eJournal of Tax Research

Volume 8, Number 1 June 2010

CONTENTS

Atax
UNSW
Faculty of Law

ISSN 1448-2398

eJournal of Tax Research (2009) vol. 8, no. 1, pp. 6-31

Financial Institutions' Tax Disclosures and Discourse: Analysing Recent Australasian Evidence

Adrian Sawyer [*]

Abstract
Litigation involving structured finance transactions by New Zealand's largest banks has dominated the tax avoidance scene in New Zealand. Disclosures by these banks in their financial statements have received minimal attention. In this paper I trace the developments in the disclosures from 2004 through to 2009. This study finds that the banks have been defensive in their discourse, arguing that their positions were supported by expert advice, and quick to indicate that they will challenge all assessments and appeal any unfavourable judgments. Financial provision for the impact following the Commissioner's litigation successes and the recent settlement agreement has commenced.

1.0 INTRODUCTION

This paper forms part of a wider project examining the (alleged) tax avoidance activity of New Zealand's largest banks (most of which are Australian owned). The amount of tax and interest in dispute is significant (estimated at $NZ2.75 billion (excluding any penalties), which is approximately 2 percent of New Zealand's gross domestic product (GDP) and between 4-5 percent of 2009 tax revenues). Earlier work (Sawyer, 2008) has examined the twenty five decisions largely focusing on technical issues (including secrecy issues), prior to the first substantive decision on tax avoidance where the Commissioner of Inland Revenue (Commissioner) was successful against the Bank of New Zealand (BNZ).

The purpose of this paper is to examine the disclosures by the large banks in their financial statements and regulatory disclosure statements with respect to their disputes with the Inland Revenue Department (IRD) over various structured finance transactions. Its motivation is to critically examine, through the use of discourse analysis, the banks' public posturing defending their positions that their structured financing transactions were not tax avoidance (partially on the basis of expert advice supporting their position) and that they would rigorously challenge the Commissioner's assessments.

[*] This paper was prepared while holding the position of Research Fellow in the Australian School of Taxation (Atax), University of New South Wales. The funding and opportunity to undertake this research is gratefully acknowledged. This paper examines the available disclosures of the banks as at 24 December 2009. I am grateful for the useful comments received from the reviewer on an earlier version of this paper.

Future work within the umbrella of the larger project intends to examine the implications of the settlement agreement reached between the banks and Inland Revenue. This is intended to be followed by critical analysis of the impact of the structured finance litigation from economic and jurisprudential perspectives.

The remainder of this paper is organised as follows. Section 2 discusses the disclosures by banks outlining the general issues involved. This is followed in section 3 by a brief overview of the key areas of tax disclosures in financial statements. Section 4 outlines the limited prior literature and details the methodology followed in this paper. Section 5 briefly outlines the banks included in the analysis, namely: ANZ National Bank (part of ANZ Australia), BNZ (owned by National Australia Bank, NAB), ASB Bank (owned by the Commonwealth Bank of Australia, CBA), Rabobank (Netherlands) & Westpac (owned by Westpac Banking Corporation, Australia). Section 6 outlines the essence of the structured finance transactions that were the subject of the disputes with the IRD. This is followed by the focus of the study in section 7, the tax dispute disclosures and discourse of the New Zealand banks. Section 8 provides a brief overview of the surprise settlements reached between the banks and the IRD in late December 2009. Section 9 provides further discussion and analysis, and asks what can we learn from the disclosures and discourse concerning tax disputes? This is followed in section 10 with the conclusions, limitations and areas for future research.

2.0 DISCLOSURES BY BANKS IN FINANCIAL STATEMENTS

Registered banks in New Zealand must report, for financial purposes, in a similar manner to other issuers, but they have a number of different characteristics, including high levels of debt to equity (a result of a small capital base), along with other financial reporting disclosure obligations. In addition to producing financial statements, banks are required to produce general (and specific) disclosure statements as required by the central bank (in New Zealand this is the Reserve Bank of New Zealand, RBNZ).

In the notes to their financial statements, contingent liabilities need to be disclosed as required by applicable reporting standards. In New Zealand the requirements were set out in Financial Reporting Standard (FRS) 15 (*Provisions, Contingent Liabilities and Contingent Assets*). In Australia this was governed by Australian Accounting Standards Board (AASB) Statement 1044 (*Provisions, Contingent Liabilities and Contingent Assets*). With the advent of International Financial Reporting Standards (IFRS), for New Zealand disclosure is now governed by NZ IAS 37 (*Provisions, Contingent Liabilities and Contingent Assets*) and for Australia disclosure is governed by AASB 137 (*Provisions, Contingent Liabilities and Contingent Assets*).

Of particular interest to this study is the level and nature of disclosure, including the position taken by banks with respect to the likelihood of their contingent liabilities from their disputes with the IRD materialising. The study also examines whether the flavour of the disclosures changes with time and new developments.

3.0 TAX DISCLOSURES IN FINANCIAL STATEMENTS

The key disclosures in relation to taxation in financial statements for the purposes of this study (for the banks under review) include:

- Significant accounting policies (including consolidation, income tax, and goods and services tax (GST));
- Income tax expense (including current tax, deferred tax, reconciliation of tax expense to pre-tax accounting profit);
- Deferred tax balances & movements (recognized & unrecognized);
- Imputation Credit Account (Franking Credit Account) balances & movements.

In addition to the Profit & Loss (Income) Statement, Balance Sheet (Statement of Financial Position), and Statement of Cash Flows, tax disclosures may also appear in various notes to the financial statements, such as Provisions, Contingent Liabilities & Contingent Assets. Also in New Zealand FRS 19 (*Accounting for Goods and Services Tax*) applies for financial reporting purposes.

It is important to note that the purpose of this paper is not to relate the disclosures in financial statements of a number of major New Zealand banks to the relevant accounting standards to ascertain the extent to which the banks have complied with the disclosure requirements. Such an exercise would require a study of compliance with reporting disclosure obligations and would need to be wider than merely disclosures with respect to the structured finance disputes. Such a study is also likely to make observations concerning whether the disclosures requirements are sufficient to achieve their purpose, and hence beyond the scope of this paper. With respect to disclosures in financial statements this paper seeks to examine what may be gleaned from the disclosures in financial statements prepared in accordance with the current reporting frameworks of Australia and New Zealand. It does not seek to examine the adequacy of the requirements and suggest whether further obligations or guidance with respect to disclosures is warranted. Neither does this paper intend to analyse the methodology relating to financial statement disclosures other than to examine financial statement disclosures utilising the lens of discourse analysis, which is introduced in the latter parts of the next section.

4.0 PRIOR STUDIES AND METHODOLOGY

Outside of financial reporting studies generally, there is scant prior research on the tax disclosures of banks in Australasia, and unsurprisingly little on the structured finance disputes between the New Zealand banks and the IRD. One important contribution is that of Newberry (2005), who reviews the BNZ's and Westpac's financial statements. She notes that for the BNZ, had it included the additional tax of $NZ416 million (in dispute with the IRD) for the 1999 to 2005 years, its effective tax rate (ETR), measured as tax expense over net profit, would be on average 33 percent (the applicable statutory rate) for this period. Table 1 from Newberry's (2005) study is reproduced below setting out the BNZ's actual ETRs:

TABLE 1: BANK OF NEW ZEALAND: TAX EXPENSE COMPARED WITH OPERATING PROFIT BEFORE TAX

	Total	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
$NZ	$mill	$mill	$mill	$mill	$mill	$mill	$mill	$mill
Operating profit before tax	4,375	710	625	752	750	587	513	438
Tax expense	1,046	169	154	204	168	147	124	80
Tax expense as % of profit	24%	24%	25%	27%	22%	25%	24%	18%

With regard to Westpac, Newberry (2005) is unable to clearly determine the appropriate figures since there are discrepancies between Westpac, and Westpac Banking Corporation (the Australian parent - NZ segment). However, for Westpac, for whatever basis is used, if the additional tax is added back to the tax expense, Newberry (2005) reports that the ETR would be at, or above, the statutory rate (33 percent) for each year. I have reproduced only the Westpac table:

TABLE 2: WESTPAC NZ BANKING GROUP: TAX EXPENSE COMPARED WITH OPERATING PROFIT BEFORE TAX

As reported in NZ	**Total**	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
	NZ$mill	NZ$mill	NZ$mill	NZ$mill	NZ$mill	NZ$mill	NZ$mill	NZ$mill
Operating profit before tax	4,972	917	918	667	786	610	579	495
Tax expense	1,398	292	297	203	168	131	144	163
Tax expense as % of profit	28%	32%	33%	30%	22%	22%	25%	33%

Newberry (2005) summarises her analysis by stating (emphasis added):

> "Both [BNZ and Westpac] are required by law to observe financial reporting standards, but those standards do not allow clear identification of actual tax assessed, and tax records filed with the IRD are not publicly accessible. *There is little in their financial reports to help with assessing the banks' tax activities other than the disclosures provided by both banks of the amount of tax under dispute*."

