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

OA NO'S 01/2018, 08/2018

	BETWEEN	**AIR NEW ZEALAND LIMITED** Appellant
	AND	**COLLECTOR OF INLAND REVENUE** Respondent

Hearing: 24 & 25 March 2022

Appearances: Messrs G D Clews and S J Davies, for Appellant
Mr M J Ruffin, for Respondent

Judgment: 9 July 2022 (NZT)

[REDACTED] JUDGMENT OF HUGH WILLIAMS, CJ

Result:

A. On each of the questions discussed in this judgment and for the reasons appearing in the judgment, the Commissioner acted incorrectly in determining that the indemnity payments paid to Air NZ by the Government were deemed to be sourced in the Cook Islands or wholly sourced in the Cook Islands under ss 83(a), (f), (j), (k) and (m) of the Income Tax Act 1997. The Cases Stated are therefore both answered "No".

B. Mr Rowe's apportionment calculations are adopted by the Court.

C. Leave is reserved to the parties within one month of delivery of this Judgment to address consequential matters that require to be considered under Part V as per paragraph [155].

D. The attention of recipients of an unredacted version of this Judgment is drawn to the Addendum at the end of the same.

Solicitors

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Introduction: Cases Stated; The Issues.

[1] This judgment deals with assessment appeals brought under Part IV of the Income Tax Act 1997[1] by way of Cases Stated dated 14 February and 22 August 2018. Both, broadly put, relate to the taxability of payments made to Air New Zealand Limited[2] by the Government of the Cook Islands in relation to Air Services Agreements[3] between those parties concerning the Cook Islands – Los Angeles and the Cook Islands – Sydney[4] direct routes flown by Air NZ for which, in terms of the Cases Stated, "the Government of the Cook Islands agrees to 'indemnify'[5] the losses incurred by the appellant".

[2] The Cases Stated arise out of the company's 2013-2016 income tax returns[6]. In the 2013 and 2014 returns Air NZ returned the indemnity payments as income derived in the Cook Islands and as being partly sourced in the Cook Islands and partly sourced elsewhere, with the proportion of income sourced in the Cook Islands assessed at 50% of the payments. For the 2015 and 2016 returns the indemnity payments were returned as income partly sourced in the Cook Islands and partly sourced elsewhere but the proportions of income sourced in the Cook Islands were assessed for the RAR-LAX route at 40.62% and 41.68% successively for the two years, as ratios of the indemnity payments, and for the RAR-SYD route at 14.2% and 19.94% for those years on the same basis.

[3] For all years, the respondent Collector assessed the payments as being wholly sourced in the Cook Islands and attributable as 100% assessable income.

[4] As required by s 36, Air NZ, on a "without prejudice" basis, paid the tax assessed for each of the years in question: **[REDACTED BY ORDER OF THE COURT OF 9 AUGUST 2022]**.

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1 'ITA' All statutory references in this judgment are to the ITA unless otherwise specified.
2 "Air NZ".
3 "ASAs"
4 "RAR-LAX" and "RAR-SYD" respectively.
5 Quotation marks added to first mention for reasons later discussed.
6 Both Cases Stated have been fully consolidated and accordingly only one judgment is necessary. The Government's financial years in question are those ending on 31 December 2013-6, but Air NZ's financial years in question are those ending on 30 June 2014-7. As the exemption later cited was in force to 1 January 2014, the 2013 assessment applied to the first half of the 2013 year.

[5] Air NZ objected to the indemnity payments being assessed as 100% derived and assessable for income tax in the Cook Islands on the basis that the ASAs were partly performed in the Cook Islands and partly performed elsewhere; that the apportioning of income derived under the ASAs should reflect the proportion of the services that were performed only in the Cook Islands; and that the services performed in the Cook Islands were for the carriage of outbound passengers and freight as "codified" under s 75(3).

[6] On 6 September 2017 and 15 March 2018 respectively, the Collector disallowed all Air NZ's grounds of objections. By letters dated 5 December 2017 and 14 June 2018 Air NZ requested, under s 29(2), that its objections be heard in this Court.

[7] The questions for determination, as expressed in both Cases Stated, are whether the Collector was correct in determining that the indemnity payments were deemed to be sourced in the Cook Islands under ss 83(1)(a)(f)(j)(k) and (m); and whether the Collector was correct in assessing the indemnity payments as wholly sourced in the Cook Islands under s 83(f).

[8] Apart from differences in the amounts under review, the detail of the grounds of objection and disallowance in both Cases Stated are identical and read:

> "The grounds for the Company's objection to each assessment are as follows:
>
> 1. The assessments are wrong in fact and law.
>
> 2. Without limiting the generality of the foregoing ground, the assessments incorrectly bring to charge for CI income tax, sums calculated by the Collector as reflecting the whole of a "subsidy"[7] payable to the Company under two … ASAs between it and the CI Government.
>
> 3. Without limiting the foregoing ground 2, no part of the subsidy paid or payable to the Company is assessable to CI income tax, because the subsidy is not income that is susceptible to taxation in CI on the basis of source or otherwise. Without limiting this ground, the objection is advanced on the basis that:

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[7] Quotation marks added to first mention.

(a) In legislating for the taxation of certain revenues derived by non-resident airlines from 1 January 2014 the CI Parliament has limited the income tax charge imposed on such airlines by introducing a code for their taxation;

(b) The code brings to charge only payments made to an airline for outbound carriage from CI;

(c) The subsidy paid to the Company under the ASAs is not a payment for outbound carriage. Instead it is a general payment to the Company because such payments for outbound (and other) carriage as the Company does receive are insufficient to operate the relevant routes economically;

(d) The code supervenes on all other parts of the ITA insofar as the taxation of non-resident airlines is concerned;

(e) As a result, no part of the subsidy falls to be taxed to the Company under general provisions of the ITA.

4. If and to the extent that the foregoing ground 3 is incorrect (which is not conceded), then the Collector has incorrectly brought to charge all of the subsidy, because the amount chargeable with CI income tax is less than that.

5. Without limiting the foregoing ground 4, any sum paid or payable to the Company under the ASAs is subject to apportionment so as to distinguish between a part that is subject to CI income tax and a part that is not.

6. Without limiting the foregoing ground 5, such apportionment must be made on the basis that:

(a) Part of the subsidy has a source in CI and part does not;

(b) Apportionment is required where, under any head of source in section 83 of the ITA, a non-CI source is attributable to the relevant income;

(c) The "Government contract" head of source in section 83(1)(f) leads to anomalous results without apportionment, is not applied by the Collector consistently with its words, and so cannot be applied in this case as asserted by the Collector;

(d) Comity between nations requires CI to apportion in this case to avoid fiscal over-reach in taxing non-residents;

(e) Taxing non-resident airlines without apportionment ignores where real economic activity is carried on under the ASAs, contrary to good tax administration and practice.

7. Without derogating from the foregoing ground 3, or limiting the foregoing grounds 5 and 6, apportionment should be based on an analysis of where services are performed by the Company under the ASAs.

8. If the foregoing ground is incorrect (which is not conceded), then apportionment should be on the basis that only that proportion of the subsidy as relates to outbound carriage should be brought to charge, and the balance excluded from CI taxation because of the operation and limited scope of section 75 of the ITA."

and the grounds for disallowance read:

"3. The amount under review, an indemnity payment of **[REDACTED]** made to Air New Zealand by the Government of the Cook Islands, is apportioned by the Collector as 100% sourced in the Cook Islands for income tax purposes.

4. The determinations of source and apportionment for the indemnity payment and its assessment for income tax under sections 75(3), 80(2), 83 and 84 of the Act.

The grounds for objection raise the following issues:

5. Does the indemnity have a source in the Cook Islands? (refer first, second and third grounds)

6. Does section 75(3) restrict the assessment of the Company for income tax to section 75(3) to the exclusion of all source provisions under the Act? (refer third ground)

7. What should be the basis for apportionment in relation to source between the Cook Islands and elsewhere for the indemnity payment? (refer fourth through eighth grounds)

The Collector's Determination

<u>The First and Second Grounds</u>

8. The Collector's assessments correctly rely on the facts and law given the reasons below.

9. The objection that the whole of the indemnity payable under the … ASAs is assessed for tax in the Cook Islands cannot be sustained for the following reasons:

   a) The indemnity is a profit or gain the company receives in the Cook Islands under section 46 … that provides:

"… the assessable income of any person shall include, unless otherwise provided for, (a) all profits or gains derived from any business …"

b) Under ordinary concepts a payment of this type is income as it is paid or payable in order to indemnify a loss of a profit or gain;

c) The whole of the indemnity is assessed for income tax as reviewed in the following grounds.

The Third Ground

10. The objection that the indemnity may not be considered an amount paid or payable for outbound carriage and cannot therefore have a source in the Cook Islands is not considered relevant (nor is it conceded) given the source of the indemnity is provided for under other provisions of the Act.

11. The objection that section 75(3) restricts the assessment of the indemnity to only those provisions under section 75(3) … is disallowed because:

a) The ordinary meaning of the words "… the amount paid or payable … must be included in the total income derived …" is an explicit inference that other amounts of income other than those amounts under section 75(3) must be considered when deriving the total income of Air NZ.

b) Without any explicit provisions for restricting the application of section 75(3) there is no ground for excluding the operation of the source rules under sections 80(2) and 83.

12. The indemnity payment has a source in the Cook Islands because it is one or more of the following classes of income deemed to be derived in the Cook Islands:

a) The indemnity is income derived from a business carried on in the Cook Islands under section 83(1)(a) …

b) The indemnity is Income derived from … a contract made with the Government of the Cook Islands under section 83(1)(f) …

c) The indemnity is Income derived from contracts made or wholly or partly performed in the Cook Islands under section 83(1)(j) …

d) The indemnity is Income derived from the carriage by sea or by air of merchandise, goods, livestock, mail, or passengers shipped or embarked in the Cook Islands under section 83(1)(k) …

e) The indemnity is income derived directly or indirectly from any other source in the Cook Islands under section 83(1)(m) …

13. The particular indemnity is an amount of income derived from the Cook Islands because it is derived from a contract(s) made with the Government of the Cook Islands under section 83(1)(f) as follows:

    a) A contract between Air New Zealand and the Government of the Cook Islands known as the Agreement for provision of air services between the Cook Islands and the Los Angeles USA is signed on 25 March 2014.

    b) A contract between Air New Zealand and the Government of the Cook Islands known as the Agreement for provision of air services between the Cook Islands and Sydney Australia is signed on 25 March 2014.

The Fourth, Fifth and Sixth Grounds

14. A determination of apportionment between the Cook Islands and elsewhere must satisfy the following:

    a) The indemnity has a source in the Cook Islands under section 83 ….

    b) Apportionment is just and reasonable under section 84 … having regard to the nature and relative importance of the sources of the indemnity whenever one of the following applies:

        i. the indemnity is apportioned between its source in the Cook Islands and its source elsewhere;

        ii. the indemnity is attributed to one such source to the exclusion of the other.

