

UNIVERSITY OF LONDON
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 LEGAL STUDIES
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 25 RUSSELL SQUARE
 LONDON W.C.1

IN THE PRIVY COUNCIL

No. 3 of 1970

O N A P P E A L

FROM THE COURT OF APPEAL OF NEW ZEALAND

B E T W E E N

OWEN THOMAS MANGIN

Appellant

- and -

THE COMMISSIONER OF INLAND REVENUE Respondent

CASE FOR THE RESPONDENT

- 10 1. This is an appeal from a judgment of the Court of Appeal of New Zealand (North P., Turner and McCarthy JJ.) given on 26 August 1969, allowing an appeal from a judgment of the Supreme Court of New Zealand (Wilson J.) given on 4 February 1969. p. 77
p. 55
- 20 2. The question in this appeal is whether the Respondent acted incorrectly in making amended assessments of income tax under the Land and Income Tax Act 1954 in respect of the Appellant for the income years ended 31 March 1966 and 31 March 1967 by increasing his assessable income for those years by the amounts of £739.11.3. and £631. 0.10 respectively, which sums were the net proceeds of certain farming operations carried out on land owned by the Appellant. p.6,L.5-9
p.3.L.26 -
p.4,L.5
- 30 3. The circumstances giving rise to this question may be broadly outlined as follows. For some years prior to the income years in question the Appellant had carried on the business of farming on land he owned at Methven. The farm was 385 acres and the type of farming was sheep-farming and mixed cropping with an emphasis on cropping. Early in 1965 the p.47,L.9-11

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p.47,L.11-31	Appellant sought the advice of his accountant and solicitor as to whether anything could be done to reduce his burden of income tax. He was told that "a simple paddock trust" would fill his needs. The essence of the arrangement	
p.55,L.13-18	was to set up a family trust and each year to lease to the trustees a paddock intended to be used for cropping. Under this arrangement the Appellant was to be and was in fact paid for the work involved in preparing the ground and sowing and harvesting the crop and rent for the land itself out of the proceeds of sale. The trustees ran virtually no risk. They were not called on to provide any capital. There was a Government guaranteed price for wheat and the only risk they ran was that the crop might fail which was itself a very unlikely happening.	10
p.71,L.24-35		
p.53,L.40 - p.54,L.10 p.71,L.47 - p.72,L.9		
	4. In accordance with the plan the following transactions were put in train:	
Annexure A to Case Stated pp.6-15	(1) The father of the Appellant by deed dated 15 April 1965 created a trust for the benefit of the Appellant's children. The trustees were the Appellant's wife and Pyne Gould Guinness Ltd., a trustee company.	20
Annexure B to Case Stated pp.16-18	(2) On the same day the Appellant and the trustees entered into an agreement to lease under which the Appellant agreed to lease to the trustees a paddock of about 25 acres on the Appellant's farm for a term of one year at a rental of £3 per acre payable on the last day of the term of the lease.	30
p.48,L.49- p.49,L.1 p.49,L.1 - p.49,L.12	(3) The Appellant had prior to 15 April 1965 started preparing the paddock in question for growing wheat. After the lease was executed, he prepared it further for cultivation and sowed it in wheat.	
p.48,L.34-43	(4) It was decided that the trust was not satisfactory in that the Appellant's wife was not a beneficiary. By deed dated 20 August 1965 a new trust was created by the father of the Appellant for the benefit of the wife and children of the Appellant and for a longer term than the original trust.	40
Annexure C to Case Stated pp.19-29		