The highlighted portion taken from Newberry (2005) suggests that improvements in disclosure obligations with respect to important events may be warranted, but as indicated in the previous section of this paper, this issue is beyond the scope of this study. Newberry (2005) notes that both the BNZ and Westpac appear to have stopped engaging in structured financing transactions. This should not come as a surprise given the IRD audit activity, litigation and subsequent change in the legislation enacted during 2005. Nevertheless, Newberry (2005) comments that in late 2005 permissions issued to Westpac by the New Zealand Overseas Investment Commission (OIC) suggest the need to remain alert for the effects of other structured finance arrangements. Details from the OIC approvals reveal that the amounts involved are around $NZ2 billion.

With respect to the subject manner, the disclosures in financial statements concerning a series of major tax disputes, this study sets a benchmark for comparison with future studies. It does so in regard to analysing a series of major events (the ongoing investigation and subsequent litigation with the IRD) that affected a number of similarly situated major businesses (major New Zealand trading banks predominately owned by Australian parent banks) and the approach by which these businesses chose to publicly disclose these events and their impact upon their financial statements. It also benefits from a degree of closure in that in the midst of the "battle" the banks have agreed to settle with the IRD, a decision which should significantly impact the 'final' series of disclosures required for the banks' 2010 financial statements.

In terms of the methodology of this paper, it adopts of a form of discourse analysis, supplemented by critique of the statements made by the banks analysed. Discourse analysis is a general term for describing a number of approaches to analysing written, spoken or signed language use. Discourse analysis can be characterised as a way of approaching and thinking about a problem. Discourse analysis will enable the researcher to reveal the hidden motivations behind a text or behind the choice of a particular method of research to interpret that text.

Discourse analysis has been applied to regulatory processes as this is a communicative activity. Black (2002, pp 164-5) makes the following insightful observation:

> "Discourse analysis would go one step further in its own justification, for it contends that social action can be comprehended only by comprehending discourse, that discourse is the basis of social action in that it is constitutive, functional, and coordinative. It is constitutive in that it builds objects, worlds, minds, identities, and social relations, not just reflects them. *It is functional in that it is designed to achieve certain ends, for example, to persuade (its rhetorical and argumentative aspect)*. It is coordinating in that in the activity of producing meaning and shared senses it requires and produces coordination, and the possibility of coordination is at the basis of social life." (emphasised added)

Discourse analysis is also used in accounting and in relation to financial statement analysis. For example, in Gallhofer et al (1999/2000) the authors argue that accounting is shaped by a culture of spin and that it is important to continue to monitor and critique accounting practice. Craig and Amernic (2004) provide an insightful analysis of Enron discourse as a case study example of micro-discourse. Llewellyn and Milne (2007) provide an overview of accounting as codified discourse. In relation to taxation, Flowerdew and Wan (2006) provide the results of their empirical analysis into the tax accounting discourse community (through examining tax computation letters), utilising business genre analysis (linguistic choices in preparation of communication material). Amernic and Craig (2009) offer a review of empirical evidence of accounting discourse in order to understand accounting as a conceptual metaphor.

In this paper the subject matter is external financial statement information, especially notes to the financial statements. Thus this research forms part of financial accounting analysis, and to this end, the aim is to establish the motivations behind the discourse contained in the financial statement disclosure text of the subject matter (major New Zealand banks) in relation to a significant event (IRD investigations and subsequent disputes over structured financing transactions, leading to a surprise settlement between the parties in late 2009). In this paper I seek to demonstrate that notwithstanding attempts to draw a favourable picture, through a form of public discourse in financial statements, a defensive approach that does not impartially incorporate all of the evidence can come 'unstuck', and in itself lead to another discourse, namely downplaying the major back down of the banks in agreeing to settle with the IRD.

It is acknowledged that there is support for, and criticism of, discourse analysis as a theoretical paradigm. It is not the intention of this paper to contribute to that debate other than offer another instance of where discourse analysis assists in understanding the message conveyed in financial statements with respect to tax disclosures.

5.0 BANKS INCLUDED IN THE ANALYSIS

5.1 ANZ National Bank

This bank was formerly two banks: ANZ Bank and the National Bank of New Zealand (NBNZ – this was formerly owned by Lloyds TSB – United Kingdom - until late 2003). The tax dispute with the IRD commenced while the banks were separate entities, but the disputes (and associated assessments) have been amalgamated to represent the new banking arrangements. Financial information is now only available for the merged banking operations in New Zealand. The estimated tax in dispute is $NZ365 million plus $NZ203 interest and potentially shortfall penalties (ranging from 20 percent to 100 percent).[1] ANZ-National Bank is owned by the ANZ Bank (Australia).

5.2 ASB Bank

There are no separate financial statements prepared for the ASB Bank with all information obtained from the Commonwealth Bank of Australia's (CBA's) financial statements, drawing primarily upon the ASB Bank segmental reporting. The ASB Bank is reported to have $NZ280 million in dispute (including interest) and potentially penalties (of 20 percent up to 100 percent). CBA is an Australian-owned bank.

5.3 BNZ

Separate financial statements are produced for the BNZ which is wholly owned by National Australia Bank (NAB) – an Australian-owned bank. The BNZ was the first to have its substantive tax avoidance case heard in the High Court in Wellington. It was unsuccessful in defending the Commissioner's allegations of tax avoidance with $NZ416 million due in additional tax plus $NZ238 million interest.[2] This total sum ($NZ654 million) may go as high as $NZ830 million with inclusion of the 100 percent abusive tax position shortfall penalty,[3] or increase to $NZ737 million with a 20 percent shortfall penalty (such as for an unacceptable interpretation/unacceptable tax position[4]). This decision has been appealed to the Court of Appeal with judgment expected later in 2009.

[1] Shortfall penalties are provided for in Part IX of the Tax Administration Act 1994 (TAA 1994).

[2] *BNZ Investments Ltd v CIR*, CIV 2004-485-1059, CIV 2005-485-1045, CIV 2006-485-1028, CIV 2006-485-2084, CIV 2008-485-1056, 15 July 2009, High Court, Wellington Registry, Wild J.

[3] This penalty is provided by s 141D of the TAA 1994.

[4] This penalty is provided for by s 141B of the TAA 1994. The penalty was originally for taking an unacceptable interpretation, but was changed for tax positions taken on or after 1 April 2003.

5.4 Rabobank NZ

Rabobank is a small player for which there are no separate New Zealand financial statements. Limited information (from 2006 onwards) may be obtained from its parent based in the Netherlands. No publicly available figures of the tax assessments have been released.

5.5 Westpac

Separate financial statements are prepared for the New Zealand operations of this bank. At the time of writing Westpac has just received the decision regarding its substantive tax avoidance case before the High Court in Auckland.[5] It was unsuccessful in defending the Commissioner's allegations of tax avoidance with $NZ586 million due in tax plus $NZ325 million of interest, and potentially shortfall penalties (ranging from 20 percent to 100 percent). With shortfall penalties included (and based on current amounts of interest) this could see the total sum fall in the range of $NZ1.028 billion to $NZ1.487 billion. The decision is expected to be appealed to the Court of Appeal. Westpac is owned by its Australian parent, Westpac Banking Corporation.

One bank (Deutsch Bank A G) settled with the IRD early in the piece and is thus not included in this analysis. The settlement terms are confidential, although public information suggests that the tax in dispute was in the vicinity of $NZ75 million.