15. The indemnity is determined to be exclusively derived in the Cook Islands because:

    a) The source of the indemnity is a payment of indemnification under clause 9.2 of the ASA being a contract made with the Government of the Cook Islands.

    b) A contract made with the Government of the Cook Islands is indivisible and incapable of apportionment.

    c) The indemnity is exclusively derived from clause 9.2 of the ASA using the practical man test for determining source under *CIR v NV Philips Gloeilampenfabrieken* [1955] NZLR 868.

The Seventh and Eighth Grounds

16. The grounds that apportionment should be made on where the Company performs the services and the relationship to outbound carriage may apply under a contract for services; however, the nature of the ASA agreement is an indemnity payment for certain losses and not for the services themselves. It follows that the grounds for apportionment do not apply."

[9] Air NZ's Answer to the Cases Stated[8] gave notice it had reviewed the basis of its apportionments to income with a Cook Islands' source, concluded its previous calculations were incorrect, and accordingly advised that the calculations and apportionment in each of the Cases Stated were no longer relied on, but were to be replaced by the amended calculations and apportionments attached to the formal Answer. As the Collector's disallowance was based on the contention that Air NZ's income under the ASAs was wholly sourced in the Cook Islands and was attributed as to 100% assessable income there, Air NZ's change of calculation left the disallowances unaffected.

Evidence

[10] The ASAs for the four relevant financial years, 31 December 2013-6, were in evidence by consent but because Mr Ruffin, counsel for the Collector, submitted that many of the other documents in evidence, including ASAs before and after the four years in question, were irrelevant and inadmissible, that point requires to be decided first in order to set the evidential context against which the Cases Stated are to be determined.

[11] However, as s 31[9] entitles the Court, in proceedings such as these, to "receive such evidence as it thinks fit, whether receivable in accordance with law in other proceedings or not", Mr Ruffin's point was somewhat academic but, in light of his submissions, the topic will be dealt with, though comparatively briefly.

[12] Mr Ruffin's submissions as to admissibility and interpretation – as distinct from narrative or context – of the documents in evidence other than the four main ASAs were, as all ASAs provided they were governed by New Zealand law, principally based on a recent decision of the New Zealand Supreme Court, *Bathurst Resources Limited* and *Buller Coal Limited v L&M Coal Holdings Limited*[10]. The case concerned the proper interpretation of a contract for the sale of coal mining rights.

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8 Files on 28 September 2018 (NZ time).
9 Listed, but not argued, by Mr Ruffin.
10 [2021] NZSC 85, SC 29/2020, 14 July 2021.

The Supreme Court judgments were clearly intended to resolve a number of hitherto contentious points of New Zealand contractual interpretation.

[13] Mr Ruffin's submissions particularly focused on the decision of the minority[11] as to the objective approach to contractual interpretation, the admissibility of background or extrinsic material, both before and subsequent to the making of the contract, the contextual reading of the contractual terms used, the exclusionary rule concerning negotiations prior to the contract and parties' subsequent conduct, the role of the law of evidence, especially the Evidence Act 2006 (NZ), in contractual interpretation, specialised meanings and the implication of terms.[12]

[14] Based on *Bathurst* and the Evidence Act 2006 (NZ) Mr Ruffin submitted that the first relevant agreements were two dated 20 December 2010 relating to the RAR-LAX and RAR-SYD routes. Evidence of ASAs prior to that date, he submitted, were irrelevant as was evidence relating to Air NZ's prior subjective intention.

[15] The last relevant ASAs, in Mr Ruffin's submissions, were those dated 25 March 2014, and accordingly, in Mr Ruffin's submission, ASAs made after that date were irrelevant, as was evidence of Air NZ's subjective intention in relation to them.

[16] Particularising, Mr Ruffin submitted:

(a) The RAR-SYD and RAR-LAX agreements of 20 July 2004 were neither relevant nor admissible;

(b) The 7 March 2007 RAR-LAX, 16 January 2009 RAR-LAX, October 2009 RAR-SYD seasonal service, 13 January 2010 RAR-LAX and RAR-SYD agreements were all neither relevant nor admissible, were too remote in time from the 20 December 2010 first

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11 With whom the majority agreed on this point.

12 *Firm PI 1 Limited v Zurich Australia Insurance Limited* [2015] 1 NZLR 432, [2014] NZSC 147. *Vector Gas Limited v Bay of Plenty Energy Limited* [2010] 2 NZLR 444, [2010] NZSC 5, per Tipping J, at [64]. *Gibbons Holdings Limited v Wholesale Distributors Limited* [2008] 1 NZLR 277, [2007] NZSC 37, and *Bathurst* at [43]–[117].

relevant ASAs and could not be used as extrinsic evidence to aid the interpretation of those and subsequent relevant agreements.

[17] In saying the ASA's are governed by New Zealand law, the agreements are unclear.

[18] If what was meant was that Cook Islands law has no application to them, the provision is erroneous as the whole of these proceedings are based on the applicability of the ITA and the Cook Islands' taxation regime to the ASAs and the payments thereunder. Ms Day, Manager Taxation for Air NZ, said that income tax exemptions for foreign airlines applied in the Cook Islands for 25 years up to 1998, and gave evidence concerning intended and actual exemptions granted since that date under the ITA. The necessity for tax exemptions for international air carriers is an acknowledgment that the Cook Islands' taxation regime applied to their operations, but would not be invoked.

[19] If the agreements being governed by New Zealand law was intended to cover admissibility and interpretation, as Mr Ruffin submitted, then, applying the relevant passages in *Bathurst* to the admissibility of the documents in evidence in this case, each of the ASAs covering the periods directly in issue is entire within itself. Evidence of discussions, negotiations, events and other agreements including those prior to those directly in issue are capable of explaining the narrative background and describing the context in which the relevant agreements were made, including the commercial imperatives which led to their terms, and therefore, to a limited extent, provide some objective view on the relevant documents' meaning.

[20] The relevant ASAs, for the most part, use ordinary wording so ordinary meanings are appropriate but, to the extent they were regulating an area of specialised activity, agreements other than those relating to the years in question are admissible as providing some interpretative assistance in that respect. The same can be said of the evidence concerning matters subsequent to the relevant ASAs. But all of that needs to be seen against the background of other matters and documents in evidence including variations in and between the ASAs, the Global Financial Crisis, the Cook Islands' 2013 Tax Review, the importance of the RAR-SYD and RAR-LAX flights to

both parties and, as far as subsequent conduct is concerned, though very limited assistance can be taken from them, such matters as the pandemic-related decline in Air NZ's viability and the Cook Islands' economy.

The Main ASAs

[21] The first ASAs relating to the periods in question were the pair dated 20 December 2010 governing each route. Analysis of their principal provisions follows. Other aspects are discussed elsewhere.

[22] That relating to the RAR-LAX route included in its preamble:

> 1.1 Air New Zealand operates a non-stop air service between Rarotonga and Los Angeles and Air New Zealand agrees to continue to operate such a service, subject to the terms and conditions agreed to in this Agreement.
>
> 1.2 Air New Zealand recognises the critical importance to the tourism industry and to the economy of the Cook Islands of scheduled air services between Rarotonga and the United States of America, with the ability to connect to services to and from Great Britain and Europe and the desire of the Government to ensure the service is continued in as cost effective manner as is possible.

[23] Relevant provisions of the agreement were:

- The agreement was for three years, 1 April 2011 – 31 March 2014, with a right of renewal if the parties previously met and agreed.
- Air NZ was to provide a minimum of one B767 service weekly in each direction with the option, by agreement and "subject to seasonal or other demand, [to] increase capacity".
- Fares were to be fixed by Air NZ to maximise profit and minimise loss, amongst other matters, but with fares being competitive with other South Pacific destinations.
- Air NZ was required to disclose to the Government "the method and any changes to the method by which pro-rating of long-haul airfares in respect of the Service are calculated".

- Air NZ was to promote air cargo revenue potential.

- The agreement required monthly financial reports from Air NZ using a template in an annexed schedule, plus financial accounts and reports in the format of another schedule with a formula for reconciliation.

- A consultative committee was to be established to review all matters arising out of the operation of the service with an obligation to meet regularly with the Cook Islands Tourism Corporation[13] to review "coordinating marketing programmes in the most cost efficient and effective manner" and with the Government making a "strong commitment" in its Budget to further the agreement's objectives.

- The parties had a general obligation to use their best endeavours to give full effect to the "intentions of the Parties as evidenced by this Agreement".

[24] Importantly, cl 7, under the heading "Commercial Risk", said "any losses incurred by Air NZ in respect of operating the service during any contractual year during the term shall be **[REDACTED]**", the losses being calculated in accordance with a schedule and Air NZ's standard accounting practices, with the parties agreeing that "should an extraordinary event occur … which has the effect of resulting in a material increase in the amount of the fixed costs allocated to the service" the Government "may give notice to Air NZ that it wishes to negotiate" further on that matter and, failing agreement, might terminate the contract.

[25] The RAR-SYD agreement's preamble noted that the Government had "invited Air NZ to establish and operate" a weekly service in each direction on that route with a minimum of one B767 service, but with the option to increase capacity "subject to seasonal or other demand". The agreement was for two years, nine months from 1 July 2011 with a right of renewal, similar provisions as in the RAR-LAX agreement concerning fares, cargo, financial records, consultation, sales and marketing and the like, with cl 7, covering "Commercial Risk", saying the "Government agrees to ensure that Air NZ earns a return of not less than **[REDACTED]** of operating the Service"

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13 "CITC" including its other names.

with "any losses incurred by Air NZ in respect of operating the Service during any contractual year … [to] be **[REDACTED]**" as calculated in accordance with an annexed schedule.

[26] Both 2010 ASAs were extended by undated deeds of variation from 1 April 2011 to 19 (RAR-LAX) and 25 October 2014 (RAR-SYD) with the RAR-LAX variation deleting the existing cl 7.1 in favour of a provision, similar to that in the 2010 RAR-SYD agreement, by which the Government agreed to ensure Air NZ earned a return to the end of the contractual term of "not less than **[REDACTED]**'" with any losses during the term being **[REDACTED]**, both calculated in accordance with schedules. The minimum guaranteed return was a departure from the previous focus on compensation for loss.

[27] Mr Ruffin, emphasising that all ASAs said they constituted the entire understanding of the parties and superseded any prior agreements, also compared them, submitting that they were not "underwrite agreements" and that the formulae for calculating Air NZ's losses required a **[REDACTED]** of total costs.

[28] While denying he ever described the ASAs as "underwrite" agreements[14], he said the Government was underwriting the loss so this was why the relevant commercial risk clause could be described as an underwriting clause. In support, he pointed to cl 21.2 under which the Government was required to bear the losses up to the date of termination but noted cls 7 and 8 as to risk, survived termination.

[29] The next pair of ASAs relevant to the years in contention were both dated 25 March 2014.

[30] The RAR-LAX agreement recited that the Government had invited Air NZ to "continue to operate" a weekly service in each direction during a four year term commencing 1 November 2014 with a right of renewal.