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- (5) By deed dated 30 August 1965 the trustees of the original trust (called the Mangin Family Trust) assigned to the trustees of the new trust (called the O. T. Mangin Trust) the residue of the term of the lease of the paddock. The original trust was then wound up. Annexure D to Case Stated p.30 Annexure E to Case Stated p.31; p.55,L.40-44
- 10 (6) The Appellant harvested and sold the crop early in 1966. The Appellants received and banked a cheque from the merchants, which included the amount due for the crop from the paddock leased to the trustees as well as an amount due to the Appellant personally. He paid the trustees by cheque the full amount received for the paddock crop (£1147. 8. 7) and subsequently received payment from the trustees for the amount due to him for rent, seed and other expenses and contracting charges (£401.11.4.). p.49L.9-14 p.50,L.38 - p.51,L.4 p.80 p.51,L.4-6 p.49,L.15-49
- 20 5. A similar pattern was adopted the following year :
- (1) An agreement to lease dated 16 May 1966 was entered into again for a period of one year but relating to a different paddock of about 24 acres and at a rental of £4 per acre payable on the last day of that term of the lease. Annexure F to Case Stated pp. 32-34
- 30 (2) The Appellant cultivated the paddock, sowed it in wheat, and harvested and sold the crop. The cheque for the proceeds less a deduction for a debt by the Appellant to the merchants, was made out to the Appellant but passed by him to the trustees and he gave them credit for the amount deducted in the account for rent and other moneys due to him. The gross proceeds of sale of the crop was £942.8.10 and the deductions for rent and other expenses and charges of the Appellant amounted to £292.10.0. p.51,L.20-28 p.52,L.15-33 p.84 p.52,L.22-26 p.84
- 40 6. Trust income was paid to the Appellant's

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p.54L.22-30
p.56L.35-38

wife and used for clothing for the children and other family purposes.

p.2,L.37 -
p.3,L.2

7. The Appellant's returns of income for the income years ended 31 March 1966 and 1967 disclosed assessable income of £1,699. 3. -. and £1,608. -. -. respectively and the Respondent initially assessed the Appellant on the basis of the incomes as returned.

Subsequently the Respondent considered:

(1) That the transactions between the Appellant and the trustees in respect of the land and the wheat grown thereon and the transactions between the Appellant, the Trustees and the purchasers of the wheat fell within the provisions of section 108 of the Land and Income Tax Act 1954, and alternatively 10

p.3L.12-25

(2) That the amount returned by the trustees as income of the O. T. Mangin Trust was received by the trustees under a disposition which applied to such income after it had been derived by the Appellant 20

p.2,L.37 -
p.3,L.2
p.3,L.12 -
p.4,L.5

and he increased the assessments for the respective years in question by the net farming profits from the paddocks (£739.11.3. for the year ended 31 March 1966 and £631. -.10 for the year ended 31 March 1967).

8. Section 108 provides as follows :-

"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." 30

9. In addition to section 108 the following 40

provisions of the Land and Income Tax Act 1954 are material:

- (a) The definition of "assessable income" in section 2 which unless the context of the Act otherwise requires is as follows :

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"Assessable income" means income of any kind which is not exempted from income tax otherwise than by way of a special exemption expressly authorised as such by this Act."

- (b) The definition of "taxable income" in section 2 which at the material times unless the context of the Act otherwise required was as follows :

"'Taxable income' -

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- (a) In relation to ordinary income tax, means the residue of assessable income after deducting the amount of all special exemptions to which the taxpayer is entitled in respect of ordinary income tax:

- (b) In relation to social security income tax, means the residue of assessable income after deducting the amount of all special exemptions to which the taxpayer is entitled in respect of social security income tax."

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- (c) Section 77 (1) and (2) (a) which at the material times provided as follows :

"77, Income tax imposed - (1) Subject to the provisions of this Act, there shall be levied and paid for the use of Her Majesty ... for the year commencing on the first day of April in each year, a tax herein referred to as income tax, which shall consist of two parts, namely, ordinary income tax and social security income tax."

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(2) Subject to the provisions of this Act , -

(a) Income tax shall be payable by every person other than a subsisting company or a public authority or a Maori authority on all income derived by him during the year ... for which the tax is payable:"

(d) Section 78 which is as follows :

"78. Rates to be fixed by annual taxing Act - (1) Income tax shall be assessed and levied on the taxable income of every taxpayer at such rate or rates as may be fixed from time to time by Acts to be passed for that purpose. 10

(2) The Act by which the rate of income tax is so fixed for any year is in this Act referred to as the annual taxing Act."