6.0 THE ESSENCE OF THE STRUCTURED FINANCE TRANSACTIONS

While there are a number of subtle differences between the structured finance transactions that are the subject of the various disputes, they have a number of similarities. The following discussion is based on the transactions described in the BNZ High Court judgment.[6]

Essentially the New Zealand banks (ANZ National Bank, ASB Bank, BNZ, Rabobank and Westpac) entered into a number of similar structured financing transactions known as 'repo' deals. Under a repo arrangement, A, the holder of shares or other securities, sells them to B on terms that B will sell them back to A at an agreed time and price. The transaction is regarded as secured collateralized borrowing by financial markets. Economically, a repo is similar to a loan, particularly one secured by a pledge of shares.

Under the repo deals, the New Zealand bank made an equity investment in an overseas entity on terms requiring the overseas counterparty to repurchase that investment when the transaction terminated. The parent of the overseas counterparty would guarantee the repurchase, by its subsidiary, for a fee (the guarantee arrangement fee (GAF) or guarantee procurement fee (GPF)). The New Zealand bank's subsidiary would pay the fee to the overseas counterparty to procure that guarantee from its parent.

---

[5] *Westpac Banking Corporation v CIR*, CIV 2005-404-2843, 8 October 2009, High Court, Auckland Registry, Harrison J.

[6] See n 2 above.

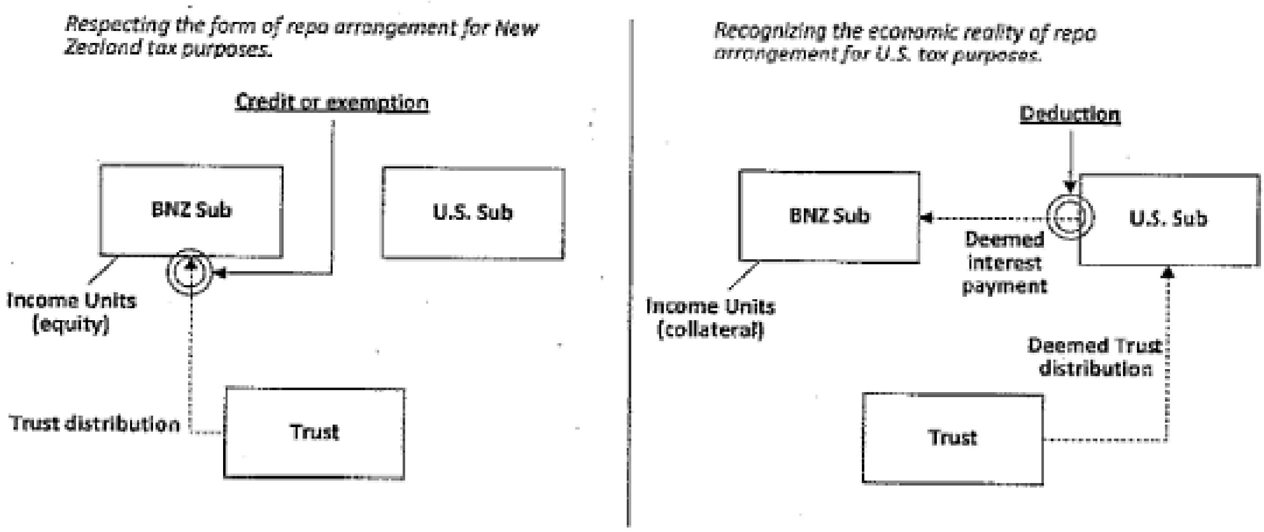
The return to the New Zealand bank's subsidiary from this funding arrangement was to come from distributions it would derive, through its equity interest, from the overseas counterparty. The amount actually received would take into account an interest rate swap arrangement between the parties included in the transaction, the guarantee fee expense, and the borrowing costs of the taxpayer's subsidiary.

The transactions were structured to enable the New Zealand banks to deduct the cost of borrowing, the guarantee fee expense and the net cost incurred in the interest rate swap. The New Zealand banks would treat the distributions it received as tax exempt income, either as distributions received from an overseas owned company, or under foreign tax credit provisions.

New Zealand tax law treated the transactions as equity investments, the counterparties' jurisdictions (the United Kingdom, United States or elsewhere) treated the transactions as secured loans. This enabled the counterparties to deduct, as interest, the distribution they made which the taxpayer received free of tax in New Zealand.

The following (figure 1) is taken from the BNZ High Court judgment to reflect the essence of the mismatch between the New Zealand and United States treatment of the structured finance transactions. More complex examples are included in the judgment.

FIGURE 1: FORM VS. ECONOMIC REALITY OF THE REPO ARRANGEMENT



7.0 TAX DISPUTE DISCLOSURES AND DISCOURSE BY NEW ZEALAND BANKS

This portion of the study traces the evolution in disclosures by each of the banks individually, up to the latest developments in early September 2009. To set the scene, the IRD audited the financial statements of the banks for the 2000-2005 income years (for the BNZ the audits went back to its 1998 financial statements). In 2005 the New Zealand Government amended the income tax law to alter the tax treatment of such transactions (from 1 July 2005), limiting the future impact of such transactions.[7] Tax disclosures

[7] See sections FB 8B to FB 8J of the Income Tax Act 2004 inserted by the Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005.

concerning the structured finance transactions audits (and subsequent litigation commenced) in the 2004 financial statements for most of the banks.

7.1 ANZ National Bank

The first disclosure for the ANZ National Bank appears in its 2004 financial statements in the Notes section: *Contingent Liabilities*. This Note refers to Notices of Proposed Adjustment (NOPAs) received from IRD for one transaction in the 2000 year.[8] It explains the nature of NOPAs, such that they are not an assessment and do not establish a tax liability. The estimated effect if the IRD took the same position on other transactions is given ($NZ348 million including interest), with $NZ116 million of indemnity from Lloyds TSB for the NBNZ as part of the acquisition arrangements). The bank states it has sufficient provisions and downplays the issue through using neutral language.

In the 2005 financial statements, the Notes refer to the Australian Tax Office's (ATO's) risk reviews and other settlements. The Note also refers to NOPAs, with an estimated effect given ($NZ432 million (including interest), with $NZ124 million of indemnity from Lloyds TSB). The bank notes other normal audits are underway in the United Kingdom, United States and other jurisdictions. The bank also states that it holds sufficient provisions and downplays the issue again through using neutral language.

There is no separate disclosure available for the 2006 year in the financial statements, which is surprising given the publicity over the ongoing disputes between the bank and the IRD. However, in 2007 the financial statements include similar comments to that which appeared in the 2005 financial statements. The Notes refer to normal audits occurring in New Zealand and other jurisdictions. The Notes also refer to NOPAs, with estimated effect ($NZ506 million (including interest), with $NZ142 million of indemnity from Lloyds TSB). The bank states that it holds sufficient provisions and once again it uses neutral language.

In the 2008 financial statements, reference is again made to the ATO reviewing transactions (including structured financing transactions) with some assessments being challenged. The Notes also refer to NOPAs, with an estimated effect ($NZ541 million (including interest), with $NZ151 million of indemnity from Lloyds TSB). Further detail is provided on the transactions under dispute. The bank states that it holds sufficient provisions, but that based on advice it is confident its approach is correct. The language used is more defensive than previously adopted.

In the interim 2009 financial statements (the nine months to 30 June 2009), reference is made to the court decision (of 16 July 2009) in favour of the IRD (against the BNZ). The bank refers to disputing its assessments, with an estimated effect ($NZ568 million (including interest), with $NZ159 million of indemnity from Lloyds TSB). The bank states that it holds sufficient provisions, and that based on advice they are confident their approach is correct. Reference is made to the possibility of penalties, but that application is inappropriate and unlikely. Defensive language is used once again. The ANZ-National Bank publicly indicated that it is continuing to challenge the Commissioner's assessments notwithstanding events regarding BNZ's and Westpac's

[8] The process for preparing and issuing NOPAs is set out in sections 89B to 89L of the TAA 1994.

court cases. That said the ANZ-National Bank's commitment to challenging the assessments ceased with the settlement reached on 23 December 2009.

7.2 ASB Bank

All information is contained in the parent bank's financial statement (CBA) since there are no separate financial statements prepared for the ASB Bank that are publicly available. The first mention is in the 2004 financial statements in the Note on *Income Tax Expense*. Reference is made to audits by the IRD focusing on structured financing transactions as part of normal IRD procedures, with no assessments issued at this time. Neutral language is used. The 2005 financial statements include a similar statement to the previous year's financial statements.

In the 2006 financial statements reference is made to audits of structured financing transactions as part of an industry-wide review, and of receipt of an assessment for the 2001 year, with NOPAs issued for other years. The bank states that it is confident the tax treatment adopted is correct and any assessments received will be disputed. Thus strong (and defensive) language is used.

