IN THE PRIVY COUNCIL No. 6 of 1975

ON APPEAL

FROM THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN

SIDNEY BOYD ASHTON First Appellant

- and -

JOHN WORRALL WHEELANS Second Appellant

- and -

COMMISSIONER OF INLAND REVENUE Respondent

CASE FOR THE RESPONDENT

1. This is an appeal from a judgment of the Court of Appeal of New Zealand (McCarthy P., Richmond and Speight JJ.) given on 29th May 1974 allowing an appeal from a judgment p.115
of the Supreme Court of New Zealand (Wilson J.) given on 22 September 1972. The judg- p.97
ments in both the Supreme Court and in the Court of Appeal dealt with two separate cases stated by the Respondent pursuant to
10 s.32 of the Land and Income Tax Act 1954 (called "the Act") in respect of separate objections made by each of the Appellants. The facts of each case were in all material respects the same and they were accordingly, by consent, heard together.

2. The question in this appeal is whether the Respondent acted incorrectly in making adjustments to the allocations of partner-
20 ship income between the partners of the partnership known as Ashton Wheelans and Hegan and in making amended assessments

of income tax under the Act in respect of each of the Appellants for the income year ended 31st March 1967.

Cases Stated p.5 11.28-36; p.62 11.3-11 p.4 1.27 pp 6-22 p.61 1.3 pp.23-39

In respect of the Appellant Ashton, the Respondent increased his assessable income by the amount of £NZ2,111.12.2 ($NZ4,223.22) which was the net income of the Ashton Trust for the same income year. In respect of the Appellant Wheelans, the Respondent increased his assessable income by the amount of £NZ2,105.5.1 ($NZ4,210.51) which was the net income of the Wheelans Trust for the same income year.

3. The circumstances giving rise to this question may be broadly stated as follows:

(a) For a number of years up until 31st October 1965, the Appellants had practised in partnership in Christchurch as public accountants under the firm name "Ashton and Wheelans". As from 1st November 1965 one, Regan, an accountant who had been employed by the Appellants for some years, was admitted to partnership and thereafter, at all material times, the Appellants and Regan practised in partnership under the firm name "Ashton Wheelans and Regan". p.101 1.18-21 p.101 1.21-24

(b) At all material times there were four companies namely Cresta Finance Limited (called "Cresta"), Warwick Credits Limited (called "Warwick"), Westburn Investments Limited (called "Westburn") and Worcester Holdings Limited (called "Worcester") carrying on business in Christchurch. (They are hereafter called collectively "the finance companies" or individually "the finance company".) The activities of the finance companies were concerned with the provision of finance for the purchase of motor vehicles on hire purchase terms. The basis on which such business activities were conducted was that the hire purchase agreement was prepared by the p.101 1.26-30 p.102 1.1-6

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motor vehicle dealer (called "the dealer") and executed by the hirer. The dealer then assigned his interest in, and the benefit of, such hire purchase agreement to one of the finance companies. Included in the amount payable under the hire purchase agreement by the hirer was a sum called "office charges". These office charges were attributable largely to the work involved on the part of the dealer in having the hire purchase agreement and the proposal for insurance of the vehicle completed. The office charges received from the finance companies amounted to about $8,000 per year.

p.76 l.15-16; p.91 l.14-16; p.76 l.16-23. p.101 l.43 to p.102 l.10; p.76 l.15-23, l.44-46; p.102 l.1-12. p.102 l.13

(c) For some time prior to 1st November 1965, the finance companies had employed the Appellants to attend to their accounting work. At all material times, both before and after that date, the Appellant Wheelans was secretary of each of the finance companies. Remuneration of the Appellants for this accounting work was in two parts, namely (a) a sum equal to an agreed percentage of the amount of money handled on behalf of the particular finance company (called "the percentage remuneration") and (b) a sum equal to office charges received by the finance company from the hirer. There was considerable competition among companies providing finance for motor vehicle hire purchase transactions and as a result dealers had in some other cases, been able to insist that the office charges be paid to them. It was due to the close association of the Appellants, particularly the Appellant Wheelans, with the dealers who dealt with the finance companies, and the trouble the Appellants went to in ensuring that the dealers were satisfied with arrangements, that the finance companies retained the dealers' business.

