

## **TRACK A TO E ALPHABET SOUP: JOHN RUSSELL'S STILL COOKING!**

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### **ABSTRACT**

John George Russell is well known in the New Zealand tax community as the creator and defender of the 'Russell tax template', developed in the 1980s and described as a mechanism to turn the 'water' of taxable receipts into the 'wine' of untaxed gains. Template related issues are still being litigated some three decades later. There have been well over 80 cases related to the template covering both substantive and procedural issues. Mr Russell has had limited success on procedural grounds claiming his wins have been the result of good luck more than anything else. He strongly claims Inland Revenue has run a vendetta against him for many years. He has possibly received more section 17 Tax Administration Act 1994 notices to furnish information than any other taxpayer in New Zealand, receiving 101 notices in one day alone!

Inland Revenue has taken several different 'tracks' when assessing various parties it considered received the tax advantage from the template. The 'tracks' used to assess various parties are also regarded by Mr Russell as a vendetta tactic. Ultimately the litigation has led to 'Track E' with Inland Revenue personally assessing Mr Russell for tax, penalties and interest totalling in excess of NZD \$138 million. A High Court decision found for Inland Revenue and confirmed Mr Russell's personal tax assessment. Mr Russell has been granted leave to the Court of Appeal. He states that if 'Track E' fails for Inland Revenue they will invent a 'Track F'.

One of the least known postures of the Compliance Model is that of the 'game player'. It would appear that Mr Russell has many tendencies attributed to a person classified under this Model's framework to be a classic game player. This paper attempts to provide an overview of arguably Inland Revenue's most litigious taxpayer and asks whether Inland Revenue are now on 'track' to a conclusion.

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## I INTRODUCTION

John George Russell is well known in the New Zealand tax community as the creator and defender of the 'Russell tax template', developed in the 1980s and described as a mechanism to turn the 'water' of taxable receipts into the 'wine' of untaxed gains. Template related issues are still being litigated some three decades later. There have been well over 80 cases related to the template, covering both substantive and procedural issues. Mr Russell has had limited success on procedural matters claiming his wins have been the result of good luck more than anything else. It may be easy to dismiss Mr Russell as having been 'yesterday's news' in the world of (alleged) tax avoidance with the more recent and significantly larger risk to the revenue of *Ben Nevis*<sup>1</sup> and the structured finance litigation.<sup>2</sup> Mr Russell still battles Inland Revenue after thirty-something years, although some of his earlier optimism of substantive litigation success may now be fading.

The personal strength required to prepare for and engage in 'battle' with Inland Revenue can easily be overlooked. This paper attempts to provide a brief background of how Mr Russell became engaged in the template litigation, as well as providing his reasons for the justification of his actions. Section II provides a brief background of Mr Russell and the 'rise and fall' of the Securitibank; the pre-template years. This section also briefly discusses the *Challenge* case where the liquidator of Securitibank sought to find a buyer for the substantial accumulated tax losses of one of the Securitibank companies, initially gaining Inland Revenue approval to do so. The formation of Commercial Management is also discussed. Section III discusses and briefly explains the Russell template. This section also provides a brief background of the Millers and O'Neils. The *O'Neil v CIR* (2001) 20 NZTC 17,051 (PC) case is perhaps the most well known of all the template litigation. Section IV examines the different 'tracks' used by Inland Revenue to assess the tax liability arising from the template transactions. Track E, which assesses Mr Russell personally for a substantial amount of income derived from the template scheme led to an allegation of bias being raised, and an unsuccessful judicial recusal application, discussed in section V. Section VI considers the validity of Mr Russell's claims of a vendetta being directed towards him by Inland Revenue including two cases where allegations of impartiality, unnecessary obstruction and managing a trial by calling the wrong witnesses were advanced. Section VII provides a glimpse of the concerns held by Inland Revenue that led to the formation of a specific 'Russell tax avoidance team.' Section VIII considers the Inland Revenue Compliance Model and its application to Mr Russell. This section also discusses the 'game player' posture of the Compliance Model. Section IX, the conclusion, examines whether the litigation is drawing to a conclusion to allow Inland Revenue to 'move on' and allow Mr Russell a 'peaceful' retirement.

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<sup>1</sup> *Accent Management Limited v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027, *Accent Management Limited v Commissioner of Inland Revenue* [2007] NZCA 230; (2007) 23 NZTC 21,323, *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue* [2008] NZSC 115; [2009] 2 NZLR 289; (2009) 24 NZTC 23,188.

<sup>2</sup> See for example *BNZ Investments Limited v Commissioner of Inland Revenue* (2009) 24 NZTC 23,582.

## II THE PRE-TEMPLATE YEARS

### A *The Early Years*

Mr Russell grew up in Hamilton and was just a usual 'country lad' growing up on a farm. Academically he succeeded well at both school and college. Initially when enrolling at college he had intended to study engineering with a view to take over the family farm, as his father had envisaged. An enrolment error led to him attending introductory accounting classes which he enjoyed immensely. Although perhaps disapproving at first, his father ultimately agreed that he should continue studying the accounting discipline. Mr Russell became both a Chartered Secretary and a qualified accountant. He worked as an accountant for some well known New Zealand companies at the time, such as L J Fisher & Co. Limited, Lamson Paragon (NZ) Limited, and Butland Industries Limited. These companies were all leaders in quite different industries; building and construction, printing, and food manufacturing.

The promise of a very large pay rise saw Mr Russell relocate to Auckland and enabled him to marry Melva; together aged 20 and 21 respectively they started married life in Onehunga, Auckland. Mr Russell's chosen field of study had led him initially into a successful career of cost accounting, however he then went on to become a leading figure in the formation of the emerging money market in New Zealand.

### B *The Rise and Fall of Securitibank*

*'...what was happening really is we were stretching the rules...we were within the rules but they were really being stretched...without people doing that you don't get any development...'<sup>3</sup>*

Short Term Deposits Limited was established by an Auckland share broking firm with Mr Russell being its first employee. The shareholders of Short Term Deposits Limited were all major New Zealand insurance companies. After receiving only minimal training for two weeks in Australia Mr Russell began operating out of a small one room office in central Auckland, assisted only by a typewriter. Short Term Deposits Limited was licensed as an official short term money market dealer and such was a very restricted license. Short Term Deposits Limited had 'lender of last resort' facilities with the Reserve Bank which was similar to the commercial banks. Initially people were cautious with regard to Short Term Deposits Limited, being used to previously only dealing with established banks.

Mr Russell travelled the length of New Zealand promoting the new business, competing with the banks for depositor's funds, and taking on speaking engagements to promote the new business. Short Term Deposits Limited saw an opportunity of expanding into other instruments like Bills of Exchange. Another company, Secured Deposits Limited was set up to take deposits with a minimum of \$1,000 and provide Local Authority Stock as well as Government Stock as security.

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<sup>3</sup> Interview with Mr John Russell, Christchurch, 27 July 2011.

Securitibank Limited was set up as a holding company. The shares in Short Term Deposits Limited and Secured Deposits Limited were transferred to Securitibank. Securitibank then created its own merchant bank, Merbank, to provide facilities for the Bill market. Securitibank expanded very quickly and in 1976 had approximately \$100 million dollars in the Bill market. The Securitibank Group became very exposed in a falling property market and this ultimately led to its collapse in 1976.

The shareholders of Securitibank voluntarily placed the company into liquidation, with liquidators appointed. Ultimately every creditor was paid in full, with a surplus distributed to some of the Bill holders by way of a Court order. Mr Russell was 41 years of age at the time of the collapse.

Securitibank was located on Queen Street in central Auckland. Mr Russell worked up to an estimated 100 hours a week, indicative of his personal stamina. Merbank, the company initially named and registered by Mr Russell, was one of the companies in the Securitibank Group involved in the case which led to the Privy Council decision in *CIR v Challenge Corporation Limited* (1986) 8 NZTC 5,219, a major contributor to New Zealand tax avoidance jurisprudence at the time.

### **C Tax Avoidance in the 1970s - The Challenge Case**

A well known New Zealand tax case is *CIR v Challenge Corporation Limited* (1986) 8 NZTC 5,219 (PC).<sup>4</sup> Challenge Corporation Limited entered into arrangements to purchase the shares of two loss companies with accumulated losses, relying on a particular Income Tax Act provision. Neither loss company traded after Challenge Corporation Limited had acquired them. This case led to subsequent legislative amendment preventing a similar *Challenge* arrangement and outcome arising. What is interesting about this case is that at the time of the Securitibank liquidation, a tax advisor (Mr William Wilson) to the then liquidator of the Securitibank Group was asked to investigate whether shares in one of the companies<sup>5</sup> involved in the Securitibank collapse, which had incurred a substantial loss for the year ending 31 March 1978, might attract a buyer on the basis that although insolvent, its large tax loss might be an attraction to a purchaser in a profit position. After approaching a number of major public companies without success, Mr Wilson interested a profitable Challenge Corporation Limited in purchasing the shares. The principal difficulties foreseen by Mr Wilson in the negotiations related to s 188<sup>6</sup> and s 191<sup>7</sup> of the *Income Tax Act 1976* (NZ) (ITA 1976) in force at the time.

Mr Wilson wrote to the District Commissioner of Taxes in Auckland on 28 November 1977, setting out the basis proposed for the transaction and seeking his comments. In a letter dated 3 March 1978, a senior examiner from Inland Revenue at Lower Hutt, Mr Paganini, advised Mr Wilson of his views of the particular transaction and approval to

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<sup>4</sup> *Challenge Corporation* [1986] 2 NZLR 556 contributed to the judicial development of s 99 *Income Tax Act 1976* (NZ) (the general anti-avoidance provision) equivalent to s BG 1 where the Privy Council made it clear that s 99 was of a general application and may apply notwithstanding that specific anti-avoidance provisions exist within a particular section.