In the 2007 financial statements, similar statements are made (using strong, defensive language) as in 2006. The ASB Bank states that assessments have now been received for transactions in 2001 and 2002.

The 2008 financial statements are most peculiar in that there is absolutely no reference in any of the Notes (or elsewhere) to the IRD's NOPAs and assessments. This omission aside it was public knowledge that such IRD activities were continuing with respect to the ASB Bank and the other banks with respect to the structured finance transactions. This failure to make disclosures is very misleading and brings into question the rigour of the reporting standards.

In the 2009 financial statements no reference is made to the NOPAs and the ongoing disputes with the IRD. This would appear to be a failure to make a material disclosure with non-disclosure certainly not going to make the disputes go away. Interestingly the ASB Bank (through its parent CBA) does not provide in the financial statements any quantitative estimates of the tax and interest in dispute. That said the ASB Bank's position regarding its structured finance dispute with the IRD changed with the settlement reached on 23 December 2009.

7.3 BNZ

The first reference to the IRD's actions concerning the BNZ appears in the *Pending Proceedings or Arbitration* section of the 2004 financial statements and in the *Contingent Liabilities* Note. In the Notes the bank advises of receiving assessments from the IRD on its structured finance transactions. Strong language is used such that the bank is confident that its position on the tax law is correct, that it has received independent legal advice supporting its position, and that it is disputing the IRD's position. Note 34 contains extensive detail (emphasis added) in this regard:

> **"Amended assessment from the Inland Revenue Department – structured finance transactions**
>
> The New Zealand Inland Revenue Department (the "IRD") is carrying out an industry wide review of structured finance transactions. A wholly-owned

subsidiary of the Bank, BNZ Investments Limited, together with some of its subsidiaries, have received amended tax assessments from the IRD with respect to three structured finance transactions entered into in the 1998 and 1999 income years. The amended assessments are for income tax of approximately $36 million. Interest would be payable on this amount, and the possible application of penalties has yet to be considered by the IRD. *In addition, the IRD has also issued amended assessments based on an alternative approach to reassessing the transactions. This alternative approach results in a lower additional tax liability*.

The IRD has not yet issued amended assessments for these three disputed transactions for income years after 1999. Notwithstanding that, based on the assessments received to date, the maximum sum of primary tax which the IRD might claim for the years from 2000 to 2004 is approximately $240 million.

The IRD is also reviewing further transactions of a similar nature to the disputed transactions. An estimate for the year ended 30 September 2004 of the maximum sum of primary tax that the IRD might assess for these further transactions is approximately $111 million.

As at 30 September 2004, if the IRD reassessed all structured finance transactions of this nature, the maximum tax liability in dispute is likely to be $387 million. In addition, interest would be payable on this amount of $86 million (net of tax).

The Banking Group is confident that its position in relation to the application of the taxation law is correct and is disputing the IRD's position with respect to these transactions. The Banking Group has obtained legal opinions that confirm that the transactions complied with New Zealand tax law.

The financial effect of the unpaid balance of the amounts owing under the amended assessments has not been brought to account in the General Disclosure Statement for the year ended 30 September 2004. The Banking Group will maintain its existing tax treatment of the transactions until amended tax legislation comes into effect on 1 July 2005."

In the 2005 financial statements, similar statements are made to those in the 2004 financial statements (using strong language), with minor wording changes in Note 35. Updated financial information is provided with assessments of $NZ47 million for the 1998 and 1999 income years, along with information on the NOPAs for the 2000-2002 years. The maximum tax assessed is expected to be $NZ416 million plus $NZ117 million interest for all structured finance transactions under review. It is noted that all structured finance transactions *matured* or *were terminated by 30 June 2005*. Brief mention is made that the IRD had yet to consider the possibility of penalties.

In the 2006 financial statements, once again similar statements are made to the previous year's financial statements, with minor wording changes in Note 42. Updated financial information is provided of $NZ47 million for the 1998 to 2002 income years (with maximum tax of $NZ256 million, plus interest for this period). The overall maximum tax assessed is expected to be $NZ416 million plus $NZ149 million interest for all structured finance transactions under review. It is noted that the New Zealand

Government introduced legislation effective 1 July 2005[9] to address the concerns it had with such transactions entered into by banks. The BNZ also notes that all such transactions subject to the investigation *were terminated* by 30 June 2005. The BNZ also advised that it had now commenced legal proceedings to challenge the IRD's assessments. Throughout strong and defensive language is used.

In the 2007 financial statements, once again similar statements were included to the previous year, noting that the IRD had now completed its review of structured finance transactions in the banking industry. The maximum tax assessed is expected to be $NZ416 million plus $NZ183 million interest for all structured finance transactions. The BNZ persists with using defensive language in its approach.

In the 2008 financial statements, similar statements are made to those made in 2007, although in 2008 these statements are somewhat briefer in their content. The maximum tax assessed is likely to be $NZ416 million plus $NZ217 million interest. Defensive language continues to be used.

In a media release on 28 April the CEO was upbeat, reporting a solid net profit. However, the 2009 financial statements make reference to a number of significant events during the financial year. The bank makes the following comment, using strong language regarding the litigation; see *Pending Proceedings or Arbitration* (emphasis added):

> "Certain members of the Banking Group have received amended tax assessments from the Inland Revenue Department (the "IRD") in respect of certain structured finance transactions. These amended assessments were challenged in the High Court and a judgment was delivered on 15 July 2009, finding against the Banking Group. *The Banking Group considers that elements of the judgment are wrong in fact and law and has lodged an appeal with the Court of Appeal. Penalties, which could possibly be up to 100% of the tax shortfall, have not yet been imposed by the IRD. …*"

Furthermore, in Note 42, similar comments to those included in the 2008 financial statements are included with respect to the IRD assessments, and to the above statement regarding the court proceedings (a further detail provided is that the appeal lodgement date is 11 August 2009). More importantly, the bank has made a provision of $NZ661 million (tax $NZ416 million, and interest and associated costs of $NZ245 million (net of tax)) in its Income Statement for this period, leaving a loss for the year of $NZ181 million. At last the defensive approach has given way to "acceptance" and quantification of the impact of the ongoing dispute with the IRD. That said the BNZ remained committed to pursuing its appeal until the settlement reached on 23 December 2009.

Similar disclosures regarding the BNZ's tax dispute over the period of review have been included in the NAB's financial statements. The NAB has made a provision for $A524 million should the BNZ fail in its appeal. However, in setting up various subsidiaries to issue shares to the public in 2008, no disclosures of the BNZ parent company's disputes and litigation over the structured financing transactions were made in the prospectus or subsequent financial statements. Potential investors would

[9] See note 2 above.

need to investigate BNZ's financial statements to be appraised of the situation and determine how this may impact upon their decision to invest.

7.4 Rabobank

This bank has provided minimal disclosure, with the first mention of the dispute with the IRD (that I have been able to source) appearing in the 2007 financial statements. However, it is the smallest of the banks subject to investigation for structured finance transactions. The bank concludes with strong language, as evidenced in Note 29 *Contingent Liabilities* (emphasis added):

> "The Inland Revenue Department (the "IRD") is carrying out a review of certain structured finance transactions in the banking industry.
>
> The Bank and its wholly-owned controlled entity have received Notices of Proposed Adjustments ("NOPAs") for the 2001 to 2004 tax years from the IRD with respect to certain structured finance transactions.
>
> *These notices do not create a tax obligation for the Bank, but advise of the IRD's intention to issue amended assessments for those years.*
>
> *The Bank has obtained independent legal advice that confirms the transactions complied with New Zealand tax law*."

In the 2008 financial statements (to 31 December 2008), the language is more direct in that the bank advises that the IRD was disputing structured finance transactions, with several court cases under way with hearing dates assigned. There is no quantification of the bank's potential exposure. At the time of writing in 2009 no further information is publicly available regarding the structured finance disputes or the bank's position with respect to the 23 December 2009 settlements.

