Privy Council Appeal No. 6 of 1975

Sidney Boyd Ashton and another - - - - - *Appellants*

v.

Commissioner of Inland Revenue - - - - - *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 9TH JULY 1975

Present at the Hearing:
LORD DIPLOCK
LORD MORRIS OF BORTH-Y-GEST
VISCOUNT DILHORNE
LORD KILBRANDON
LORD SALMON

[*Delivered by* VISCOUNT DILHORNE]

The Appellants before 1965 carried on business in partnership at Christchurch, New Zealand, as public accountants. At all material times the Appellant Wheelans was secretary of four finance companies which were concerned with the provision of finance for the purchase of motor vehicles on hire purchase. The dealer who sold the car assigned his interest in and the benefit of the hire purchase agreement to one of the finance companies. Included in the sum the hirer agreed to pay under the hire purchase agreement were what is called "office charges", a sum attributed to payment for the work involved in completing the hire purchase arrangements and in securing insurance for the vehicle.

The finance companies employed the Appellants to attend to all their accounting work. For that they were paid a percentage of the money handled for each finance company, and a sum equal to the office charges received by the finance company. The office charges amounted to some $8,000 a year.

In about October, 1965, the Appellants decided to take an employee of theirs, a Mr. Hegan, into partnership with them. He was required to make a payment to them for goodwill, but he was not willing to pay any sum for goodwill in respect of the office charges for he regarded that source of income as precarious. There was competition between finance companies to secure business from dealers and there was a growing practice of dealers taking advantage of this to retain the office charges for themselves.

There appears to be no reason why on the formation of the new partnership it should not have been agreed between the three partners that the office charges should be divisible between the Appellants and that Mr. Hegan should have no share in them.

Earlier in the year the Appellant Ashton had had a serious illness. The Appellants, differing from Mr. Hegan, regarded the office charges as a valuable source of income and they were concerned to see that on the death of one of them his share of the income would go to his family. Again, one would have thought that this could have been secured by agreement between the two Appellants that the survivor of them so long as he received the office charges would pay half of them to his deceased partner's family.

No such simple agreements were, however, entered into. Instead a much more complicated arrangement was made which took effect during the lifetime of the Appellants. The old partnership between them was dissolved and on the 21st October, 1965, each finance company passed a resolution withdrawing the Appellants' appointment as public accountants and recording that in their place the Appellants and a Mr. Beadel should be asked to undertake from the 1st November, 1965, the same work as that previously done by the Appellants. Mr. Beadel is a solicitor and a member of the firm of Saunders, Heney and Beadel. He acted for the Appellants and was instructed in relation to most, if not all, of the events with which this appeal is concerned.

The Appellants and Mr. Beadel were to be paid " all office charges " in addition to remuneration on a percentage basis and the resolution passed by each company contained the following:

> " THE Directors record their understanding that Messrs. Ashton, Wheelans and Beadel have agreed to accept the above appointment in their respective capacities as trustees under certain trust deeds which are to be produced to the Directors AND FURTHER that although Messrs. Ashton, Wheelans and Beadel shall be personally responsible to the Company for the carrying out of the work undertaken by them, it is their intention to delegate all such work to Messrs. Ashton, Wheelans and Hegan . . . . AND the Directors do accordingly RESOLVE to confirm such delegation of duties to Messrs. Ashton, Wheelans and Hegan ".

On the 26th October, 1965, the Appellant Wheelans, in his capacity of secretary to each company, wrote to the Appellants terminating their employment as public accountants, and wrote to the Appellants and Mr. Beadel in accordance with the terms of the resolution referred to above.