(e) Section 92 which is as follows :

"92. Income credited in account or otherwise dealt with - For the purposes of this Act every person shall be deemed to have derived income although it has not been actually paid to or received by him, or already become due or receivable, but has been credited in account, or reinvested, or accumulated, or capitalised, or carried to any reserve, sinking, or insurance fund, or otherwise dealt with in his interest or on his behalf." 30

(f) Section 109 which is as follows :

"109. Debentures issued free of income tax - (1) Nothing in section 108 of this Act shall be so construed as to render void any contract, agreement, or arrangement made or entered into by any company (whether before or after the commencement of this Act [but before the eighth day of August nineteen hundred and fifty-eight]) to the effect that the 40

10 interest on any debentures issued by that company shall be free of income tax; and all such contracts, agreements and arrangements are hereby declared to be valid and effective in accordance with this section unless the company is expressly or impliedly prohibited, by its memorandum or articles of association, from making or entering into any such contract, agreement, or arrangement.

(2) Where any debentures issued by a company purport to be issued free of income tax the company shall be liable for the payment of the income tax payable in respect thereof, and the debenture holders shall be entitled to receive the full amount of interest payable pursuant to the debentures:

20 Provided that this subsection shall not apply to any debenture issued by a company pursuant to any contract, agreement, or arrangement made or entered into by the company on or after the eighth day of August, nineteen hundred and fifty-eight."

30 10. The Land and Income Tax (Annual) Acts of 1965 and 1966 fixed the rates of ordinary income tax and social security income tax on taxable income derived during the years ended 31 March 1966 and 31 March 1967 respectively. In each of the years referred to, social security income tax was at a flat rate of 1 1/5d. for every sum of 16d. or part thereof of taxable income but ordinary income tax was imposed at a progressively increasing rate on taxable income derived by taxpayers and each individual taxpayer had a special exemption from social security income tax of £104 and from ordinary income tax of £468. Income derived by a trustee was assessable to the trustee but where 40 it was also derived by a beneficiary entitled in possession to the receipt thereof during the same income year, the trustee was deemed to be agent of the beneficiary and in the case of each such beneficiary the income tax was calculated

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on the basis of the taxable income of the beneficiary.

11. In the Supreme Court of New Zealand Wilson J. held that the Appellant had acted incorrectly in making the amended assessments and in doing so he rejected both grounds for the assessments relied on by the Respondent and referred to in paragraph 7.

p. 57, L. 22-
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12. At the hearing in the Supreme Court Wilson J. had held on the facts that the trust income had not been derived by the Appellant before the trustees received it. In his judgment he considered that s.92 of the Act had no relation to the facts of the case because of his finding of fact that the Appellant had genuinely leased the paddocks to the trustees and farmed and managed the paddocks as their paid employee or contractor and his conclusion from that finding was that the resultant income was derived by the trustees not the Appellant, even though the merchant who purchased the wheat paid the proceeds to the Appellant.

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p. 57, L. 27-
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13. Wilson J. then considered the argument based on s.108 which he said raised questions which he found to be of considerable difficulty. First, he rejected the argument for the Appellant that a distinction should be drawn between s.108 and its Australian counterpart, s.260 of the Income Tax Assessment Act 1936-1968, because of the differences in the statutory language. He held that the Court of Appeal of New Zealand in Elmiger v. Commissioner of Inland Revenue [1967] N.Z.L.R. 161 had held for present purposes that there was no difference in the effect of the two sections. He accordingly held that the principle enunciated by this Board in Newton v. Federal Commissioner of Taxation [1958] A.C.450 was applicable. He reasoned from the statement of principle in Newton that in every case in which s.108 is involved three questions arise:

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p. 58, L. 1-5

(1) Whether the transactions said to be void constitute a "contract agreement or arrangement".

(2) If so, whether they in any way alter the incidence of income tax or relieve any person from his liability to pay income tax.

