IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2009-404-000120
CIV-2010-404-002826

BETWEEN	TELSTRA NEW ZEALAND HOLDINGS LIMITED Plaintiff
AND	COMMISSIONER OF INLAND REVENUE Defendant

Hearing: 25 November 2010

Appearances: R Simpson and M McKay for the Plaintiff
B Brown QC, MSR Palmer and RL Roff for the Defendant

Judgment: 6 December 2010

JUDGMENT OF WYLIE J

This judgment was delivered by Justice Wylie
on 6 December 2010 at 11.00 am
Pursuant to r 11.5 of the High Court Rules

Registrar/Deputy Registrar
Date

Solicitors/Counsel:
R Simpson;ralph.simpson@bellgully.com
M McKay,
B Brown QC,brendan.brown@xtra.co.nz
MSR Palmer,
RL Roff,

[1] This application raises a short but interesting point. Has Telstra New Zealand Holdings Limited ("Telstra") abused the process of the Court by discontinuing proceedings it commenced against the Commissioner of Inland Revenue ("the Commissioner") in respect of assessments issued for the 2003 to 2005 income tax years, when those proceedings had been designated as a test case by the Commissioner, and where substantially the same points have been raised by Telstra in fresh proceedings challenging assessments issued by the Commissioner for the 2006 to 2008 income tax years?

Background

[2] Telstra is one of a number of taxpayers currently in dispute with the Commissioner over deductions claimed for the notional interest cost component embedded in what are known as optional convertible notes ("OCNs") issued by New Zealand resident taxpayers to their non-New Zealand resident parents to fund acquisitions or refinance existing operations in New Zealand. The interest cost is notional because no interest is in fact paid. Rather the deductions claimed by Telstra and the other OCN issuers have been quantified by applying a determination issued by the Commissioner on 24 October 1990.

[3] The OCN litigation involves nine taxpayer groups with over 20 sets of proceedings. There is approximately $200 million of potential tax revenue which the Commissioner has assessed as tax avoidance. This figure does not include penalties or use of money interest that will be accruing on the tax that has been assessed. Further, not all income years have yet been assessed, and some taxpayers — including Telstra — are claiming deductions for OCNs still on foot. The Commissioner estimates that there are further potential assessments of approximately $100 million outstanding.

[4] From the outset, these cases had been managed by the Commissioner as a group, due to the substantially identical facts and issues that arise in each dispute.

Telstra's Dispute

[5] Telstra claimed deductions for the notional interest cost component of the OCNs it had issued to its Australian parent company for each of the financial years 2003 to 2005 (inclusive).

[6] The Commissioner did not accept those deductions. He commenced the disputes procedure against Telstra by issuing a notice of proposed adjustment under s 89B of the Tax Administration Act 1994 ("the Act") on 20 April 2007. That notice related only to the 2003 to 2005 income tax years.

[7] Telstra rejected the proposed adjustments and filed a notice of response on 19 June 2007.

[8] Telstra retained counsel — a Mr L McKay. A number of the other taxpayers involved in the OCN litigation also retained Mr McKay.

[9] On 3 August 2007, Mr McKay had a general discussion with a Mr Hendriksen, a solicitor employed by the Commissioner. Mr McKay raised the possibility that "test case" status should be assigned to one of the various taxpayers involved. Mr Hendriksen indicated that that was a possibility, but that the Commissioner had not taken any view on that possibility at that time. Although Mr McKay indicated that Telstra's case might be most appropriate case to be allocated test case status, there is nothing to suggest that this was a formal proposal made on Telstra's instructions.

[10] In August 2007, the Commissioner and Telstra attended a conference to discuss the proposed adjustments. When it became clear that the dispute could not be resolved, Telstra expressed the desire that the parties should move to the next stage of the disputes procedure; namely, that they should exchange statements of position, and then refer the dispute to the Commissioner's adjudication unit.

[11] Referral to the adjudication unit is an administrative practice. It offers the opportunity for an independent determination of the dispute by legally trained

officers of the Inland Revenue Department who have not previously been involved in the investigation and dispute. If the matter is decided by the adjudication unit in the taxpayer's favour, the Commissioner will not take the matter further. However, if the adjudication unit decides in the Commissioner's favour, the Commissioner will issue an assessment that reflects his position. The taxpayer can then challenge the Commissioner's assessment in the Taxation Review Authority or in the High Court.

[12] Mr McKay wrote formally to Mr Hendriksen on 15 August 2007 confirming the position and advising that if the dispute was not resolved in Telstra's favour, it would bring High Court proceedings to challenge any resulting assessment.

[13] On 1 October 2007, Mr Hendriksen wrote to Mr McKay advising that the Commissioner was seeking the agreement of other taxpayers involved in the OCN dispute to compromise their processes, so that their disputes would effectively be determined by the adjudication unit's consideration of the dispute between Telstra and the Commissioner. The Commissioner indicated that if the other taxpayers agreed to defer the processing of their disputes, he would be prepared to exchange statements of position with Telstra, and to have the dispute referred to the adjudication unit.