[31] Under cl 9.1 governing "Commercial Return", the Government agreed to ensure Air NZ earned a return from the service through an entitlement to impose charges of **[REDACTED]**, both calculated in accordance with a schedule, but, if Air

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NZ incurred a loss, it was to be **[REDACTED]** after calculation in accordance with a schedule and after deducting the cl 9.1charges. The schedule was extended to include several examples covering variations in the commercial return according to differences in the costs and revenue allowances.

[32] The companion RAR-SYD agreement was also for Air NZ to "commit to continue" a weekly service for four years from 1 November 2014 with an identical formula for the "Commercial Return" as in the RAR-LAX agreement, again with the same schedule, including the examples.

[33] For completeness as to earlier ASAs, the 20 December 2010 RAR-LAX agreement was preceded by one dated 28 February 2007, the terms of which largely mirrored those of later ASAs including the references to the CITC and the Budget. The preamble noted that the "Government has invited Air New Zealand to establish and operate a direct non-stop air service between Rarotonga … and Los Angeles" with Air NZ, as in the 20 December 2010 ASA, recognising the "importance to the tourism industry and to the economy of the Cook Islands" of such services and having the "ability to connect to services to and from Great Britain and Europe". The agreement was exploratory in the sense that after the initial 12 months of the three-year term either party could terminate it if the service was "uneconomic to an extent significantly greater than that contemplated at the time of entering into this agreement" or the losses incurred were forecast to be more than twice the maximum liability of the Government under the commercial risk-sharing clause which provided for equal sharing of profits and losses, capped in accordance with formulae.

[34] The 28 February 2007 agreement was varied in December 2008[15] because of "significant fluctuations in the cost of fuel and currency exchange rates and recent developments in the world economy" for a term of one year from 1 April 2009 for the weekly RAR-LAX service and with, pursuant to cl 7.1, Air NZ's losses being borne **[REDACTED]** and for equal sharing of profits, each calculated in accordance with formulae in the schedule.

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[15] Signed for the Government on 16 January 2009.

[35] That agreement was again varied on 17 December 2009, for one year from 1 April 2010, again citing fluctuations in fuel costs, currencies and the world economy.

[36] For the RAR-SYD route there was a further agreement, also dated 17 December 2009, for 17 weeks, 4 July- 30 October 2010, with the losses being **[REDACTED]** and profits shared, all as calculated in a schedule. Other terms echoed those in the 2010 agreement.

[37] At the other end of the time spectrum, though Mr Ruffin argued they were neither relevant nor admissible because of the end point of the assessment periods in issue, for completeness it is noted that, effective from 1 November 2018, two further ASAs were entered into in relation to the RAR-LAX and RAR-SYD routes to cover weekly services for four years from that date. Though more detailed, the agreements were effectively identical to their predecessors, but the commercial return clauses provided that, subject to an **[REDACTED]** cap, the Government agreed to ensure Air NZ earned a return from the services after it had imposed **[REDACTED]**, both calculated in accordance with a schedule and that, if Air NZ incurred a loss from operating the services each year, the loss should be **[REDACTED]**. Clauses 9.3 & 4 both provided that Air NZ would not earn more than **[REDACTED]** during each year calculated in accordance with the formula, again with examples, in a schedule.

ICAO Policies

[38] Since 1986 the Cook Islands has adhered to the 1944 Convention on International Civil Aviation,[16] the taxation policies of which were updated in 2000[17]. Recognising the many variables affecting taxation of international air carriers it, generally, limited taxation on international air transport and movable property associated with aircraft operation "to the state in which any such enterprise has its fiscal domicile"[18] and obliged each contracting state, to the fullest possible extent, to grant reciprocal exemption from taxation on the income of a non-resident air carrier derived in that state, based on the principle that "lack of implementation of this rule of

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16 "ICAO": Collector's evidence: Toleafoa Ex Vol F 611.
17 Air NZ Bundle: 2/622.
18 Air NZ Bundle: 2/629.

reciprocal exemption involves either multiple taxation or considerable difficulties of income allocation in a very large number of taxing jurisdictions". The policy document said "non-observance of the principle of reciprocal exemption … was also seen as risking retaliatory action with adverse repercussions"[19]. Effecting those principles was to be through bilateral negotiation of double tax agreements or by other methods such as the inclusion of appropriate provisions in bilateral agreements for the exchange of commercial air transport rights or by legislation granting such "exemption to any other State that provides reciprocity"[20].

[39] Mr Ruffin stressed that, under the ICAO Convention, "tax is a levy that is designed to raise national or local Government revenues, which are generally not applied to civil aviation in their entirety or on a cost specific basis".[21]

[40] For Australia, airline operators must calculate their taxable income in accordance with Australian income tax law. Australia has entered into a number of tax treaties and other agreements concerning profits for international air transport[22]. For New Zealand, another State's airline is liable to income tax on its income sourced from New Zealand, absent a double tax agreement or an exemption by the Commissioner of Inland Revenue, but New Zealand law does not provide for ASAs to give tax exemption.[23]

[41] That, Mr Ruffin submitted, supported the evidence of Mr Toleafoa, an employee of the Revenue Management Division of the Ministry of Finance and Economic Management, that, in altering the tax obligations of Air NZ, the Government was not in breach of the ICAO Convention as "no reciprocal arrangement exists where a New Zealand company services the Cook Islands and a Cook Islands company services New Zealand [as] they would each only be taxed in their home country"[24].

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19 Ibid: 2/626.
20 F 629.
21 2000 version 634.
22 2/652-3.
23 F 764, 78.
24 Toleafoa brief at 64.

[42] All of that was to answer the submission by Mr Clews, leading counsel for Air NZ, that the ICAO approach as in the Convention documents should, if consistent, affect interpretation of the relevant ASAs.

Tax Review, Statutory Provisions & Exemption Order.

[43] That leads into a discussion of the Government's September 2013 Tax Review[25], the background to which, plus the ASAs, was described by Mr Kleinsorge, Manager, Network Planning, for Air NZ. He said that, prior to 1984, Air NZ's services to the Pacific were through its "Coral Route", a service from which, up to 2000, it gradually withdrew as aircraft capacity and range grew in association with increasing passenger loadings. Its RAR-LAX service ceased in 2002 but the company re-assessed it in 2004, concluding that the service could not be viable without financial support from the Government. That led to a 2006 request for resumption from the CITC but, given the then price of fuel, Air NZ concluded a significant loss would result from reinstating the service. That, in its turn, led to the 28 February 2007 ASA with Government meeting Air NZ's losses. Similar assessments took place as to the RAR-SYD route. It was economically unviable but, in October 2009, the CITC again requested initiation of a RAR-SYD service and that lead to the 17 December 2009 and 20 December 2010 ASAs. Neither of these services would have occurred, Mr Kleinsorge said, had it not been for the financial support of the Government.

[44] A different perspective on that narrative was given by Ms Day whose evidence concerning the longstanding tax exemptions for non-resident airlines was earlier recounted. She said a retroactive Order in Executive Council[26] extending the exemption was intended to be promulgated in 2002 but did not materialise. That intention, she said, lead to the original s 75 which, in essence, made 5% of aircraft operators' gross receipts from goods, passengers and the like taxable. That was amended by the Income Tax Amendment Act 2002 which enacted s 75(1A)-(1C) and gave power for an OIC to exempt aircraft operators from the 5% tax if the Order was in the public interest and a Cook Islands aircraft operator would not be liable to income tax imposed by a country outside the Cook Islands.

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25 Air NZ Bundle 2/577

26 "OIC"

[45] In effect, according to Ms Day, Air NZ understood the amendments to confirm Government adherence to ICAO policies. And although, in 2011, the Minister of Revenue advised that the possibility of taxing international airlines was being explored, an OIC under s 75(1A) was issued on 19 January 2012 which retrospectively confirmed that the income of foreign aircraft operators was tax exempt to 31 December 2010.

[46] Twenty months after the 19 January 2012 OIC, the Government's September 2013 Tax Review was published. Paragraph 3.4.2 recommended ending the tax exemption for airlines from 1 January 2014 and their being charged normal company income tax. The reasoning was that lifting the exemption was unlikely to "affect local or global profits for international carriers" because both New Zealand and Australia offered credits for company tax paid in foreign jurisdictions. So, if Air NZ were profitable globally and in the Cook Islands, "then their tax obligations in the Cook Islands will be fully offset against their tax liabilities in their home countries", while were they not internationally profitable, but were tax exempt in the Cook Islands, the "Cook Islands taxpayer is effectively subsidising loss-making routes in other areas of the world". The express recommendation was that "airlines be subject to company tax rates on their locally derived profits on a net profit basis" to ensure their taxability was consistent with other Cook Islands' companies.

[47] Perhaps unsurprisingly, on 17 October 2014 Air NZ objected to the proposal on the grounds it was contrary to international practice, contradicted ICAO tax policies and created the risk of double taxation. It recommended the exemption continue until completion of a Double Tax Agreement, a stance to which it adhered in negotiations the following month.

[48] However, according to Ms Day, there was effectively no further consultation with Air NZ prior to the enactment, on 17 December 2013, of the Income Tax Amendment Act 2013 which, with effect from 1 January 2014, repealed the 1997 s 75 and substituted another.

[49] The evidence included officials' explanatory note to Members of Parliament concerning the Income Tax Amendment Bill 2013 and the Parliamentary debate on the

measure. Neither provide any detailed explanation for the change nor reference to ICAO policies.

[50] The 1997 s 75 relevantly read:

> 75 Overseas shipping freight and passage money -
>
> (1) Notwithstanding anything to the contrary in this Act, where a ship or aircraft belonging to or chartered by any person being resident in a country or territory outside the Cook Islands and not being resident in the Cook Islands, carries outside the Cook Islands merchandise, goods, livestock, mail or passengers shipped or embarked in the Cook Islands , 5 percent of the gross amount paid or payable to that person in respect of that carriage, whether that amount is payable in or outside the Cook Islands, shall be deemed to be taxable income derived by that person from the Cook Islands. No person to whom this subsection applies shall, in respect of carriage as aforesaid, be assessable for income tax otherwise than as provided in this subsection.
>
> …

[51] The 2013 substitute s 75 relevantly reads:

> 75 Taxable income from ships and aircraft owned by non-residents
>
> (1) …
>
> (2) …
>
> (3) For the purposes of this Part[27], the amount paid or payable to the owner of an aircraft who is not a resident of the Cook Islands for the carriage of merchandise, goods, livestock, mail, or passengers by the aircraft to outside of the Cook Islands must be included in the total income derived by the owner from the Cook Islands, irrespective of whether
>
> (a) the amount is payable in or outside the Cook Islands; or
>
> (b) the aircraft calls at 1 or more other airports in the Cook Islands before finally leaving.
>
> (4) Subsection (3) applies unless an Order in Council made under subsection (5) provides otherwise.
>
> (5) The Queen's Representative may, by Order in Council, do either or both of the following:

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[27] Part V: "Income Tax", subpart "Companies and Associations" setting up specific regimes for particular classes of taxpayers.