Two deeds of trust each dated the 26th November, 1965, were entered into. In one the Appellant Ashton was the settlor and he and Mr. Beadel were the trustees. The deed recited that that Appellant was desirous of making provision for Mrs. Wheelans and Mr. Wheelans' children. The amount settled was £1 and it was agreed that that sum together with any other property which might thereafter be paid to the trustees should be held on the trusts contained in the deed. In the other deed the Appellant Wheelans was the settlor and he and Mr. Beadel were the trustees. That deed recited that the Appellant Wheelans was desirous of making provision for Mrs. Ashton and Mr. Ashton's children, and again the amount settled was £1 and it was agreed that that sum together with any other property paid to the trustees should be held on the trusts contained in the deed.

On the 27th October, 1965, Messrs. Saunders, Heney and Beadel, the solicitors acting for the Appellants and Mr. Beadel, wrote to the Appellants and Mr. Hegan instructing them " to act professionally in the capacity of Public Accountants for our clients in carrying out the work required by these " four finance " Companies ". For their services the new

partnership of the Appellants and Mr. Hegan were to be paid a percentage but not the office charges. These were to be retained by the Appellants and Mr. Beadel in their capacity of trustees.

After the completion of these arrangements each finance company sent a cheque monthly to the Appellants and Mr. Beadel for the remuneration on a percentage basis and the office charges. The amount received was divided in half, half being paid into the bank account for the Wheelans family trust and half into that of the Ashton family trust. Then out of each bank account would be paid to the Appellants and Mr. Hegan the amount which represented the remuneration on a percentage basis.

A very considerable amount of the money paid into the trust bank accounts ultimately found its way into the pockets of the Appellants. In 1967 of the monies retained by the Wheelans trust after payment of the remuneration to the Appellants and Mr. Hegan, £705. 5s. 1d. was accumulated and added to the capital of the trust, £200 was paid to Mrs. Wheelans and £1,200 appropriated equally between the four Wheelans' children of which £1,100 was paid into the Appellant Wheelans' bank account and used by him mostly towards the purchase of a bigger home for his family. He said he also used the money for his children's maintenance and support. The funds in the Ashton family trust were disposed of in the same fashion, £200 was paid to Mrs. Ashton and £1,170 appropriated equally between their three daughters of which over £1,000 was paid to the Appellant Ashton and used by him to send a child to a private school and in buying land in his wife's and his name for a family home.

In their return of income for the year ended 31st March, 1967, the new partnership of the Appellants and Mr. Hegan returned their income as amounting to £10,479. 16s. 8d. of which the share of the Appellant Ashton was £3,659. 18s. 11d. and the Appellant Wheelans £3,659. 18s. 10d. The income of the Ashton trust returned by the Appellant Wheelans as trustee was £2,111. 12s. 2d. and that of the Wheelans trust returned by the Appellant Ashton as trustee was £2,105. 5s. 1d.

As the Respondent considered the arrangements made for the payment of the office charges void by virtue of section 108 of the Land and Income Tax Act 1954, he, in effect, added to the income returned by the Appellant Wheelans the income of the Wheelans family trust, that is to say, £2,105. 5s. 1d. and to that of the Appellant Ashton the income of the Ashton trust, namely, £2,111. 12s. 2d., and assessed them accordingly. Ordinary income tax in New Zealand is imposed at a progressively increasing rate. The arrangements made, if effective, would result in a saving of tax for each of the Appellants.

Section 108 is in the following terms:

> " 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 ".

The Appellants objected to the increased assessments. The Respondent disallowed their objections and stated cases. The two cases were heard together by Wilson J. who heard evidence from Mr. Hegan and the Appellants.

The Appellant Wheelans testified that the purpose for which the trusts were created was to secure that in the event of his death his share of the office charges should be received by his family. The Appellant Ashton

confirmed this. The arrangements made were, of course, to operate immediately.

Wilson J. came to the conclusion that the purpose stated by the Appellant Wheelans was " perfectly reasonable " and " justified what was done without any thought of the tax consequences ". He did not regard the transactions as " ordinary business transactions " but as " ordinary family dealing " although he recognised that the Appellants were conscious that a tax saving would be involved. He said that having heard them he was satisfied that " the predominant purpose of the arrangement was to provide security for their families ". He therefore held that section 108 did not apply.