p.101 l.39-42. p.101 l.37-39. p.10 l.42 to p.102 l.6; p.91 l.5-12 p.102 l.14-21; p.64 l.19-30 p.102 l.17-21; p.72 l.7-24

(d) When Hegan was negotiating with the Appellants to be admitted to partnership he was unwilling to pay any amount for goodwill in respect of income which might have been expected to accrue to the new partnership from receipt of office charges because he considered that it was insecure and could be lost at any time. It was therefore agreed that goodwill would not be paid for office charges nor would they form part of the income of the new partnership. It was, however, accepted that the accounting work of the finance companies, remunerated by the percentage remuneration, would form part of such income and this was accordingly taken into account in fixing the goodwill figure Hegan paid to the Appellants.

p.102 l.27-34; p.64 l.19-30

p.102 l.35-37

p.75 l.8-19

(e) The Appellants gave evidence that they wished to see that from the commencement of the new partnership, the income represented by office charges would be used for the benefit of their respective families. They accordingly had discussions with one, Heney, a solicitor, with a view to the formation of trusts for the respective benefit of their families to which the office charges, accruing after the formation of the new partnership, could be paid. Pursuant to these discussions, two deeds of trust were completed both dated 26th November 1965. Under one (called "the Ashton Trust") the Appellant Wheelans was named as Settlor and the said Wheelans and one, Beadel (the solicitor then advising the Appellants) were named as Trustees. Under the other Trust (called "the Wheelans Trust") the Appellant Ashton was named as Settlor and the said Ashton and Beadel were named as Trustees.

p.109 l.17-21; p.70 l.8-9

Annexure "A" to Case Stated (Ashton) pp.6-22

Annexure "A1" to Case Stated (Ashton) pp.23-39

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(f) On 26th October 1965, pursuant to resolutions of their directors of 21st October 1965, each of the finance companies, under the hand of the Appellant Wheelans, as secretary, wrote to the Appellants (under their firm name Ashton and Wheelans) withdrawing their instructions to act as public accountants for the finance companies. On the same day, 26th October 1965, each of the finance companies, again under the hand of the Appellant Wheelans, wrote to the Appellants and Beadel, confirming their appointment to act for each such company in the capacity of accountants in such company's business as a finance company in the lending and advancing of money. Each letter specified the remuneration the Appellants and Beadel were to receive as consisting of office charges and a percentage remuneration, and recorded that the finance company had been advised that the Appellants and Beadel intended to delegate their obligations to the company to the firm of Ashton Wheelans and Hegan, that it agreed with such delegation, but that no further delegation was to take place without the prior approval of the company's directors. The letters also pointed out that the appointments were revocable at any time. The suggestion to the directors of the finance companies that the companies' instructions should be transferred in this way came from the Appellant Wheelans. It was recorded by the directors of each of the finance companies that acceptance of the appointment by the Appellants and Beadel to act as accountants to the finance companies was in their capacities as trustees under certain deeds of trust to be produced to the directors.

Exhibit "I" to Wheelan's evidence - pp.83 & 84

Exhibit "H" to Wheelan's evidence - p.83

Annexures "B", "B1", "B2" and "B3" to Case Stated (Ashton pp.40-44)

p.77 1.6-8

Exhibit "I" to Wheelan's evidence - p.84 1.13-18

(g) On 27th October 1965 Saunders, Heney and Beadel (a firm of barristers and solicitors in which Beadel was a partner) under the hand of Beadel wrote on behalf of the Appellants and Beadel, to Ashton, Wheelans and Hegan advising that the Appellants and Beadel had accepted an appointment by the finance companies to carry out their accountancy work in connection with their finance and lending activities. The letter confirmed an earlier verbal request that Ashton, Wheelans and Hegan should act professionally, in the capacity of public accountants, to carry out the accountancy work required by the finance companies. The suggested rates of remuneration to be paid to Ashton, Wheelans and Hegan were the same as the percentage remuneration to be paid by the finance companies to the Appellants and Beadel. The letter also pointed out that the Appellants and Beadel were acting as trustees under certain Deeds of Trust. On 29th October 1965 the firm of Ashton, Wheelans and Hegan wrote in reply to Saunders, Heney and Beadel accepting the appointment at the rates of remuneration set out in Saunders Heney and Beadel's letter.