<sup>5</sup> Kelmec Property Consultants Limited, a subsidiary of Merbank Limited (in liq).

<sup>6</sup> Section 188 *Income Tax Act 1976* (NZ) [Losses incurred may be set off against future profits].

<sup>7</sup> Section 191 *Income Tax Act 1976* (NZ) [Companies included in a group of companies].

proceed. Later, this transaction was 'challenged' by Inland Revenue when they changed their view on the tax consequences of the transaction.<sup>8</sup>

Mr Russell stated of the *Challenge* case:

'Merbank was one of mine...I wasn't involved in the sale to Challenge but they [Inland Revenue] used to approve these transactions all the time...in fact \$10,000 plus half the tax benefits was the "going rate" ...'<sup>9</sup>

### **D The Formation of Commercial Management**

After the well publicised Securitibank collapse, being the largest corporate collapse in New Zealand history at the time, Mr Russell claimed it was difficult to find employment opportunities and this led him to start Commercial Management Limited, initially run out of a small office in Upper Queen Street, central Auckland and ultimately run out of his family home in Pakuranga.

Mr Russell stated:

'There was no point really in applying for a job anywhere...while you are successful you are a financial genius, if you are unsuccessful you are a crook...that is basically the way you are looked at in New Zealand'.<sup>10</sup>

Mr Russell further stated that he had 'quite a few people come along to me and want me to rescue their businesses and all that sort of thing...'<sup>11</sup> He considered that if half the businesses that came his way could be turned around and saved, that was a very good percentage. So Commercial Management Limited began in 1977 with just a few clients and experienced rapid growth.

Mr Russell placed some initial advertisements in the *Accountant's Journal*,<sup>12</sup> never having placed an advertisement in a newspaper. He soon found that he could not handle the volume of work, as 'word of mouth' recommendations flourished. He shifted Commercial Management Limited from the Upper Queen Street premises to his home at Pakuranga. Having had five children, the Russells had purchased this house in 1971. It had seven bedrooms and as children left the home to go flatting or get married Mr Russell 'speedily converted their room into an office!'<sup>13</sup> Six rooms were converted into

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<sup>8</sup> The Commissioner is under a statutory duty to discharge his responsibilities, he cannot waive or suspend the application of the law unless he is vested with the statutory duty to do so and estoppel cannot be raised against him: CCH New Zealand Limited, "Commissioner's duties", *New Zealand Master Tax Guide*, (Auckland, 2010), [1-520].

<sup>9</sup> Interview with Mr John Russell, Kawakawa Bay, 27 January 2010.

<sup>10</sup> Interview with Mr John Russell, Kawakawa Bay, 27 January 2010. Mr Russell on occasion would give lunchtime addresses to the Auckland business community, his speeches being well reported.

<sup>11</sup> Interview with Mr John Russell, Kawakawa Bay, 27 January 2010.

<sup>12</sup> The New Zealand Society of Accountants (NZSA), now the New Zealand Institute of Chartered Accountants (NZICA) member magazine.

<sup>13</sup> Mr Russell displays his sense of humour during our interview of 27 January 2010 by saying that it was hard to convince his wife of the need for the additional room as an office at one stage saying 'Look Melva, we have got to do this because (1) we need it for the business, and (2) if we don't, they [the children] might come back!'

offices and a lounge was used for meetings with clients. The business was very well organised with a booking system for the meeting room (the lounge) initiated and daily lunch provided by Mrs Russell for all the staff. Mr Russell had shifts of accountants working from 4am in the morning until 11pm at night. With this activity all being run out of a suburban home it is unsurprising it led to official neighbour complaints made to the local council. Staff shared the desks but each had their own drawer in a desk belonging specifically to them. Ultimately staff numbers peaked at 59. Mr Russell stated he had no problem getting good staff as a lot of people found the flexibility of hours very suited to them, especially young mothers that had previously been full time accountants, who could work a couple of days a week at unusual hours suiting their other family responsibilities.

Mr Russell did have success in the 'doom and disaster business' as he referred to it. There were also the real disasters too, the real doom and gloom businesses that could not be rescued in any way.

### III THE TEMPLATE

*'...so anyway...they come across this Russell template...it was just a loss company taking over a profit company...now there is nothing wrong with that...and it is still done today...and they don't call it tax avoidance with anybody else...but with me they did...'*

John Russell, interview, Kawakawa Bay, 27 January 2010

The Taxation Review Authority (TRA) once estimated that up to 1,000 smaller businesses including 3,500 individuals had been affected by the Russell tax template.<sup>14</sup> This is hotly disputed by Mr Russell. The template was promoted and implemented firstly in 1980 with the last transaction entered into in 1986.

#### ***A The Russell Template discovered – the Pakuranga House Call***

Although Mr Russell has had numerous requests for information under s 17<sup>15</sup> *Tax Administration Act 1994* (NZ) (TAA) he has never been subject to a s 16<sup>16</sup> TAA request for information. When away on a business trip<sup>17</sup> Mr Russell spoke to his receptionist who said that there were 'a couple of guys sitting in a car...it looks like they are staking the place out.'<sup>18</sup> Mr Russell decided to head home early. When he arrived he saw a 'huge truck there with an army of people carrying files out of my house'.<sup>19</sup> His business affairs were under investigation by the Justice Department who were there with a Court order, as well as three policemen. Mr Russell thought perhaps 'they must have been expecting a big fight.'<sup>20</sup> Inland Revenue then issued a s 17 *Tax Administration Act 1994* (NZ) Notice

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<sup>14</sup> *Case T52* (1998) 18 NZTC 8,378, 121.

<sup>15</sup> Equivalent to s 264 of the *Income Tax Assessment Act 1936* (Cth).

<sup>16</sup> Section 16 TAA 1994 [Commissioner may access premises to obtain information]. This section is equivalent to s 263 of the *Income Tax Assessment Act 1936* (Cth).

<sup>17</sup> Mr Russell was approximately two hours out of Auckland. Mr Russell's practice when away was to phone daily to check in with the office.

<sup>18</sup> Interview with Mr John Russell, Kawakawa Bay, 27 January 2010.

<sup>19</sup> *Ibid.*

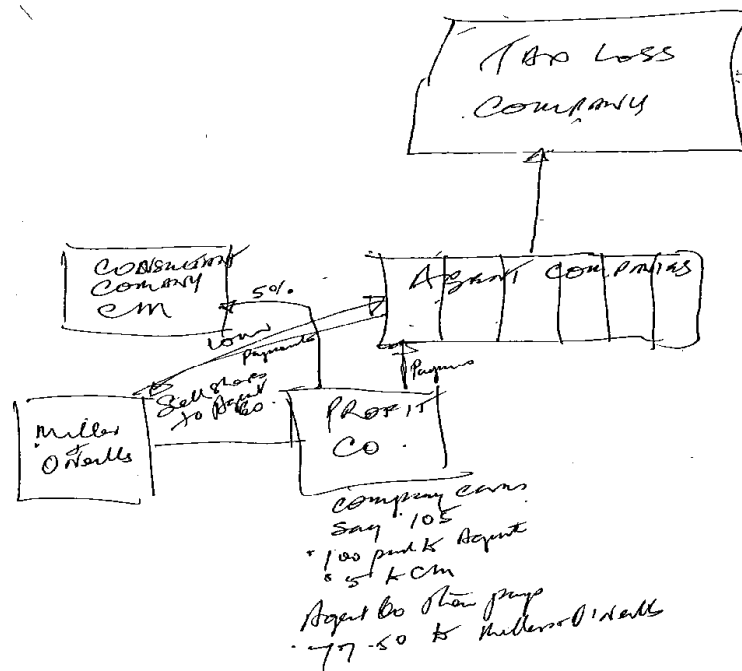
<sup>20</sup> *Ibid.*



to Furnish Information to the Justice Department who soon after photocopied the files for Inland Revenue.<sup>21</sup> This led to the 'Russell template' being uncovered. Inland Revenue has never 'raided' Mr Russell's house although he suggested I should not talk too loud!<sup>22</sup>

### B The Template Explained

The template essentially is grouping a loss company with a profit company through various deeds and agreements. Originally the majority of the losses for the template came from the Manning Group of companies. Mr and Mrs Manning left for the United States in 1982, giving Mr Russell unfettered control over the losses, for which the Mannings were remunerated, much to the chagrin of Inland Revenue.



The 'Russell template', drawn by Mr J G Russell, 27 January 2010.

The usual application of the Russell template was the formation of shareholders in a trading or manufacturing company selling their shares in that company to Russell entities at an inflated price and the Russell entity paying for those shares using the profits earned by the company, less fees to Russell entities. Effectively, the profits of the trading or manufacturing company pass to loss owning Russell entities and, less Russell fees, are paid back to the shareholders as capital. The vendor shareholders continue to manage the business and usually have an option to buy it back after a time for a nominal sum when, sometimes, the whole process recommences.<sup>23</sup>

One would consider that taxpayers would be 'flocking' to utilise Mr Russell's tax schemes to turn the 'water' of taxable income into the 'wine' of untaxed gains. This was

<sup>21</sup> The photocopying of the files took approximately three weeks.

<sup>22</sup> Interview with Mr Russell, Kawakawa Bay, 27 January 2010.

<sup>23</sup> *Case T52 (1998) 18 NZTC 8,378 [6]*.

however, far from reality. In fact Mr Russell defends the template suggesting that not many people participated in it due to not wanting to relinquish ownership of their businesses. To utilise the template, a person had to be self employed, as it was not available to be used by a wage or salary worker. Mr Russell commented as follows:<sup>24</sup>

‘...[there was] no way could a wage earner use it...no way could a professional person use it...and it’s only those people who are prepared to sell their enterprise to someone else and then just work for it...and not own it...now there’s very few people that would do that...’