[14] In the event, the Commissioner secured the agreement of the other taxpayers. On 20 November 2007 he wrote to Telstra confirming that all of the affected taxpayers had agreed to adopt the process outlined in the 1 October 2007 letter, and that he would issue a statement of position for Telstra in January 2008. It was the Commissioner's intention that Telstra's dispute be referred to the adjudication unit in the first half of 2008.

[15] On 24 January 2008, the Commissioner issued a disclosure notice and a statement of position to Telstra for the 2003 to 2005 income tax years. On 24 March 2008, Telstra issued its statement of position.

[16] Between May and June 2008, the parties provided further information to each other for inclusion in their respective statements of position. The dispute was then referred to the adjudication unit.

[17] On 17 November 2008, the adjudication unit confirmed the Commissioner's position. As a result, on the same day, the Commissioner issued amended assessments against Telstra. In January 2009, Telstra filed proceedings in this Court under number CIV-2009-404-120 challenging those assessments.

[18] The Commissioner has the power under s 138Q to designate a High Court challenge as a test case if he considers that determination of the challenge is likely to be determinative of all or a substantial number of issues in one or more other challenges.

[19] Here the Commissioner did not immediately designate Telstra's case as a test case under s 138Q. Rather he resisted Telstra's initial application for discovery, to give him time to consider that issue. Telstra was aware of the possibility that its challenge might be designated as a test case, and on 26 May 2009 it and the Commissioner filed a joint memorandum requesting an adjournment of the case management procedures so that the Commissioner could make a decision on whether or not to use the test case procedure, and to stay the other OCN taxpayers' disputes under s 138R.

[20] On 24 June 2009, the Commissioner designated Telstra's challenge as a test case, along with one other challenge. Telstra was given notice of the Commissioner's decision on 26 June 2009. The Commissioner also issued notices staying proceedings under s 138R to those taxpayers whose challenges were not test cases.

[21] At much the same time, the Commissioner sought to impose shortfall penalties on Telstra. Telstra challenged those assessments in separate proceedings (in CIV-2010-404-2826) and requested that they be heard together with the substantive challenge proceedings (in CIV-2009-404-120). The Commissioner agreed to that request and an order was made to this end by Associate Judge Doogue on 6 July 2010.

[22] Telstra had also sought to deduct the notional interest cost component of the OCNs it had issued to its Australian parent for each of the income tax years 2006 to

2008. To avoid the statutory time bar of four years, on 1 March 2010, the Commissioner issued amended assessments for each of those years. Telstra disputed those assessments and issued the Commissioner with a notice of proposed adjustment under s 89D informing the Commissioner that it did not accept the same on 30 June 2010. The Commissioner issued a notice of response on 2 August 2010.

[23] In the latter part of 2009 and in early 2010, Telstra conducted an internal review of the value to it of the disputed OCN deductions and associated tax losses for the 2003 to 2005 tax years. The company has a substantial balance of tax losses available for offsetting against future profits which are independent of those disputed tax deductions, and internal net profit projections within the group made during late 2009 and early 2010 suggested that the tax losses contributed by the disputed deductions would not begin to be utilised against net taxable income until sometime between the 2017 and 2019 income years. As a result, Telstra reassessed the benefit of continuing with the 2003 to 2005 proceedings.

[24] Consequent upon this reassessment Telstra initiated settlement discussions with the Commissioner in early March 2010. At a later stage, the other OCN taxpayers participated in those discussions. However, the Commissioner was reluctant to settle, given that Telstra's case was a test case, and in early September 2010, the settlement discussions came to an end.

[25] The Court had put in place a timetable in relation to the proceedings in respect of the 2003 to 2005 income tax years and they had been allocated a three-week fixture due to commence on 26 October 2010. Telstra filed its briefs of evidence in June 2010 and the Commissioner filed his briefs of evidence on 12 August 2010. Telstra was due to file its reply briefs by 2 September 2010. It did not do so. Rather it filed a notice of discontinuance of both proceedings 2009-404-120 and 2010-404-2826 on 3 September 2010.

[26] On 30 September 2010, counsel for Telstra wrote to the Commissioner stating that it rejected the Commissioner's notice of response for the 2006 to 2008 income tax years. On the same day, Telstra filed proceedings in this Court challenging the assessments for each of the 2006 to 2008 tax years. The board of

Telstra New Zealand had resolved to discontinue the 2003 to 2005 proceedings, but resolved to preserve the opportunity to retain the tax losses that had accrued in subsequent income years should one or other of the other OCN taxpayers succeed in its challenge proceedings.