Annexure "C" to Case Stated pp.45-46

Annexure "C1" to Case Stated - pp.46-47

(h) Thereafter separate bank accounts were opened for each Trust at the Australia and New Zealand Bank Limited. The bank account for the Ashton Trust was operated by the Appellant Wheelans and Beadel. The bank account for the Wheelans Trust was operated by the Appellant Ashton and Beadel. Remuneration payable to each Trust (called "commissions received" in the statements of account for each Trust) was paid each month by one cheque drawn by each finance company in favour of the Appellants and Beadel. One half of the amount of each such cheque was paid to the bank account of the Ashton Trust and the other half to the bank account of the Wheelans Trust. The Trustees

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of each Trust then drew a cheque in favour of Ashton, Wheelans and Hegan equal to one half of the amount owing to Ashton, Wheelans and Hegan in terms of the letter of appointment dated 27th October 1965, i.e. one half of the percentage remuneration for the month in question. p.71 l.18-39; p.106 l.28-40

(i) The principal source of income of the two Trusts for the income year ended 31st March 1967 was the "commissions received" from the finance companies. After deduction of accountancy charges paid to Ashton, Wheelans and Hegan, there remained in each Trust a surplus of a little over £2,000 which was credited to the respective Profit and Loss Appropriation Accounts. In the case of the Wheelans Trust, £705.5.1 was accumulated and added to the capital of the trust fund, £200 was paid to the Appellant Wheelans' wife, and the balance £1,200 was appropriated equally between the Appellant Wheelans' four children. The Balance Sheet shows that of the sum of £300 appropriated to each of such children, £275 of each such sum was paid to the Appellant Wheelans. He used the total sum of £1,100 thus received, to meet part of the cost of purchasing a bigger family home. A similar pattern was followed in the case of the Ashton Trust. A total sum of £1,150 was paid to the Appellant Ashton. He used it to purchase land and build a family home. The house was owned by him and his wife. Annexures "E" & "F" to Case Stated p.49 p.51 p.52 p.73 l.36-46 Balance Sheet - Ashton Trust p.50.

(j) By June 1972 Cresta and Worcester had ceased business. Westburn and Warwick were still carrying on business and the Appellants and Beadel were still acting as accountants for them. At this time the Broadlands Dominion Group Limited (called "Broadlands") purchased the whole of the capital and shareholders funds of Westburn and Warwick. It also purchased for p.81 l.44-p.82 l.3. p.74 l.24-25

p.107 l.31-40; p.79 l.15-20; Exhibit "L" pp.87-88. p.79 l.21-24; p.80 l.10-18 p.107 l.40-43

$40,000 the goodwill of the accounting business carried on by the Appellants and Beadel as trustees of the Ashton Trust and the Wheelans Trust. Evidence was given by the Appellant Wheelans, that Broadlands paid the $40,000 for the goodwill he and the Appellant Ashton had with the dealers. The $40,000 was treated by the Appellants and Beadel as the property of both Trusts, one half being allocated to each.

p.43 p.3 l.21-34; p.59 l.45 - p.60 l.6

4. The return of income furnished by the partnership of Ashton, Wheeland and Hegan for the income year ended 31st March 1967 (based on the balance sheet and profit and loss account of the partnership) showed assessable income of the Appellant Ashton as £3,659.18.11 and of the Appellant Wheelans as £3,659.18.10.

p.49 p.51

5. The return of income furnished by the Ashton Trust showed the assessable income of the Trust for the income year ended 31st March 1967 as £2,111.12.2. The return of income furnished by the Wheelans Trust showed the assessable income of the Trust for that income year as £2,105.5.1.

p.4 l.9-29 p.60 l.28 - p.61 l.4 p.4 l.30-38; p.61 l.5-13

6. The Respondent considered that transactions between the respective Trustees of the said Trusts and the Appellants were void by virtue of the provisions of s.108 of the Act. He accordingly adjusted the income returned by Ashton, Wheelans and Hegan (a) by adding to that allocated to the Appellant Ashton the net income of the Ashton Trust and (b) by adding to that allocated to the Appellant Wheelans the net income of the Wheelans Trust. He then made amended assessments of income tax payable by each of the Appellants.