(a) exempt 1 or more persons specified in the order from the application of subsection (3), as from a date specified in the order:

(b) vary the application of subsection (3) for 1 or more persons specified in the order by requiring only income from certain routes of carriage or types of carriage to be included in the total income of the persons, as from a date specified in the order.

[52] That was followed by the Income Tax (Exemption of Non-Resident Aircraft Operators) Order 2014[28] promulgated on 29 October 2014[29] which read:

Income Tax (Exemption of Non-Resident Aircraft Operators) Order 2014

…

2. Commencement
This order comes into force on the day after the date to which the Queen's Representative assents to it.

3. Purpose
This order gives effect to section 75(5) of the Income Tax 1997.

4. Exemption for the amount paid or payable to aircraft operators during 2013.

(1) Schedule 1 specifies the persons who are exempt from the application of subsection 75(3) of the Income Tax Act 1997 for the year commencing 1 January 2013 and ending 31 December 2013.

(2) The persons specified in Schedule 1 are exempt from including as part of the total income derived by that person the amount paid or payable for the carriage of passengers to and from the Cook Islands between 1 January 2013 and 31 December 2013.

(3) The exemption in subsection (2) applies to amounts paid or payable for all routes flown to and from the Cook Islands.

5. Exemption for the amount paid or payable to aircraft operators during 2014

(1) Schedule 2 specifies the persons who are exempt from the application of subsection 75(3) of the Income Tax Act 1997 for the year commencing 1 January 2014 and ending 31 December 2014.

(2) The persons specified in Schedule 2 are exempt from including as part of the total income derived by that person the amount paid or payable for the carriage of passengers to and from the Cook Islands between 1 January 2014 and 31 December 2015.

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28 The "Exemption Order" or the "Order".

29 Order "made" on 30 October 2014: Clerk of Executive Council certification.

(3) The exemption in subsection (2) is limited to amounts paid or payable for routes flown to and from the Cook Islands that are not subsidised by the Cook Islands Government.

Schedule 1
Specified aircraft operators for 2013

Air New Zealand Ltd – for all routes flown to and from the Cook Islands.

Virgin Australia Airlines (S E Asia) – for all routes flown to and from the Cook Islands.

Air Tahiti S A – for all routes flown to and from the Cook Islands.

Schedule 2
Specified aircraft operators for 2014

Air New Zealand Ltd – for all direct routes flown between Auckland and the Cook Islands.

Virgin Australia Airlines – for all routes flown to and from the Cook Islands.

Air Tahiti S A – for all routes flown to and from the Cook Islands.

[53] Ms Day said Air NZ was very disappointed with these changes and remains of the view that the new s 75 and the Exemption Order are "contrary to international norms of reciprocal exemption" as expressed in the ICAO tax policies requiring income to be reciprocally tax-exempt on internationally operated routes. It feels it has been "targeted" as the main provider of international air services to and from the Cook Islands. She noted that Cl 4 of the Order retrospectively "exempts the income of aircraft operators from income tax" for the 2013 year and retrospectively removes the "income tax exemption on the income of aircraft operators on routes" for which ASA payments were made from 1 January 2014. It made its concerns clear in correspondence with the Government at the highest levels.

[54] In fact, her approach and that of all other witnesses is, in terms of both versions of s 75 and the Exemption Order, not wholly correct. Both forms of s 75 effectively apply to carriage "outside the Cook Islands [of] merchandise, goods, livestock, mail, or passengers shipped or embarked in the Cook Islands". But the Exemption Order applies to amounts "paid or payable for the carriage of passengers to and from the

Cook Islands" for the periods and by the airlines named in the Schedules. The evidence did not differentiate between the carriage of passengers to and from the Cook Islands on the one hand, and the carriage of "merchandise, goods, livestock, [or] mail outside of the Cook Islands", on the other. The issue being raised with counsel by Minute (No. 2) of 9 June 2022, Mr Ruffin acknowledged that Mr Toleafoa's calculations did not make the distinction mentioned, while Mr Clews advised that "neither party has proceeded on the basis … the difference … is significant". Schedule 2 of the Exemption Order being inapplicable to these proceedings[30], when considering the effect of Schedule 1 of the Order for the limited period for which it applies to these proceedings, this judgment will therefore proceed on the basis that, though contrary to both versions of s 75, the amounts payable for the "carriage of passengers to and from the Cook Islands" is, for the purposes of this judgment, to be equated with the amounts payable for the carriage "outside [of] the Cook Islands of "merchandise, goods, livestock, mail or passengers" shipped or embarked in the Cook Islands.

Further Relevant Statutory Provisions

[55] As a prelude to the remaining sections of this judgment, it is pertinent to recount the provisions of additional sections of the ITA which the Cases Stated list as relevant.

[56] "Unless otherwise provided" in the ITA, 46(1)(a)(h) include in the assessable income of any person "all profits or gains derived from any business" and "income derived from any other source whatever", while s 80(2), under the heading "Country of Derivation of Income", reads "subject to the provisions of this Act, all income derived from the Cook Islands shall be assessable for income tax, whether the person deriving that income is resident in the Cook Islands or elsewhere" and s 80(3) contains the corollary that income not derived from the Cook Islands nor derived by a resident is not taxable.

[57] Also relevant are ss 83(1) (a)(f)(j)(k)(m), on all of which the Collector relies, and s 84, on which Air NZ relies. They read:

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30 Other than in respect of its use of "subsidised" discussed elsewhere.

83. Classes of income deemed to be derived from the Cook Islands –

(1) Subject to the provisions of section 84, the following classes of income shall be deemed to be derived from the Cook Islands -

(a) income derived from any business carried on in the Cook Islands;

…

(f) income derived from debentures or other securities issued by the Government of the Cook Islands, or from any contract made with the Government of the Cook Islands;

…

(j) income derived from contracts made or wholly or partly performed in the Cook Islands;

…

(k) income derived from the carriage by sea or by air of merchandise, goods, livestock, mail, or passengers shipped or embarked in the Cook Islands;

…

(m) income derived directly or indirectly from any other source in the Cook Islands.

84. Apportionment where income derived partly in the Cook Islands and partly elsewhere - Whenever by reason of the manufacture, production, or purchase of goods in one country and their sale in another, or by reason of successive steps of production or manufacture in different countries, or by reason of the making of contracts in one country and their performance in another, or for any other reason whatever, the source of any income is not exclusively in the Cook Islands, that income shall be apportioned between its source in the Cook Islands and its source elsewhere, or attributed to one of such sources to the exclusion of the other, in such manner as the Collector thinks just and reasonable, having regard to the nature and relative importance of the sources of that income; and the income, so far as so apportioned or attributed to a source in the Cook Islands, shall be deemed to be derived from the Cook Islands and shall be assessable for income tax accordingly.

Submissions

[58] Mr Clews summarized the appellant's approach by submitting that s 75 was a "code" covering the agreed air services, an argument which, if accepted, largely disposed of the Cases Stated, but, alternatively, submitted that, if the s 75 "code" argument were not accepted, then apportionment under ss 83 and 84 was required,

with the s 75 argument limited to payments for outbound carriage, and with apportionment being based on an assessment by Mr Rowe, Manager, Networks Scheduling, for Air NZ. As detailed later, Mr Rowe apportioned the company's liability on the RAR-LAX and RAR-SYD routes taking account of time in the Cook Islands' airspace, including time aircraft were in the air, turn round time at airports and time on the ground in Rarotonga as a percentage of time on the route.

[59] Mr Clews emphasized that, whatever decision were taken on the admissibility and interpretation issues, Air NZ contended that the terms of the ASAs in question determined its liability. He noted the Collector's submissions that the admissibility issue should effectively exclude all but one aspect of the ASAs, namely risk and loss, and that Mr Ruffin had submitted that the agreements were no more than underwriting agreements and therefore incapable of apportionment. Mr Clews, however, submitted that the key question was what the **[REDACTED]** were for, rather than what the payments did, in relation to the payments' source[31]. The payments topped up Air NZ's performance under the ASAs, mostly outside Cook Islands' airspace, to achieve an acceptable economic return. The analysis should also include Air NZ's agreement to provide economic support for the Government's aims.

[60] Against the Collector's assessment that 100% of the payment was taxable, Mr Clews drew attention to the fact that Air NZ initially apportioned 50% of the payments as income as a proxy for outbound carriage[32], but then altered its stance twice, the first of which was the abandoned financial accounting exercise. It then settled on Mr Rowe's apportionments of the provision of the air services in and outside the Cook Islands accepting it was "very difficult to see apportionment if they are mere underwrites"[33]. The payments arose out of a developing relationship between the parties, a core relevance of which was the allocation of commercial risk, an allocation which necessarily required apportionment.

[61] Mr Clews then dealt with historical aspects of Air NZ's service to the Cook Islands as encapsulated in the early ASAs and the evidence of Mr Kleinsorge and

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31 T7.
32 T8.
33 T8.

Ms Day, noting the difference in terminology between the Collector's descriptions of the payments as "underwrites" or "indemnities" and Air NZ's use of the term "subsidies". That underpinned a submission that labels were irrelevant in considering what the payments were for.[34] As part of the historical argument, Mr Clews referred to the "fractiousness" evidence in Ms Day's affidavit.

[62] Mr Clews' argument then moved to the text of the Cases Stated submitting, of the objections, that the payments were not brought to charge, because of the s 75 as a code argument. His next submission was that the Collector acted wrongly by "jumping" to s 83 as meaning that the whole of the payments were taxable being derived from a Government contract source. That ignored s 83 being subject to s 84[35].

[63] Addressing the ICAO documents, Mr Clews submitted that, if consistent with the wording, the legislation should not be interpreted in a way which contradicted those principles, especially given that international air carriers were taxed in their countries of domicile.[36] He pointed to the contractual obligations to offer fares competitive with other South Pacific destinations and the significant reporting obligations to submit that the ASAs were not really financial agreements but agreements for the operation of services for which there was a financial component.[37] He made the point that because payments were made progressively during the year and the terms of the ASAs were iterative and reflected changes in the operating environment, the ASAs were prospective not retrospective[38] and went well beyond just the financial relationship between the parties.

[64] Mr Clews then traversed the ASAs for the years in contention, submitting Air NZ's services as defined were intended to benefit the Cook Islands' interest in terms of the carriage of passengers and goods, including operative conditions such as frequency, aircraft type and promotional obligations.[39] The structure of the ASAs did not greatly change over time, but the provisions as to risk varied according to economic circumstances. As long as Air NZ performed in accordance with the

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34 T10.
35 T20.
36 T21.
37 T27.
38 T28.
39 T32.

conditions, it was entitled to a margin over its costs by way of return. He emphasized the absence of any mention of taxation in any of the ASAs, submitting that, because of the Exemption Order, neither party expected Air NZ to pay tax under the relevant ASAs until 1 January 2014 when the 2013 Amendment came into force, catching the end period for the 2010 agreements and those which followed.[40]

[65] Moving to the ASAs concluded after the relevant period, Mr Clews submitted that the drafts and the agreements themselves indicated that Air NZ was trying to ensure that, were the **[REDACTED]** to be taxable, then that charge should be factored into the amounts of the payments, particularly as any tax credit was not usable in New Zealand[41]. That resulted in express reference to this litigation in the 2018 ASA. Rather than quibble over labels for the payments, Mr Clews reiterated that the purpose of the payments had to be considered in the context of the agreements as a whole to provide air services with the varying clauses defining how the commercial risk would fall. That, in its turn, in his submission, made apportionment appropriate where the services were provided both within and outside the Cook Islands.