7.5 Westpac

The first reference to the dispute with the IRD is made in the 2004 financial statements. Brief mention also appears in Note 34 *Contingent Liabilities* … . In Note 6 *Income Tax*, extensive discussion using strong and assertive language is included (emphasis added):

> "Westpac has received Amended Tax Assessments (ATAs) and Notices of Proposed Adjustment (NOPAs) from the New Zealand Inland Revenue Department (NZIRD) in respect of three structured finance transactions.
>
> The ATAs relate to 1999 and have a maximum potential tax liability of approximately NZ$18 million (A$17 million). Including interest this increases to a tax-effected amount of NZ$25 million (A$23 million). The NOPAs relate to 2000-2002 and have a maximum potential tax liability of approximately NZ$67 million (A$63 million). Including interest this increases to a tax-effected amount of NZ$102 million (A$95 million). Westpac has calculated that the maximum potential overall primary tax liability that would arise if all similar transactions entered into to date were disputed, including 2003-2004, would be approximately NZ$548 million (A$513 million). Including interest this increases to a tax-effected amount of NZ$647 million (A$606 million).

> *A binding ruling was obtained from the NZIRD on the initial transaction in 1999 which, following a review by the NZIRD, was confirmed in 2001. The principles that underly the ruling were followed in all subsequent transactions. Independent tax and legal opinions have also confirmed that the tax treatment applied to the transactions is consistent with New Zealand law.*
>
> *Westpac is confident that the tax treatment applied in each case was correct and that the likelihood of ultimately being required to pay additional tax is low. Accordingly, no tax provision has been raised in respect of these matters.*"

In the 2005 financial statements, extensive discussion appears in both the *Overview* section and Note 34 *Contingent Liabilities*. The discussion is marginally more extensive in the *Overview* and this is set out in full (emphasis added):

> "**New Zealand Inland Revenue Department Investigation**
>
> The New Zealand Inland Revenue Department (NZIRD) is reviewing a number of structured finance transactions as part of its audit of the 1999 to 2002 tax years. This is part of a broader NZIRD investigation and review of structured finance transactions in the New Zealand market.
>
> *The transactions in question have been progressively run down and have now all been unwound*. Potential interest continues to accrue on the core tax if the NZIRD is successful in its challenge.
>
> On 30 September 2004, we received assessments totalling NZ$18 million (A$16 million) (NZ$25 million (A$23 million) with interest) in respect of three transactions for the 1999 tax year. On 31 March 2005, the NZIRD issued further amended tax assessments relating to the 2000 tax year that will impact three structured finance transactions in place in the 1999 tax year and an additional two structured finance transactions undertaken in the 2000 tax year only. The maximum potential tax liability reassessed for the 2000 tax year is NZ$61 million (A$55 million) (NZ$85 million (A$77 million) with interest). The potential primary tax in dispute for all five of these transactions for the years up to and including 30 September 2005 is NZ$220 million (A$200 million) (this includes the amounts noted above). With interest this increases to NZ$296 million (A$269 million) (calculated to 30 September 2005). *The additional tax assessed in respect of the 1999 and 2000 tax years (NZ$79 million (A$72 million) tax plus interest as noted above) has been paid to the NZIRD as 'tax in dispute' to prevent further interest accruing. This has been recorded in the Financial Statements as a receivable in 'Other assets'* reflecting our position as noted below.
>
> The NZIRD is also investigating other transactions undertaken by us, which have materially similar features to those for which assessments have been received. Should the NZIRD take the same position across all of these transactions, for the years up to and including the year ended 30 September 2005, the overall primary tax in dispute will be approximately NZ$611 million (A$556 million) (including the amounts noted above). With interest this increases to approximately NZ$750 million (A$682 million) (calculated to 30 September 2005).

> *We sought a binding ruling from the NZIRD on an initial transaction in 1999 which, following extensive review by the NZIRD, was confirmed in early 2001. The principles underlying that ruling are applicable to, and have been followed in, all subsequent transactions.*
>
> *At the time of entering the transactions, we received independent tax and legal opinions which confirmed that the transactions complied with New Zealand law. Legal counsel has confirmed that the relevant parts of these opinions remain consistent with New Zealand law.*
>
> *As previously disclosed, we are confident that the original tax treatment applied by us in all cases is correct. We remain of the view that the transactions are legitimate and do not constitute tax avoidance. Accordingly, no tax provision has been raised in respect of these matters.*
>
> *We do not consider that the outcome of any other proceeding, either individually or in aggregate, is likely to have a material effect on our financial position*."

In the 2006 financial statements the level of detail has been reduced compared to that of 2005, although the impact has been updated (figures for each of the years of assessment are given, along with an estimated total of $NZ611 million tax plus interest $NZ182 million). Westpac advises that legal proceedings for the 1999-2001 years have commenced. The language remains strong and defensive.

In the 2007 financial statements the detail is similar to that of 2006, with the impact updated (figures for each of the years of assessment, with estimated total of $NZ595 million tax plus interest $NZ220 million – a slightly reduced tax figure!). Westpac advises that legal proceedings for the 1999-2002 years have commenced. Strong language is used once again to convey Westpac's message.

In the 2008 financial statements the level of detail is similar to that of 2007, with the impact updated (figures for each of the years of assessment, with estimated total of $NZ588 million tax plus interest $NZ294 million – again a further slightly reduced tax figure!). Westpac advises that legal proceedings have commenced for all amended assessments (years 1999 to 2005) and that there are *no further transactions or tax years subject to review* (other than the transaction in relation to which Westpac received a binding ruling[10]).

In the 2009 financial statements the level of detail is similar to that of 2008 with the impact updated. In note 37, the bank states that the maximum tax assessed is likely to be $NZ586 million (yet again a slightly reduced tax figure) plus $NZ332 million interest. Westpac also states (using relatively defensive language) in Note 37 (emphasis added):

> "…On 7 October 2009, the New Zealand High Court found in favour of the NZIRD in relation to Westpac's challenge to the amended assessments in respect of four representative transactions. *The decision will apply to all transactions unless a party can show any material difference in the transactions not considered at trial*. *Westpac has lodged an appeal against*

[10] Binding rulings are issued by the Rulings Unit of the IRD under Part VA of the TAA 1994.

> *the decision to the NZ Court of Appeal. No penalties have been assessed by the NZIRD. The possible range of penalties under New Zealand law is up to 100% of the primary tax in dispute. Westpac has not raised a provision relating to penalties*. During the year Westpac raised its tax provisions relating to this litigation to NZ$918 million (A$753 million)."

Like the BNZ, Westpac remained committed to pursuing its appeal until the settlement reached on 23 December 2009.

Westpac issued two media releases in 2004 when the dispute with the IRD commenced (the second media release is an update of the first). The detail in the first media release made on 6 August 2004 is much more extensive than the financial statement disclosures (such as Westpac had received 12 NOPAs), but it takes a more defensive approach. Two key comments from this media release are set out below (emphasis added):

> "Westpac also received independent tax and legal opinions at the time which confirmed that the transactions complied with New Zealand law. *These opinions have subsequently been reviewed and confirmed by legal counsel. …*
>
> The issue of a law change to address transactions of this type in the future is also currently being discussed with the New Zealand Government and the NZIRD. *Westpac, along with the rest of the industry, is working cooperatively with the New Zealand authorities in this regard*."

In its 30 September 2004 media release, Westpac stated (emphasis added):

> "*… Westpac is confident that the tax treatment applied in all cases is correct. A binding ruling was sought from the NZIRD on an initial transaction in 1999 which, following extensive review by the NZIRD was confirmed in early 2001.*
>
> *Westpac therefore does not accept that the reassessments we have now received from the NZIRD with respect to the three 1999 transactions are correct and will contest them. ...*"

8.0 SETTLEMENT AGREEMENT – A 'CURVE BALL' TO END THE MATTER?

A settlement deal was finalised at approximately 9pm on 23 December 2009, between four of the five banks (ANZ-National Bank, ASB Bank, BNZ and Westpac), the IRD and the New Zealand Solicitor General, for approximately $NZ2.2 billion. From various media releases, one can ascertain that the deal represents approximately 80 percent of the full amount of tax and interest liabilities owed by the four banks (NZ$2.75 billion). The payments took effect from 31 December 2009. Of the approximately $2.2 billion, the amounts agreed were split approximately: ANZ-National Bank $NZ414 million; ASB Bank $264 million; BNZ $NZ658 million and Westpac $NZ885 million (total $NZ2.221 billion). Furthermore, it has emerged that no civil penalties will be imposed by the IRD, and the appeals (due to be heard in October 2010) will not proceed. Other details of the settlement remain confidential, although the Minister of Revenue has publicly stated on National Radio that the settlement is "full and final". Interestingly, there is no information, publicly available at least, concerning the position regarding Rabobank's dispute with the IRD and whether it is seeking to settle or not.