In the Court of Appeal McCarthy P. delivering the judgment of the Court said that they thought Wilson J. would probably have thought that the facts were sufficiently indicative of a principal purpose of altering the incidence of tax or of relieving the Appellants from liability to pay tax had it not been for the oral evidence of the Appellants. That Court held that the test to be applied in relation to section 108 was objective and that the purpose of an arrangement must be determined by what the transaction effects. " Motive " McCarthy P. said was irrelevant.

The first issue to be determined in this appeal is which view is correct. In their Lordships' opinion it is that expressed by McCarthy P.

A contract, agreement or arrangement to which section 108 applies may be wholly in writing, partly in writing and partly oral or wholly oral. When it appears that any part of it was oral, evidence is properly admissible to determine its terms, and when such evidence is given, it may not be easy to separate evidence relating to the terms of the contract, agreement or arrangement from evidence as to the purpose of the parties to it but it does not follow that their evidence as to their purpose is relevant to the question whether section 108 does or does not apply. In *Newton v. Commissioner of Taxation of the Commonwealth of Australia* [1958] A.C. 450 the Privy Council had to consider section 260 of the Commonwealth of Australia Income Tax and Social Services Contribution Assessment Act 1936–1961, a section very similar to section 108. In that case Lord Denning delivering the judgment of the Board said at p. 465:

> " The word ' purpose ' means, not motive but the effect which it is sought to achieve—the end in view. The word ' effect ' means the end accomplished or achieved. The whole set of words denotes concerted action to an end—the end of avoiding tax."

and

> " . . . . the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only with the means which they employ to do it. It affects every ' contract, agreement or arrangement ' (which their Lordships will henceforward refer to compendiously as ' arrangement ') which has the purpose or effect of avoiding tax. In applying the section you must, by the very words of it, look at the arrangement *itself* and see which is *its* effect—which *it* does—irrespective of the motives of the persons who made it. Williams J. put it well when he said: ' The purpose of a contract, agreement or arrangement must be what *it* is intended to effect and that intention must be ascertained from its terms. Those terms may be oral or written or may have to be inferred from the circumstances but, when they have been ascertained, their purpose must be what they effect '."

These observations of Lord Denning in relation to section 260 of the Australian Act are equally applicable to section 108. The passage he cited

from the judgment of Williams J. in *Newton* in the High Court of Australia (1956–57) 96 C.L.R. 578 at p.630 was preceded by the following:

> " During the argument of the present appeals the meaning of the words ' purpose or effect ' received considerable discussion. These words are in the alternative but they do not appear to me to have any real difference in meaning ".

Their Lordships agree. If an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose and oral evidence to show that it has a different purpose or different effect to that which is shown by the arrangement itself is irrelevant to the determination of the question whether the arrangement 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.

Lord Denning added:

> " In order to bring the arrangement within the section you must be able to predicate—by looking at the overt acts by which it was implemented—that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section ".

If Lord Denning meant that one can derive guidance as to the purpose or effect of the arrangement from the conduct of the parties after it has been made their Lordships cannot agree. In *James Miller & Partners Ltd. v. Whitworth Street Estates* [1970] A.C. 583 the House of Lords held that in construing a contract, to ascertain the intention of the parties it was not proper to have regard to their conduct after the contract had been made, Lord Reid saying (at p. 603):

> " I must say that I had thought that it is now well settled that it is not legitimate to use as an aid in the construction of the contract anything which the parties said or did after it was made ".

Whether the purpose or effect of the arrangement was that stated in section 108 must in their Lordships' opinion be determined only by reference to the arrangement and not by reference to the parties' subsequent conduct.

Section 260 provided that:

> " Every contract, agreement or arrangement . . . . . shall so far as it has or purports to have the purpose or effect of . . . . .".

