefore, I am of the view that the Collector's approach is correct.

Constitutional Interpretation Issue

141. Air Rarotonga argued that the construction of the relevant statutory provisions should be read in light of the Constitution. Any ambiguity should be resolved in favour of Air Rarotonga pursuant to its constitutional rights.[73] The Constitutional construction argument was raised for the first time at the

[73] The submission was that any ambiguity in the interpretation of the deduction provisions has to be resolved according to the constitutional priority for the protection of taxpayer property rights.

hearing. Counsel indicated that it was not intended to raise some separate head based on a constitutional right but rather as an aid to interpretation.

142. The rights referred to are contained in Article 64(1)(c) and Article 65(1) and (2).

143. Article 64(1)(c) provides the right not to be deprived of property except in accordance with law. Article 65(1) requires enactments to be construed in accordance with the fundamental humans rights set out in Article 64(1) but subject to various duties to others and interests of the Cook Islands. Article 65(2) deems every enactment to be given "such fair, large and liberal construction and interpretation as will best ensure the attainment of the objects of the enactment or provision thereof according to its true intent, meaning and spirit.[74]

144. The constitution also says that no taxation may be imposed except by law.[75] If the Collector had imposed an assessment contrary to that which is according to law the assessment would not be upheld. Therefore, it may be that any argument based on Art 64(1)(c) and Art 65 is circular.

145. Article 65(2) does not permit violence to be done to the words of the provision under consideration when it is otherwise unambiguous. In any event the ostensible intent of s45 was to create a favourable tax treatment in certain circumstances involving investment in the Cook Islands. The provision did that. If it had intended to go further and provide the Collector with a discretion it would have required clear words.

[74] A copy of Articles 64 & 65 are set out in the Schedule.
[75] Art 68 of the Constitution of the Cook Islands. Restriction on taxation - No taxation shall be imposed except by law.

146. I therefore find that the Collector was correct in his application of depreciation to the SAAB and the Bandeirante. The objections insofar as they relate to that issue are not allowed

Conclusion

147. In relation to the questions for determination as set out in the Case Stated I answer as follows:

(a) Whether the Respondent was correct in disallowing the accounting provisions made for expected future expenditure on aircraft maintenance on the basis that the expenditure had not been incurred for the purposes of section 58 of the Income Tax Act 1997;

Answer: The Respondent was correct.

(b) Whether the Respondent was correct in capitalising and depreciating the C-Check costs under section 59(a) of the Income Tax Act 1997, and depreciating the asset under section 60(1) of the Income Tax Act 1997;

Answer: The Respondent was not correct.

And

(c) If the Appellant wishes to claim depreciation, should the rate be 100% under section 45 of the Income Tax Act 1997 instead of 10% on certain assets under section 60(1) of the Income Tax Act 1997.

Answer: The rate should be 100% under section 45 of the ITA.

I have answered the questions for determination. It is now open to the Collector to assess Air Rarotonga's income tax liability in accordance with this judgment. I reserve

leave to apply to settle the terms of the judgment as to implementation and as to any incidental matters.

Non-Publication direction (interim)

148. Section 30(2) of the ITA says this objection must not be heard in open court. The Act is silent on publication of the judgment. In New Zealand, the High Court hears tax challenges in open court unless otherwise directed. In contrast hearings in the Taxation Review Authority (TRA) are not open to the public. The presumption appears to be that the TRA decisions are not published. However, the regulations allow publication of anonymised decisions unless otherwise directed by the TRA.[76]

149. The reason for the confidentiality imposed on the hearing in this case presumably reflects the interests of maintaining confidentiality of the taxpayer's commercially sensitive affairs. In this case evidence relating to not only accounting issues but the actual amounts involved were before the Court. A taxpayer's commercial interests may be damaged by publication of a decision relating to these matters. In New Zealand a taxpayer is able to elect to have the dispute heard in the TRA if the taxpayer wishes to have the matter dealt with on a confidential basis. The taxpayer, if it chooses to go to the High Court to challenge the assessment, does not have the same right to confidentiality unless appropriate orders are made by the presiding judge.

150. In this jurisdiction there is no choice for the taxpayer. Therefore, prima facie given the statutory provision that the matter is not to be heard in open court it follows that the decision itself should not be published or the objective

[76] Section 16(4) Taxation Review Authorities Act 1994 (hearing of objection or challenge not open to the public). Clause 36 of the Taxation Authorities Regulations 1998 (anonymized reports of the TRA may be published unless otherwise directed by the Authority)

would be defeated. It displaces the usual presumption that Court decisions should be published. I make an interim order that this decision not be published other than to the parties. Any application to view this judgment must be referred to a Judge.

151. I invite counsel to make submissions on this issue on or before 28 days from the date of this decision.

Costs

152. In this case as each party has succeeded in part it may be a case where costs lie where they fall. With that indication Counsel may be able to reach agreement on the costs issue. If counsel are unable to do so I invite Counsel to file and exchange submissions on costs on or before 28 days from the date of this judgment.