Mr Russell considered his tax arrangement as quite simple and validates it this way:<sup>25</sup>

It’s a tax loss company that has got losses buying an income stream...you could only do this type of transaction if you were a tax loss company...and therefore the arrangement didn’t generate the tax advantage...it was the fact that the company had tax losses that had generated the tax advantage...now there is nothing wrong with that and no one has ever suggested that there was...then it can’t be tax avoidance...because all the company did was buy an income stream to use up its tax losses.

Mr Russell further justifies the template by stating:<sup>26</sup>

My view is that it is not tax avoidance because the transaction itself doesn’t create avoidance, ...the avoidance if there is any is created by a loss company having the losses...so if they want to argue that those losses are not legitimate or something...that’s another issue, but the losses are legitimate...they have been suffered by real people...

There was reluctance on behalf of many approached with the template arrangement who did not wish to sell their business to the Russell group, although the arrangement allowed for the original owners to buy back the assets of the business at a future time if they wished, albeit at a non arm’s-length price. In fact, the Russell template could allow a business owner to re-enter the template mechanism again on similar terms to utilise a fresh set of losses. The lack of commerciality of the buyback was raised by Inland Revenue in various proceedings although Mr Russell never saw this as an important factor. The template transactions were not always a success either. In *Case M109* (1990) 12 NZTC 2,690 a motor car dealer requiring financial help cost the Russell Group parent company NZD \$2 million because of the financial guarantees given.

Mr Russell’s view of the template was that it was not a risk to the New Zealand tax base, as Inland Revenue would suggest, because in his opinion it was extremely rare for the circumstances to arise for someone to utilise the template. In *Case T52*<sup>27</sup> Judge Barber made a reference to a possible 1100 companies having the Russell template implant, (translating into affecting the lives of at least 2000, but probably about 3500 individuals). The Judge then stated only 76 groups had been placed on his Register.

### **C The Millers and O’Neils**

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<sup>24</sup> Interview with Mr J G Russell, Kawakawa Bay, 27 January 2010.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> *Case T52* (1998) 18 NZTC 8,378[121].



The most well known template case is that of *Miller & O'Neil*, having its ultimate conclusion in the Privy Council in 2001.<sup>28</sup> Mr Russell had been friends with the Miller and O'Neil families for several years prior to them entering into the template arrangement. In fact Mr Russell personally knew many of the people that became involved in the template. Mr Russell had previously been on the board of a company involved in the 'rag trade' whose shareholders were prone to frequent disagreement. Brent Miller was the accountant for the company who did his best to 'keep the peace.'<sup>29</sup> Mr Miller later formed Fiorucci Fashions Limited, one of the 'profit companies' to take part in the template scheme.

Mr Russell recalled:<sup>30</sup>

I liked Brent because he was a young guy, good thinker, knew what he was about, and had handled dealing with us...fighting shareholders, very well, I thought. So anyway, because of that association, he must have liked me too because he rang up one day and said "look, we have got a problem here".

Brent Miller and Brian O'Neil were aged in their 30s at the time of entering into the template scheme, being about 20 years younger than Mr Russell. Mr Russell recalls that Brian O'Neil was a real salesman and could 'sell anything...ice cream to Eskimos'<sup>31</sup>, and considered Brent Miller to have the personality and temperament to keep everything under control. Together, 'the two of them were great, wonderful'<sup>32</sup> recalls Mr Russell. Fiorucci Fashions Limited had around 25 employees and manufactured women's clothing for mall chain stores. Prior to the template transaction Brent Miller would contact Mr Russell for advice perhaps 2 or 3 times a year. When Fiorucci Fashions Limited struck liquidity problems Mr Russell offered to initially lend them money and ultimately Brent Miller and Brian O'Neil were offered the template arrangement. Mr Russell speaking of the template arrangement states:<sup>33</sup>

...the people were happy with the arrangement...probably because it returned more money for them than what they would get if they kept owning the assets themselves...so I suppose to that extent you could say that probably the tax advantage was one of the main reasons they did it...but it wasn't the reason the Millers and O'Neils did it...the Millers and O'Neils did what they did for the simple reason that they were facing going broke and this was a much better alternative...of being rescued immediately from their immediate problem and living to fight another day and if that day turned out well they would be all that much better off...

Brian O'Neil immigrated to the United States shortly after the Privy Council decision of *O'Neil v CIR* in 2001 where the Law Lords found the template to be 'blatant tax avoidance.' The Millers still live in Auckland.

#### IV INLAND REVENUE'S APPROACH – THE USE OF 'TRACKS'

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<sup>28</sup> *O'Neil v CIR* (2001) 20 NZTC 17,051 (PC).

<sup>29</sup> Interview with Mr John Russell, Kawakawa Bay, 29 April 2010.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

Mr Russell's view is that the 'attack' by Inland Revenue on the Russell template transaction is simply part of a vendetta Inland Revenue has been running against him. He considers the way Inland Revenue assessed one taxpayer under 'Track A' then another under 'Track B' and so forth, and could change 'tracks', was all part of the vendetta campaign. Inland Revenue have pursued five different 'tracks' to tax various template participants, 'Track A' to the current 'Track E.'

### **A 'Track A'**

In the early stages of attempting to deal with the Russell tax schemes, the Commissioner of Inland Revenue (Commissioner) concentrated upon the tax saving afforded to the trading company by the disappearance of its profits in the form of administration fees. The Commissioner made assessments on the basis that the administration fees paid would not have been allowable deductions. 'Track A' sought to tax the profit company but by the time Inland Revenue was ready to pursue the money after successful litigation, the 'cupboard was bare', with the assets essentially being stripped out and only a shell remaining. Although there were quite a few 'Track A' cases, only two of them went to Court being Ron West Motors (Otahuhu) Limited (*Case M104* (1990) 12 NZTC 2,660) and K J Cummings Limited (*Case M109* 12 NZTC 2,690).

Mr Russell considered that 'if they were assessing the money they made a mistake in the first place choosing the company.'<sup>34</sup> He considered that, under s 99(3) *Income Tax Act 1976(NZ)*<sup>35</sup> where Inland Revenue must counteract a tax advantage derived from the arrangement, the only person capable of being assessed is the person who got the tax advantage. In his mind it was quite clear that the tax advantage in the Russell template was in the parent company.

### **B 'Track B'**

The Commissioner then turned his attention to what their Lordships in the later Privy Council judgment of *O'Neil v CIR* (2001) 20 NZTC 17,051 (PC) regarded as the essence of the scheme, and assessed the appellant taxpayers on the footing that they would have received the company's net profits as remuneration. The 'Track B' assessments pursued the original shareholders, such as the Millers and O'Neils. Again this was successful to some extent. For example, Brent Miller settled with Inland Revenue, Brian O'Neil headed overseas without fully paying the tax debt. At issue in *Miller v CIR; Managed Fashions v CIR* (1998) 18 NZTC 13,961 was whether this changed approach was an appropriate application of the reconstruction power in what is now s GA 1 ITA 2007 (then s 99(3) ITA 1976). It was held that the application was appropriate. The matter

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<sup>34</sup> Ibid.

<sup>35</sup> Section 99(3) *Income Tax Act 1976* (NZ) [Adjustment of income] gives the Commissioner a wide reconstructive power. Under s 99(3) the Commissioner 'may' have regard to the income which the person he is assessing would have or might be expected to have or would in all likelihood have received but for the scheme, but he is not inhibited from looking at the matter broadly and making an assessment on the basis of the benefit directly or indirectly received by the taxpayer in question (at NZTC 13,980, NZLR pp 301 to 302). On appeal to the Privy Council in *O'Neil v CIR* (2001) 20 NZTC 17,051 the taxpayer's argument was dismissed, the court saying at [31]: "...provided that he was not using inconsistent hypotheses for his reconstructions, he was in their Lordships' opinion entitled to assess any party who had obtained a tax advantage."

was appealed to the Privy Council in *O'Neil v CIR* (2001) 20 NZTC 17,051 where the taxpayer's argument was dismissed.

### **C 'Tracks C & D'**

The least understood assessment 'tracks' and perhaps the most difficult to follow were the 'Track C' assessments. In September 1996 the Commissioner embarked on a new assessment process originally called 'Track C'. The basis of the 'Track C' assessments was that the Commissioner could assess the parent companies because 'the whole thing was a sham.'<sup>36</sup> The assessments based on the doctrine of sham were ultimately withdrawn by Inland Revenue although the time it took to do so appears to be quite excessive. Mr Russell stated 'we were never able to work out what "Track C" truly did...because we were never allowed to cross examine the architect of it.'<sup>37</sup> He considered that this particular argument 'didn't have feathers to fly with in the first place'<sup>38</sup> and it never got tested because 'Track C' was ultimately withdrawn. There were about one hundred 'Track C' assessments actually issued by the Commissioner; however, none of these assessments were paid.

Mr Russell stated that the 'Track C' process was 'unintelligible and neither the Commissioner's officers who were giving evidence or the taxpayers fully understood what was happening'. In fact, even now, Mr Russell said that he does not know for sure what the 'Track C' assessment process was all about. Interestingly, *Case U23* (1998) 18 NZTC 8,378 demonstrates the confusion that existed around this particular 'Track'. Barber J (at paragraph 18) states:

It seems to me that there has been confusion over this so called Track C assessment approach to date because, when referring to it, witnesses and/or counsel have not necessarily been talking about the same thing. It seemed to me that even different witnesses for the respondent (Inland Revenue) had a different definition of Track C.

Simply put, there were two tracks, 'Track C' taxing the parent company, and 'Track 'D' taxing Mr Russell with regard to the 5 percent consulting fee ascribed to Commercial Management (sold to Commercial Management Partnership in 1994).