Lord Denning in *Newton* at p. 467 said that it seemed to their Lordships that the inclusion of the words " so far as " showed that tax avoidance need not be the sole purpose. Section 108 also contains the words " so far as " and Mr. Richardson in opening this appeal said that he would not dispute that one of the purposes and effects of the arrangement made by the Appellants was to avoid the incidence of tax. If that was, as in their Lordships' view it clearly was, one purpose and one effect of the arrangement, it matters not what other purposes or effects it might have; section 108 applies. In their Lordships' opinion the arrangements made by the Appellant must, to apply Lord Denning's words, necessarily be labelled as a means to avoid tax and cannot properly be regarded as " ordinary business or family dealing ". An arrangement which can properly be regarded as an ordinary business or family dealing is not to be regarded as entered into for the purpose or to have the effect of tax

avoidance even though that ordinary dealing may result in less tax being paid than would otherwise be exigible. Tax avoidance is not the purpose of such a transaction (see *per* Lord Donovan in *Mangin v. I.R.C.* [1971] A.C. 739 at p. 751). For these reasons in their Lordships' opinion the Respondent's contention that section 108 applied in this case must be upheld.

That section provided that a contract, agreement or arrangement to which the section applies is to be "absolutely void". The Respondent contended that section 108 rendered absolutely void the withdrawal of the Appellants' instructions to act as accountants to the finance companies, the appointment of the Appellants and Mr. Beadel to act as accountants to the finance companies and the two trust deeds creating the Ashton's and Wheelans' trusts. In their Lordships' opinion this contention is clearly right. The two trust deeds were an essential element in the tax avoidance arrangement; so was the withdrawal of the instructions to the Appellants and the appointment of the Appellants and Mr. Beadel to act as accountants.

In *Mangin v. I.R.C.* (*supra*) Lord Donovan at p. 749 drew attention to the failure of section 108 to provide for what is to happen when an arrangement has to be treated as absolutely void and to the omission to provide that the taxpayer is to be deemed to have derived the income which he would have derived but for the contract, agreement or arrangement avoided by the section.

If the withdrawal of the instructions to the Appellants to act as accountants is treated as avoided, the consequence is that the instructions which that withdrawal purported to cancel are left in force. A somewhat similar problem arose in *Peate v. Commissioner of Taxation* [1967] 1 A.C. 308 where it was held that an agreement to dissolve a partnership being avoided, the Commissioner was entitled to treat the partnership as continuing (see pp. 331–332). The "office charges" continued to be received by the Appellants though they were paid to the Appellants and Mr. Beadel. It is not suggested that Mr. Beadel had played any part in earning them.

Section 77 (2) (*a*) of the Land and Income Tax Act 1954 provides that:

> "Income tax shall be payable by every person . . . . on all income derived by him during the year . . ."

The question therefore to be determined is: were the amounts by which the Commissioner increased the assessments on the Appellants' income derived by them?

While section 108 does not enable income not in fact derived to be deemed to have been derived, in this case no deeming arises. The office charges were in fact received by the Appellants and it matters not if the cheques by which they were paid were made out in favour of the Appellants with Mr. Beadel's name added.

In *Mangin v. I.R.C.* (*supra*) Lord Donovan said at p. 749:

> "The appellant here did derive the income. He sold the crop and received the proceeds. True, he then had to account for them to the trustees. But if this obligation has to be regarded as void under section 108, and the trusts non-existent, then one is left with the appellant receiving the income and accountable to nobody for it."

So here it was the efforts of the Appellants which entitled them to the office charges. They received them and as the trusts are to be regarded

as never having existed, one is left with the Appellants receiving the income and accountable to nobody for it. The income was thus derived by them.

In the circumstances their Lordships will humbly advise Her Majesty that this appeal should be dismissed and that the Appellants should be ordered to pay the Respondent's costs.

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In the Privy Council

SIDNEY BOYD ASHTON AND ANOTHER

v.

COMMISSIONER OF INLAND REVENUE

DELIVERED BY
VISCOUNT DILHORNE

Printed by HER MAJESTY'S STATIONERY OFFICE
1975