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No. 13 of 1975

IN THE PRIVY COUNCIL

ON APPEAL

FROM THE COURT OF APPEAL

OF NEW ZEALAND

BETWEEN

EUROPA OIL (N.Z.) LIMITED — Appellant

AND

THE COMMISSIONER OF INLAND REVENUE — Respondent

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BETWEEN

EUROPA OIL (N.Z.) LIMITED Appellant

- and -

THE COMMISSIONER OF INLAND REVENUE Respondent

CASE FOR THE APPELLANT

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1. This appeal is brought from a final judgment of the Court of Appeal of New Zealand (McCarthy P., Richmond and Beattie JJ.) dated 19 November 1974 in which the Court of Appeal allowed an appeal by Europa Oil (N.Z.) Limited (hereinafter referred to as "Europa Oil") against a judgment of the Supreme Court of New Zealand (McMullin J.) delivered on 22 March 1973 given in favour of the Commissioner of Inland Revenue (hereinafter referred to as "the Commissioner") confirming certain assessments of income tax made by the Commissioner against Europa Oil in respect of each of the six tax years ended 31 March 1966 to 31 March 1971 (both years inclusive).

8075-8076

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8012, paras 6, 7

2. Although the formal order of the Court of Appeal declared that the appeal of Europa Oil be allowed, it constituted in effect an allowance in part only, because the objections

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of Europa Oil to each of the Commissioner's assessments for the years in question were not wholly upheld. The Court of Appeal ordered that in lieu of the answer given by the Supreme Court to the question asked by the case stated a different answer should be substituted which was considered to be somewhat more favourable to Europa Oil than the effect of the judgment of the Supreme Court. To the extent that the judgment of the Court of Appeal was not in favour of or acceptable to the Commissioner the Commissioner sought and obtained leave from the Court of Appeal to appeal from that judgment to the Judicial Committee of the Privy Council. By agreement between the parties to the appeal Europa Oil has been named as appellant in the record of proceedings which relates as well to the Commissioner's appeal as to the appeal by Europa Oil.

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4 ATR 495 lines 2-6, 31-35

4 ATR 497 lines 12-16

8076A

3. In the Supreme Court Europa Oil had objected to each of the assessments by way of case stated pursuant to section 32 of the Land and Income Tax Act 1954 (hereinafter referred to as "the Act"). By the said assessments the Commissioner had disallowed in respect of each tax year in question the deductions claimed by Europa Oil under s.111 of the Act as expenditure for petroleum products supplied to it by Europa Refining Company Limited (hereinafter referred to as "Europa Refining") by an amount stated

8002-8072

8013, lines 1-12

by the Commissioner to be equivalent in each year to one half share of the net profits which were earned by Pan Eastern Refining Company Limited (hereinafter referred to variously as "Pan Eastern" or "Paneast"), half of whose shares were at all material times owned by Associated Motorists Petrol Company Limited, a wholly owned subsidiary of Europa Oil.

4. The language of s.111 of the Act was materially altered during the 6 year period covered by the assessments in this case. In respect of the years ended 31 March 1966, 31 March 1967, and 31 March 1968 (sometimes referred to as the "first 3 year period") the section provided as follows :

> 111. Expenditure or loss exclusively incurred in production of assessable income - (1) In calculating the assessable income of any person deriving assessable income from one source only, any expenditure or loss exclusively incurred in the production of the assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived for that year.
>
> (2) In calculating the assessable income of any person deriving assessable income from two or more sources, any expenditure or loss exclusively incurred in the production of assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer for that year from all such sources as aforesaid.

In respect of the years ended 31 March 1969, 31 March 1970, and 31 March 1971 (sometimes referred to as the "second 3 year period") the section, which had been substituted for the original by s.12 of the Land and

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Income Tax Amendment Act 1968, provided as follows :

> 111. Expenditure or loss incurred in production of assessable income - In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which it -
>
> (a) Is incurred in gaining or producing the assessable income for any income year; or
>
> (b) Is necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year -
>
> may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred.