[27] As a result of discontinuing the proceedings, Telstra has forfeited tax losses of some $95 million which had accrued over the 2003 to 2005 income years. It has incurred a liability for shortfall penalties of some $3.9 million, although in reality no cash tax is payable to the Commissioner as a consequence of the discontinuance as, first, the tax losses in question had not been offset against any group assessable income, and secondly, the shortfall penalties are set off against available tax losses. The only cost to Telstra in cash terms is its liability for costs on the discontinuance. In that regard, Telstra requested the Commissioner to prepare a schedule of costs on a scale basis when it filed its discontinuance. The Commissioner declined to do so. Rather he seeks costs on an indemnity basis, in the event that the discontinuance is not set aside.

The High Court Rules — discontinuance

[28] The right to discontinue proceedings is contained in r 15.19 of the High Court Rules. It provides as follows:

> **15.19 Right to discontinue proceedings**
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> (1) At any time before the giving of judgment or a verdict, a plaintiff may discontinue a proceeding by—
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> (a) filing a notice of discontinuance and serving a copy of the notice on every other party to the proceeding; or
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> (b) orally advising the court at the hearing that the proceeding is discontinued.
>
> (2) A notice of discontinuance under subclause (1)(a) must be in form G 24.
>
> (3) This rule is subject to r 15.20.

[29] Rule 15.19 gives a plaintiff the right to discontinue a proceeding. Subject to r 15.20, the leave of the Court is not required. The rule requires simply that a notice of discontinuance be filed before the giving of judgment or a verdict.

[30] Inherent in r 15.19 is the principle that a plaintiff cannot be compelled against his will to proceed to a trial or to a judgment. If a plaintiff finds it unnecessary, or is unwilling to put his allegations in a statement of claim to proof, then the defendants' remedy will generally be to apply for costs.[1]

[31] Rule 15.20 restricts the right to discontinue contained in r 15.19 in certain limited situations. Where the Court has granted an interim injunction, or made an interim order, or where a party to the proceedings has given an undertaking to the Court, the leave of the Court is required before the proceedings may be discontinued. Further, where a plaintiff to whom an interim payment has been made wishes to discontinue, he or she requires the written consent of the other party by whom the payment was made, or the leave of the Court. None of these circumstances apply in the present case.

[32] The High Court Rules also provide that the Court can set aside a discontinuance. Rule 15.22 provides as follows:

> **15.22 Court may set discontinuance aside**
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> (1) The court may, on the application of a defendant against whom a proceeding is discontinued, make an order setting the discontinuance aside if it is satisfied that the discontinuance is an abuse of the process of the court.
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> (2) An application under subclause (1) must be made within 25 working days after discontinuance under rule 15.19.

[33] Here, the Commissioner has asked the Court to make an order setting aside Telstra's discontinuance, on the basis that it is an abuse of the process of the Court.

Abuse of Process

[34] The commentary in *McGechan on Procedure*[2] states that situations where discontinuing a proceeding constitutes an abuse of the Court's process will "surely

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1 *O'Brien v New Zealand Social Credit Political League Inc* (No 2) [1984] 1 NZLR 68 (CA) at 73 per Cooke J.

2 Andrew Beck and others *McGechan on Procedure* (looseleaf ed, Brookers) at [HR15.22.01]

be rare". It is noted in *Sim's Court Practice*[3] that it is likely to be an abuse of process where (apart for questions of costs) the discontinuance has been filed in the hope of avoiding some unfinished business or remedy the defendant or another party may be entitled to.

[35] Whether there has been an abuse of the process of the Court in any given case must always be a question of fact and degree. The jurisdiction to set aside a discontinuance is likely to be used sparingly and only where it is plainly justified. The circumstances in which abuse of process will arise will necessarily be varied.[4]

[36] What can amount to abuse of process was helpfully discussed in *Packer v Meagher*.[5] Hunt J in the Supreme Court of New South Wales considered that the legal process of a Court is abused when it is used to exert pressure to effect an object not within the scope of the process, where it is used for a purpose other than that for which the proceedings are properly designed and exist, or where the plaintiff in the proceedings is seeking some collateral advantage beyond what the law offers.

[37] Counsel also brought my attention to the decision of the Court of Appeal of England and Wales in *Gilham v Browning*,[6] where May LJ noted:

> There is a clear public interest, in addition to the interests of individual litigants, that litigation should be justly, speedily and economically conducted and to conduct litigation in a way which is contrary to that interest is in my judgment capable of being an abuse. The court's jurisdiction and duty to manage and control cases in the interests of speed and economy is a developing one. The court's jurisdiction to control abuse is also developing...

[38] In *Hunter v Chief Constable of the West Midlands Police*,[7] Lord Diplock noted that any court of justice must possess an inherent power to prevent misuse of its procedures in a way which, although not inconsistent with the literal application of its procedural rules, would nevertheless be manifestly unfair to a party to litigation

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3 *Sim's Court Practice* (online looseleaf ed, LexisNexis) at [HCR15.22.3].
4 *Gilham v Browning* [1998] 1 WLR 682 (CA) at 689.
5 *Packer v Meagher* [1984] 3 NSWLR 486 (SC) at 492.
6 At 690.
7 *Hunter v Chief Constable of the West Midlands Police* [1982] 1 AC 529 (HL) at 536.

before it, or would otherwise bring the administration of justice into disrepute among right-thinking people.