Both the Minister of Revenue and the Commissioner have publicly announced that they are pleased with the outcome, with the Solicitor General also reported to be satisfied. Each of the four banks has made their own press release in response to the settlement, and these press releases in themselves offer another interesting insight, providing a further example of a discourse intended to provide closure to the series of events. Before I analyse their responses, a brief comment is warranted in terms of early observations from various experts with respect to the impact that the settlement will have on the cost of the disputes and whether it is a 'good deal'.

David Tripe, director of Massey University's Centre for Banking Studies, is reported as stating (NZPA, 2009c): "Possibly, in terms of the negotiation the Government has done slightly better. I guess 80 percent is a fairly good return."

Tripe assumed 80 percent was 'thrashed out' across the negotiating table and banks had settled because there was the possibility they might not win, even though they thought they were in the right. Tripe goes on to comment that the settlement (NZPA, 2009c):

> "… got rid of the uncertainty of things and everybody can get on with life. It certainly isn't a good look for the banks to be engaged in long term litigation. One can understand them wanting to get these sorts of matters tidied up."

Tripe is also reported as stating that if the cases had continued through the courts there would have been considerable and costly delay in getting to a final solution (Parker, 2009): "All of those things mean there is some rational justification behind agreeing to settle."

Media reports[11] suggest that the IRD has spent over $NZ38 million, to date, on pursuing the banks. While this is a considerable sum and will not capture all costs, it is relatively "small" in the context of the amount of tax and interest in dispute (over $NZ2.4 billion). Prior to the announcement of the settlement, if the outcome of the BNZ and Westpac tax avoidance cases was taken as a guide for future litigation, then this would seem to be a justifiable cost and investment by the IRD in recovering a substantial amount of tax revenue. Interestingly the Solicitor General's office (via the Crown Law Office) and the IRD have set up a Structured Finance Governance Committee that meets monthly during the duration of the structured finance litigation.[12]

The total cost of the disputes to the banks is likely to be higher (in some instances) than the provisions made given the legal costs involved. The IRD has indicated that prior to the settlement it spent $NZ39.5 million on the litigation, and there will also be legal costs spent by both parties, along with deadweight costs to society as a whole. Tripe commented that while the IRD had spent millions of dollars on the court case

[11] See, for example, van den Bergh (2009).

[12] The responsibilities of this committee include: considering any settlement related matters; ensuring effective budget management and allocation; and ensuring effective development of litigation strategy and legal arguments. See Protocols between the Solicitor General and Commissioner of Inland Revenue (2009); available at: http://www.cch.co.nz/CA_DocumentLibrary/protocol.pdf; and the Proposed Relationship Structure of the IRD and Crown Law Office (2009); available at: http://www.ird.govt.nz/resources/3/b/3bce83804f32a3cc9190d342d98f1b86/ir-protocols.jpg. Post the 23 December 2009 settlements the future of this Committee is uncertain.

this amount is a fraction of the discount and thus (NZPAc, 2009): "This is a very good return in terms of the investment made to pursue them."

What have the banks to say regarding the settlement? ANZ-National Bank's CEO Jenny Fagg stated on 24 December 2009 (Scoop, 2009a):

> "We are pleased to have reached a commercial settlement in relation to six out of the seven disputed tax transactions which largely puts this matter behind us. We have operated in New Zealand for over 150 years. It has always been our approach to pay all appropriate tax and we believed the transaction structures were appropriate given the independent advice received on the relevant law and rulings held by the industry. Given recent legal cases however, it is clear we need to approach these transactions differently and today's settlement reflects this. ANZ has not entered into any of these types of structured transactions since 2003 and since late 2005 all of these transactions have either matured or been terminated."

Of seven transactions undertaken by ANZ-National Bank which were under dispute, one residual transaction involving $NZ27 million in income tax remains subject to commercial dispute with the Commissioner. The ANZ-National Bank advises that it will continue to work through the issues with Inland Revenue in relation to this transaction. The settlement includes an amount of $NZ105.8 million related to three transactions for which ANZ holds an indemnity from Lloyds Banking Group plc associated with The National Bank of New Zealand. The ANZ-National Bank also advises that it holds adequate provisions for the settlement with the Commissioner and advises that there will be no negative impact on ANZ-National Bank's 2010 financial results.

The ASB Bank announced on 24 December 2009 that it has reached a settlement with the Commissioner relating to four structured finance transactions. The ASB Bank's CEO Charles Pink said that the ASB Bank has settled the disputed assessments by agreeing to pay NZ$264 million, which represents 80 percent of the full amount of tax and interest in dispute (Scoop, 2009b):

> "ASB entered into the transactions on the basis of the best tax and legal advice available, and accepted banking practice at the time. However, in light of the High Court's recent decisions in cases involving structured finance transactions of other banks, we have decided to conclude this matter by negotiation with the [Commissioner]."

Pink also stated that ASB Bank's existing provision is adequate to cover the settlement.

In a statement on 24 December 2009 the BNZ said it had reached agreement covering disputed tax assessments for six structured finance transactions entered into between 1998 and 2005. The BNZ's CEO Andrew Thorburn stated (Scoop, 2009c):

> "This is a complex and technical issue, and it has been the subject of much debate. Simply put; we acted in good faith at the time, the High Court has delivered a judgment, and now it is time to settle so that we can move on and move forward."

Collectively, these payments fall within the provision of $NZ661 million raised by BNZ in August 2009 to reflect the High Court decision in which it lost its challenge against the Commissioner. The BNZ also indicated that the interest component of the settlement will be tax deductible.

Westpac announced on 24 December 2009 that it will pay the amount agreed in the settlement (that is, 80 percent of the full tax and interest), with its New Zealand CEO George Frazis stating (Scoop, 2009d):

> "We entered these transactions relying upon expert advice and a ruling issued by the IRD in relation to a similar transaction, but we accept the court has ruled and that, on balance, it is best that we accept this industry settlement and move on."

Westpac fully provided for the value of income tax and interest claimed by the Commissioner as part of its 2009 result, and as a result there will be a write back in 2010 of approximately $NZ190 million.

Thus the remaining matter of interest will be how each of the four banks makes its disclosures with respect to their settlement in their 2010 financial statements due out in the latter half of 2010. In terms of financial statement disclosures this should bring 'closure' to the matter. That said the situation with Rabobank remains unclear.

9.0 DISCUSSION AND ANALYSIS – WHAT CAN WE LEARN FROM THE DISCLOSURES AND DISCOURSE CONCERNING TAX DISPUTES?

It would come as a surprise if the IRD, as part of its regular review of large corporates' financial and tax positions, undertook financial analysis including that of calculating ETRs for the banks. Assuming such analysis, the IRD would discover that the ETRs were considerably lower than the statutory rate, justifying further investigation to establish the cause. The reason for such low ETRs could not be attributed to declining profits or bringing previous years' losses to account (indeed over the period of the structured finance transactions (1998-2005) the banks were reporting increased profits), so there would need to be other explanations. As Newberry (2005) observes, the use of structured finance transactions largely explains the ETRs being lower than the statutory rate for the BNZ and Westpac. Similar analysis would naturally have led the IRD to investigate these transactions, and made indeed have lent support to the New Zealand Government to introduce (and subsequently enact) remedial legislation to remove the effectiveness of such transactions for the banks going forward from 1 July 2005.

The IRD (2008) has included a note in its financial statements for the year ending 30 June 2008 concerning the structured finance transactions, in which it takes a conservative approach:

> **"Note 8: Structured finance transactions**
>
> The Crown is currently in dispute with a number of financial institutions regarding the tax treatment of certain structured finance transactions. Taxation revenue from these transactions has not been recognised as revenue or a contingent asset. At this stage, revenue of $1,589 million has been assessed. This includes use of money interest in some cases."