[66] Analysing the relevant statutory provisions, Mr Clews acknowledged that Air NZ was, under s 80(2), caught in respect of a Cook Islands sourced income, but the corollary was in s 80(3), namely that income neither derived from the Cook Islands nor by a person resident in the Cook Islands was not assessable for income tax, a submission which led him to further analyse s 75. That, he noted, was based on s 81 of the Income Tax Act 1972. Both created a special regime for non-resident international shippers and air carriers outside residence or source-based taxation.[42] Section 75, in his submission, preserved the previous special taxation regime and was inapt to catch the ASAs.[43] None of the payments, he submitted, fitted within the new s 75. It applied only to outbound carriage and the ASA payments were clearly not that.

[67] He emphasised that the substituted s 75 encapsulated the outbound carriage rule and contained the power in s 75(5) for an OIC to exempt carriers as set out in the subsection. That power the Government exercised in the Exemption Order, which, he

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40 T34.
41 T35.
42 T39.
43 T40.

noted, was promulgated only on 29 October 2014, just days before the 25 March 2014 ASAs came into effect. That situation, he submitted, justified Air NZ's concern that, having agreed to the March 2014 ASAs some seven months earlier, including specific provisions as to commercial return, only days before they came into force the Government fundamentally altered Air NZ's taxation position for both the 2013 and 2014 years. Irrespective of Air NZ's concern, Mr Clews submitted that the substituted s 75 and the Exemption Order still remained a separate taxation regime covering international air carriage.[44]

[68] Turning to the Collector's submission that the source and residence tests in s 80 applied, Mr Clews noted that s 83 had its counterpart in the Land and Income Tax 1954 (NZ) and that each of the heads of source listed in s 83(1) were, by the subsection, deemed to be derived from a source in the Cook Islands. The Collector's argument was that the ASA payments were all pursuant to contracts with the Government – and were also within other limbs of s 83 – and, being deemed to be sourced from the Cook Islands, were wholly taxable.[45]

[69] The answer, Mr Clews submitted, was that s 83 is expressly subject to s 84. That deals with apportionment, and accordingly logically applied to apportion income deemed to be derived from the Cook Islands under s 83. And s 84, he submitted, required apportionment as to the true source of the income either within or outside the Cook Islands. Where it is mixed, s 84 imposes an obligation to apportion on a just and reasonable basis.

[70] Dealing with the 2013 Tax Review, Mr Clews made the point that the initial recommendation for international air carriers to be taxed as if they were ordinary Cook Islands companies was never enacted. Had it been, the substituted s 75 reference to outbound carriage would have been otiose.

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44 T41.
45 T42.

[71] On source and derivation, both counsel referred to the decision of the New Zealand Court of Appeal in *Commissioner of Inland Revenue v N.V Philips Gloeilampenfabrieken*[46].

[72] In that case a New Zealand company imported goods from a Dutch company being required to pay in sterling for them in Holland. A debt accrued. The New Zealand company was unable to pay. It was converted to a loan to the New Zealand company repayable in instalments with interest, also in sterling. After execution of a deed covering the arrangement, the Dutch company sent a sterling cheque for the debt to the NZ company which endorsed and returned it in payment. The Dutch company was assessed to income tax on the interest on the loan but it was held that both the cheque in sterling to be honoured in the UK and the interest on the loan were not derived from money "lent in New Zealand" under s 87(j) of the Land and Income Tax Act 1923 (NZ) nor were they income "derived … from any other source in New Zealand" in terms of s 87(n). Accordingly New Zealand tax was not payable. After that holding in relation to the Dutch company, K. M. Gresson, J turned to whether the interest paid by a New Zealand resident on money borrowed abroad was, in the hands of the recipient, income derived from a "source" in New Zealand and continued[47]:

> The ordinary meaning of "source" is the starting point which, when used in relation to physical things, e.g. a river, is a matter of location. But it is a word of flexible meaning, especially when used of something non-material or abstract. It can, and often does, mean the chief or prime cause of something. What has to be determined is the sense in which the Legislature used the word in s. 87(n). The test – what a practical man would regard as the real source as a practical, hard matter of fact – which was formulated in *Nathan v. Federal Commissioner of Taxation* (1918) 25 C.L.R. 183, approved as it has been by the Privy Council in *Liquidator, Rhodesia Metals, Ltd. (In Liqdn). v. Commissioner of Taxes* [1940] A.C. 774; [1940] 3 All E.R. 422, must be adopted. The answer which I should expect the "practical man" to make to a question – What was the source of the money which was received by the Dutch company? – would be the loan it made which means, in effect, the lending of the money – the transaction. The money was paid because the New Zealand company had contracted to pay it; so that, in some sense, it can be said the obligation which had been entered into was the source of the payment made. But one must look behind that. It is seldom that a person makes a payment except under an obligation to do so, and it is, I think, unreal and incompatible with a practical approach to regard the obligation as the source. It is what produced the obligation that is important…. An obligation is seldom, if ever, accepted *in vacuo*: it requires some transaction to give it birth. The obligation arises from something which has been, or will be, done to warrant it, *e.g.,*

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46 [1955] NZLR 868, 6 AITR 158.NZLR version cited.

47 At 883, 163.

> rendering services, making land or other property available. The practical man, in regarding the loan as the source of the payment, would mean, I think, the conduct or the action which was the reason for the obligation being accepted. The document executed stated that the loan had been made, and that was the originating cause of the payment of interest. That was the view taken by Watermeyer, CJ., in the South African case of *Commissioner for Inland Revenue v. Lever Brothers and Unilever, Ltd.* (1946) 14 S. Af. Tax Cas. 1 – that "source" does not mean the quarter whence the moneys come, but the originating cause of the payment being made – the *quid pro quo* which the recipient of the money gave to entitle him to receive payments from time to time; that in the case of a loan, the lender provides money for the borrower, who, in return, pays interest until such time as he makes repayment…."

And then held:[48]

> "It appears to me that in interpreting s. 87 (n), proper regard must be paid to the word "derived"; it should not be read as "received". The word "derived" means more than received; it connotes the source or origin, rather than the fund or place, from which the income was taken. It means flowing, springing, emanating from, or, as was said in *Commissioners of Taxation v. Kirk* [1900] A.C. 588, 592, arising from or accruing. To be a "source" of the income within the meaning of the subsection, it is necessary, I think, to look to the originating cause. It is not sufficient to ascertain the fund out of which the income was in fact paid, which is no more than the reservoir from which it was drawn. It is not whence it was paid, but why it was paid, that is the determining factor. The emphasis is not upon the receipt, but upon the derivation of the income."

[73] Relying on *Philips*, Mr Clews submitted that the contractual obligation to make the ASA payments was not the source. The payments were for the provision of the air services.[49] And the provision of the services was the *quid pro quo* for the obligation to make the payments so the provision is the source of the payments for tax purposes[50] and the true source was Air NZ's services. Air NZ felt aggrieved it appeared to have been singled out with the Collector's stance being to recoup 28% of the payments the Government agreed to make with little or no consultation on the topic.[51]

[74] As to the correct approach to ss 83 and 84, Mr Clews relied on the decision of the New Zealand Supreme Court[52] in C*ommissioner of Inland Revenue v Salmond and Spraggon Limited*.[53]

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48 At 884, line 164.
49 T61.
50 T62.
51 T62.
52 Now the High Court.
53 [1969] NZLR 242; (1968) 15 ATD 248.

[75] In that decision an American company agreed with a New Zealand company to manufacture goods under formulae, with technical information provided by the American company and with the goods sold under its trademarks in New Zealand. The New Zealand company paid royalties to the American company which were partly apportioned by the Commissioner as being derived between sources inside and outside New Zealand for the supply of know-how under the then current Land and Income Tax Act 1954 (NZ), s 167(l) of which was materially identical to s 83(l). Holding the royalty payments not taxable, A. L. Tompkins, J said:[54]:[55]

> Sections 165 to 169 of the Act deal with the country of derivation of income. Section 165 lays down three general principles. First, that all income derived by a person resident in New Zealand is assessable whether derived from New Zealand or elsewhere; secondly, that all income derived from New Zealand is assessable, whether the person deriving the income is resident in New Zealand or elsewhere; thirdly, that no income which is neither derived from New Zealand nor derived by a person resident in New Zealand shall be assessable for tax. Section 166 defines the place of residence of a taxpayer. Section 167 sets out what classes of income are deemed to be derived from New Zealand. But the section also sets out a very important qualification, which applies to all those classes of income. That qualification is that all those classes are subject to the provisions of ss. 168 and 169. Section 168 makes special provisions in regard to commission agency contracts. Section 169 gives a right of apportionment if the source of any income is not exclusively in New Zealand, and says that the income, so far as so apportioned or attributed to a source in New Zealand, shall be deemed to be derived from New Zealand and assessable accordingly.
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> The opening words of s. 167 may, accordingly, I think, be paraphrased in this way: subject to the right under s. 169 to have income, the source of which is not exclusively in New Zealand, apportioned between that source and its source elsewhere, the following classes of income shall be deemed to be derived from New Zealand. It seems to me that the opening words of s. 167 are clear, precise and unambiguous, and mean what they say, namely, that the inclusion of any of the classes mentioned in s. 167 as being income derived from New Zealand is not to exclude the right of the taxpayer under s. 169 to have income, the source of which is out of New Zealand, apportioned out of his assessable income. That right is expressly preserved by the opening words of s. 167 so as to make it apply to all classes of income therein set out.

going on to hold[56] that "income which, for any reason, has a source not exclusively in New Zealand shall be apportioned and assessable for tax only in respect of the portion having a source in New Zealand" and that "income having a source outside New Zealand was never in the taxable classes mentioned … because the whole of that

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54 At 245-6, ATD 251.
55 At 245-6.
56 At 246, 252

section was expressly made subject to s 169" and that, otherwise, "there would appear to be no need to make s 167 subject to s 169 at all".

[76] Mr Clews submitted[57], on the basis of *Salmond and Spraggon,* that when s 83(1)(f) speaks of a contract entered into with the Government, if the income is not sourced properly in the Cook Islands then the head of source in that section is inapplicable because of s 83 being subject to s 84.

[77] The New Zealand Parliament rapidly legislated the effect of *Salmond and Spraggon* out of existence but ss 83 and 84 have never been similarly amended.[58]

[78] Mr Ruffin began his submissions by orally addressing a number of topics not in his comprehensive written submissions, but as he accepted that some were advanced only to protect the Collector's position and were not relevant to the issues raised by the Cases Stated, only those germane to those issues need recounting.