7. Section 108 (in the form in force during the income year ended 31st March 1967) provided as follows:

108. Agreements purporting to alter incidence of taxation to be void - Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax.

8. At the hearing of the Cases Stated in the Supreme Court of New Zealand, Wilson J. heard evidence from each of the Appellants and from Hegan. He also had before him the documentary evidence set forth on pages 6 to 57 and 83 to 88 of the Record. In giving reasons for his judgment, he held that no part of the income from the respective Trusts was properly assessable as income of the respective Appellants and that accordingly the Respondent had acted incorrectly in making the amended assessments. p.90 l.18-25

9. In his reasons for judgment, after summarising the facts, Wilson J. dealt first with the question as to whether or not s.108 of the Act applied in the circumstances. He decided that, although the course followed by the Appellants was novel, it was an "ordinary family dealing" as those words were used by Lord Denning in Newton v. Federal Commissioner of Taxation [1958] A.C. 450 at p.466. He considered that "ordinary family dealing" meant "no more than dealing in such a way as the ordinary person faced with the circumstances as faced the taxpayer would have acted had he not been seeking to evade liability for tax". He thought that although the transactions in question could not be classed as ordinary business dealings, he could predicate that what was done was to ensure that the income became that of the Trusts and was not referrable in any significant degree to any desire on the part of the Appellants to avoid tax. p.93 l.27 to p.94 l.18

10. Wilson J. considered that his finding that s.108 did not apply in the circumstances really concluded the matter, but he went on to consider the consequences of its application to the transactions in question, in case he was wrong in holding that the section did not apply. He referred to the Respondent's submission that the following transactions were avoided, namely

(a) the Trusts

(b) the appointment by the finance companies of the Trustees of each Trust as accountants for the finance companies

(c) the appointment by the Trustees of Ashton, Wheelans and Hegan to carry out accounting duties for the finance companies.

p.94 l.27-35

He considered that if the Trusts were annihilated the position would be that the finance companies paid the money to the Trustees who, having received it in a capacity which no longer existed, held it on a resulting trust in favour of the finance companies not the Appellants. The learned Judge also considered an alternative submission of the Respondent that upon annihilation of the transactions, a situation was disclosed under which the Appellants had given consideration for the receipt of the money, because they had been active in ensuring the continuity of the business which the finance companies received from the dealers. He considered that some question of quantum meruit might then arise but thought as the money had been paid to the Appellants and Beadel it did not become the income of either of the Appellants. He pointed out that there was no evidence of consideration given by either of the Appellants other than the consideration mentioned in the documents. He also considered the evidence that a portion of the income from each family trust was paid to the respective Appellant concerned, but concluded that such payment did not constitute such income, the income of the Appellant concerned.

p.94 l.39 to p.95 l.7

p.95 l.8-17

p.95 l.17-24

p.95 l.45 to p.96 l.27

11. The reasons for the judgment of the Court of Appeal of New Zealand were given by McCarthy P. After stating the facts in some detail he stated the Court's stated conclusions as follows:

(a) If the letters of appointment of Ashton, Wheelans and Beadel were read on their own (containing as they did, no reference to the three men acting as trustees) no question as to the application of s.108 would arise because the moneys would be received in their personal capacities in return, presumably, for their personal exertions. In their hands it would be derived income. As Beadel acted as solicitor or agent for the Appellants, the Respondent could invoke the agency sections of the Act. McCarthy P. then referred to the fact that the Respondent had accepted in the Cases Stated that the Appellants and Beadel had been appointed in their capacities as Trustees of the Trusts. p.108 l.18 -35 p.108 l.36 to p.109 l.7