### **D 'Track E'**

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<sup>36</sup> In *Snook v London West Riding Investments Limited* [1967] 2 QB 786, 802 where Diplock LJ said that 'sham' '...means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities...that for acts or documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.'

<sup>37</sup> Interview with Mr John Russell, Kawakawa Bay, 29 April 2010.

<sup>38</sup> *Ibid.*

'Track E', which has been the subject of more recent litigation, attempts to tax all income derived by the Commercial Management Partnerships to Mr Russell personally.<sup>39</sup> The amount at stake under 'Track E' as at April 2010, was NZD \$138,796,819.38. This amount has been increasing daily due to use of money interest and late payment penalties.

In the Auckland High Court in 2010<sup>40</sup> Mr Russell challenged the 'Track E' assessments claiming that he had 'never received any benefit from the money.' Wylie J, in a succinct decision, dealt with this aspect of Mr Russell's case saying that the definition of tax avoidance was broad enough to capture his activity. He was the 'main man' in charge of everything and had the ultimate control of the funds.

For the first time Mr Russell (via counsel) accepted that there were 'arrangements' for the purposes of section 99 ITA 1976 and its successor between the Commercial Management partners and the various loss companies over the period. Mr Russell conceded that while tax avoidance had occurred, it was restricted to the loss companies and the taxpayer. Inland Revenue took a broader analysis. Mr Russell has sought appeal of this finding to the Court of Appeal who will hear the case in February 2012.

Mr Russell has no doubt that if he is successful in the 'Track E' litigation then 'Track F' would soon be on the Inland Revenue 'drawing board'. The 'Track E' assessment process is considered by Mr Russell to be plainly designed to cover deficiencies in 'Track D'. In the 'Track E' assessments the Commissioner is assessing not only the 5 percent consulting fee and add-ons, but also the whole of the income declared by the Commercial Management business partnerships over some 15 years, to Mr Russell personally. Mr Russell was unable to personally attend the 'Track E' High Court case due to requiring back surgery at the time.

Mr Russell did not contest that the arrangement by which the six Commercial Management partner companies (see diagram of the template above – the 'agent companies') diverted their income to loss companies amounted to tax avoidance and that it was void as against the Commissioner. He did contest that his personal relationship with the companies as director was part of the tax avoidance arrangement. It was submitted that no tax was avoided as a result of the director/company relationship and that Mr Russell was not a party to *or affected by* the tax avoidance arrangements. It was also argued that each company was a separate legal entity<sup>41</sup> and that there was no legal basis for lifting the corporate veil to assess income to Mr Russell as a director simply because he was a director.

When considering the scope of the arrangement with respect to Mr Russell, Wylie J stated that:<sup>42</sup>

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<sup>39</sup> Mr Russell considers this 'daft' due to the fact that he employed up to 59 people doing the work. In Court, Mr Russell's business structure was compared to that of a partner of an accounting firm and quickly dispensed with by His Honour.

<sup>40</sup> *Russell v CIR* (2010) 24 NZTC 24,463.

<sup>41</sup> See *Salomon v Salomon* [1897] AC 22 and *Lee v Lees Air Farming Limited* [1961] AC 12.

<sup>42</sup> *Russell v CIR* (2010) 24 NZTC 24,463 [96(f)].

he personally promoted the Russell template; he could be contacted personally by clients; he supervised all staff employed by CML [Commercial Management Limited]; he signed all cheques; he signed all agreements on behalf of the partners; he was the receiver, liquidator or director of all loss companies; he corresponded on behalf of the partnership with the loss companies; he introduced new loss companies when needed.

In summary, Wylie J considered there was one overall arrangement over the years 1985 to 2000 (inclusive). His judgment stated:<sup>43</sup>

In my judgment, there was one overall arrangement over the years 1985 to 2000 (inclusive). It was put in place by Mr Russell. It comprised a convoluted series of interlocking contracts, agreements, understandings and plans. They are collectively evidenced and constituted the arrangement. There were changes to entities involved in the arrangement over the years. The partners in the Commercial Management Partnership changed. There were changes to the loss companies over the years. Indeed changes to the loss companies were inevitable. It was inherent in the model that new loss companies would be required from time to time as losses in the old loss companies were exhausted. The fact that new entities were, from time to time, introduced to maintain the structure does not preclude there being one overall arrangement. Regardless of the entities, the end result was that income was diverted into companies that had losses and those losses were utilised to avoid the payment of income tax on the income. The basic arrangement remained essentially unchanged for 15 years. This points to there being one overall arrangement.

Mr Russell's involvement in all that occurred was in Wylie J's view the most relevant factor in concluding there was one overall arrangement. His Honour considered Mr Russell as the 'lynchpin on which all turned', paraphrasing a description used by Lord Denning MR in *Wallersteiner v Moir*:<sup>44</sup>

'[Mr Russell] controlled [the parties'] every movement. Each danced to his bidding. He pulled the strings. No one else got within reach of him. Transformed into legal language, they were his agents to do as he commanded. He was the principal behind them.'

Wylie J considered it beyond dispute that Mr Russell controlled everything and that he was the architect of the overall plan. Each of the parties to the arrangement, starting with Mr Russell and finishing with Mr Russell, had the expectation that the other parties would act in a particular way, because all of their actions were orchestrated by Mr Russell. In effect, Mr Russell provided consensus, although Wylie J doubted that this was a necessary ingredient of any arrangement.<sup>45</sup>

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<sup>43</sup> Ibid [99].

<sup>44</sup> *Wallersteiner v Moir* [1974] 1 WLR 991.

<sup>45</sup> An arrangement is defined to include a 'plan'. The use of the word 'plan' in contradistinction with the words 'contract and agreement', suggests that consensus is not a necessary ingredient. A plan can be devised and carried out by one person, as was the case with Mr Russell and the template. In *BNZ Investments Limited v C of IR* (2000) 19 NZTC 15,732, at 15,787 the court held that a contract, plan or understanding required conscious involvement and that s BG 1 was confined to persons engaging in consensual activity towards an end (at 15,789). The majority in the Court of Appeal decision of *C of IR v BNZ Investments Limited* (2001) affirmed the High Court decision. The majority in the Privy Council decision *Peterson v C of IR* (2005) 22 NZTC 19,098 held that a taxpayer does not need to be a party to an arrangement to be affected by it, while knowledge of the arrangement's details is also unnecessary.

The arrangement was not confined to the agreements between the partners and the loss companies as proposed by Mr Russell. Wylie J said this because the partners and the loss companies derived no benefit from the arrangement and took no independent role in the overall plan. They were functionaries that acted at Mr Russell's behest. The end result of the arrangement was Mr Russell deciding how untaxed monies he directed into the finance companies were to be utilised.<sup>46</sup>

Mr Russell claimed that he used legitimate corporate and trust structures. The recent *Commissioner of Inland Revenue v Penny* (2010) 24 NZTC 24,287 (CA) and *Penny v Commissioner of Inland Revenue* [2011] NZSC 95 judgments make it clear that this is not the end of the matter. The Commissioner was not challenging the legitimacy of the structures put in place by Mr Russell but was challenging the way those structures were applied.

Wylie J had reached the view that the arrangement put in place by Mr Russell was designed to ensure that income which Mr Russell earned through his personal exertions was diverted into a series of partnerships and companies controlled by him, and that no tax was paid on that income, with Mr Russell retaining control and directing how the untaxed monies were used. Wylie J accepted that Mr Russell may have preferred to trade through a corporate structure<sup>47</sup> to avoid any personal liability; however that was not the end of the matter. His Honour considered the arrangement as 'so tortuous that it is hard to escape the conclusion that it was put in place simply to obfuscate the situation and to confuse even the most diligent tax inspector.'<sup>48</sup>

With respect to Mr Russell and his numerous staff, Wylie J considered the evidence was clear that Mr Russell supervised all of the activities of the various employees. He reviewed all of their work and signed all correspondence including cheques. In his view, the fact that some or even much of the work was undertaken by employees did not materially affect the relationship between Mr Russell's personal exertions and the earning of the income of Commercial Management Limited.

Referring to the *Commissioner of Inland Revenue v Penny* (2010) 24 NZTC 24,287 (CA) decision, Wylie J addressed the issue of Mr Russell's salary. Mr Russell allocated a nominal salary to himself each year that did not bear any relationship to the work Mr Russell undertook or to salaries properly payable in the marketplace. Very significantly, Mr Russell retained control of the whole of the income generated with only he being able to direct how it was to be applied. In Wylie J's view the income of the Commercial Management partnership was derived from Mr Russell's personal exertions and he had retained complete control over it.

Wylie J agreed with Judge Barber in the TRA that the steps taken by Mr Russell were not within the purpose or contemplation of Parliament<sup>49</sup> when it enacted the loss offset

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<sup>46</sup> *Russell v Commissioner of Inland Revenue* (2010) 24 NZTC 24,463 [102].

<sup>47</sup> *Salomon v Salomon* [1897] AC 22(HL).

<sup>48</sup> *Russell v Commissioner of Inland Revenue* (2010) 24 NZTC 24,463 [118].

<sup>49</sup> The Supreme Court decision in *Ben Nevis Forestry Venture Limited v Commissioner of Inland Revenue* [2008] NZSC 115 now constitutes the definitive statement on the law of income tax avoidance in New Zealand. The taxpayer must satisfy the court that the component parts of the arrangement fall within the specific taxing provision, construed in light of its purpose, and are within Parliament's



provisions contained in s 191 ITA 1976 and its successor sections. His Honour considered that the unrestricted transfer of profits to loss companies included in the group, purely because of the losses they brought with them, in the manner the template sought to achieve, would bypass the company grouping rules contained in the legislation, and significantly undermine the tax base contrary to Parliament's intention.