[79] The first oral submission concerned the ICAO documents and Mr Toleafoa's evidence, saying the Collector takes the view the Cook Islands is not in breach of the Convention because there is no reciprocal agreement where a New Zealand company services the Cook Islands and vice versa, referring to a number of passages in the ICAO documents emphasising the reciprocity of exemptions as risking retaliatory action.[59] For that reason, Mr Ruffin submitted it was not a principle of interpretation that a reading of the ASAs consistent with the ICAO Convention was appropriate. None of the ICAO material, he submitted, should influence the approach to s 75 and, in considering whether it was a code, none meant adopting an interpretation consistent with the policies.[60]

[80] The 2013 Tax Review, Mr Ruffin submitted, set the context for the statutory amendments that followed[61], a submission he supported by reference to a number of

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57 T66.
58 T68.
59 T74.
60 T78.
61 T79.

passages in the document. Taken together, he submitted, the argument that s 75 is a code was incorrect when the statutory amendments were seen in light of the Review.

[81] He submitted Air NZ's dissatisfaction with the process at the time when the amendments were formulated was misplaced having regard to letters from the company, especially one of 17 October 2013, a conference on 30 October that year[62] and subsequent correspondence. The substitute s 75 said nothing about the new section being a code.[63]

[82] Turning to his third topic, the assessment processes and evidential matters, Mr Ruffin submitted Air NZ's letter to Mr Toleafoa of 16 September 2016[64] contained two important admissions; the passage dealing with the source of the subsidy relying on a Price Waterhouse Coopers report of 9 September 2016 saying s 84 must be considered in the context of all relevant income classes in s 83 – a suggested admission contested by Mr Clews having regard to Air NZ rethinking its position[65] – and a further passage in the PWC report as to where the ASAs were made, opining they were made in New Zealand.[66]It is difficult to see a client not demurring from a professional advisor's opinion as amounting to a formal admission of a contentious issue, especially when the issue is to be decided by other parties.

[83] His sixth point dealt with the submission that Air NZ only gets a tax credit for tax paid in New Zealand if in profit, saying counsel had agreed that for all the years in contention Air NZ was in profit in New Zealand and would have received a credit for any tax paid in the Cook Islands.[67] Mr Clews agreed.

[84] He then turned to his written submissions beginning with references to all the agreements between these parties, including those he submitted had no relevance to the issues. The six ASAs in contention were, he submitted, self-contained[68],

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62 T81.
63 T83.
64 1/107.
65 T84-5.
66 1/113, T86.
67 T90.
68 T92.

something he inferred from the terms of the ASAs, particularly seen in light of *Bathurst*.[69]

[85] On further evidential matters, Mr Ruffin pointed to Art 65(2) of the Constitution and the Acts Interpretation Act 1924 (NZ)[70] and the purposive interpretation in the latter against its historical context with "any discernible themes and patterns and underlying policy considerations".[71]

[86] Analysing the terms of s 84, he accepted that a repositioning of its relative clauses was open as a construction, but submitted, in reliance on *Philips*, that there was no real difference between source and derivation[72], saying that a pre-condition was that it must be demonstrated the source not in the Cook Islands is in another country or countries which can tax the remainder,[73] submitting that, in this case, Air NZ, in order to be entitled to apportionment in the Cook Islands, must prove its taxation position in the USA and Australia. There was no evidence of that. He continued that it has not "been demonstrated what other countries can claim taxation rights to the income" and that, because the pre-condition had not been met, nor had the source, it must entirely be taxed in the Cook Islands,[74] adopting the proposition that for Air NZ

> "… to avail itself to any apportionment [it] must not only prove the amount of its income derivable [or] sourced outside the Cook Islands [but] as a matter of both taxability and quantum they must also show how much, whether they pay tax in the USA and if so how and on what percentage of the revenue, and similarly in Australia".

[87] That, Mr Ruffin submitted, was because Air NZ bears the onus of proof. His submissions did not address the point, made by Mr Clews, that Air NZ is exempt from tax in California, the USA, New South Wales and Australia. Mr Ruffin said Air NZ had "returned 50% of the subsidy payment in [Air NZ's] tax return in New Zealand

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69 S23, T93.
70 In force in the Cook Islands.
71 *Challenge Corporation Limited v Commissioner of Inland Revenue* [1986] 2 NZLR 511, 549, per Richardson J. T95.
72 T98.Memorandum of 16 June 2022 (NZ Time) at 2.
73 T99.
74 T101.

that is why we consider the Cook Islands payment should be 50% because only the appellant has the ability to prove that evidence".[75]

[88] If, he submitted, Air NZ had proved its tax position relevant to the ASA payments in California, the USA, New South Wales and Australia then the "demarcation of apportionment would be quite obvious and it would be quite wrong for the Cook Islands to be interfering"[76], but the onus was on Air NZ to demonstrate what it had paid in the other countries and, in that, its evidence was lacking.

[89] In this case, he submitted, the only source of the underwriting income was from the **[REDACTED]**, were there a loss, in order to bring Air NZ to a break-even point, describing that as a "contractual loss". Once that contractual loss was demonstrated, the Government was required to indemnify Air NZ, that being the reason for the payment, and, applying s 83(1)(a)(f)(j)(k) and (m), on all of which the Collector relied, he submitted that all caught the underwriting fee because, once a contractual loss was ascertained, the Government's indemnity obligations arose.[77] That, drawing on *Philips*, was the "practical matter of hard fact". The loss, he said, was indivisible and unapportionable. That, he submitted, applied to all the relevant contracts, irrespective of differences in wording.[78]

[90] In reply, Mr Clews repeated that Air NZ pays no tax in Australia or the USA, but Mr Ruffin's suggestion that it was necessary for it to demonstrate that position before apportionment could be considered was incorrect. The Collector's statutory mandate is to attribute the sources between the Cook Islands and elsewhere with only the former being taxable income. The enquiry was solely Cook Islands based[79] so, in default of any other, Mr Rowe's assessment was appropriate.

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75 T102.
76 Ibid.
77 T103.
78 T104.
79 T108.

Discussion and Decision

Summary

[91] To recapitulate, condensed, the questions for determination in the Cases Stated are the correctness of the Collector's determinations that the ss 75 were not a code entirely determining Air NZ's liability to income tax, that the indemnity payments were deemed to be wholly sourced in the Cook Islands under ss 83(a)(f)(j)(k) and (m) and that apportionment under s 84 was not statutorily mandated.

[92] Deciding those issues resolves into:

- Labels
- Derivation and source, including the "nature and relative importance" of the sources
- Whether the original s 75 was a code;
- Whether the substituted s 75 was a code;
- Sections 83 and 84;
- Apportionment.

Labels

[93] The Cases Stated refer to the **[REDACTED]** under the ASAs as "indemnity payments" whereas other terms such as "subsidy/subsidised" in the inapplicable clause 5 of the Exemption Order, "underwrites" and similar terms were used in evidence and submissions. There is force in Mr Clew's submissions that the ASAs describe satisfaction of the **[REDACTED]**, and it is unhelpful to ascribe any other label to them. Indeed, given that other labels might come freighted with other nuances of meaning, it could be misleading to substitute any other label for "payments".

Derivation and source, including "nature and relative importance"

[94] While discussion of source and derivation may apply more directly to consideration of ss 83 and 84, it is the case that both forms of s 75 made the categories of Air NZ's income they describe ones derived in the Cook Islands. Though calculation of the amounts so derived seems largely an accounting exercise conducted in accordance with formulae, all relevant statutory provisions need to be interpreted in the light of *Philips* and *Salmond and Spraggon*, that is to say, that, to determine source, the inquiry must be into the originating, chief or prime cause of the **[REDACTED]** being made, looking behind the words in accordance with the test of what a practical person would say was the real source of the obligation, with "derived" connoting the "source or origin rather than the fund or place from which the income was taken," or the source whence the obligation emanates. Of the **[REDACTED]**, it is not just the fund from which the money was paid, but why they were paid and what was the originating cause of the payments.

[95] Here, the originating, chief or prime cause of the agreements was to ensure Air NZ provided the flights under the ASAs, its performance of which, consequently, led to the **[REDACTED]**. In that sense, as in *Philips*, the documents stated the payment obligation and how it was to be calculated and paid, but what, looking behind the documents for what produced the obligation for the Government to pay is, in terms of *Philips*, crucial.

[96] As *Philips* said, it would be "unreal and incompatible with a practical approach to regard the obligation as the source" without going behind the fact of that obligation to decide what, in K.M. Gresson J's graphic phrase, gave it "birth", noting that the Government's obligation was, like those of most payers, "seldom, if ever, accepted in *vaccuo*". That involves consideration of the wording of the relative ASAs seen against the historical and contemporary backgrounds. That, in its turn, bears on the "nature and relative importance of the sources" of the **[REDACTED]** to it and to Air NZ.

[97] Applying that test, the question is what, in terms of the relevant ASAs, was the source which gave rise to the Government obligations?

[98] The salient terms of the ASAs were earlier summarised. The balance of the contractual provisions show, as might be expected, a high degree of commonality within the respective ASA pairs and between the 2010 and 2014 pairs. Even when the nomenclature differs, synonymous terms are used.

[99] Nearly all of what might be called the machinery provisions used in the relevant ASAs are effectively identical. Differences between them stem partly from the different circumstances applying to the routes in question, but more particularly stem from changes in economic and other circumstances applying, over time, to the flights, as recorded in the ASAs themselves.

[100] The ASA provisions of most importance in the search for the source of the parties' obligations, the provisions which best disclose the primary purpose of what led to the **[REDACTED]** and Air NZ's assumption of its performance obligations are the preambles, plus the obligation, in clause 10.2 of both 2010 ASAs, for the Government to "maintain a strong commitment in its annual appropriation" to the CITC, coupled with the history leading up to execution of the ASAs. They show that, looking behind the agreement for the **[REDACTED]** to Air NZ under the ASAs, the chief, the primary, the originating cause or source which produced the Government's obligation was not to ensure its small population and its few consignors had two-way direct flights to Sydney and Los Angeles available, but to ensure the commencement and continuation of flights to those destinations to improve tourist traffic to and from the Cook Islands and the uplift to the country's economy and the Government's revenues which would follow. That was what a practical person would conclude was the real source of the obligation to fly the routes, the performance of which led, consequentially under the ASAs, and long after the flights and passage in question, to the **[REDACTED]**.

[101] That conclusion is supported by a number of indicia in the ASAs and the prior history of the matter.

[102] The first, and main, indication is that the 2010 RAR-LAX preamble recounts Air NZ's operation of the service on the route and its agreement to continue it, and contains a recognition by the airline of the "… critical importance to the tourism

industry and to the economy of the Cook Islands" of the service and its connectivity, while the 2010 RAR-SYD preamble recounts the Government's invitation to Air NZ to establish and operate the service and the airline's agreement so to do.

[103] Additional to the purpose of advancing tourism to the Cook Islands, a country whose economic prosperity was, at all relevant times, heavily dependent on that avenue of revenue, is that the evidence shows it was CITC which sought the initiation or continuation of the flights to which Air NZ agreed in the ASAs and that, initially at least, the Government agreed to its Budgetary commitment to fund the CITC to enable it to continue that role. Most ASAs were signed by Ministers of Tourism.