5. In addition to the disallowance by the Commissioner of the deductions claimed under s.111 of the Act the Commissioner contended that various contracts, agreements, and arrangements, namely :

"(a) The Petroleum Products Sales Contract marked "A" .. 3001-3014, the Contract for Organisation of Pan Eastern marked "A7" pp.3049-3070 and the related agreements marked "A1" to "A6" and "A8" to "A23" pp.3015-3048 and 3071-3103 both inclusive, the incorporation of Pan Eastern and the carrying out of the said Contracts and Agreements; 8014 Line 29 8015 Line 4

(b) The incorporation of Pan Eastern, the Feedstock Supply Contract marked "B" pp.3112-3129 and the related agreements marked "B1" to "B13" both inclusive pp.3130-3198, the 8015 Line 5

"Arrangements" between Europa Oil and Europa Refining marked "C.S.15", the documents and acts referred to in (a) of this sub-paragraph, and the carrying out of the Contract, Agreements and Arrangements"

in each case constituted an arrangement having the purpose or effect of altering the incidence of income tax or relieving Europa Oil from its liability to pay income tax under s.108 of the Act, and were void accordingly pursuant to that section.

6. For the first 3 year period s.108 of the Act provided as follows :

> 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.

7. The section was amended by s.16(1) of the Land and Income Tax Amendment Act (No. 2) 1968 with respect to every contract, agreement, or arrangement made or entered into after the passing of that amendment (11 December 1968) and thereafter provided as follows :

> Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes 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.

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8. On the application of s.108 the Commissioner contended that Europa Oil derived in each of the tax years in question, - 8015/18 - 8016/24

(a) Either a profit or gain or assessable income equal to the sum disallowed in his assessment; or

(b) The deductions claimed by Europa Oil were to be

(i) ignored; or

(ii) allowed in the sums stated in the Commissioner's assessment; or

(iii) the assessments should be increased by the Court.

9. In relation to the disallowance by the Commissioner under s.111 (as originally enacted) of deductions claimed by Europa Oil as expenditures incurred in the first 3 year period it was accepted that both the Supreme Court and the Court of Appeal were bound by the principle enunciated by the Judicial Committee of the Privy Council in earlier litigation between the same parties, Commissioner of Inland Revenue v. Europa Oil (N.Z.) Ltd [1971] A.C. 760; [1971] N.Z.L.R. 641, where the majority of their Lordships held (at p.772; p.649):

> For a claim to disallow a portion of expenditure incurred in purchasing trading stock to succeed, the Crown, in their Lordships' judgment, must show that, as part of the contractual arrangement under which the stock was acquired some advantage, not identifiable as, or related to the

> production of, assessable income, was gained, so that a part of the expenditure, which can be segregated and quantified, ought to be considered as consideration given for the advantage. Taxation by end result, or by economic equivalence, is not what the section achieves.

In applying that test to the contractual arrangements under which various payments were made by Europa Oil in that case the majority of their Lordships considered that the expenditures claimed were not deductible, and upheld the Commissioner's appeal accordingly. In the present case both in the Supreme Court and in the Court of Appeal Europa Oil has reserved the right to contend on the hearing of the present appeal, if necessary, that (a) the test formulated in the decision on the earlier appeal should be reconsidered; and (b), accepting it as completely appropriate, its application in that case to the contractual arrangements pertinent to the present appeal should also be reconsidered. Finally, it has been contended for Europa Oil at all stages in the present litigation that the evidence adduced by Europa Oil in the present case establishes sufficient points of distinction including evidence as to New Zealand Government benchmarks between the earlier case and this with the result that, even applying the test stated by the majority of their Lordships in the earlier case to the facts of the present, the expenditures claimed by Europa Oil are deductible as "exclusively incurred in the production of the assessable income" of Europa Oil for each of the income years 31 March 1966, 31 March 1967,

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and 31 March 1968 or "incurred in gaining or producing the assessable income" or "necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income" for each of the income years ended 31 March 1969, 31 March 1970, and 31 March 1971.

10. In the Supreme Court McMullin J. upheld the Commissioner's contention and declared that the Commissioner had acted correctly in disallowing so much of the expenditures as was represented by the one half shares of the net profits earned by Paneast. In the Court of Appeal however the appeal of Europa Oil was allowed and it was held unanimously that in respect of the first 3 year period Europa Oil was entitled to deduct part of its actual expenditures calculated in accordance with a formula stated by Richmond J. in his separate judgment and approved by the two other members (McCarthy P. and Beattie J.) of the Court. The working out of the judgment of the Court of Appeal requires a finding as to the quantum of the actual arm's length long term market values prevailing at all material times. Since there had been no finding on that point in the Supreme Court, the Court of Appeal remitted the case to the Supreme Court to hear further evidence and then to determine the actual arm's length long term market values of the petroleum products purchased by Europa Oil.