[39] In *Grovit v Doctor*,[8] Lord Woolf noted that commencing and continuing litigation that a party has no intention of bringing to a conclusion can amount to an abuse of process.

[40] The cornerstone case regarding the Court's jurisdiction to set aside a discontinuance for abuse of process is *Castanho v Brown & Root (UK) Ltd*.[9] In that case the plaintiff, who was a Portuguese citizen residing in Portugal, issued proceedings in England claiming damages for personal injury. After the second defendant had made an admission of liability, a consent order was made requiring the second defendant to make an interim payment of damages. Payments were made. The plaintiff then discontinued the proceeding and filed fresh proceedings in Texas, on advice that he would obtain a larger award of damages in that jurisdiction. The House of Lords ultimately allowed the discontinuance of the English proceedings, but only on terms. The leading judgment was given by Lord Scarman. His Lordship noted that the court has an inherent power to prevent a party from obtaining by the use of its process a collateral advantage which it would be unjust for him to retain.[10] He noted that termination of process (by a discontinuance) can, like any other step in the process, be so used, and that service of a notice of discontinuance without leave, even though it complied with the rules, can be an abuse of the process of the court. He stated as follows:[11]

> A sensible test is that which both the Judge and Lord Denning M.R. applied. Suppose leave had been required ... would the court have granted unconditional leave? It is inconceivable that the court would have allowed a plaintiff, who had secured interim payments and an admission of liability by proceeding in the English court, to discontinue his action in order to improve his chances in a foreign suit without being put on terms, which could well include not only the repayment of the moneys received but an undertaking not to issue a second writ in England.

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8 *Grovit v Doctor* [1997] 1 WLR 640 (HL) at 647.
9 *Castanho v Brown & Root (UK) Ltd* [1980] AC 557 (HL).
10 At 571.
11 At 572.

[41] There are relatively few cases in which the courts, either in New Zealand or in other comparable jurisdictions, have exercised the jurisdiction to set aside a discontinuance on the ground that it is an abuse of process. Such authorities as there are are illustrative of the kind of circumstances that are required to support a finding of abuse of process. I refer to the following:

a) In *Fakih Brothers v AP Moller (Copenhagen) Ltd*,[12] the plaintiffs issued proceedings against the defendants in England for breach of a bill of lading contract. When the defendants acknowledged service, the plaintiffs arrested the defendants' ship and issued proceedings in Sierra Leone. This was in breach of an undertaking that had been agreed at an earlier point in time before the United Kingdom proceedings were issued. The defendants applied for an injunction in the United Kingdom to restrain the plaintiffs from pursuing their action in Sierra Leone and to prevent the plaintiffs removing assets from the jurisdiction to frustrate any judgment the defendants might obtain in a counterclaim for damages. At first instance, the High Court granted the defendants an injunction and ordered the plaintiffs to discontinue the proceedings in Sierra Leone. The plaintiffs then served a discontinuance of the United Kingdom proceedings to defeat the injunction application. The Court held that if the plaintiffs had had to apply for leave to serve a notice of discontinuance, they would have been put on terms, and that the terms would have undoubtedly included a requirement that they cease to be in contempt of court, and that they bring to an end the proceedings in Sierra Leone and release the defendants' ship from arrest. The Court considered that the plaintiffs, by giving notice of discontinuance, were attempting to avoid the imposition of the conditions which had been imposed by the Court at first instance, and it exercised its jurisdiction to strike out the notice of discontinuance.

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12 *Fakih Brothers v AP Moller (Copenhagen) Ltd* [1994] 1 Lloyd's Rep 103 (QB).

b) In *Gilham v Browning*,[13] the plaintiff issued proceedings against the defendants, who responded with a counterclaim. The plaintiff died and his executrix was substituted as plaintiff. The defendant then attempted to file further evidence on the counterclaim. When the Court refused leave to the defendants to file the late evidence on the ground that the delay prejudiced the plaintiff, the defendant filed a discontinuance with the intention of issuing fresh proceedings for the counterclaim. The discontinuance was set aside as an abuse of process. The Court noted that whether there is an abuse of process is a question of fact and degree. It held that by issuing a notice of discontinuance, the defendants were seeking to escape by a side door from the first action, where their counterclaim was evidentially hopeless, in order to start a new action where the evidential problems would not arise, and in circumstances where a long overdue date for trial of the first action was fixed and imminent.

c) In *Sheltam Rail Co (Proprietary) Ltd v Mirambo Holdings Ltd*,[14] a claimant with no assets or business presence in the United Kingdom filed proceedings in London challenging an adverse arbitration award. A few days before the hearing it issued a discontinuance notice because it had run out of funds. The defendants were concerned that the claimant would retain the option of using the same jurisdictional objections to the award to delay or resist any attempt by them to enforce the award in another state. They applied to set aside the discontinuance and to confirm the award. The claimant gave an undertaking that it would not seek to challenge the enforcement of the award and on that basis the discontinuance was allowed to stand.

d) In *Davies v Christie*,[15] the plaintiff, the male partner in a de facto relationship, filed a motion for an order for the sale of a jointly funded property in lieu of partition and for equal division of the proceeds.