(b) Had it not been for the oral evidence given by the Appellants, Wilson J. would probably have held that the facts were sufficiently indicative that the principal purpose of the arrangement was the altering of the incidence of tax or relieving the objectors from liability to pay tax. However, in the Court's view it was plainly established by the authorities that the test to be applied in relation to s.108 was an objective one and it referred to the well-known passage from Lord Denning's speech in Newton's case ([1958] A.C.450 at p.465). Purposes must be determined by what the transaction effects. Motive is irrelevant. It did accept, without deciding, that it is permissible for the Court to recognise the background to the scheme, while still accepting the test laid down in Newton's case, namely, that the question to be decided was whether it can be predicated from the way the transaction was implemented that it was entered into for the purpose of avoiding tax. p.109 l.8-17 p.109 l.26 to p.110 l.13 p.110 l.37 to p.111 l.6

(c) That there were broadly three divisions of cases arising under s.108 namely:

(i) Where it cannot be predicated on the stated test that the sole purpose, or at least the principal purpose, was to avoid tax - in such case the Respondent fails.

p.111 l.7-14

(ii) Where the taxpayer merely exercised a right to choose, within the range of ordinary family or business dealings, a method of carrying out the arrangement which was most favourable to him from a taxation point of view - in such case the Respondent also fails.

p.111 l.15-21

(iii) Where the overt acts enable it to be predicated, that though the taxpayer may have other concurrent objectives, the principal purpose for carrying out the transaction in the way it was carried out was to avoid tax - in such case the Respondent succeeds.

p.111 l.21-29

(d) The Court then held that s.108 applied and that Wilson J. was wrong in holding to the contrary. In arriving at its conclusion it mentioned in particular the following matters:

p.111 l.30-31
p.113 l.3-4

(i) The transaction was a highly artificial one.

p.111 l.32

(ii) The exclusion of office charges from Hegan's share of partnership income could have been effected more simply by a specific term of the partnership.

p.111 l.33-38

(iii) That in seeking to emphasise the reasonableness of the arrangement, having regard to the Appellants' desire to make provision for their families after death, counsel for

the Appellants failed to recognise sufficiently that the Appellants were not elderly men, that the contracts with the finance companies could come to an end at any time and that the arrangement was to operate on immediate income and not merely in respect of office charges received after the death of one of them. p.112 l.4-25

(iv) That when the steps by which the transaction was implemented are seen in their totality, it is not possible to describe such transaction as an ordinary family or business dealing. p.112 l.37-45

(e) The Court then considered the question of the effect of the application of s.108. It held that the crucial documents were the Deeds of Trust, the revocation of the appointment of the firm of Ashton and Wheelans by the finance companies and the new appointments by the finance companies. If these were eliminated, the Court said, the income received by the Appellants and Beadel (as their solicitor or agent) must be treated as income derived by them. p.113 l.5-6 p.113 l.6-9 p.113 l.9-14

(f) It then considered the submission of the Appellants that the Trusts and the revocation of the appointment of Ashton and Wheelans could not be set aside because the Appellants were not parties in the strict sense, to such transactions. It referred to the judgments of Turner J. in Wisheart MacNab and Kidd v. Commissioner of Inland Revenue [1972] N.Z.L.R.319 and of the Chief Justice in Udy v. Commissioner of Inland Revenue [1972] N.Z.L.R. 714 but agreed with that of the Chief Justice. There was no reason, it considered, to restrict the operation of the section to documents p.113 l.14-25

to which the taxpayer was a party, if it can be shown that the document was procured by or with the connivance of the taxpayer, and as a part in the whole scheme. The two Trust Deeds in question were within that test.

p.113 l.25 to p.114 l.3

(g) It then considered a further argument by counsel for the Appellants, that the revocations and new appointments were in the same class as the grant of the insurance agency in Wisheart's case (supra) where it was plain that the insurance company concerned was not implicated in any scheme to avoid tax and was free to grant its agencies where it wished. The Court pointed out that the facts in the case before it were very different, in that there was such an interdependence between these two documents and the other steps in the transaction, and the Appellants were so clearly in a position to procure and did procure the steps which were taken, that it would be unreal to see such documents as anything but the pieces in a scheme, worked out and put into operation by the Appellants.

p.114 l.4-15

p.114 l.15-25

12. The Court of Appeal accordingly allowed the appeals by the Respondent and upheld the assessments he had made in respect of each Appellant.