3 A.T.R. 512

4 A.T.R. 455

4 A.T.R. 488

4 A.T.R. 487
4 A.T.R. 500

4 A.T.R. 487 - 488

(1955) 1 T.R.N.Z. 8

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11. The second main issue raised by the Commissioner, namely the application of the avoidance provisions in s.108 of the Act, had also come before the Courts in the earlier case. In the Supreme Court in that case McGregor J. held on the facts before him that when Europa Oil entered into arrangements in 1956 for the supply of petroleum products it was not Europa Oil's purpose to avoid any tax liability. Apart from making that finding McGregor J. did not consider it necessary to reach any conclusion as to the application of s.108. On appeal by Europa Oil against the adverse judgment of the Supreme Court in the earlier case the Court of Appeal held that the various transactions which the Commissioner sought to avoid were capable of explanation by reference to ordinary commercial dealings. The Court of Appeal further doubted whether, even if the section did apply, the effect of the annihilation of various contracts pursuant to s.108 would result in taxable income reaching the hands of Europa Oil. On further appeal to the Judicial Committee of the Privy Council the majority of their Lordships found it unnecessary to deal with the Commissioner's alternative contention based on s.108, and accordingly expressed no opinion whether, had the Commissioner's claim under s.111 failed, the claim under s.108 could have succeeded. On the other hand, the minority of their Lordships (Lord Donovan and Viscount Dilhorne), having

[1970] N.Z.L.R. 356 lines 20-48

North P. [1970] N.Z.L.R. 387 line 9 - 389 line 39

Turner J. [1970] N.Z.L.R. 413 line 39 - 415 line 29.

McCarthy J. [1970] N.Z.L.R. 430 lines 5 - 43

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dissented on the application of s.111, were compelled to consider the application of s.108. They rejected the argument as hopeless. [1971] A.C. 783B.

12. In the present case the Commissioner repeated his contention that s.108 of the Act applied. In the Supreme Court McMullin J., although indicating that it was not necessary for him in view of his conclusions on s.111 of the Act to consider the point, nevertheless made certain comments on the facts and law favourable to the Commissioner. However, in the Court of Appeal McCarthy P. (with whom Richmond and Beattie JJ. concurred) referred to the manner in which the Commissioner's submissions on the application of s.108 had been disposed of in the first Europa Oil case, expressed the view that the earlier judgment of the Court of Appeal and the opinions of Lord Donovan and of Viscount Dilhorne should be considered decisive and indicated that he could see no point in restating the discussion. In view of the conclusions reached by the Court of Appeal with respect to the application of s.108 it is the Commissioner who is dissatisfied with the judgment under appeal. 3 A.T.R. 535 line 25 - 536, line 53.

13. The facts relevant to the present appeal are set out in the following paragraphs.

14. At all material times Europa Oil was a substantial independent company, wholly owned by shareholders ordinarily resident in New Zealand, and engaged as a wholesaler licensed under the Motor Spirits Distribution

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Act 1953 and engaged in the marketing of petroleum products throughout New Zealand. The business competitors of Europa Oil throughout the period relevant to the present case were five New Zealand subsidiaries of different international companies.

North P. [1971] N.Z.L.R. 371, lines 18 - 25.

15. In consequence of that situation it was at all times necessary for the survival of Europa Oil as a trading entity to secure long term contracts for the supply of petroleum products from world wide sources on such terms as would avoid so far as humanly possible any possibility of cessation of supplies by reason of "force majeure" or otherwise.

McGregor J. [1970] N.Z.L.R. 332 lines 4-12.

North P. [1970] N.Z.L.R. 371 lines 18-24

McCarthy J. [1970] N.Z.L.R. 425 lines 4-10

16. Over a period of 25 years prior to 1956 Europa Oil had imported gasoline and other petroleum products into New Zealand pursuant to long term contracts; firstly with the Russians and then from 1936 until 1956 with California Texas Oil Co. Limited (hereinafter referred to as "Caltex"). Up until 1964 there was no oil refinery in New Zealand and all petroleum products had to be imported.