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13 *Gilham v Browning* [1998] 1 WLR 682 (CA).
14 *Sheltam Rail Co (Proprietary) Ltd v Mirambo Holdings Ltd* [2008] 2 Lloyd's Rep 195 (QB).
15 *Davies v Christie* HC Wellington M466/84, 23 June 1987.

This was filed in 1984. Pending the hearing, he continued to reside in the property. The defendant did not object to the sale, but sought an unequal distribution of the proceeds. She pressed to have the proceedings set down for trial. In December 1986, the motion was set down for trial in mid-1987. Immediately before trial, the plaintiff filed a discontinuance, the aim being to defer the Court making an order for the sale of the property in which he continued to reside. The Court held that there was "an element of" abuse of process because of the deliberate procurement of delay. Although it is not altogether clear from the decision, it seems that the discontinuance was set aside, and an order was made extending the time for the defendant to file a counterclaim. The trial date was delayed but only for a short period.

e) In *Packer v Meagher*,[16] the plaintiff was the chairman of a large media organisation. He sued the defendant, who was senior counsel assisting a Royal Commission inquiring into a union's activities. The plaintiff alleged that the defendant had published to a newspaper confidential case summaries from the Royal Commission that were highly critical of the plaintiff. The allegation made in the statement of claim of grave impropriety by the defendant was deliberately published widely in media controlled by the plaintiff primarily to cause the defendant embarrassment. The plaintiff then attempted to discontinue the proceedings. The Court considered the facts and concluded that the plaintiff's purpose in bringing the proceedings was not to vindicate his own reputation, but for the "dominant, ulterior and collateral" purpose of investigating the conduct of the Royal Commission and to denigrate the defendant. The defendant was successful in his application to have the discontinuance set aside. The Court then dismissed the proceedings themselves as being an abuse of process.

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16 *Packer v Meagher* [1984] 3 NSWLR 486 (SC).

[42] As can be seen from these examples, misconduct must be plain and obvious before a Court will find that its processes have been abused.

Submissions

[43] Mr Brown QC for the Commissioner acknowledged that whether or not there has been an abuse of process must turn on the circumstances in which the discontinuance was filed, and what the plaintiff was seeking to achieve by the discontinuance.

[44] Mr Brown referred to the fact that Telstra's challenge proceedings were designated by the Commissioner as a test case. While he accepted that that of itself was not a decisive factor, he did suggest that the test case nature of the Telstra challenge proceedings amplified the harm caused by the abuse which he submitted had occurred. He noted that the conduct of the Telstra investigation was a matter not only for the Commissioner and Telstra, but also that it had significant implications, in terms of costs and delay, for the other OCN taxpayers, and for the Court.

[45] The Commissioner's case was prefaced on the fact that Telstra has filed near identical proceedings challenging the Commissioner's assessments for the 2006 to 2008 income tax years. Mr Brown noted that a ruling by the Court in respect of the discontinued proceedings would determine not only those proceedings, but also Telstra's latest challenge. He argued that:

a) Telstra's discontinuance was a strategic decision on its part to gain a litigation advantage and to prejudice the Commissioner and his expert witnesses in terms of costs and delay;

b) Telstra, having had the opportunity of reviewing and considering the Commissioner's evidence, is able to address the shortcomings in its own evidence by issuing new proceedings in an attempt to "have another bite at the same cherry";

c) maintaining the proceedings with the intention of discontinuing prior to trial, and then reissuing a near identical claim shortly thereafter is an abuse of process. He submitted that Telstra never intended to have its substantive dispute adjudicated by the Court, and that this is particularly abusive behaviour given that its proceedings had been designated as a test case; and

d) the Court should take notice of the disruption and inconvenience Telstra has caused to the Court and to other litigants by discontinuing and "re-filing" its proceedings.

[46] Mr Simpson for Telstra argued that Telstra had not used the discontinuance to secure a collateral advantage and that it has not abused the process of the Court. Rather he submitted that Telstra had permanently abandoned its right to challenge the Commissioner's assessment for the 2003 to 2005 income tax years, resulting in the permanent forfeiture of the tax losses incurred in those years and a liability to shortfall penalties. He noted that it did so for sound commercial reasons, namely that it regarded the 2003 to 2005 losses under challenge as having limited economic value relative to the costs of trial, and given that Telstra has other accumulated tax losses. He noted that the test case regime does not abrogate the right of a designated taxpayer to discontinue its tax challenge proceedings. He submitted that the decision to designate Telstra's case as a test case was unilaterally made by the Commissioner, that Telstra did not request that its proceedings be designated as a test case, and that it did not consent to the designation. In relation to the new proceedings, he submitted that they are entirely separate claims relating to the deductibility of separate interest costs incurred in separate years. The discontinued 2003 to 2005 proceedings and the 2006 to 2008 proceedings relate, he said, to different liabilities for tax.

