

Structuring Choices (Alesco)

The Court of Appeal has emphatically confirmed a tax avoidance finding against Alesco. The decision demands a major re-think on what structuring choices taxpayers may take.

Alesco NZ had borrowed \$78m from its Australian parent in order to fund acquisition of two local businesses. On the back of advice from KPMG (but without the benefit of an IRD ruling), Alesco borrowed these funds by way of an optional convertible note (OCN), carrying a nil interest rate. It did so in the expectation of obtaining a tax advantage in the form of an interest deduction. It expected to gain that advantage because New Zealand's tax rules expressly granted a tax deduction for interest "notionally" paid under such arrangements.

Many tax advisers have supported the structure chosen by Alesco, on the basis that it merely took advantage of provisions in our tax legislation that expressly permitted the tax results that Alesco was seeking. The Court of Appeal's verdict demands that all tax advisers think again.

The current approach to whether tax avoidance provisions apply to an arrangement is to analyse whether the arrangement complies with the scheme and purpose of the Tax Act. In the context of the OCN arrangement entered into by Alesco this demanded analysis of whether the tax provisions that permitted the tax deduction properly contemplated such deduction being available in circumstances where there was no true economic cost. There was no true economic cost because the obligation on Alesco NZ to issue shares on conversion was one that its parent could have engineered at any time of its choosing. On this analysis the OCNs did not comply with the scheme and purpose of the Tax Act and a tax avoidance finding followed.

This decision is one that all taxpayers and tax advisers alike should pay strict regard to. The ability, when entering into a commercial arrangement, to choose upon a structure that delivers the most beneficial tax outcome is now essentially subject to a "prudence" test, ie whether a proposed arrangement delivers tax results that, when looked at with a prudent set of eyes looks right.

This represents a paradigm shift in thinking in what has prevailed to date. Taxpayers should take careful note of this.