A more extensive disclosure is offered by the IRD (2009a) in its 2009 financial statements (which were issued prior to the settlement agreements):[13]

> **"Note 8: Structured finance transactions**
>
> The Crown is currently in dispute with a number of financial institutions about the tax treatment of certain structured finance transactions. Due to a favourable High Court ruling for one structured finance case, all structured finance assessments have been recognised as revenue, $1,423 million in the 2008–09 financial year. However, as legal proceedings are still ongoing for other structured finance cases and there is the likelihood of appeal, we have also recognised the assessed tax as a contingent liability of $1,423 million.
>
> A contingent asset of $1,191 million has also been recognised in relation to the structured finance transactions. This relates to use-of money-interest due on all structured finance cases as at 30 June 2009. The interest has been calculated based on the maximum amount which the taxpayers are due to pay to Inland Revenue at that date. However, some of these taxpayers may have money in the tax pooling account which they could transfer at an earlier date. As this is at the taxpayers' discretion, the exact amount of use-of-money-interest is not quantifiable until all cases are resolved and taxpayers have made final payment to Inland Revenue.
>
> Shortfall penalties that Inland Revenue may impose have not been quantified because it is too uncertain at this stage. These penalties would not meet the asset definition or recognition criteria due to the fundamental uncertainty as to what penalty would be applied and the value of the penalty that Inland Revenue would impose. Penalties would be recognised following a final court decision when all appeals are exhausted."

The IRD (2009b) has indicated in its Compliance Focus 2009-10 that it will continue to focus on large institutions (including banking and finance industry) with respect to their compliance with structured financial arrangements. The IRD (2009b, p 21) states that: "[o]ur investigation focus will be on structured finance arrangements that financial institutions either take part in or facilitate for their customers."

Both Standard and Poor's (S&P)[14] and Moody's[15] have affirmed the credit ratings of ANZ-National Bank, ASB Bank, BNZ and Westpac following the BNZ High Court tax avoidance decision, notwithstanding that major provisions will need to be made by the banks in their financial statements. S&P recognises that these payments will be one off, and that the payments are able to be sustained within the banks' capital bases. One potential repercussion of the BNZ and Westpac tax avoidance decisions (assuming there had been no settlement, the appeals were continued with the High Court decisions upheld on appeal, and similar findings emerge for the other banks) is that the banks would be likely to seek to keep their margins high to recuperate some of

[13] Other references to structured finance transactions appear throughout the IRD's 2009 Annual Report under various headings including: tax revenue, litigation, use of money interest as a contingent asset, and accounting policies.

[14] See, for example, NZPA (2009a).

[15] See, for example, NZPA (2009b).

this loss over the next few years, and perhaps reduce their level of competition with one another.

Overall this analysis would suggest that the approach to disclosure by the banks is to provide as little information as possible in the early stages, and then provide more information that supports their position, including that their approach is supported by expert legal and tax opinions. Furthermore, the approach taken with respect to the additional assessments is far from conservative. None of the banks (with the exception of Westpac) indicated (prior to the 23 December 2009 settlements) that they have paid up to half of the disputed tax (an approach no longer mandated by legislation but one that minimise the potential future impact while not being an admission of the correctness of the Commissioner's position), an approach which would limit their exposure to interest should they ultimately be unsuccessful. As events unfolded the banks were unsuccessful to the extent that they have agreed to pay 80 percent of the tax and use of money interest, but have been 'successful' through saving 20 percent (of the tax and use of money interest) and will not face the risk of shortfall penalties being imposed. In contrast the IRD's approach is conservative through not recognising any revenue in its financial statements. This is appropriate given that in preparing its 2008 financial statements there had not been any court decisions on the substantive issue. Nevertheless, this situation has changed in 2009 with the BNZ and Westpac High Court decisions, with the IRD recognising an asset of $NZ1.43 billion of tax revenue for the 2009 financial year, counterbalanced by a contingent liability of the same amount.

When something adverse occurs (such as an unfavourable court decision) the banks are quick to indicate they will be challenging and appealing the outcomes. Overall a defensive style is adopted. This is typical of 'repo' deals although usually it is impossible to obtain a favourable tax ruling (Bradford, 2008). In this codified discourse, the banks appear to be exploiting the flexibility in interpretation and application of accounting judgment with their selection of inclusion of relevant information on the structured finance transaction disputes and litigation in their financial statements. Further analysis that could lead to recommendations regarding tightening or providing greater guidance with respect to judgments associated with the content of disclosures is beyond the scope of this paper. That said, as a result of the surprise settlement agreements, the four banks involved have been quick to downplay the matter in a somewhat defensive manner and seek to "move on".

Disclosure in the notes to the financial statements may be overlooked by shareholders and analysts; even if information is disclosed, there is a variable level of detail for readers to digest. To this end, BNZ and Westpac provide the most informative detail in terms of their financial statement disclosures, while Rabobank provides the least (and arguably less than would be required by NZ IFRS if it applied – exploration of this issue is beyond the scope of this paper). However, even when figures are provided, readers are left to "crunch the numbers" to assess the potential impact of the disputes in the financial statements.

To this end both the BNZ and Westpac in their 2009 financial statements include the effect of their disputes with the IRD, taking a huge "hit" (both the tax, interest and legal costs are included for the full amount for the periods reassessed). Interestingly there is no prior period adjustment to "correct" or "restate" previous years' financial statements.

Reference to penalties in the financial statement disclosures is limited although the BNZ and Westpac both indicate in their 2009 financial statements that penalties may be up to 100 percent (this would result if the abusive tax position shortfall penalty[16] were to be imposed). A penalty of this magnitude is unlikely (and indeed no penalties will be imposed following the 23 December 2009 settlement). Indeed I would suggest that this statement reflects the approach of taking the maximum "hit" (or "Big Bath"[17]), and "painting a gloomy outcome" with the intention of allowing more positive news to be presented once the dispute is finalised and penalties determined. This is a further example of adopting a particular accounting discourse. It is more likely, had there been no settlement, that if shortfall penalties were imposed, they would be in the 20-40 percent range (either for not taking reasonable case (20 percent),[18] taking an unacceptable interpretation/tax position (20 percent)[19] or gross carelessness (40 percent)[20]).

10.0 CONCLUSIONS, LIMITATIONS AND FUTURE RESEARCH

The enormity of the tax in dispute (for each of the banks individually and collectively), plus the amount of interest and legal costs is substantial (estimated at over $NZ2.75 billion or 2 percent of New Zealand's GDP). Absent the 23 December 2009 settlements, this sum would have grown further (assuming the court decisions yet to be heard and delivered found or upheld the actions to be tax avoidance) if shortfall penalties were imposed (which may be from 20 percent to 100 percent of the tax in dispute). Indeed, the amount of penalties could have ranged from an estimated $NZ330 million (20 percent) to as high as an estimated $NZ1,650 million (100 percent). Table 3 below summarises the tax and interest in dispute based on reported figures, and the December 2009 settlement figures:

TABLE 3: SUMMARY OF BANKS' DISCLOSED TAX (PLUS INTEREST) IN DISPUTE: 2004 TO 2009 (BASED ON REPORTING YEAR)

Bank / Year	2004 NZ$m	2005 NZ$m	2006 NZ$m	2007 NZ$m	2008 NZ$m	2009 NZ$m	Settlement NZ$m
ANZ National Bank	348 (116)	432 (124)	N/D	506 (142)	541 (151)	568 (159)*	414 (106)
ASB Bank	N/D	N/D	N/D	N/D	N/D	N/D	264
BNZ	473	533	565	596	633	661	658
Rabobank NZ	N/D	N/D	N/D	N/D	N/D	N/D	N/D
Westpac	647	750	793	815	882	918	885
Total (est)	1,468	1,715	1,358	1,917	2,056	2,147^	2,221

(Figures in ( ) for ANZ-National Bank is the indemnity from Lloyds TSB; N/D - no disclosure of amount - when the estimate for ASB Bank (NZ$280) is added, this comes to NZ$2,427m.)

The banks have been very confident about having taken correct tax positions, backed by legal and tax expert opinions. This stance only changed for the BNZ (to some degree) in its 2009 financial statements, taking a provision for the full impact of the High Court's tax avoidance decision ($NZ416 million tax plus $NZ245 million

[16] See section 141D of the TAA 1994.
[17] In the context of earnings management see, for example, Jordan and Clarke (2004).
[18] See section 141A of the TAA 1994.
[19] See section 141B of the TAA 1994.
[20] See section 141C of the TAA 1994.

interest and costs). Westpac's approach to its High Court decision eventually led it to take (reluctantly) a similar position to the BNZ and provide for tax and interest of approximately $NZ911 million in its 2009 financial statements. That said the scene changed late on 23 December 2009 with the settlements, a stark contrast to the bank's prior public discourse with respect to their structured finance disputes.