Further, in Wylie J's view, the steps taken by Mr Russell to divert the income which he generated by his personal exertions into the Commercial Management partnership were not within the contemplation of Parliament. Parliament had intended that individuals pay income tax at the appropriate rate on their net income. Wylie J referred to an obiter statement from *Spratt v Commissioner of Inland Revenue*<sup>50</sup> that:

'no taxpayer can, by way of assignment, escape assessment of tax on income resulting from his or her personal activity, and that such income always remains truly as income and is derived by him irrespective of the method he may adopt to dispose of it.'

In conclusion, Wylie J considered that Mr Russell had structured the arrangement so that he gained a tax advantage in an artificial and contrived way. In his Honour's view, the purpose of the complex corporate structure was to divert income from Mr Russell's personal exertions, whether generated either directly through Mr Russell's activities, or indirectly through his control of employees, into companies, who were able to access the losses in the unrelated companies to avoid the payment of income tax. At no stage did Mr Russell lose control of the monies. They could only be applied as he directed. The companies and other entities used were all ultimately controlled by Mr Russell. At no point was the income beyond his direct control. Ultimately Mr Russell, and other entities which he was interested in or controlled, benefited from advances made by the finance companies controlled by him.

Wylie J stated that the arrangement subject to this appeal not only had the effect of altering the incidence of income tax, but that this was also its primary purpose. By virtue of s 99(3) ITA 1976 the Commissioner could adjust the assessable income of any person affected by the arrangement so as to counteract any tax advantage obtained. Once the existence and scope of the tax avoidance arrangement had been established, all those taxpayers who have benefited from it are subject to corrective adjustment by the Commissioner in the exercise of the reconstruction powers conferred by the anti-avoidance provisions.

Mr Russell's counsel submitted that Mr Russell was not a person affected by the arrangement. He argued that Mr Russell did not receive a dollar from the arrangement, either directly or indirectly. Wylie J, with respect, stated that this was not the test. The correct test was whether Mr Russell was a person affected by the arrangement through obtaining a 'tax advantage' from it.<sup>51</sup> Nonetheless, Wylie J accepted that Mr Russell did

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contemplation; and that the arrangement as a whole is within Parliament's contemplation. At [108] of the judgment the Supreme Court observed that '...a classic indicator of a use that is outside Parliamentary contemplation is the structuring of an arrangement so that the taxpayer gains the benefit of the specific provision in an artificial or contrived way. It is not within Parliament's purpose for specific provisions to be used in that manner.'

<sup>50</sup> [1964] NZLR 272 (HC) at p 274.

<sup>51</sup> *Russell v Commissioner of Inland Revenue* (2010) 24 NZTC 24,463 [142].

not directly receive any of the income generated by the arrangement, but that was because the *purpose* of the arrangement was to ensure that he did not have to pay tax on that income.

Wylie J agreed with the TRA that the income was Mr Russell's personal exertion income. His Honour also agreed with the TRA that Mr Russell was the only real person underpinning the arrangement. Mr Russell was the person who 'pulled all the strings'.<sup>52</sup> Mr Russell controlled all of the untaxed monies through the finance companies and no one else could access the funds unless he permitted them to do so. Money was advanced by the finance companies to Mr Russell to enable him to meet his personal obligations. Monies were also advanced to various trusts which Mr Russell had settled for the benefit of his family.

## V RECUSAL

The 'Track E' litigation also led to an application for judicial recusal.<sup>53</sup> The issue of bias had never been raised in any template cases prior to Mr Russell's personal assessment under 'Track E'. Mr Russell considered it fatal to have his personal case, 'Track E' heard at first instance before the same judge who had heard the template litigation for over some twenty years. Judge Barber would have previously had several hundred hearing days concerning the template litigation, with Mr Russell considering that Judge Barber's bias and preordained views had become quite apparent. Perhaps the most notable comment was raised in *Case R25* where Judge Barber had stated his view that Mr Russell was a tax avoidance specialist, with an 'obsession with saving tax', that the taxpayer had a 'mental block' affecting his judgment;<sup>54</sup> and that the taxpayer had used due process for the purposes of delay and confusion. Mr Russell requested that Judge Barber recuse himself from the 'Track E' litigation; however, Judge Barber refused, with Mr Russell seeking an appeal on the recusal grounds through a higher court. In both the High Court<sup>55</sup> and Court of Appeal<sup>56</sup> the recusal application was dispensed with. The Court of Appeal at [3] acknowledged that there was a basis for Mr Russell's objection to Judge Barber hearing the case but did not need to decide whether he should have recused himself because of the view that any basis for challenge had been overtaken by the High Court rehearing the merits of the challenge to the tax assessment. There was no question of the High Court decision of Wylie J being tainted by bias because no such allegation was made against the judge and the facts applied were established by agreement. The question of whether the Taxation Review Authority should have recused himself was accordingly treated by the Court of Appeal as moot. Mr Russell, representing himself, unsuccessfully sought leave to appeal to the Supreme Court.<sup>57</sup>

## VI THE VENDETTA CLAIM

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<sup>52</sup> Ibid [143].

<sup>53</sup> The recusal of TRA Authority Barber J who has heard numerous template cases. Mr Russell considers bias a real prospect in his own tax case.

<sup>54</sup> *TRA 92/061, 92/062, 92/063, 92/064, 92/065* at 33. Alt cit. *Case R25* [1994] 16 NZTC 6,120.

<sup>55</sup> *Russell v Taxation Review Authority* (2009) 24 NZTC 23,284.

<sup>56</sup> *Russell v Taxation Review Authority* [2011] NZCA 158.

<sup>57</sup> *JG Russell v Taxation Review Authority and Commissioner of Inland Revenue* SC 56/2011, [2011] NZSC 96.

### ***A Information Requests Directed to Mr Russell***

Mr Russell may have received more section 17 TAA<sup>58</sup> information requests than any other tax agent or individual taxpayer. During an interview, Russell stated that he had received thousands of section 17 TAA requests for information over the years. He views this as having nothing to do with information collection but is part of 'plain pure vendetta harassment'<sup>59</sup> further stating 'because it is a vendetta...it's an absolute war that goes on...they dream up any way they can waste my time...'<sup>60</sup>

Mr Russell was prosecuted for 226 'failure to furnish' information charges and considered this too to be part of the vendetta.<sup>61</sup> At the height of the information seeking by Inland Revenue he was receiving an average of 3,500 information requests per year for about three years. The requests were so frequent that Mrs Russell kept a record book of how many would turn up each day. October 1, 1996 was the day that held the record – 101 requests arriving in courier bags.<sup>62</sup>

### ***B The Vendetta Claim in the Taxation Review Authority***

There are two cases in relation to the claim of vendetta that Mr Russell regards as significant. Mr Russell stated:<sup>63</sup>

'...Judge Willy used to give me quite a tongue lashing about this vendetta business...but he had never seen the evidence of it until *Case U11*.'

#### ***1 Case U11***

*Case U11* (1999) 19 NZTC 9,100 was not a template case. In fact, Mr Russell's role was purely on a professional basis, being instructed to act by his client, Dandelion Investments Limited. It was alleged the taxpayer was prejudiced because of the antagonistic attitude shown towards Mr Russell by Inland Revenue officers. These included such matters as withholding information that was essential to the proper preparation by the tax agent of a case, and managing a trial by ensuring the wrong witnesses were called by the Commissioner. The TRA found that these complaints were made out. Judge Willy was satisfied that in relation to these complaints the taxpayer was not treated even-handedly. In some respects the Commissioner adopted what the TRA described as a 'thoroughly unmeritorious stance'.<sup>64</sup> Judge Willy held it was quite

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<sup>58</sup> Section 17 TAA 1994 Information to be furnished on request of Commissioner.

<sup>59</sup> Interview with Mr John Russell, Kawakawa Bay, 27 January 2010.

<sup>60</sup> Ibid.

<sup>61</sup> Mr Russell was not convicted. He was 'dead lucky' (interview 27 January 2010) as he was able to prove that the person that issued the informations (charges laid in the court) was not authorised to do so. Mr Russell estimated this case cost Inland Revenue and him in the vicinity of \$1 million dollars combined. The only reason he won was due to a procedural mistake. Mr Russell became aware of the authorisation issue during cross examination of Denise Latimer, who was on the Russell Team. Mr Russell stated that he holds a deep respect for Denise Latimer.

<sup>62</sup> On the day of our interview on 30 April 2010 Mr Russell showed me five s 17 notices that had arrived that morning. He estimated that they would take a couple of days to comply with, but stated it is now so much easier to comply with the volume of requests than it used to be.

<sup>63</sup> Interview with Mr John Russell, Kawakawa Bay, 29 April 2010.

<sup>64</sup> *Case U11* (1999) 19 NZTC 9,100, 9,137.

wrong for the Commissioner's staff to allow their feelings for Mr Russell personally (whether or not they were well founded) to rebound to the detriment of the taxpayer<sup>65</sup> He found the allegations of lack of impartiality and unnecessary obstruction of the taxpayer by the Commissioner to be proved.

The second allegation of managing the trial by ensuring the wrong witnesses were called was considered by Judge Willy to be very serious and 'if made idly would deserve censure.'<sup>66</sup> In essence the complaint was that the Commissioner had deliberately chosen an employee to give evidence on behalf of the Commissioner whose knowledge was so limited that the objector (Dandelion Investments Limited) was precluded from exercising its rights of cross examination in any useful way, in essence stonewalling Dandelion's attempts to prove that the assessment was wrong and by how much.