McGregor J. [1970] N.Z.L.R. 325 lines 20-23

[1970] N.Z.L.R. 334 lines 16-30

North P. [1970] N.Z.L.R. 371 lines 35-41

17. In 1955 it became necessary for Europa Oil either to renew its Caltex contract, which was due to expire on 31 December 1956, or to arrange an alternative source of supply. Negotiations took place between Europa Oil and Caltex in 1955, but no agreement could be reached upon the terms of a further contract. The only

McGregor J. [1970] N.Z.L.R. 325 lines 37-38

[1970] N.Z.L.R. 326 lines 5-6

North P. [1970] N.Z.L.R. 371 line 35 - p.372 line 19

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proposal of Caltex at that time was to supply gasoline for a further period at posted prices.

18. Europa Oil accordingly began negotiating with Gulf Oil Corporation (hereinafter referred to as "Gulf") with which it had been in previous contact in 1944 and also in 1954. As early as 1944 and consistently thereafter the management of Europa Oil had been interested in participating in the profitable refining sector of the oil industry. In 1944 proposals had been considered by Europa Oil and Gulf for the construction of a refinery in New Zealand, and technical studies had been carried out. In addition a study from an independent United States Refinery Consultant was obtained by Europa Oil. The economics of such an operation appeared to be against the proposal, which was then allowed to lapse. In 1954 Europa Oil had again taken up with Gulf the proposal of constructing an oil refinery in New Zealand and Europa Oil had obtained another economic project prepared by an independent American Refinery Consultant; but the economics of the operation appeared on balance to be against the proposal, and the discussions were again allowed to lapse for the time being. The principal factor which operated against the establishment of a New Zealand refinery was the unduly high proportion of gasoline consumed on the New Zealand market in relation to the "heavy end" products such as gas oil and fuel oil which would also have to be produced by the refinery. The "heavy end" products would be far in excess of New Zealand requirements

McGregor J. [1970] N.Z.L.R. 326 lines 5-21

North P. [1970] N.Z.L.R. 372 lines 20-51

North P. [1970] N.Z.L.R. 373 lines 18-42

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and this would necessitate back haul transportation of those excess "heavy ends" some thousands of miles to the nearest worthwhile markets, an operation which was considered to be uneconomic.

19. However in 1955 because of the mutuality of interests existing by reason of the fact that Europa Oil had access to a market in New Zealand for "light ends" while Gulf possessed outside New Zealand production and refining facilities and had access to a worldwide market for "heavy ends" the discussions between Gulf and Europa Oil turned to a different proposal. Instead of participation by Europa Oil in the refining within New Zealand of the crude oil required to produce the total requirements of Europa Oil, an agreement was reached whereby Europa Oil could participate in the related overseas refining and thereby in the related profits of such overseas refining. That proposal was made by Gulf and accepted in principle by Europa Oil. Negotiations then proceeded in 1955 to establish the corporate structure and the contracts by which such intention might be effectuated. Caltex thereupon reopened negotiations with Europa Oil and submitted proposals which also envisaged participation in the overseas refining operations of Caltex related to Europa Oil's requirements for products, but after due consideration Caltex's final proposals were declined by

McGregor J. [1970] N.Z.L.R. 326 lines 5-21

North P. [1970] N.Z.L.R. 373 lines 18-42

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Europa Oil and binding contracts were entered into with Gulf on 3 April 1956.

20. A company was formed under the name of Pan Eastern Refining Company Limited (Paneast), and the shares in the company were issued half to Propet Company Limited, a wholly owned subsidiary of Gulf, and half to Associated Motorists Petrol Company Limited (hereinafter referred to as "A.M.P."), which is incorporated in New Zealand and is a wholly owned subsidiary of Europa Oil. Because Gulf had wished Paneast to be incorporated in the Bahamas Islands (at all material times within the sterling area) the consent of the United Kingdom Treasury was required for the formation of Pan Eastern and that consent was duly obtained. In support of the application for consent a letter was sent setting out the nature of all the contracts proposed to be entered into.

McGregor J. [1970] N.Z.L.R. 327 lines 38-41

North P. [1970] N.Z.L.R. 374 lines 22-27

McGregor J. [1970] N.Z.L.R. 328 lines 10-24

21. The following is a summary of the contracts then entered into:

McGregor J. [1970] N.Z.L.R. 326 line 24 - p.327 line 38

(i) The Petroleum Products Sales Contract made between Gulf Iran (a subsidiary of Gulf) and Europa Oil whereby Gulf Iran contracted to supply Europa Oil for a period of ten years with all of its gasoline and some of its gas oil requirements in New Zealand, the prices for such products to be posted prices.

North P. [1970] N.Z.L.R. 373 line 42 - p.374 line 50

(ii) A Freight Contract under which Gulf was responsible for the delivery of

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petroleum products supplied by Gulf Iran to New Zealand ports.