Statements made by the banks in their financial statements (and in their relatively few separate media releases prior to 24 December 2009) have generally been defensive, underplaying the seriousness of the potential impact, should the banks ultimately be unsuccessful. Indeed the BNZ and Westpac High Court tax avoidance decisions would suggest that the banks have been underplaying the likelihood of failing to win their litigation against the IRD. The settlements reached on 23 December 2009 support this contention.

Instead of taking a very conservative approach and making an early provision, the banks have disclosed a contingent liability with the impression that they will be successful and have no liability. Provision for the tax impact arising in their financial statements has been left until their court action against the IRD is unsuccessful (BNZ and Westpac) and following the settlements for ANZ-National Bank and ASB Bank. The position regarding Rabobank is unclear since there have been no recent public disclosures. Arguably this approach by the banks has been misleading for investors and raises once again the 'thorny' issue (investigation of which is beyond the scope of this paper) of whether accounting standards need to be tightened with respect to disclosures and making provisions for contingencies. Nevertheless, the positions taken may be representative of the market place reality that the banks operate in.

It is important to note that this paper has limitations. First it adopts discourse analysis, a research paradigm that is not without its criticisms and limitations. Second, this paper forms part of a larger project and thus only examines part of the picture that is emerging as a result of the banks' structured finance litigation. This larger picture includes: analysis of the structured financing litigation leading up to the first major tax avoidance decision,[21] a discourse analysis of the financial statement disclosures resulting from the investigation and subsequent litigation between the IRD and the five banks (this study); an examination of the impact of the 23 December 2009 settlement; and a critical analysis of the impact of the structured finance litigation from economic and jurisprudential perspectives.

The implications of the BNZ's and Westpac's tax avoidance decisions have yet to be examined thoroughly in academic and related research; however, this is only a matter of time. Such analysis is expected to emerge in the near future, in the context of recent anti-avoidance decisions in key cases such as *Ben Nevis*[22] and *Penny v CIR; Hooper v CIR*.[23] An early commentary on these leading decisions is offered by Elliffe and Keating (2009).

Future research in this area needs to incorporate the remaining parts of the wider investigation, namely at least two further studies: the first an examination of the

[21] For an early analysis forming part of this project see the analysis of the cases prior to the substantive avoidance case against the BNZ and Westpac in Sawyer (2008).
[22] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* (2009) 24 NZTC 23,503 (SCNZ).
[23] *Penny v CIR; Hooper v CIR* (2009) 24 NZTC 23,406 (HC). The Court of Appeal judgment is pending as at the time of writing.

impact of the 23 December 2009 settlement; and the second a critical analysis of the impact of the structured finance litigation from economic and jurisprudential perspectives.

REFERENCES

ANZ-National Bank, *Financial Statements for the year ending 30 September* (2004 to 2008) and 9 months to 30 June (2009); available at: http://www.anz.co.nz.

Amernic, J. and Craig, R. (2009), Understanding accounting through conceptual metaphor: Accounting is an Instrument?", *Critical Perspectives on Accounting,* 20: forthcoming.

ASB Bank; refer to Commonwealth Bank of Australia, *Financial Statements for the year ending 30 June* (2004 to 2009); available at: http://www.cba.com.au.

Black, J. (2002), "Regulatory Conversations", *Journal of Law and Society,* 29(1): 163-196.

BNZ, *Financial Statements for the year ending 30 September* (2004 to 2008) and 9 months to 30 June (2009); available at: http://www.bnz.co.nz.

Bradford, M. (2008), "The Development of Tax-Efficient Finance in the Context of Globalization: Principles and Categorization, Opportunities and Limitations – A Few Typical Examples, *Intellectual Economics,* 2(4): 7-14.

Craig, R.J. and Amernic, J.H. (2004), "Enron discourse: the rhetoric of a resilient capitalism", *Critical Perspectives on Accounting*, 15: 813-851.

Elliffe, C. and Keating, M. (2009), "Tax Avoidance: Still Waiting for Godot?", *New Zealand Universities Law Review,* 23(2): 368-392.

Flowerdew, J. and Wan, A. (2006), "Genre analysis of tax computation letters: How and why tax accountants write the way they do", *English for Specific Purposes*, 25: 133-153.

Gallhofer, S., Haslam, J., Morrow, S. and Sydserff, R. (1999/2000), "Accounting, Transparency and the Culture of Spin: Re-orientating Accounting Communication in the New Millennium", *Pacific Accounting Review*, 11(2): 97-111.

IRD, *Annual Report 2008*: *Part 6: Financial schedules - Crown as administered by Inland Revenue: note 8* (2008); available at: http://www.ird.govt.nz/aboutir/reports/annual-report/annual-report-2008/part-6/ar-2008-part6-notes-financial-schedules.html (viewed 7 September 2009).

IRD, *Annual Report 2009*: *Part 8: Financial schedules - Crown as administered by Inland Revenue: note 8* (2009a); available at:

http://www.ird.govt.nz/aboutir/reports/annual-report/annual-report-2009/part-8/ar-2009-part8-notes-financial-schedules.html (viewed 11 January 2009).

IRD, *Helping you get it right: Inland Revenue's compliance focus 2009–10* (2009b); available at: http://www.ird.govt.nz/resources/4/d/4d9dd2004e687633aa24ae4bfdc4072d/compliance-focus-2009-10.pdf.

Jordan, C.E. and Clark, S.J. (2004), "Big Bath Earnings Management: The Case of Goodwill Impairment under SFAS No. 142", *Journal of Applied Business Research*, 20(2): 63-69.

Llewellyn, S. and Milne, M. (2007), "Accounting as codified discourse", *Accounting, Auditing and Accountability Journal*, 20(6): 805-824.

Newberry, S., *Financial Analysis: BNZ and Westpac*, (2005); available at: http://www.converge.org.nz/watchdog/11/04.htm (visited 31 August 2009).

NZPA, "Bank ratings unaffected by tax case", (2009a) *Business Day* (17 July) available at: http://www.stuff.co.nz (visited 7 September 2009).

NZPA, "Agency says bank ratings unaffected", (2009b) NZ Herald (22 July) available at: http://www.nzhearald.co.nz (visited 7 September 2009).

NZPA, "Bank tax settlement 'good for both sides'", (2009c) TVNZ (24 December) available at: http://tvnz.co.nz/business-news/bank-tax-settlement-good-both-sides-3318038 (visited 11/01/10).

Parker, T. "Settlement on $2.2b tax case hits banks hard", (2009) New Zealand Herald (26 December) available at: http://www.nzherald.co.nz/taxation/news/article.cfm?c_id=335&objectid=10617445&pnum=1 (visited 11/01/10).

Rabobank, *Financial Statements for the year ending 31 December* (2007 to 2008); available at: http://www.rabobank.co.nz.

Sawyer, A.J., (2008), "The Impact of Recent Bank Structured Financing Litigation on Interpreting and Applying New Zealand Legislation", *Journal of International Banking Law & Regulation*, 22(12): 627-635.

Scoop, "Settlement with New Zealand Inland Revenue", (2009a) (24 December) available at: http://www.scoop.co.nz/stories/BU0912/S00595.htm (viewed 11/01/10).

Scoop, "ASB Resolves Tax Dispute" (2009b) (24 December) available at: http://www.scoop.co.nz/stories/BU0912/S00600.htm (viewed 11/01/10).

Scoop, "BNZ reaches a settlement with Inland Revenue", (2009c) (24 December) available at: http://www.scoop.co.nz/stories/BU0912/S00596.htm (viewed 11/01/10).

Scoop, "Resolution to New Zealand Structured Finance Litigation", (2009d) (24 December) available at: http://www.scoop.co.nz/stories/BU0912/S00597.htm (viewed 11/01/10).

Smellie, P., "NZ tax case will barely dent Aussie Banks, UBS analysts say", (2009) *Businesswire* (17 July); available at: http://businessscoop.co.nz (visited 7 September 2009).

Van den Bergh, R., "IRD spends $38m chasing banks", (2009) *The Dominion Post* (12 August); available at: http://www.stuff.co.nz (visited 31 August 2009).

Westpac, *Financial Statements for the year ending 30 September* (2004 to 2008) and 9 months to 30 June (2009); available at: http://www.westpac.co.nz.

Westpac, *Media Releases* (2004); available at: http://www.westpac.co.nz.