Judge Willy had some sympathy for the Inland Revenue witness who was subjected to days of gruelling examination on matters of which he had very little firsthand knowledge.<sup>67</sup> Much of his evidence amounted to no more than his views on the work and the opinions of others.<sup>68</sup> He considered that the witness should never have been asked to bear the weight of the Commissioner's case and the question was why was he put in that position when there were others much better qualified.

Judge Willy saw only two possibilities - either the witness was called by mistake or the choice of a patently inappropriate witness was by design. In the absence of evidence from the Commissioner on this point the Judge was left to draw his own inferences. He could not accept that somebody as experienced in tax litigation as the Commissioner with all the legal resources would have made such an elementary mistake. Judge Willy concluded that the decision to rely on an inappropriate witness was consciously made. The effect seriously undermined the ability of the taxpayer objector to prove that a tax assessment was wrong and by how much. The decision of the inappropriate witness also added unnecessarily to the hearing, and the time taken to write the judgment. The Judge considered it resulted in a serious misuse of the resources of the TRA. More importantly, Judge Willy stated that it meant that the taxpayer objector was put into an unhappy position of itself calling the appropriate departmental witnesses at its own cost in order to seek to discharge the onus of proof resting on it. It also significantly lengthened the case and fuelled Mr Russell's concerns that the taxpayer, for whom he appeared, had not been treated by the Commissioner in an even-handed way.

Judge Willy considered this attitude at odds with the way Mr Russell presents to the TRA and stated 'He puts forward, and argues his cases professionally albeit trenchantly.'<sup>69</sup> The Judge strongly stated that 'It is for the Courts to decide the merits of the cases that arise, not for the Commissioner to seek to obstruct the objector's ability to have those merits put before the Court.'<sup>70</sup> Judge Willy considered this a matter of serious public interest and saw it as the resources of the Court and monies of clients

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<sup>65</sup> Ibid 9,139.

<sup>66</sup> Ibid 9,137.

<sup>67</sup> Ibid 9,138.

<sup>68</sup> Ibid 9,139.

<sup>69</sup> TRA No. 93/103, Alt cit. *Case U11*, at 51.

<sup>70</sup> TRA No. 93/103, Alt cit. *Case U11*, at 52.

being dissipated in adjudicating on sterile side issues which should never, (or perhaps rarely), be allowed to arise. Judge Willy also referred to cases involving this taxpayer objector as well as the *Miller* and *McDougall* cases,<sup>71</sup> as illustrating the fact that this sort of wrangling in any case Mr Russell was involved in was becoming the norm.

Judge Willy stated, 'this feuding must stop. The Department must treat Mr Russell's clients as impartially as they treat those of any other tax practitioner.'<sup>72</sup> The Judge found the allegations of lack of impartiality, and unnecessary obstruction of the objector taxpayer by the Commissioner to be proved.

Judge Willy also held that this finding vitiated the assessment. On appeal<sup>73</sup> before Tompkins J, his Honour was not disposed to disturb that factual finding. However, the finding by the TRA that the lack of impartiality and unnecessary obstruction of the objector by the Commissioner vitiated the assessment did not stand.

## 2 Case U16

The other case considered by Mr Russell as evidence of him being treated unfairly is *Case U16* (1999) 19 NZTC 9,168. The case involving Inland Revenue Special Audit concerned the deductibility of various expenses of a business conducting motor vehicle auctions. A creditor had put the taxpayer into liquidation and Mr Russell was appointed as receiver. From extensive evidence Judge Barber concluded that, at all material times, the financial records of the objector company were quite inadequate and in rather a mess. That situation developed well before Mr Russell was able to take control of the taxpayer's affairs, and he had done his best to reconstruct matters but, naturally, in a favourable manner to the objector. With regard to Inland Revenue's conduct Judge Barber stated:<sup>74</sup>

At this point I record that Mr Russell made extensive submissions along the lines of improper purposes and motives of officers of the respondent and alleged a general *venda-tta* (sic) of the respondent's department towards him and his clients. I noted, in the course of the hearing, that I felt that the attitude of the respondent's department to Mr Russell "lacks maturity and needs polishing". I have often felt that officers of the IRD are quite unhelpful to Mr Russell - *sometimes hostile to him and sometimes flippant*. Such attitudes do not assist resolution of tax disputes whether between the department and Mr Russell or his many clients. I appreciate that Mr Russell's interpretation of revenue laws, particularly, in terms of tax avoidance, and his general strategies and the extent of his tax advisory business, are *thorns in the side of the department* and relate to enormous unpaid taxes overall; but *treating him as an enemy of the State* does not expedite resolution. However, in this case those IRD attitudes do not affect the validity or integrity of the assessment process. **(My emphasis)**

## VII INLAND REVENUE PERCEPTIONS OF MR RUSSELL

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<sup>71</sup> Mr Russell had made a similar allegation in *Miller v CIR; Managed Fashions Limited v CIR* (1998) 18 NZTC 13,961.

<sup>72</sup> TRA No. 93/103, Alt cit. *Case U11*, at 52.

<sup>73</sup> *Commissioner of Inland Revenue v Dandelion Investments Limited* (2001) 20 NZTC 17,293.

<sup>74</sup> *Case U16* (1999) 19 NZTC 9,168, 9,169.

*'He was always pleasant to deal with and doesn't harbour a grudge'*

Ian Ramsay, Justice Department

### **A Introduction**

It would be difficult to imagine an individual taxpayer that has had more interaction with Inland Revenue of a sustained nature than John George Russell. By early 1992 the Russell template and template cases had become a serious concern for Inland Revenue, mainly that other tax agents may copy the template if they saw Mr Russell 'getting away with it'.<sup>75</sup> Crown Law was approached for help to develop a strategy to address the concerns raised by Mr Russell's activities, which were having a significant effect on Inland Revenue resources.<sup>76</sup>

Inland Revenue considered that because of Mr Russell's success in concealing information and Inland Revenue's lack of coordination and commitment in dealing with him, it was difficult to form an overview of his activities and his use of Inland Revenue's resources. A clear limitation with this paper is the lack of being able to interview Inland Revenue with regard to Mr Russell, however the 1992 Oomen Report and the 1994 Booth Report provide some insight into the concerns Inland Revenue held in respect of Mr Russell and his tax activities.

### **B Overview & Oomen Report**

The Oomen Report was written to identify and address the concerns being raised by Mr Russell's activities. Mr Michael Oomen,<sup>77</sup> referred to Mr Russell's motivation as being a mystery. He considered that Mr Russell's motivation may have been:

'...a sense of satisfaction at having successfully accumulated wealth, and having outwitted and out manoeuvred the Justice Department, the Inland Revenue Department, the Courts and creditors over 15 years'.<sup>78</sup>

Oomen described Mr Russell as 'being in this tax avoidance *game* now for almost 15 years' and that 'money does not seem to be a major concern of his, unless he has pulled off the most extraordinary deception for the last decade and a half.'<sup>79</sup> Mr Russell has always appeared to have a modest lifestyle. The Oomen Report continued: 'it is unlikely that Mr Russell is deceiving people over his lack of interest in money. No-one I have

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<sup>75</sup> Oomen Report, (1992) [1.6]. The Report was headed 'Draft Strategy for Dealing with J G Russell' and was dated late 1992.

<sup>76</sup> Although impossible to gauge the amount of tax avoided for Mr Russell's clients it was estimated to be in the vicinity of between \$20 million over six years to in excess of \$40 million over eight to ten years (Oomen Report, paragraph 1.4).

<sup>77</sup> Mr Michael P J Oomen was a regional solicitor, Northern Region, Inland Revenue. The Report was headed 'Draft Strategy for Dealing with J G Russell' and was dated late 1992.

<sup>78</sup> Oomen Report, 'Biography of J G Russell', Appendix 'A', [16].

<sup>79</sup> Ibid.



spoken to can see him ceasing his activities and leaving the country to live a life of luxury in some tax haven'.<sup>80</sup>

Oomen wrote that those that had dealt with Mr Russell over a long period believed that it had all become a 'game' to him. Oomen thought that if that were so, Mr Russell had become someone who was 'possessed' by it. By way of example Oomen referred to the voluminous correspondence involving over 20 detailed *Official Information Act 1982* (NZ) (OIA 1982) requests in respect of a tax matter where the tax at issue was in the order of \$20.00!<sup>81</sup>

It would appear that in 2011 the 'game' is now wearing a bit thin with Mr Russell stating 'I'm getting sick of it for the simple reason that I'm getting old, everything's taken longer to do, and you think there's better things to do than this.'<sup>82</sup>

It was estimated by the Northern Region of Inland Revenue that Mr Russell was successfully tying up in excess of 18,000 employee hours (more than nine full time staff) each year, for every year.<sup>83</sup> A 'primary weapon in Russell's armoury' was continual delay. A typical Russell tactic, according to Oomen, was to withhold or deliberately supply incorrect information. Mr Russell had conducted a 'correspondence war' on behalf of his clients, and had 'abused' rights provided for under the OIA 1982. Oomen considered requests for information under the OIA 1982 were for information of 'no value and an undisguised attempt to tie up administrative resources'.<sup>84</sup> Over a one month period<sup>85</sup> an Inland Revenue employee (Mr Player, the chief 'architect' of 'Track A') received 29 letters from Mr Russell seeking information. One request dated 29 January 1992 contained 31 specific requests pursuant to the OIA 1982. A typical letter would make 15 to 16 requests for information. Mr Oomen had personally answered a single Russell letter containing 7 requests for information and it took him five hours to complete! One of the most time consuming tasks was answering the OIA 1982 requests coming to Inland Revenue.