(iii) A collateral agreement between Gulf Iran and Europa Oil providing for certain modification of the terms and conditions of the Supply Contract in the event of a refinery being established in New Zealand during the period of the Petroleum Products Sales Contract.

(iv) A Processing Contract executed between Gulf and Paneast by which Gulf undertook to supply Paneast with sufficient crude oil at posted prices to produce the equivalent quantity of the gasoline requirements of Europa Oil under the Supply Contract with a provision that Paneast would have the crude oil processed by Gulf for a commercial refining fee. Paneast would then sell to Gulf Iran such refined products as were required by Gulf Iran to meet its obligation under the Petroleum Products Sales Contract and Paneast would sell to Propet (another subsidiary of Gulf) the balance of such products, which principally comprised the "heavy ends" products of the refining operation.

The total result of these contractual arrangements was that Paneast would earn the conventional refiner's margin on the quantity

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of crude oil required to supply the equivalent of Europa Oil's requirements of gasoline. That margin was estimated to be approximately 52.5 United States cents for every barrel of crude oil processed, based on the posted prices then prevailing.

22. On the basis of the current prices in 1956 for crude oil and for gasoline and for other products the estimated profit of Paneast of 52.5 cents per barrel of crude oil was equivalent to 5 cents in respect of every gallon of gasoline imported by Europa Oil under the Petroleum Products Sales Contract, but this figure would fluctuate with any movement in the posted prices of either crude oil or of gasoline.

North P. [1970] N.Z.L.R. 374 lines 27-50

23. The conclusion of these arrangements was to the considerable mutual advantage of Gulf and Europa Oil. Gulf had a secure and substantial market for the "heavy ends" of the refining operation but very little market for the gasoline. Europa Oil was in the converse position. Further, the participation of Europa Oil in this sector of Gulf's overseas refining operations was an effective substitute for the original plan of participation by both companies in refining operations in New Zealand. Both parties still had in contemplation the possibility at some time in the future of establishing a refinery in New Zealand, and this is borne out by the further negotiations which took place in 1958.

McGregor J. [1970] N.Z.L.R. 326 lines 14-21

24. The first deliveries of gasoline under the Petroleum Products Sales Contracts entered into on 3 April 1956 were made in 1956 and thereafter all the contracts between the parties were carried out according to their tenor. The accounts of Paneast were kept by the Accounts Division of Gulf in Pittsburgh Pennsylvania, United States of America; they were detailed accounts recording all transactions between Gulf and Paneast and between Paneast and Propet.

25. During the last quarter of 1956 and the first quarter of 1957 the profits earned by Paneast in terms of cents per gallon of gasoline purchased by Europa Oil amounted to 5.46 cents per gallon, but thereafter the profits commenced to decline and fell as low as 3.42 cents in the first quarter of 1958. That progressive decline was due to the continual fall in the posted prices of gasoline and the simultaneous rigidity, due to the action of the oil producing countries through OPEC, of the Middle East posted price of crude oil (being the price payable by Paneast under the Processing Contract). Because of that decline in profits caused by the rigidity of posted prices having the effect of reducing its profit as determined by the formula below the current level of refining profits generally Paneast engaged in lengthy negotiations with Gulf for a revision of the profit formula and finally, in August 1959, Gulf proposed, not to vary the formula, but to grant a voluntary discount off the sale price of crude oil sold by Gulf to Paneast of such an amount as would restore

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the earnings of Paneast to a minimum level of 5 cents per gallon of gasoline.

26. In each of the years from 1959 (retroactively for the years in which Paneast had not reached the level of 5 cents per gallon) to 1965 inclusive (until the 1964 feedstock contract with Gulf came into force) Gulf in fact granted a crude oil discount to Paneast within the scope of the 1956 contract of an amount sufficient to bring the earnings of Paneast up to the equivalent of 5 cents per gallon of gasoline supplied to Europa Oil. If Gulf had not taken that action, the level of the earnings of Paneast throughout this period would have been considerably less than 5 cents.