(3) If so, whether the alteration or relief was achieved in a way which necessarily leads to the conclusion that it was adopted so as to effect such alteration or relief otherwise than as an incident of ordinary business or family dealing,

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and that the onus was on the taxpayer to establish that one or more of the questions must be answered in the negative.

p.59L.19
p.60,L.26

14. Wilson J. said that counsel for the Appellant had not argued that either of the first two questions should be answered "no". In the Court of Appeal it was agreed by both counsel that Wilson J. was in error in making this statement and that counsel for the Appellant had addressed argument on the second question relating to the scope of s.108.

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p.60,L.34-
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p.69,L.29-
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15. Referring to the statement of principle in Newton Wilson J. reasoned that it is the category of the arrangement which must be looked at in deciding whether it comes within the description of "ordinary family dealing", not the details of its "implementation", and that provisions for maintenance and advancement of a man's wife and children are the most common arrangements in that category. He therefore considered that the arrangements before him constituted ordinary family dealing and went on to hold that the only practicable method for the Appellant to provide an income for his wife and children separate from his own was the one he adopted and accordingly that the transactions escaped being necessarily labelled as a means to relieve from liability to pay income tax.

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p.60,L.40 -
p.61,L.29

p.61,L.30 -
p.62,L.33
p.63,L.21 -
p.64,L.34
p.65,L.39-
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16. In the course of his reasoning Wilson J. said that s.108 could still work if tax avoidance was one of the purposes or effects but that as far as his researches went it had

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p.64,L.35- p.65,L.2	not been held sufficient to avoid the arrangement unless it was the predominant purpose or effect.	
p.66,L.1- 15	17. In view of the decision he had reached Wilson J. did not find it necessary to consider the Appellant's submission that s.108 does not apply to the case where the taxpayer had divested himself of a particular source of income.	
p.68	18. The Respondent appealed to the Court of Appeal of New Zealand from the judgment of the Supreme Court on the grounds that the judgment was erroneous in fact and law. Judgment of the Court of Appeal was delivered on 26 August 1969 when the Court unanimously allowed the appeal.	10
p.73,L.14- 20	19. At the hearing in the Court of Appeal counsel for the Respondent did not pursue the argument (rejected in the Supreme Court) that the trust income had been derived by the Appellant (the Respondent in the Court of Appeal) before the trustees received it. The argument in that Court was thus limited to the application of s.108. Further, counsel for the Appellant did not base any argument founded on the effects of the annihilation of the arrangement.	20
p.73,L.20- 26		
p.70,L.38- p.71,L.23	20. North P. commenced his judgment by considering whether Wilson J. was right in his conclusion that the arrangement was capable of explanation by reference to ordinary family dealing and was not therefore necessarily to be regarded as a means of relieving the Appellant from his liability to pay income tax. He referred to the consideration of the applicable principles in a number of Australian cases and held that the approach that the Court was required to adopt was that discussed in <u>Newton</u> .	30
p.71,L.24- p.72,L.33	Turning to the facts he found it impossible to accept that the arrangement was capable of explanation as an ordinary business dealing and further found that it was not capable of explanation as an ordinary family dealing. He concluded that the arrangement was obviously an attempt by the Appellant to escape payment of income tax on what was really in truth his income.	40
p.72,L.33- 37		

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- 10 21. He then referred to the argument as to the true interpretation of s.108. He referred to the formal submission that Elmiger v. Commissioner of Inland Revenue [1967] N.Z.L.R. 161 (C.A.) was wrongly decided and then held that for the reasons he had given in Marx v. Commissioner of Inland Revenue and Carlson v. Commissioner of Inland Revenue (in which judgments had been delivered earlier that day) the arrangement was caught by the two limbs of s.108. p.72,L.44- p.73,L.13
- 20 22. Turner J. was of opinion for the reasons given in his judgment in Marx and Carlson that s.108 was not apt to catch such a case in which the income in question was not in the event derived by the taxpayer at all. But he considered he was bound by the view of the majority in Marx and Carlson and went on to consider whether Wilson J. was right in his inferences of fact. He reviewed the facts and concluded that Wilson J's. view of the facts was untenable. In his opinion the whole scheme smacked of such business unreality that he could not accept Wilson J's conclusion and he was convinced that the only proper inference to be drawn from the facts of the arrangement and of the profits resulting therefrom was that the scheme was devised for the sole purpose, or at least the principal purpose, of enabling the Appellant to escape liability for tax on a substantial part of the income which, but for the arrangement, he would have derived. p.74,L.4-18 p.75,L.28-30 p.74,L.18-22
- 30 23. McCarthy J. delivered a short judgment. He agreed with the other members of the Court that this was manifestly a case where it could be predicated that the arrangement was implemented in the way it was for the purpose of altering the incidence of and relieving the Appellant from his liability to pay income tax. He then rejected the argument that s.108 had no application when the income is diverted before receipt, for the reasons given in his judgment in Marx and Carlson. p.74,L.28 - p.75, L.27
- 40 24. The Court of Appeal of New Zealand p.76,L.4- 11 p.76,L.12- 20