Three or four OIA 1982 requests were coming in for each client (company and shareholders) after amended assessments had been issued addressing the tax avoidance. If any of the OIA 1982 requests had gone unanswered Mr Russell would apply for a court adjournment citing the non-response to his letters. In a similar vein, if these tactics were not working as efficiently as expected, Oomen stated that another technique used by Mr Russell was to send letters and requests to entirely different sections of Inland Revenue so that one section of Inland Revenue would not know that another section had received a request. Often the first a particular Inland Revenue section would know about a request received by another section would be when Mr Russell raised the particular letters in court. A claimed variation to this theme was for Mr Russell to start dealing with one Inland Revenue section, then to start corresponding with another section of Inland Revenue without telling either that he was dealing with the other! If any contrary decisions from different Inland Revenue District Offices were

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<sup>80</sup> Ibid.

<sup>81</sup> Ibid [17].

<sup>82</sup> 'Russell continues 30 year tax battle', *The Press*, 29 April 2011.

<sup>83</sup> Oomen Report, (1992) [1.5].

<sup>84</sup> Ibid [3.7.1]

<sup>85</sup> The one month period was from the start of January 1992 to early February 1992.

received on the same issue, he would use this as ammunition to attack the other decision.

According to Oomen, Mr Russell would also request a review of any decision made by Inland Revenue. Harassment of individual tax officers was also a claim made by Oomen. It was claimed that Mr Russell demanded to know the names of those dealing with a file, as well as their proof of authority. Oomen stated that if Mr Russell was unhappy with the outcome of a case, he would threaten the officer concerned with the prospect of a formal complaint about their performance, or sometimes threaten to personally sue them. It was claimed this tactic was often effective at the Inland Revenue District Office level by inculcating fear, with a resulting inaction on the part of the person to whom the request was addressed. Oomen suggested that the delay suited Mr Russell, who generally would only act again if Inland Revenue sought to take some recovery or compliance action. When action was commenced, Mr Russell would lodge a formal complaint with the regional controller over a *lack of response* by the departmental officer concerned.

Oomen also stated a Russell ploy was to create 'a bewildering network of companies and partnerships.'<sup>86</sup> In many cases, according to Oomen, companies that formed part of Mr Russell's tax schemes were included for no apparent reason other than to complicate and confuse investigators.

### ***C The Booth Report & the Russell Team***

Mr Russell is one of a few people who have had a dedicated team of investigators and legal counsel solely focused on his activities. This team was known as the 'Russell Team'. The Oomen and Booth Reports were both written in early 1990s addressing the concerns Inland Revenue had over Mr Russell's template scheme and the impact it would have on a larger tax population.

The Booth Report<sup>87</sup> followed on from the Oomen Report. It covered the formation and activity of the Russell Project Team. Reg Booth was the project Manager and was well aware of the issues surrounding Mr Russell and his interaction with Inland Revenue. The report set out an outline of the enforcement strategy towards Mr Russell. The information requests from Mr Russell had not abated and in 1994 Booth commented:

'each succeeding request (and our reply) gets longer and longer and the content deteriorates as well. In fact, in talks with the Ombudsman's Office they have indicated that after second requests the requests are really debates on the various points he wishes to raise'.

One Inland Revenue staff member had at the time of the Booth Report answered 350 letters!<sup>88</sup> Booth commented that the letters were wide ranging and sought information

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<sup>86</sup> Oomen Report [3.12.1].

<sup>87</sup> The Booth Report was dated 11 February 1994 and had a picture of a boat oar on the front of it. The letters on the oar appeared as 'O. A. R.' Mr Russell questioned the significance of the oar and the letters. He suggested to Mr Booth that they stood for 'Operation against Russell'. This was neither confirmed nor denied.

<sup>88</sup> Booth Report, [5.11].

on personnel, the Commissioner's practice, copies of internal documents, the reasons for everything, as well as the basic facts that most others would limit their request to. There was a close similarity in all the requests, but there was enough variation to prevent Inland Revenue from answering 'refer to reply of another request.'

Benefits in establishing the 'Russell Team', were seen as rapidly developing expertise in dealing with Mr Russell, preventing Mr Russell's ability to effect delay by directing matters to people with little or no experience, reducing the effect of his harassment technique, and allowing Inland Revenue to build an accurate picture of his activities, and to be consistent in their dealings with him. The team commenced in July 1993 with Mr Reg Booth the initial project manager. Booth considered Mr Russell's activities the 'biggest tax avoidance scam in New Zealand.'<sup>89</sup> He suggested that if Inland Revenue took firm action the Russell scheme would be dealt a 'mortal blow', and that 'we shall win the approbation of many other taxpayers and we shall present our masters with a handsome dollar return.'<sup>90</sup> Booth, perhaps rather optimistically in hindsight, thought that 'the firstfruits (sic) of such a vision can be gathered in before 30 June 1994'.<sup>91</sup>

The Booth Report clearly stated that Inland Revenue:

'must increase investigations of him over all revenues, we must maintain any pressure he feels and if necessary increase it where appropriate...and in court work be more aggressive against him, i.e. take the fight to him.'<sup>92</sup>

An enforcement strategy was prepared and was concentrated on answering correspondence, to preparing for upcoming court cases, and to 'home in on Russell and "his" companies.'<sup>93</sup> Booth stressed the absolute necessity of a coordinated approach... '...to hit him personally....but not put him out of business, although that may be a natural end result'.

## **VIII THE COMPLIANCE MODEL AND MR RUSSELL**

The Inland Revenue Compliance Model<sup>94</sup> focuses on the strategies adopted by those enforcing the law. Different strategic responses can be adopted by those on the receiving end of the law too, and these translate into different approaches to compliance.<sup>95</sup> Motivational postures reflect the degree to which individuals are accepting of a tax authority in terms of its goals and ways of operating and the degree to which they are sympathetic to the enterprise and open to its influence. Two postures, capitulation and commitment, are sympathetic postures, the former because resistance to authority seems useless, and the latter because paying tax is seen to be a noble action.

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<sup>89</sup> Letter titled 'Operation Avoidance' to the Regional Controller, Northern from Reg Booth, Project Manager dated 11 February 1994.

<sup>90</sup> Ibid.

<sup>91</sup> Ibid.

<sup>92</sup> Executive Summary of the Booth Report, (1994) [1.4].

<sup>93</sup> Booth Report, (1994) [4.8].

<sup>94</sup> Inland Revenue Compliance Focus 2011-12.

<sup>95</sup> Doreen McBarnet, 'When Compliance is not the Solution but the Problem: From Changes in Law to Changes in Attitude' in Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (2003) 229.

Three other postures represent the placing of greater distance between the tax office and taxpayers. Resistance reflects the posture of those who are within the system but object strongly to the way it is operating, disengagement reflects the posture of those who have cut themselves off completely from the system and want nothing more to do with it, and game playing reflects detachment with effective defiance. Those who adopt the game playing posture relax the social distance constraints to the point where they can obtain the information they need to beat the tax office at its own game. Game playing is about tax avoidance, in essence, finding ways of legally using law against the tax authority and sidestepping the obligation to pay tax.<sup>96</sup> The concerns raised in the Oomen Report support the adoption of this posture in relation to Mr Russell.

The Compliance Model has both the deference postures of commitment and capitulation as well as the defiance postures of resistance, disengagement and game playing.<sup>97</sup> Ambiguity surrounding what it means to comply with tax law, together with social divisions over the morality of taxation has allowed the motivational posture of game playing to flourish. This posture is not easily managed by regulators because it focuses on the grey areas of tax law, areas where administrators are uncertain and taxpayers see opportunity. Taxpayers who game authorities find clever ways of complying on strictly technical grounds while visibly thumbing their nose at the spirit of the law. This is perhaps why there has been a natural tension between s BG 1 ITA 2007 (and its predecessors) and the more specific provisions of the ITA 2007 (and its predecessors). More recent examples in New Zealand have been the *Chelle Properties (NZ) Limited v Commissioner of Inland Revenue*<sup>98</sup> GST case where tension existed between the timing of input tax claims, and *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue* (2009)<sup>99</sup> where the Supreme Court held that due to the presence of certain unnecessary features in the arrangement, the taxpayer's compliance with specific deduction provisions was not within Parliament's purpose.

To engage with a tax authority successfully, a 'game player' must have a mastery of tax law and be able to successfully engage in the court process. The game playing posture can sit anywhere along the left axis of the Inland Revenue's Compliance Model indicating quite clearly that a taxpayer may be 'willing to do the right thing' and yet cause Inland Revenue considerable angst. Mr Russell adamantly considers that he has complied with the relevant legislation by way of what the statute actually says in the specific sections, such as the loss offset provisions.<sup>100</sup>

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<sup>96</sup> Valerie Braithwaite, Friedrich Schneider, Monika Reinhart and Kristina Murphy, 'Charting the Shoals of the Cash Economy' in Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (2003) 93, 97.

<sup>97</sup> At an individual level, compliance is not a static, uncomplicated phenomenon. People can move in and out of compliance, often through ignorance and apathy, rather than calculative design. The job of regulators is to keep taxpayers more 'in' than 'out'. The Inland Revenue Compliance Model is a tool used to assist in this ongoing process. For more on this topic see , Braithwaite (ed), *Taxing Democracy, Understanding Tax Avoidance and Evasion* (2003).

<sup>98</sup> *Chell'e Properties (NZ) Limited v Commissioner of Inland Revenue* (2004) 21 NZTC 18,618 (HC); (2007) 23 NZTC 21,442 (CA)

<sup>99</sup> *Ben Nevis Forestry Ventures Limited v Commissioner of Inland Revenue* (2009) 24 NZTC 23,188 (SC); *Accent Management Limited v Commissioner of Inland Revenue* (2005) 22 NZTC 19,027 (HC); (2007) 23 NZTC 21,323 (CA).

<sup>100</sup> Section 188 [Losses incurred may be set off against future profits] and s 191 [Companies included in Group of Companies] Income Tax Act 1976.