[104] A further indication from the terms of the ASAs of what lay behind the parties assumption of their respective obligations and that they were entered into in order to increase Cook Islands' tourist traffic, is the obligation in clause 5.1(c) for Air NZ to offer fares "competitive with other South Pacific Island destinations", a provision most likely to have been included to maintain the Cook Islands' competitiveness in the Pacific tourism industry.

[105] An additional indicator that enhancement of that the tourist industry was the real source which primarily motivated Air NZ's acceptance of its obligations under the ASAs and, in consequence of its performance, motivated **[REDACTED]**, is clause 7.3 of the 2012 RAR-LAX ASA – clause 7.5 of the RAR-SYD agreement of the same date – that **[REDACTED]** for "tourism promotions and marketing" are additional to payments due under the ASAs.

[106] The emphasis on tourism as the motivating *raison d'être* of the ASAs is also consistent with the history of Air NZ's services to the Pacific and the Cook Islands in particular.

[107] The ASAs were not normal commercial initiatives instigated by a multinational company where initial losses leading to forecast profits are the norm. As Mr Kleinsorge's evidence showed, in July 2004 Air NZ assessed the RAR-LAX route, concluding it was not economically viable without financial support from the Government. It reached a similar conclusion two years later when reassessment was

instigated by the CITC. The service resumed with Government support for three years under the 28 February 2007 ASA.

[108] Similarly, at the CITC's request, it assessed the RAR-SYD route in July 2004, but decided it was economically unviable. It repeated the exercise reaching the same conclusion in October 2008, but a year later, again at CITC's request, it reconsidered the service and, in the 17 December 2009 ASA, agreed on resumption with Government support.

[109] That history shows that, when Air NZ reviewed the viability of the two routes several times during the early 2000s, it concluded they were economically unviable without Government support, but were persuaded to resume flying the routes only when the CITC and the Government offered that support.

[110] For its part, Air NZ was obviously prepared to pick up the Government's initiatives and commence and continue the services but only with satisfactory commercial outcomes. Those varied according to global financial circumstances at the time and as the financial outcome of running the services became clear: from an equal sharing by the parties of profits and losses to the point where, in varying formulae, the parties felt their way to the position where losses were expected and were to be **[REDACTED]**.

[111] The "relative importance" of the matter to the Government was the initiation and continuation of the flights to improve the tourism industry with the resultant "flow on" effect on Government revenue, while the "relative importance" to Air NZ was that it shared any profits from the flights, but bore no losses should they occur.

Was the original s 75 a code?

[112] As noted, the original s 75 was repealed on 31 December 2013 and therefore only applied to the outward carriage of "merchandise, goods, livestock, mail or passengers shipped or embarked in the Cook Islands" for a limited period, and that clause 4(2) of the Exemption Order exempted Air NZ "for all routes flown to and from

the Cook Islands" for payments "for the carriage of passengers to and from the Cook Islands" for the 2013 year.

[113] Without the Exemption Order, for that limited applicable period, 5% of the gross amount paid to Air NZ for outward carriage of the persons and goods mentioned in the subsection would have been deemed to have been taxable income derived by Air NZ from the Cook Islands. The Exemption Order being broader in scope than the original s 75(1), no income tax was payable by Air NZ under the section for the relevant period and the Collector was incorrect if he assessed any part of the ASA payments to Air NZ as assessable income for that period.

[114] That view is fortified by the fact that the original s 75(1) commenced by saying it applied, "Notwithstanding anything to the contrary in this Act" and contained the second sentence that, "No person to whom this subsection applies shall, in respect of carriage as aforesaid, be assessable for income tax otherwise than is provided in this subsection", The use of those phrases must have been intended to exclude any other provision imposing tax obligations from encroaching on the exclusivity of the s 75(1) tax regime.

[115] The **[REDACTED]** for Air NZ's performing its carriage obligations by putting on the flights required by the ASAs cannot be described as coming within the phrase the "gross amount paid or payable to that person in respect of that carriage", namely the outward carriage of "merchandise, goods, livestock, mail or passengers", wording which is also inapt to make taxable payments made under the ASAs to ensure two-way traffic on the routes in question. The payments cannot be seen as being "in respect of carriage": they were to ensure the two-way flights took place, not to ensure outbound passengers and consignors paid for carriage.

[116] It follows that, to the extent the original s 75 applies to the periods in contention in this matter, the original Section was a code which would, absent the Exemption Order have made 5% of the gross revenue received, taxable, but no other revenue, including the ASA payments.

Is the substituted s 75 a code?

[117] The substituted s 75 continued the former taxation regime as far as non-resident shippers were concerned but created a new taxation regime for non-resident aircraft operators.

[118] The Exemption Order being inapplicable to the routes in question in this matter, the substitute s 75 required the whole of the amount paid to Air NZ for the outbound carriage of "merchandise, goods, livestock, mail, or passengers" to be included in Air NZ's "total income derived … from the Cook Islands", absent an OIC exempting it from that obligation.

[119] The question therefore is whether the express creation of a taxation regime for non-resident aircraft operators limited to receipts from outbound passengers and consignors leads to the conclusion that only that category of Air NZ's income is required to be included in its total income derived from the Cook Islands, that is to say that the **[REDACTED]** under the ASAs do not fall within s 75(3) and therefore should not be bought to charge for income tax.

[120] Indications that no part of Air NZ's income outside the categories described in s 75(3) can be brought to charge include that s 83(1)(k) expressly includes in the classes of income deemed to be derived from the Cook Islands, income derived from the carriage by air of precisely the same categories of goods or persons embarked in the Cook Islands as appear in s 75(3). That indicates that the receipt of fares from outbound passengers and freight charges, but no income beyond that, is brought to charge for income tax under the subsection. That view is supported by the absence from the substituted s 75 of the phrase "notwithstanding anything to the contrary in this Act" and the second sentence of the original s 75.

[121] In addition, although clause 5 in Schedule 2 of the Exemption Order is inapplicable to the carriage in contention in this matter, it is noteworthy that clause 5(3) specifically refers to flights "not subsidised" by the Government. The absence of a comparable provision from clause 4 indicates that the existence and effect of the ASAs must have been known to the framers of the Exemption Order and that inclusion

of subsidisation was considered, but was deliberately excluded. Had it been **[REDACTED]** taxable in addition to the classes of income expressly deemed taxable, it would have been straightforward to provide to that effect in the substitute section. As Mr Clews submitted, there is no mention in the contemporary documents of that issue, so failure to include such a provision is an additional indication that the **[REDACTED]** under the ASAs were not intended to be brought within the reach of ss 75(3). Put another way, the ASA payments, made according to a contractual formula long after the carriage for which outbound passengers and consignors had paid, are not easily construed as coming within the express terms of s 75(3) so, had it been Government's intention to make them taxable, when passing the Income Tax Amendment Act 2013 that intention could have been made explicit, and the failure so to do is a clear indicator they were not intended to be taxable.

[122] It is the case that the Tax Review discussed making companies such as Air NZ as liable to income tax as Cook Islands' companies but, as Mr Clews submitted, that recommendation did not persist into the new section. That is a further indication that liability to income tax on all avenues of income for companies such as Air NZ was rejected, in favour of the more limited classes of income the section makes liable to tax.

[123] It is correct, as Mr Ruffin mentioned, that the later ASAs mention an **[REDACTED]** component in the calculation of the payments, but in default of evidence that such was an indication that the **[REDACTED]** under the ASAs were to be taxable, it seems more likely that the reference to **[REDACTED]** was simply use of a standard accounting measure.

[124] For the ASA payments to be brought to charge for income tax purposes, a clear indication of the taxability of those payments would be needed, but there is no evidence of it being discussed in the negotiations leading up to execution of the ASAs, let alone for it to be clearly included in the terms of the ASAs themselves. As Mr Clews submitted, had it been intended that the ASA payments be brought to charge for income tax, that factor is highly likely to have affected the quantum of the amounts and the formulae for their calculation given its impact on the viability of the routes in question, yet there is nothing in the evidence to suggest that the Collector's present

stance was an aspect of the negotiations or of the way the ASAs were phrased. For the payments to go from being exempt to being liable for income tax beyond the plain words of s 75 was such a major change it would be expected to have been the subject of considerable debate in the negotiations over the ASA's terms, but the evidence is silent on that score.

[125] The finding is accordingly that s 75(3) is a self-contained code which makes the income described in it taxable, but does not make taxable other income, including the **[REDACTED]** under the ASAs.

[126] In light of all of that, the finding on this part of the Cases Stated is that, in terms of both versions of s 75, no part of the **[REDACTED]** to Air NZ under the ASAs was brought to charge for income tax and accordingly the answer to the questions posed for determination in the Cases Stated is that the Collector, in assessing 100% of the **[REDACTED]** to Air NZ under the ASAs as assessable for tax was incorrect. The questions posed are accordingly both answered "No".

Sections 83 and 84

[127] Those findings make discussion of the remaining topics largely redundant but, having regard to the importance of the issues to the parties, consideration should be given to them.

[128] In light of the discussion in *Philips*, the source of Air NZ's income in relation to its performance under the ASAs was partly within and partly outside the Cook Islands' territorial limits. Irrespective of whether Air NZ's performance falls within s 83(1)(m), it was indisputably income falling within s 83(1)(a),(f), and, in particular, s 83(1)(k) and the source of its income under those headings not being exclusively in the Cook Islands, s 84 required that income to be apportioned between the Cook Islands and outside sources "in such manner as the Collector thinks just and reasonable, having regard to the nature and relative importance of the sources of that income" with the income apportioned to a Cook Islands source deemed to be derived from the Cook Islands and assessable for income tax.

[129] Mr Ruffin, as noted, argued that s 84 is not "open ended," as he put it, but subject to four pre-conditions denoted by the use of "whenever". He relied on *Salmond and Spraggon* in support.

[130] However, *Salmond and Spraggon* adopted the interpretative approach to the relevant New Zealand provision at the time – identical with s 84 – that the section should be interpreted as if it commenced with a right of apportionment between sources of income not exclusively sourced in the Cook Islands and other sources or classes of income deemed to be derived from the Cook Islands. Paraphrasing A. L. Tompkins J "The opening words of s 83 are clear, precise and unambiguous and mean what they say, namely, that the inclusion of any of the classes mentioned in s 83 as being income derived from the Cook Islands is not to exclude the right of a taxpayer under s 84 to have income, the source of which is out of the Cook Islands, apportioned out of his assessable income."

[131] On that footing, applying *Salmond and Spraggon,* and irrespective of part of Air NZ's income falling within subsections of s 83, pursuant to s 84, to which s 83 is subject, Air NZ was entitled to having its income sourced, internally and externally to the Cook Islands, being apportioned between those sources in a just and reasonable manner having regard to its nature and importance, with only that portion attributed to sources within the Cook Islands being assessable for income tax.

[132] To the extent that the Collector did not carry out an assessment on that basis, the Collector was in error, and the questions in the Cases Stated for determination should again both be answered "No".