27. In 1959 the New Zealand Government had made it known it would permit a refinery to be established in New Zealand on terms that it would be owned and operated by a company which would include all the New Zealand oil marketing companies as shareholders. Europa Oil and Gulf had resumed negotiations in 1958 regarding the construction in New Zealand on their joint behalf of a type of refinery known as a naphtha reformer, the intent being not only to produce gasoline for the New Zealand market but also, if possible, to export gasoline to Australia. Those negotiations however had been terminated by the decision of the New Zealand Government in 1959 just referred to. It now became necessary for a contract to be negotiated with Gulf or with

North P. [1970] N.Z.L.R. 375 lines 32-43

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some other overseas oil company for the supply of crude oil and other feedstocks necessary for participation by Europa Oil in the operations of the proposed New Zealand refinery, subject always to Europa Oil still being committed to Gulf until 1966 under the 1956 Petroleum Products Sales Contract.

28. After a conflict of views had been finally resolved Gulf agreed to enter into a future feedstock supply contract within the framework of the existing Paneast structure. The broad basis of the proposed agreement was the same as under the 1956 contracts. The only substantial difference was that, instead of Paneast earning the refiner's margin derived from the complete refining of crude oil into gasoline and other products, it would earn under the new processing contract the more limited refiner's margin to be derived from the partial refining of crude oil for production of the equivalent quantity of naphtha and middle distillate to be supplied to Europa Oil for further processing at the New Zealand refinery.

29. For a variety of reasons it was decided to incorporate a company, called Europa Refining Company Limited (hereinafter called "Europa Refining") which would enter into a new set of contractual arrangements containing the agreed terms for the supply of feedstocks to be processed in the refinery in New Zealand whenever it should come into operation ("on stream"). The collective objectives which were in mind

McCarthy P. 4 A.T.R.465 line 23 - p.467 line 9

4 A.T.R. 477 line 48 - p.478 line 4.

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when Europa Refining was formed were the negotiation of new arrangements for the supply of feedstocks without any prior pre-emption commitment to Gulf; the obtaining of flexibility in financing participation in the New Zealand Refinery; the achieving of exemption from retention tax, then recently imposed; and the keeping of refining profits distinct from marketing profits in New Zealand.

Furthermore Europa Refining enjoyed entitlement for use of the New Zealand Refinery as an "affiliate" in terms of the Participants Agreement relating to the administration of the refinery and would consequently be entitled to process feedstocks in it and otherwise to join in the obligations and benefits of the Participants Agreement. Europa Refining was not at any time a subsidiary of Europa Oil. Although it was contemplated that Europa Refining might become a wholesaler of petroleum products in New Zealand, application to the Motor Spirits Licensing Authority for such a licence was withdrawn. Consequently it was important that Europa Refining should not engage in the sale of petroleum products in New Zealand.

30. On 27 December 1962 Europa Refining, Gulf, and Paneast executed a series of contracts designed to put into effect, whenever the New Zealand refinery came on stream, the agreed terms for supply of feedstocks to Europa Refining.

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McGregor J. [1970] N.Z.L.R. 334 lines 17-28

Turner J. [1970] N.Z.L.R. 408 line 50 - p.409 line 31

In summary, the main provisions of the

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contracts were :

(a) Europa Refining contracted to buy for a period of ten years all its naphtha, middle distillate, and crude oil feedstocks from Gulfex, a subsidiary of Gulf. 3112 - 3129 3134 - 3146

(b) Gulf agreed to sell and Paneast agreed to buy sufficient crude oil as such and sufficient crude oil to yield, by the refining process, the feedstocks required by Europa Refining under its Supply Contract with Gulfex.

(c) Paneast agreed to sell and Gulfex to buy the naphtha and middle distillate feedstocks produced from this crude oil at the same price at which an equivalent quantity would be sold by Gulfex to Europa Refining.

(d) The prices of the naphtha and middle distillate sold by Paneast to Gulfex would be at the same prices for equivalant quantities of such feedstocks sold by Gulfex to Europa Refining under the Feed Stock Supply Contract and such prices received by Paneast, after allowing for the cost of crude oil and the cost of processing by Gulf, would yield a refining profit to Paneast.

(e) Paneast agreed to sell and Propet to buy all fuel oil and surplus middle distillate produced from the aforesaid refining process at a price sufficient to produce in the aggregate the same amount of profit as

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had been realised by Paneast on the sale of naphtha, middle distillate, and crude oil to Gulfex.

(f) By a contract of affreightment made between Propet and Europa Refining the former company agreed to transport the shipments of feedstocks to be made under the Supply Contract with Gulfex.