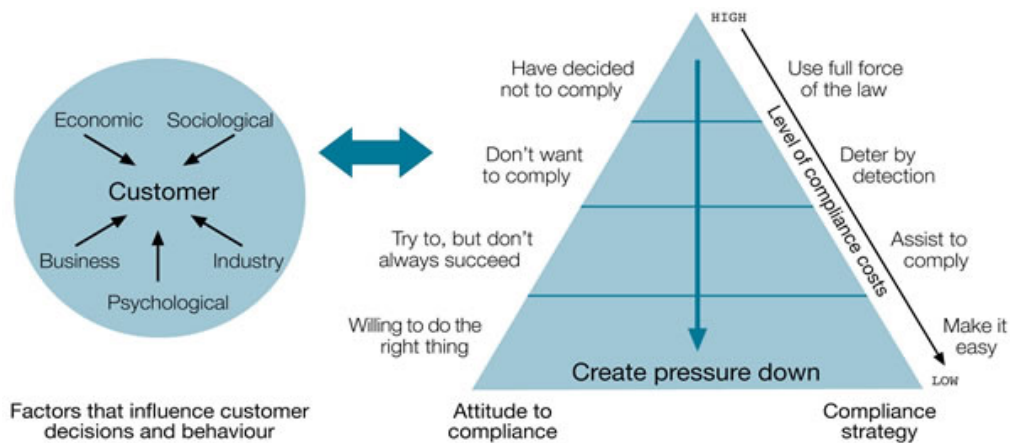


Figure 1: Inland Revenue Compliance Model (source: Inland Revenue).

Braithwaite<sup>101</sup> states that the management of game playing is bound to be difficult, and currently the psychology of game playing is lacking the theoretical infrastructure that has been built around other postures. Different motivational postures can be held simultaneously so it is relatively easy for them to wax and wane over time. Braithwaite states by way of example that when instructions arrive in the mail for a yearly tax return we might feel committed, or at least capitulate to the system. As we look in detail at how much tax we have paid or owe, we might feel resistance, disengagement or perhaps even a desire to play games. Having completed the transaction, however, we might revert to our committed posture, believing that paying tax is the right thing to do. In other words, as the context in which we find ourselves changes, our motivational postures change, making us cooperative at times, uncooperative at other times.<sup>102</sup> One can only assume that the continual requests for information directed to Mr Russell and his entities over time, as well as a tax outstanding amount that has grown beyond the realms of being able to be paid, has contributed to a posture of game playing, where although the stakes are high, in reality Mr Russell has no ability to pay the amount that appears on his Inland Revenue Statement of Account.

Braithwaite, referring to the multiple postures a taxpayer can hold, and observing that postures can change, states: <sup>103</sup>

There is evidence that those that are persistently resistant can go towards being disengaged or game players. They don't start out as being disengaged or game players, but a grievance such as '*they've got a vendetta against me*' may facilitate the change in posture. At some level a taxpayer does care that the tax authority have pursued him in this way, so there's the resistance, there's the component of resistance, but combined with that there's something else, so with those postures of game playing and disengagement there's often big ideological ideals and particular attitudes to that authority and I know what it is in the tax context and that is that it is driven by a desire to win at all costs, now in my more colourful moments I have called it narcissism...

<sup>101</sup> Interview with Valerie Braithwaite, December 2008, Australian National University.

<sup>102</sup> Valerie Braithwaite, 'Dancing with Tax Authorities: Motivational Postures and Non-compliant Actions', Valerie Braithwaite (ed), *Taxing Democracy: Understanding Tax Avoidance and Evasion* (2003), 15, 23.

<sup>103</sup> Interview with Valerie Braithwaite, Australian National University, 4 December 2008.



With regard to the context of time, by reference to the lower Court decisions of *Challenge*,<sup>104</sup> coupled with Inland Revenue's granting of approval for the selling of tax losses as being relatively commonplace, Mr Russell can justify the template arrangement, and, in some respects, his position that he has followed the law and has been at the 'willing to do the right thing' part of the Compliance Model (see Figure 1 'Compliance Model' above). From a timeline perspective the Russell template was applied from the early 1980's, with the last template clients in 1986, whereas the 4:1 Privy Council decision of *Commissioner of Inland Revenue v Challenge Corporation Limited*<sup>105</sup> was released in 1986.

Although the Compliance Model has been in existence for quite some time, Mr Russell's first glance at the Model was during an interview with the author in early 2010. He considered that he sat on the bottom of the 'pyramid' along with most taxpayers regarding himself as clearly being 'willing to do the right thing'. He considered that Inland Revenue had a completely separate category for him well above the 'use full force of the law' compliance strategy. Logically, this suggests that a taxpayer's perceptions of where they sit on the Model and Inland Revenue's perceptions of the taxpayer can naturally be quite distant.

## IX CONCLUSION

Mr Russell 'officially' retired in 1999. One thing that is not often considered is the personal time and toll that the template and associated litigation has taken on Mr Russell and his family. Mr Russell admits that there was a cost to family life with the long hours spent at the office during his working life.<sup>106</sup> With litigation spanning over so many years, and with the cost estimated at NZD \$5 million to defend the template only being part of the story, there is also the psychological cost of time and worry. Clearly one would have to be motivated to keep going with this type of litigation. Many people would have simply given up. Mr Russell described the ongoing litigation as 'a bit like being pregnant...you really have to see it through.'

It is doubtful whether Inland Revenue will recoup much of the funds it seeks to collect. The ultimate outcome after years of litigation may be bankruptcy for Mr Russell. However, even though this is the outcome he would not necessarily wish for, at least his retirement years may become a little more peaceful without the frequent section 17 TAA requests arriving in the mail.<sup>107</sup> It will remain, like the initial template 'Track A' case outcomes, perhaps a 'pyrrhic' victory for Inland Revenue if they are successful in the final round of the template litigation.

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<sup>104</sup> *Challenge Corporation Limited v Commissioner of Inland Revenue* (1984) 6 NZTC 61,807; *Commissioner of Inland Revenue v Challenge Corporation Limited* (1986) 8 NZTC 5,001

<sup>105</sup> *Commissioner of Inland Revenue v Challenge Corporation Limited* [1986] 2 NZLR 513; (1986) 8 NZTC 5,219.

<sup>106</sup> Mr Russell made the comment during an interview on 27 January 2010 that working such long hours had taken a toll on the time he had spent with his children when they were younger, especially during the Securitibank years.

<sup>107</sup> Five s 17 Notices to Furnish Information arrived on the day of my second interview with Mr Russell in April 2010.



In relation to having any regrets in life Mr Russell replied to the author, after taking a moment to reflect, 'I don't think so...' and went on to say:

'I would have rather not have had this row with Inland Revenue, but I don't see how you can...the point is I firmly believe if it hadn't been over the Russell template it would have been over something else...' <sup>108</sup>

From a personal time perspective Mr Russell said the template litigation and associated matters have occupied more than half his time for a period of around 26 years.

As far as a life outside of the 'tax wars', Mr Russell still plays the organ in the local Presbyterian Church and tries to maintain his health. Although Mr Russell's intention is to try to retire from the ongoing 'tax war' within 12 months, he thinks that might be a bit of wishful thinking. With regard to his greatest achievement he states 'tongue in cheek': 'I think staying alive with all this...survival is probably the greatest achievement...' <sup>109</sup>

When asked when the litigation will end he replies that it is up to Inland Revenue. He does not think it will end within the next year or so. In fact, with regard to the Track 'E' litigation he thinks it will go on for a while yet.

Mr Russell continues with a touch of humour:

...so you have to be realistic about the prospects...but you know...I'm certainly determined to battle it out...because I believe that they have got no case...and if it is going to end up that I have a bill for \$138 million<sup>110</sup> [see following] that they have got up to now...well, you know...I will have to start saving up obviously...

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<sup>108</sup> One of the interview questions I had written was to discuss with Mr Russell the 'Track A to E arguments'. I asked him during our interview if a 'Track F' was yet to come. He replied 'yeah, there might be a track F...they will never give up...whereas they live forever...I don't...and the idea is to get rid of me...one way or another!'

<sup>109</sup> Interview with Mr John Russell, Kawakawa Bay, 29 April 2010.

<sup>110</sup> The Inland Revenue Statement of Account for November 2011 has a payment due total of \$177,177,400.00 payable immediately.

PLEASE DISREGARD THIS REQUEST FOR PAYMENT IF THE ACCOUNT HAS BEEN PAID.

● Use the payment slip below when paying. Tear off here ▼ Keep this top part for your records.



**Inland Revenue**  
Te Tari Taake

**Payment slip**

IRD number [REDACTED]

MR  
JOHN GEORGE RUSSELL

Post your payment in the Inland Revenue envelope provided to: P O BOX 1535 HAMILTON

|  |                    |             |                  |
|--|--------------------|-------------|------------------|
| INCOME TAX   | Payment due        | IMMEDIATELY | \$138,796,819.38 |
| If the payment you're making is different from the payment due write the details here. | Year/period        | Tax type    | Amount \$        |
|  |                    |             |                  |
|  |                    |             |                  |
|  | Total payment made |             | ▶                |

**Inland Revenue, *Statement of Account*, April 2010**

Mr Russell, commenting about the prospect of Inland Revenue collecting some of the tax, states that Inland Revenue thought that he was worth at least NZD \$80 million. He claims, however, that he is:<sup>111</sup>

‘not worth anything really...in money terms...the house, the motor car for what it’s worth...I don’t even own them...I have never owned them...the trust has always owned them...and so the prospects of them getting any more money are...pretty remote’.

Mr Russell considers it was never really about the money for Inland Revenue – it was about getting rid of him.

The litigation continues.

<sup>111</sup> Interview with Mr John Russell, Kawakawa Bay, 29 April 2010.