Analysis

[47] In my judgment, the Commissioner's arguments must fail. I am not satisfied on the material before me that the discontinuance filed by Telstra was an abuse of the process of the Court.

[48] There is nothing in the evidence to suggest that Telstra's discontinuance was a strategic decision on its part to gain a litigation advantage. Nor is there anything to suggest that it was seeking to procure a collateral advantage. A comprehensive affidavit was filed by a Mr Smith on Telstra's behalf. It was clear from that affidavit that Telstra's directors decided to discontinue the proceedings, following a comprehensive review conducted in late 2009 and early 2010. Telstra's decision to discontinue the 2003 to 2005 proceedings reflected its conclusion that the financial costs and loss of personnel time that would be incurred in the trial of the proceedings was disproportionate to the economic value of the tax losses at issue, particularly having regard to the existence of other tax losses, including those that had accrued in the subsequent tax years. This evidence was not challenged. Telstra has done no more than make a commercial decision not to incur further costs by proceeding to trial. Litigants frequently discontinue proceedings for that reason. To do so is not an abuse of process.

[49] Nor in my view can it be asserted that Telstra's discontinuance inappropriately prejudices the Commissioner and his expert witnesses in terms of costs and delay. The discontinuance has not put the Commissioner to additional cost and delay in relation to the discontinued proceedings. To the contrary, it has avoided the no doubt significant costs of a three week trial. The Commissioner's expert witnesses will have been inconvenienced, and there will no doubt be further costs and delays in resolving the OCN disputes. I have not seen the evidence. It is however reasonable to infer that the evidence will not be wholly wasted. While it will no doubt require some amendment, the expert evidence adduced by the Commissioner must generally be applicable to the other OCN cases. Otherwise Telstra's proceedings would not have been designated as a test case in the first place.

[50] I accept that the Commissioner has lost the opportunity to obtain a judgment in the proceedings, which, if successful from his perspective, would then have been used to try and settle outstanding disputes with other OCN taxpayers. I also accept that the discontinuance of the proceedings has seriously inconvenienced the Commissioner. Nevertheless, inconvenience does not compel the conclusion that Telstra has abused the process of the Court. The test case regime contained in the Act does not abrogate the right of a designated taxpayer to discontinue its tax

challenge proceedings. The decision to designate challenge proceedings as a test case is a decision made unilaterally by the Commissioner. When a case is designated, neither the Commissioner nor the taxpayer thereby acquires any right to a test case judgment.

[51] Further, under the rules as they stand, it is only a defendant who may seek to set aside a notice of discontinuance, and then only when there is an abuse of process. Other parties directly affected by the filing of a notice of discontinuance — for example, the other OCN taxpayers potentially affected by judgment in the Telstra proceedings which have now been discontinued — have no right to seek to set aside a discontinuance.[17]

[52] Nor is there any substance to the argument that Telstra sought to discontinue the proceedings to obtain the collateral advantage of being able to address shortcomings in its own evidence by issuing new proceedings and giving it another "bite at the cherry". There can be no new proceedings in relation to the 2003 and 2005 income tax years. Telstra's right to challenge the assessment made by the Commissioner for those income tax years is now time-barred. Nor does the available evidence suggest that Telstra was seeking to gain the opportunity to review its own evidence, having received the Commissioner's evidence. Indeed, the facts suggest that this cannot have been a consideration leading to Telstra's decision to discontinue. There is an evidence exclusion rule contained in s 138G of the Act. Once the Commissioner issues a disclosure notice, and the taxpayer challenges the Commissioner's decision, generally the Commissioner and the taxpayer may raise in the challenge only the facts and evidence, the issues arising from them, and the propositions of law that are disclosed in the parties respective statements of position. The Commissioner's evidence could not have been materially different from the evidence contained in the Commissioner's statement of position exchanged with Telstra in January 2008. In any event, at the stage the proceedings were discontinued, Telstra had the right to file evidence in reply. It did not need to discontinue the proceedings to address whatever may have been outstanding —

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17 *Foster Construction & Building Services Ltd (in liquidation) v AAPC New Zealand Pty Ltd* HC Wellington CIV-2004-485-970, 18 February 2005.

assuming that there was something outstanding, and there is nothing in the materials before me to suggest this.

[53] The Commissioner asserts that Telstra maintained the proceedings with the intention of discontinuing prior to trial, and then re-issuing a near identical claim.