31. In 1963 the then Commissioner examined the 1956 contracts previously referred to in order to decide whether he could lawfully assess as income of Europa Oil the share of A.M.P. in the profits of Paneast, but after due consideration he came to the conclusion that such profits were not assessable under any provision of the Land and Income Tax Act 1954. The Commissioner notified Europa Oil of his decision by letter dated 27 June 1963 addressed to the Managing Director of Europa Oil.

North P. [1970] N.Z.L.R. 376 lines 15-28

McGregor J. [1970] N.Z.L.R. 347 line 44 - p.348 line 6

32. Following the said notification by the Commissioner it was decided to ask Gulf to agree to the re-drafting of the 1962 feedstock contracts (which were not yet in operation) so as to make their structure accord more closely with the structure of the 1956 contracts. Gulf agreed with the proposal and on 20 March 1964 another set of feedstock contracts was drawn up between Gulf and Paneast and Europa Refining to operate for a period ending on 31 December 1973. The only material difference between the 1962 and 1964 contracts was in relation to the

North P. [1970] N.Z.L.R. 376 line 45 - p.377 line 8

[1970] N.Z.L.R. 382 lines 10-32

3112 - 3198

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contract of affreightment. Under the 1962 contract of affreightment the benefit of the alternate freight rate was secured to Paneast, whereas by the 1964 contract that benefit was secured to Europa Refining.

33. The New Zealand refinery came on stream in 1964. Although for some time petroleum products had still to be imported under the 1956 contracts so that for a limited period the 1956 and 1964 contracts were in operation simultaneously, the operation of the 1956 contracts in due course ceased and were wholly superseded by the provisions of the 1964 contracts, which remained current at all material times throughout the period covered by the assessments in question in this case.

North P. [1970] N.Z.L.R. 382 lines 10-20

4 A.T.R. 459 lines 40-48

4 A.T.R. 474 line 45 - p.475 line 30

34. On 30 March 1965 the Commissioner issued assessments against Europa Oil for the year ended 31 March 1959 and subsequently for the five years immediately following up to the year ended 31 March 1965. By each of those assessments the Commissioner added to the assessable income of Europa Oil (inter alia) an amount equal to one half of the profits of Paneast for the corresponding year. All of the foregoing assessments were based on ss.111 and 108 of the Act. Europa Oil duly objected to all of the assessments, and after succeeding on appeal to the Court of Appeal against the adverse judgment of the Supreme Court it lost on further appeal by the Commissioner to the Judicial Committee of the

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Privy Council. Thereafter the Commissioner issued further assessments against Europa Oil in respect of the six years from and including the years ended 31 March 1966 to 31 March 1971, the years in question in the present case. 8012, paras. 6, 7

35. Once again Europa Oil duly objected to all of the assessments and on the disallowance of each of its objections by the Commissioner it required the Commissioner to state a case for the opinion of the Supreme Court. In the Supreme Court McMullin J. held in favour of the Commissioner and answered the question in the case stated to the effect that the Commissioner had not acted incorrectly in making the assessments objected to by Europa Oil. On appeal to the Court of Appeal Europa Oil contended as follows : 8013, para. 8 8013, para. 9 8073

A. As to s.111

(a) as originally enacted

(i) Accepting the decision of the majority of the Judicial Committee of the Privy Council in the first case as binding in the Courts in New Zealand, there was on the evidence only one purpose for the expenditure by Europa Oil of the cost price of petroleum products and that purpose was the acquiring of such petroleum products as trading stock for its marketing operations.

(ii) That Europa Oil was not a party to any of the 1964 contracts with Gulf.

(iii) That it was no part of the contractual arrangement under which the petroleum products were acquired by Europa Oil that some advantage, not identifiable as, or related to the production of assessable income, was gained.

(iv) That the legal and factual position of Europa Oil under the 1964 arrangements differed from its legal and factual position under the 1956 contracts, so that the reasoning and the decision of the Judicial Committee of the Privy Council in the first case did not automatically apply to the 1964 arrangements in respect of this case.

(v) That, if the Court were to hold that, consistent with the decision of the majority of the Judicial Committee of the Privy Council in the first case, the expenditures incurred by Europa Oil were effected for a dual purpose, the Commissioner had failed to show what part (if any) of the expenditure could be segregated and quantified and consequently considered as consideration given for the advantage unrelated to the production of assessable income by Europa Oil.

(vi) That, in any event, the proportion

of the net profits of Paneast representing the amount disallowed by the Commissioner in each year (being one half of the earnings of Paneast) could not constitute the consideration given for the advantage not identifiable as or related to the production of the assessable income.