153. In particular the submissions should address:
    (a) Any reasons for awarding costs to either party in the circumstances of the outcome of this case;

    (b) The level of contribution to costs which is appropriate in this case;

    (c) The amount of costs incurred by the party and charged including an explanation and breakdown of the costs and the fee rates applied with reference to prevailing costs and rates;

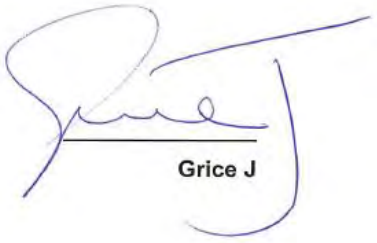
    (d) Full details of and justification for any disbursements;

    (e) Comparisons with other relevant awards of costs and disbursements;

(f) Relevant authorities;

(g) Such further and/or other submissions and information as counsel consider relevant.

In the event of a determination as to costs being necessary the costs of the examination of Mr O'Meara by Skype shall be as certified by the Register.



Grice J

Copy judgment with interim nonpublication flag removed
Discharged 22 September 2017.

Schedule

The Constitution of the Cook Islands (Excerpt)

PART IVA FUNDAMENTAL HUMAN RIGHTS AND FREEDOMS

"Fundamental human rights and freedoms –

64. (1) It is hereby recognised and declared that in the Cook Islands there exist, and shall continue to exist, without discrimination by reason of race, national origin, colour, religion, opinion, belief, or sex, the following fundamental human rights and freedoms:

(a) The right of the individual to life, liberty, and security of the person, and the right not to be deprived thereof except in accordance with law;

(b) The right of the individual to equality before the law and to the protection of the law;

(c) The right of the individual to own property and the right not to be deprived thereof except in accordance with law:

Provided that nothing in this paragraph or in Article 40 of this Constitution shall be construed as limiting the power of Parliament to prohibit or restrict by Act the alienation of Native land (as defined in section 2(1) of the Cook Islands Act 1915 of the Parliament of New Zealand);

(d) Freedom of thought, conscience, and religion;

(e) Freedom of speech and expression; (f) Freedom of peaceful assembly and association.

(2) It is hereby recognised and declared that every person has duties to others, and accordingly is subject in the exercise of his rights and freedoms to such limitations as are imposed by any enactment or rule of law for the time being in force, for protecting the rights and freedoms of others or in the interests of public safety, order, or morals, the general welfare, or the security of the Cook Islands.

Construction of law –

65. (1) Subject to subclause (2) of this Article and to subclause (2) of Article 64 hereof, every enactment shall be so construed and applied as not to abrogate, abridge, or infringe or to authorise the abrogation, abridgement, or infringement of any of the rights or freedoms recognised and declared by subclause (1) of Article 64 hereof, and in particular no enactment shall be construed or applied so as to –

(a) Authorise or effect the arbitrary detention, imprisonment, or exile of any person; or 34 Constitution

(b) Impose or authorise the imposition on any person of cruel and unusual treatment or punishment; or

(c) Deprive any person who is arrested or detained –

(i) Of the right to be informed promptly of the act or omission for which he is arrested or detained, unless it is impracticable to do so or unless the reason for the arrest or detention is obvious in the circumstances; or

(ii) Of the right, wherever practicable to retain and instruct a barrister or solicitor without delay; or

(iii) Of the right to apply, by himself or by any other person on his behalf, for a writ of habeas corpus for the determination of the validity of his detention, and to be released if his detention is not lawful; or

(d) Deprive any person of the right to a fair hearing, in accordance with the principles of fundamental justice, for the determination of his rights and obligations before any tribunal or authority having a duty to act judicially; or

(e) Deprive any person charged with an offence of the right to be presumed innocent until he is proved guilty according to law in a fair and public hearing by an independent and impartial tribunal; or

(f) Deprive any person charged with an offence of the right to reasonable bail, except for just cause; or (g) Authorise the conviction of any person of any offence except for the breach of a law in force at the time of the act or omission; or

(h) Authorise the imposition on any person convicted of any offence of a penalty heavier than that which might have been imposed under the law in force at the time of the commission of the offence.

(2) Every enactment, and every provision thereof shall be deemed remedial, whether its immediate purpose is to direct the doing of anything that the enacting authority deems to be for the public good, or to prevent or punish the doing of anything it deems contrary to the public good, and shall accordingly receive such fair, large, and liberal construction and interpretation as will best ensure the attainment [[of the object] of the enactment or provision thereof according to its true intent, meaning and spirit.

(3) In this Article the term "enactment" includes any Act of the Parliament of England or the Parliament of Great Britain or the Parliament of the United Kingdom, being an Act in force in the Cook Islands, and any regulation, rule, order, or other instrument made thereunder. The words "of the object" were inserted in subcl.(2) by s.9 of the Constitution Amendment (No.10) Act 1981 (C.I.).

66. Saving - Nothing in this Part of this Constitution shall limit or affect any right or freedom, not specified in this Part, that may exist in the Cook Islands at the commencement of this Part.

Part IVA was inserted by s 8 of the Constitution Amendment (No.9) 1980-81 (C.)