[54] There is simply no evidence of this. As I have already noted, Telstra has explained why it discontinued the proceedings in respect of the 2003 to 2005 income tax years. There is nothing to suggest that it maintained the proceedings from some indeterminate time with the intention of subsequently discontinuing them. It prepared for trial by filing its own evidence. It also tried to settle with the Commissioner. It did not discontinue until settlement negotiations failed. It cannot be criticised for doing so.

[55] I do not think that the fact that Telstra has issued proceedings in respect of the income tax years 2006 to 2008 alters the position.

[56] First, Telstra has explained why it has issued separate challenge proceedings in respect of the 2006 and 2008 income tax years. Effectively, it wishes to preserve its position in respect of those years. If it had not issued proceedings in respect of the 2006 to 2008 income tax years, it would have lost the right to dispute the Commissioner's assessments for those years. There is nothing in the evidence to suggest that Telstra does not intend to take the fresh proceedings through to trial if necessary, although naturally it would prefer if the proceedings could be resolved consequent on another OCN taxpayer succeeding in its dispute with the Commissioner. There is nothing improper in that. Moreover, I am concerned with the discontinuance of the 2003 to 2005 proceedings — not with what may or may not happen to the 2006 to 2008 proceedings.

[57] Secondly, and while I agree with Mr Brown that the issues in dispute in the later proceedings were also raised in the discontinued proceedings, as a matter of law the proceedings in relation to the 2006 to 2008 income tax years are separate proceedings, in respect of separate income tax years. A previous decision, relating to

a different year of income, does not determine the tax liability of a taxpayer in respect of later years of income.[18]

[58] Finally, in this regard, I note that r 15.24 of the High Court Rules only prevents a plaintiff who has discontinued a proceeding against a defendant from commencing another proceeding against that defendant arising out of the same or substantially similar facts until the plaintiff has paid any costs ordered against it relating to the first proceeding. If the rules permit a plaintiff to commence fresh proceedings against the same defendant arising out of facts that are the same or substantially the same once costs on the initial discontinuance are paid, it cannot be the case that Telstra has abused the processes of the Court by bringing fresh challenge proceedings against the Commissioner in respect of assessments for different tax years, even if the fresh proceedings do arise out of the same or substantially similar facts.

[59] There is nothing in the evidence to suggest that Telstra's actions in discontinuing the proceedings were anything other than commercially based, and from that perspective rational and bona fide. It was not obliged to maintain its challenge by pursuing the discontinued proceedings to trial for the Commissioner's convenience. In my judgment, Telstra's discontinuance is not an abuse of the process of the Court, and the discontinuance must stand.

[60] I note that Mr Brown did suggest, albeit tentatively, that if the 2006 to 2008 proceedings are resolved in Telstra's favour, either on the Telstra litigation or consequent upon a successful challenge by another OCN taxpayer, the Commissioner may consider that he is obliged to reopen the 2003 to 2005 assessments under s 113 of the Act. Section 113(1) provides as follows:

> **113 Commissioner may at any time amend assessments**
>
> (1) Subject to sections 89N and 113D, the Commissioner may from time to time, and at any time, amend an assessment as the Commissioner

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[18] *Society of Medical Officers of Health v Hope* [1960] AC 551 (HL); *Caffoor v Commissioner of Income Tax, Columbo* [1961] AC 584 (PC); *Orica Ltd v Federal Commissioner of Taxation* (2001) 182 ALR 77 (FCA); rev'd *Commissioner of Taxation v Dulux Holdings Pty Ltd* [2001] FCA 1344 on other grounds; *Spassked Pty Ltd v Commissioner of Taxation* (2008) 245 ALR 350 (FCA).

thinks necessary in order to ensure its correctness, notwithstanding that tax already assessed may have been paid.

...

Mr Simpson for Telstra was adamant that this possibility had not occurred to his client. He assured me that this was not his client's intention, nor its understanding. Mr Simpson has since provided an undertaking to the Court. That undertaking reads as follows:

The plaintiff hereby gives the following undertakings to the Court:

1. The plaintiff undertakes that, should it be allowed to discontinue these two proceedings to challenge the Commissioner's assessments disallowing deductions claimed in its 2003 to 2005 income years and imposing shortfall penalties:

   (a) The plaintiff will not petition the Commissioner to have its 2003 to 2005 income year deductions reinstated and the shortfall penalties revoked under s 113 of the Tax Administration Act 1994; and

   (b) The plaintiff will not seek to judicially review the exercise of the Commissioner's discretion under s 113 of the Tax Administration Act 1994 not to amend or revoke the assessments for the plaintiff's 2003 to 2005 income years.

2. These undertakings are without prejudice to the plaintiff's proceeding under CIV 2010-404-6563 to challenge the Commissioner's assessments disallowing deductions claimed in its 2006 to 2008 income years, or to any similar proceedings issued by the plaintiff in respect of any later income years.

3. These undertakings are also without prejudice to any future proceedings issued by the plaintiff challenging the imposition of shortfall penalties in relation to the 2006 to 2008 income years or to any later income years.