p.114 l.28-30

13. The Respondent submits:

(i) that there was an arrangement which was entered into by the Appellants and others;

(ii) that the arrangement had or purported to have the purpose or effect of altering the incidence of income tax payable by the Appellants or relieving them from their respective liabilities to pay income tax;

(iii) that the provisions of section 108 of the Act accordingly apply and so much of such arrangement as effects an alteration of the incidence of income tax payable by the Appellants or relieves them from liability to pay income tax, is void;

(iv) that in the factual situation remaining after those parts of the arrangement referred to above had been avoided the Appellants derived the additional assessable income on which they were assessed.

14. As to the first submission (i) in para. 13 hereof; the Respondent submits that the arrangement which was entered into by the Appellants and others involved the withdrawal of the finance companies' instructions to the Appellants to act as public accountants, the appointment of the Appellants and Beadel to act as accountants to the finance companies, the appointment of Ashton, Wheelans and Hegan to carry out accounting work for the Appellants and Beadel, the establishment of the Ashton Trust and the Wheelans Trust and the continuation of the close business relationship between the Appellants (particularly the Appellant Wheelans) the dealers and the finance companies. It included the following documents namely, the letters withdrawing the Appellants' instructions to act for the finance

companies, the letters from the finance companies appointing the Appellants and Beadel to act as accountants for the finance companies, the letter from Saunders, Heney and Beadel on behalf of the Appellants and Beadel requesting Ashton, Wheelans and Hegan to carry out accounting work on behalf of the Appellants and Beadel, the letter from Ashton, Wheelans and Hegan accepting such appointment and the two deeds of Trust.

15. As to the second submission (ii) in para. 13 hereof; the Respondent submits that the arrangement entered into by the Appellants is not capable of explanation as an ordinary business or family dealing without necessarily being labelled as a means to alter the incidence of income tax or relieve from liability to pay income tax when regard is had, inter alia, to the following matters:

(a) the highly artificial way in which the transaction was implemented;

(b) the transaction had complete business unreality;

(c) the arrangement affected immediate income only and there was no certainty that it would continue for any specific period nor, in particular, after the death of either Appellant;

(d) there was no transfer of any income producing asset to either the Ashton Trust or the Wheelans Trust which would provide an assured income for the beneficiaries of such Trusts;

(e) a substantial portion of the income received by each Trust was promptly distributed so as to result in an immediate benefit to the Appellants.

16. As to the third submission (iii) in para. 13 hereof; the Respondent submits that:

(a) The effect of the application of section 108 to the arrangement is that the following transactions are void for income tax purposes:

(i) the Ashton Trust;

(ii) the Wheelans Trust;

(iii) the withdrawal of the Appellants' instructions to act as accountants to the finance companies;

(iv) the appointment of the Appellants and Beadel to act as accountants to the finance companies.

(b) That this is so notwithstanding that neither Appellant was in the strict sense a party to the Trust created for the benefit of his wife and family; and further that neither Appellant was a party in a strict sense to either the revocation of the old appointments or the giving of the new ones for the reason that all the transactions were steps in the whole scheme which were either procured or connived at, by the Appellants.

17. As to the fourth submission (iv) in para. 13 hereof; the Respondent submits that the two Trusts, the revocation of the old appointment and the giving of the new appointment being void, there remained a factual situation in which the Appellants received remuneration for services rendered by them to the finance companies and accordingly derived the additional assessable income.

18. The Respondent contends that this appeal should be dismissed with costs for the following among other

R E A S O N S

(1) That an arrangement was entered into between the Appellants and others.

(2) That the arrangement had or purported to have a purpose or an effect of altering the incidence of income tax or relieving the Appellants from their respective liabilities to pay income tax.

(3) That the facts exposed after stripping away so much of the arrangement as gave effect to that purpose or effect attracted the application, inter alia, of ss.77, 78 and 92 of the Act resulting in the derivation by the Appellants of the additional assessable income on which they were assessed.

(4) That the decision of the Court of Appeal in New Zealand was correct.

R.C. SAVAGE

H.E. BLANK