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granted the Appellant on 21 November 1969 final leave to appeal from the judgment of the Court of Appeal to Her Majesty in Council.

25. The Respondent submits:

- (1) That there was an arrangement which was entered into;
- (2) That the arrangement had or purported to have a purpose or an effect of altering the incidence of income tax or relieving the Appellant from his liability to pay income tax; and 10
- (3) That upon the facts remaining, after stripping aside so much of the arrangement as gave effect to that purpose or effect, the Appellant derived the additional assessable income on which he was assessed.

If all three conditions referred to in the previous sentence exist, the assessments appealed from are supported. The Appellant did not argue either in the Supreme Court of New Zealand or the Court of Appeal of New Zealand that conditions (1) and (3) were not satisfied on the facts. 20

26. Section 108 does not impose upon a person a liability to pay income tax; that liability is imposed by other sections. The operation the section performs is to leave exposed to the liability-imposing sections what remains after it has treated as absolutely void so much of a "contract agreement or arrangement" as has or purports to have the purpose or effect of altering the incidence of income tax or relieving any person of his liability to pay income tax. 30

27. Section 77 (2) provides that subject to the provisions of the Act income tax is payable by every person on all income derived by him and s.78 requires that income tax be assessed and levied on the taxable income of every taxpayer at the rate or rates fixed by Acts passed for that purpose. 40

28. Relief from the liability imposed by ss.77 and 78 may be effected and the incidence of income tax under those sections may be altered in any given case by arrangements which affect income before that income has been derived. An arrangement may change into capital income which at the moment of change has not been derived by the taxpayer. The effect of such an arrangement is an ultimate beneficial receipt by the taxpayer but not a receipt of income: so that in such a case under the arrangement the escape from ss.77 and 78 is made by there being no "income" or "taxable income". Another arrangement may fasten on income which has not yet been derived by a particular taxpayer and substitute a person controlled by him or connected with him to be the deriver of that income in his stead. The effect of this arrangement is the receipt by the substitute taxpayer of income for the benefit of the particular taxpayer; so that in this case under the arrangement the escape from ss.77 and 78 is made by that income not being derived by the particular taxpayer.

29. The Respondent contends that s.108 works on both types of arrangement. First, the words "liability" and "incidence" are not confined to existing liability and existing burden. The section applies to arrangements having the purpose or effect of relieving from a prospective liability for income tax (on future income) and of altering the incidence of income tax on income to be derived. Second, once it is recognised that s.108 can apply to arrangements affecting the future earning of income it is not determinative who receives that income when it is derived under the arrangement. "Purpose" and "effect" are alternatives and where the arrangement affects the future earning of income the purpose of tax relief and of altering the tax incidence exists under the arrangement before the income is derived and the derivation of that income by someone other than the taxpayer is only a means of carrying out that purpose and thus achieving the "effect" of tax relief. Further, if

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regard is had to the situation at the end of the income year following the entry into the arrangement, the effect is that the arrangement has achieved the end in view of shifting income the taxpayer would otherwise have derived and thereby shifting the tax on that income.