[61] Had leave to discontinue been required, I would have imposed a condition to this effect on Telstra. The fact that Telstra has proffered the undertaking reinforces my view that it has acted appropriately and that it has not sought to abuse the process of the Court.

Costs

[62] By way of an alternative, the Commissioner sought indemnity costs against Telstra.

[63] The starting point is r 15.23. It provides that a plaintiff who discontinues a proceeding against a defendant must pay costs to the defendant of and incidental to the proceeding up to and including the discontinuance. The principles applicable were discussed by the Court of Appeal in *Kroma Colour Prints Ltd v Tridonicatco NZ Ltd*.[19] It was there noted that the general costs discretion contained in r 14.1 can override r 15.23. It was also noted that the Court should not speculate on the merits of a case it has not heard, but that the reasonableness of the stance of the parties can be considered.

[64] Here, I do not speculate on the merits of Telstra's challenge. I have considered the reasonableness of its stance. I note that Telstra endeavoured to negotiate a settlement with the Commissioner in early to mid-2010. It discontinued the proceedings once settlement could not be achieved. I have concluded that the discontinuance was not an abuse of process. Further, in my judgment, Telstra did not, in the circumstances as it saw them, act unreasonably in discontinuing the proceedings.

[65] The Commissioner is entitled to costs on the discontinuance. Normally those costs would be fixed according to scale. While the Court has a discretion to order increased costs or indemnity costs under r 14.6, I cannot see that there is any principled basis on which to order that Telstra should pay indemnity costs. The general rule is that indemnity costs are exceptional, and will only be awarded where a party has behaved badly, very unreasonably, or is guilty of flagrant misconduct.[20]

[66] The Commissioner based his claim on r 14.6(4)(a) and/or (f). He relies in large part on the fact that new proceedings have been issued for the 2006 to 2008 income tax years.

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19 *Kroma Colour Prints Ltd v Tridonicatco NZ Ltd* (2008) 18 PRNZ 973 (CA) at 975.
20 *Bradbury v Westpac Banking Corporation* [2009] 3 NZLR 400 (CA) at [27]–[28].

[67] I cannot see that either subparagraph has any application in the circumstances or that the issue of the new proceedings is relevant. An award of indemnity costs must be confined to costs attributed to unreasonable conduct in the proceedings in which the costs award is made.[21] Further, I have already expressed the view that there is nothing improper in Telstra issuing the new proceedings in relation to the 2006 to 2008 income tax years.

[68] I decline to award the Commissioner costs on an indemnity basis. For much the same reasons I decline to make an award of increased costs.

[69] Telstra is entitled to costs on the Commissioner's unsuccessful application to set aside the discontinuance. The Commissioner is entitled to costs on the proceedings which have been discontinued. Both costs should be calculated by reference to the scales set out in the High Court Rules. I was handed a draft schedule of costs by Mr Palmer for the Commissioner. It is clear that different categories have been applied to different stages in the proceeding. It seems to me that that is appropriate.

[70] Having dealt with the substantive issues between the parties, I will, as requested by Mr Simpson, give the parties the opportunity to resolve costs. The parties are to file a memorandum, within 10 working days of the date of release of this judgment, advising whether or not they have agreed to costs between them. If costs are not agreed, then they are to advise where the disagreements lie, and I will rule on the same.

Need For Reform?

[71] This case has exposed deficiencies in the test case procedure contained in the Tax Administration Act. That procedure is important for the Commissioner. It can save substantial costs and resources and can lead to increased efficiency for both the Commissioner and for taxpayers.

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[21] *Paper Reclaim Limited v Aotearoa International Limited* [2006] 3 NZLR 188 (CA) at [160].

[72] Unfortunately the test case procedure is not backed up by the legislation or by the High Court Rules.

[73] I was advised from the bar that in Australia, there is a test case litigation programme whereby the taxpayer can become eligible for financial assistance for litigation which is likely to develop important legal precedent in the revenue area. I was also told that various interested professional bodies have been advocating for change in the New Zealand test case designation procedure to align it more closely with the procedure in Australia.

[74] The position is exacerbated in this country because there are no rules specific to designated test cases and because of the general provisions contained in the High Court Rules. As was noted by Miller J in *Agrotain International LLC v Fertiliser Quality Council Inc*,[22] the High Court Rules do not recognise that a defendant might acquire an independent right to judgment on a plaintiff's claim. Nor do the rules recognise that there may be a public interest which justifies delivery of judgment.

[75] When challenge proceedings have been designated as a test case, there is clearly a tension between the Commissioner's expectations, which are founded in the public interest, and a taxpayer's rights, which are founded on personal interest. In my view, the legislation and the rules could more helpfully address this tension.

Wylie J

[22] *Agrotain International LLC v Fertiliser Quality Council Inc* HC Wellington CIV-2009-485-1855, 17 December 2009 at [73].