[133] It is, despite that, necessary to assess whether that finding should be affected by Mr Ruffin's submissions that it was fatal to Air NZ's position that it had not tested its taxation position in Australia or the USA, so Mr Rowe's approach did not apply.

[134] Because Air NZ's claimed exemption from taxation in Australia and the USA was in Mr Clews' submissions, but not covered in evidence, by Minute (No.3)[80] counsel's assistance was sought on the point.

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[80] Issued 13 June 2022.

[135] Appellant's counsels' response was twofold. First, they repeated that, under s 84, the Collector is to allocate income between the source in the Cook Islands and sources elsewhere. His mandate, they submitted, was limited to determining tax on the Cook Islands income, not tax imposed in any other jurisdiction.

[136] Secondly, attention was directed to passages in publicly available ICAO documents, Australian tax law, the Australian/New Zealand Double Tax Agreement, the United States/New Zealand Double Tax Agreement, and United States tax law, all of which demonstrated that international air carriers, particularly Air NZ, are taxed in their home country and exempt from tax in other jurisdictions.

[137] Mr Ruffin's submissions focused attention on s 84 requiring the Collector to determine the source of income outside the Cook Islands as the "Collector thinks just and reasonable having regard to the nature and relative importance of the sources of that income" with the relevant importance of the income sources being affected by sequential changes in the Cook Islands tax law, while the "relative importance" question meant it was for Air NZ to show it was not taxed in the USA or Australia but is taxed in New Zealand and, having been profitable in the four years in question, can obtain a tax credit from the Commissioner of Inland Revenue in New Zealand. That meant, in his submission, in assessing the relevant importance of the source or derivation of the income, to decline any apportionment where the Cook Islands would miss the ability to tax the entire sum would be a tax neutral position for Air NZ.

[138] Mr Clews' submissions were persuasive. It has been demonstrated that Air NZ is exempt from tax in Australia and the USA, and that its overall operations are assessed for tax in New Zealand, its country of fiscal domicile. As the ICAO documents make clear, taxation of international air carriers is a vexed question since their profits or losses are usually earned or incurred when flying over numerous tax jurisdictions or over the open ocean where no tax jurisdiction applies. It is therefore understandable that international air carriers should be taxed on their operations in the country of their fiscal domicile.

[139] Mr Ruffin's submission that Air NZ must actually have tested its taxation position in Australia and the USA before seeking apportionment in the Cook Islands

is therefore misdirected. There is no legislative warrant to impose on the s 84 apportionment exercise a further condition such as that for which Mr Ruffin contended. The position is that, provided their home country has jurisdiction to tax international air carriers in accordance with their overall performance so there is no aspect of their activities which escapes all taxation regimes, that is sufficient to entitle Air NZ to apportionment under s 84 in a just and reasonable way, with the nature and relative importance of the sources of the Cook Islands' income being taken into account, whatever the outcome.

[140] The final point which warrants mentioning in relation to this aspect of the issues raised by the Cases Stated concerns the ICAO policies. The differences of views between these parties on whether the Cook Islands' taxation regime for non-resident aircraft operators runs counter to the ICAO tax policies was outlined earlier. It is unnecessary to resolve that issue, or whether it is a tenet of statutory interpretation that legislation on topics affecting international air carriers should be construed conformably with those policies, as it is undoubted that legislating contrary to those policies – if that be what the Cook Islands' Parliament is thought to have done – is within a Parliament's legislative powers. It is noted that the result of the Cases Stated to this point largely, though subject to s 75(3), accords with the general thrust of those policies.

Apportionment

[141] The next issue is whether Mr Rowe's approach meets the test of being "just and reasonable having regard to the nature and relevant importance of the sources", as earlier outlined and as it was accepted that, in the circumstances of this case, any apportionment was to be undertaken by the Court, the exercise becomes whether Mr Rowe's calculations – the principal assessment in evidence – meet the statutory criteria and that the Court should adopt them.

[142] In his brief Mr Rowe noted that Air NZ initially allocated the ASA payments 50/50 between inbound and outbound flights between the Cook Islands and other sources but later re-apportioned the financials twice.

[143] The apportionment on which Air NZ now relies is based on the time to fly each of the routes, including air time and time on the ground at the three airports concerned. From the total flight time, the time attributable to Cook Islands' air space and time on the ground in Rarotonga is then calculated, stated as a percentage of the total time on the route, with the calculations varying between January and July each year, and a weighted average then calculated of the percentage of total time spent within the Cook Islands' territorial limits. No two flights are identical and all are subject to a number of variables, but averaging, he noted, leads only to slight adjustments.

[144] His annual weighted average is the percentage Air NZ applied to the sum of the ASA payments, with that percentage being related to Air NZ's performance of its obligations under the ASAs and therefore the apportionment of the payments treated as having a source in the Cook Islands.

[145] His evidence then explained the elements of his calculations including publicly available schedule information, advertised and ticketed flight times and arrival slots at destination airports, using International Air Transport Association data which takes weather and other events into account in its averages. He used actual data to reflect time on the ground to calculate the final percentage attributable to time in Cook Islands' international limits having regard to seasonal factors and changes of aircraft, including halving the time between arrival in Rarotonga and departure to reflect that only outbound carriage is assessable. He used an estimated time in Cook Islands' air space of 50 minutes for descent, taxiing turn round and climbing. His spreadsheet produced the following table for time attributable for Air NZ's relevant Cook Islands' operations:

RAR-LAX				
Weighted average (financial year) of block time spent in Rarotonga				
Jan-14	Jan-15	Jan-16	Jan-17	Jan-18
7.55%	6.97%	6.47%	7.29%	8.69%

RAR-SYD				
Weighted average (financial year) of block time spent in Rarotonga				
Jan-14	Jan-15	Jan-16	Jan-17	Jan-18
13.40%	13.74%	13.95%	13.82%	14.94%

[146] Those figures are the proportion of time that Air NZ was physically operating each of the ASA routes inside Cook Islands' territory with the proportion attributed to operations inside the Cook Islands being used to apportion for tax purposes the ASA payments between the part sourced within and without the country.

[147] Mr Rowe's table must then be applied to the following table of ASA payments (expressed as $000) to Air NZ under the 2010 and 2014 ASAs, grouped by the tax years during which they were made and so requiring to be apportioned under s 84.[81]

[REDACTED]

[148] Mr Ruffin, however, submitted there was no basis for apportionment as Air NZ proposed because any apportionment needed to be linked back to the main ASAs. Relying on the provisions as to commercial risk and the schedules of costs, revenues and the like, he submitted it was not possible to apportion that calculation on time spent in the Cook Islands airspace.

[149] With respect to counsel, however, Mr Ruffin's submissions appeared to be directed to a calculation other than that required by s 84. The ASA payments were sourced as found elsewhere in the judgment, but the calculation of the amounts, are the best proxy for apportioning the data relating to the performance of that part of the services coming within s 83 and calculated in accordance with the s 84 provisions.

[150] Mr Rowe's apportionment calculations, though being averages and necessarily approximations, show the required apportionment is possible, appear logical and to be the most rational assessment available. There being no other detailed calculation of Air NZ's apportionment entitlement between flight times within and without the Cook

[81] The amounts of which, Mr Clews submitted, were not in contest.

Islands territorial limits it is accepted that Mr Rowe's calculation best apportions Air NZ's income in the Cook Islands under s 84 and, given he has divided the time between inbound and outbound flights on the relevant routes, that would appear to be just and reasonable, with the figures for the outbound routes being correctly attributed to the Cook Islands' source.

[151] The nature and relative importance of the ASA payments was earlier discussed in part. In a Memorandum of 23 June 2022, counsel for Air NZ submitted, in reliance on *JFP Energy Inc. v. Commissioner of Inland Revenue*[82] that the issue of relative importance requires a comparison of functions within the relative contract. In this case, as earlier discussed, the importance of the ASAs relevant to the parties was the Government's, or the CITC's, wish to ensure direct RAR-LAX and RAR-SYD flights occurred for the years in question for tourism purposes and, while resumption of the flights was important to Air NZ, it was only prepared to resume them if its commercial position could be safeguarded. That was the "nature and relative importance" of the ASAs to each party, and the Collector was, under ss 83 and 84, therefore obliged to apportion Air NZ's income deemed to be derived in the Cook Islands under s 83 in a just and reasonable fashion.

[152] That said, it is considered that Mr Rowe's apportionment exercise correctly meets the statutory criteria and although, as counsel submitted, the apportionment exercise at this stage is for the Court, not for the Collector, Mr Rowe's calculations are adopted.

Result

[153] In the result, on each of the questions discussed in this judgment and for the reasons appearing throughout, the questions in the Cases Stated are therefore each answered "No".

[154] On apportionment under s84, Mr Rowe's calculations are adopted by the Court.

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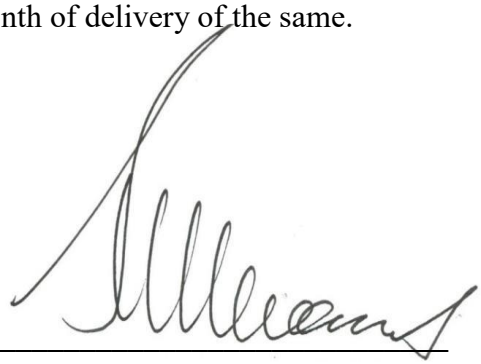
82 (1985] 11 NZTC 6,282.

[155] In light of this judgment, there may be consequential matters that require to be considered under Part IV, including possible redaction of aspects of this judgment before publication, costs ordered under s 32 and whether orders should be made under s 33. Leave is reserved to the parties to file memoranda concerning those or any other matters arising under this judgment within one month of delivery of the same.



Hugh Williams, CJ

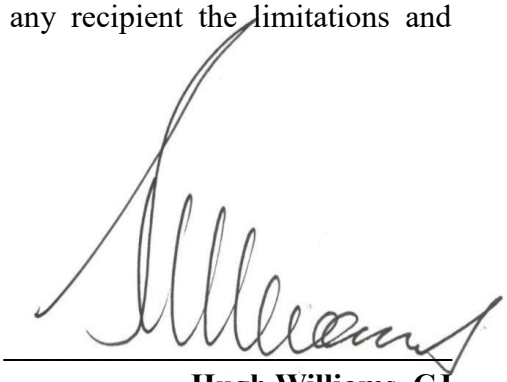
ADDENDUM

[156] Passages in the public version of this Judgment have been redacted. They are shown between **[REDACTED]**. Circulation of unredacted versions of this Judgment is limited to:

(a) the Cook Islands Government and Government Ministries and to exchanges under Exchange of Information Agreements with other Governments; and

(b) The Appellant's shareholding Minister (and ministerial staff), its Board, senior management for the litigation, its witnesses and, if necessary, New Zealand Inland Revenue.

[157] It will be a breach of the Court's Orders for redaction for any recipient of the unredacted version of the Judgment to make that version available to other persons without leave. Any person circulating an unredacted version of the decision as permitted above must draw to the attention of any recipient the limitations and requirements of this addendum.



Hugh Williams, CJ