30. Thus, an arrangement having as one of its purposes or effects the substitution of any person for another as the deriver of income may be an arrangement of the type described by s.108. 10

31. The arrangement which the Appellant set up had as a purpose and an effect the substitution of the trust (and the beneficiaries under the trust) for him as the deriver of the income which his exertions and property produced. One purpose and effect of that substitution was that the Appellant should derive part only of the farming profits from his property and not the whole as theretofore. Because of the progressive rate structure applying to the taxable income of each individual taxpayer and the substantial personal exemption for each individual taxpayer combined with the separate taxing of income of a trust at the rates applicable to the individual beneficiaries, the arrangement had the purpose and effect of substantially reducing the amount of income tax on income diverted from the Appellant to the trust. The arrangement thus had as a purpose or an effect a purpose or an effect within s.108. 20 30

32. The Respondent submits that the majority of the Court of Appeal of New Zealand in Marx and Carlson was right in holding that s.108 could cover in appropriate cases transactions where under an arrangement income sought to be taxed never passes through the hands of the taxpayer as his income and that the construction of s.108 adverted to above is consistent with and supported by the decision of the Court of Appeal of New Zealand in Elmiger v. Commissioner of Inland Revenue [1967] N.Z.L.R. 161 and the authorities on s.260 of the Australian Act, particularly Newton v. Commissioner of Taxation [1958] A.C. 450 (in the High Court of Australia, 96 C.L.R. 577) and Peate v. Commissioner of 40

Taxation [1967] 1 A.C. 308 (in the High Court of Australia 111 C.L.R. 443).

10 It is submitted further that it is established by the decisions of this Board in Newton and Peate that what is called the "avoiding limb" in the Australian s.260 applies in this way and that there are insufficient differences in the statutory language, particularly between the phrase "avoiding any
10 duty or liability imposed on any person by this Act" under s.260 and "altering the incidence of income tax or relieving any person from his liability to pay income tax" under s.108 to justify a different conclusion under s.108.

20 33. The Respondent contends that the arrangement outlined above is not capable of explanation by reference to 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, particularly having regard to the following matters:

- (a) The emphasis of the arrangement was on the income aspects and there was no possibility of capital gain to the trust.
- (b) The arrangement involved the selection of high income earning and low risk farming operations.
- 30 (c) The possibility of the trust's deriving income depended almost entirely on the actions of the Appellant in granting short-term leases, and then farming the land providing for that purpose, plant, labour and management.
- (d) The only capital of the trust was the original £5 provided by the settlor and the Appellant financed the paddock farming operations.
- 40 (e) No change occurred in the practical operations of the farm as a whole. The Appellant continued to own the same farm,

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implements, and stock and continued by his own efforts to produce all the farming income in exactly the same way as before.

(f) A substantial part of the income from the farm was syphoned off to the trust.

(g) The Appellant's wife and her co-trustee controlled the use and destination of the trust income and used it for family purposes to the relief of the Appellant and with the result that there was little left of each year's income to accumulate for any long-term benefit to the beneficiaries. 10

(h) The amount of income tax payable on the profits from the whole farm was substantially diminished through being split between the Appellant and the trust (and the beneficiaries thereunder).

34. The Respondent contends that this appeal should be dismissed with costs for the following among other reasons. 20

R E A S O N S

(1) That upon a proper interpretation of s.108 of the Land and Income Tax Act 1954, that section can apply to arrangements under which income sought to be taxed to a taxpayer never passes through his hands as his income.

(2) That an arrangement was entered into between the Appellant and others.

(3) That the arrangement had or purported to have a purpose or an effect of altering the incidence of income tax or relieving the Appellant from his liability to pay income tax. 30

(4) That the facts exposed after stripping away so much of the arrangement as gave effect to that purpose or effect, attracted the application of ss. 77, 78 and 92 of the Act resulting in the derivation by the Appellant of the additional assessable income on which he was assessed. 40

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

J. C. WHITE.

No. 3. of 1970

IN THE PRIVY COUNCIL

O N A P P E A L

FROM THE COURT OF APPEAL OF NEW
ZEALAND

B E T W E E N

OWEN THOMAS MANGIN Appellant

- and -

THE COMMISSIONER OF
INLAND REVENUE Respondent

CASE FOR THE RESPONDENT

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W.C.2.