10 (b) as amended by s.12 of the Land and Income Tax Amendment Act 1968

(i) There was on the evidence only one purpose of the expenditure by Europa Oil of the cost price of the petroleum products. That expenditure was either incurred in gaining or producing assessable income for each of the income years in question or was necessarily

20 incurred in carrying on a business for the purpose of gaining or producing the assessable income for each of the income years in question.

(ii) The expenditure incurred by a trader in acquiring trading stock is expenditure incurred in gaining or producing his assessable income, and there is no

30 justification under the first limb of s.111 for apportioning any of that expenditure.

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(iii) Under the second limb of s.111 once it is held that an expenditure has necessarily been incurred in carrying on a business for the purpose there described the whole of the expenditure is deductible.

(iv) Europa Oil was carrying on a business for the purpose of gaining or producing assessable income.

B. As to s.108

(i) Section 108 was not applicable because the arrangements were in each year ordinary business dealings.

(ii) Section 108 was not applicable because the arrangement which the Commissioner contends is void is the arrangement that in each year produced the income of Europa Oil.

(iii) If the deduction is allowable under s.111 it cannot be disallowed as void under s.108.

(iv) The Act itself recognises the freedom of taxpayers to enter into such arrangements, as it envisages the receipt of dividends from foreign companies.

(v) The transaction avoided by s.108 must be between parties within New Zealand or governed by New Zealand law and the taxpayer must be a party to the transaction.

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36. After considering argument submitted by Europa Oil and by the Commissioner the Court of Appeal delivered an interim judgment on 12 June 1974 in which it expressed the view that Europa Oil was entitled to a greater deduction for its expenditures incurred throughout the period in question than had been allowed by the Commissioner. The Court of Appeal indicated the principles and formula which in its view should have been applied by the Commissioner and invited the parties to consider their position in the light of the opinions expressed by the Court.

Court of Appeal 4 A.T.R. 455

37. The parties having been unable to come to agreement, the Court of Appeal subsequently heard further submissions on 17 October 1974 and in its formal judgment dated 19 November 1974 allowed the appeal by Europa Oil. In lieu of the answer given in the Supreme Court to the question asked by the Case Stated the Court of Appeal substituted the following answers :

8075 - 8075A

(1975) 1 T.R.N.Z. 1

(1) In respect of the years ending 31 March 1966, 1967 and 1968 the Commissioner acted incorrectly by disallowing the amounts set out in para 7 of the Case Stated and representing Pan Eastern benefits. The Commissioner should instead have disallowed a proportion of the objector's f.o.b. costs. That proportion should be determined in each year in the ratio which the Pan

RECORD

Eastern benefit bears to the sum total of that benefit and the actual arm's length long term market value of the feedstocks in respect of which the fob costs were incurred.

(2) In respect of the years ending 31 March 1969, 1970 and 1971 the Commissioner acted incorrectly by disallowing the amounts set out in para 7 of the case stated and representing Pan Eastern benefits. The Commissioner should instead have disallowed so much (if any) of the objector's fob costs in each year as exceeded the actual arm's length long term market values of the feedstocks in respect of which such costs were incurred.

The Court of Appeal remitted the case to the Supreme Court with a direction that that Court should amend the assessments in accordance with the foregoing answers and for that purpose that it should hear any evidence which the parties might wish to call and then determine the actual arm's length long term market values of the feedstocks in respect of which the cost of purchase was incurred by Europa Oil.

38. The following is a summary of the reasons for the judgments of the Court of Appeal :

(a) The Court of Appeal interpreted the decision of the Judicial Committee of

McCarthy P. 4 A.T.R. 483 lines 36-55

the Privy Council in the first Europa Oil case as emphasizing the test of reality and that what was meant by the phrase "as part of the contractual arrangement ..." in the majority judgment was that in a case like the present there must be a sufficient integration of the ordering of the goods and the machinery constructed to produce the advantage asserted by the Commissioner to enable it to be said that the placing of the order for goods contemplated that the machinery would thereby be set in motion to produce the advantage.

(b) The fact that Europa Oil was not a party to the 1964 contracts with Gulf or with any of the Gulf companies and thus lacked enforceable contractual rights linking Europa Oil with Gulf's obligations to Paneast did not enable the Court to depart from what the majority of the Judicial Committee of the Privy Council had concluded concerning the 1964 contracts in the first Europa Oil case.

McCarthy P. 4 A.T.R. 465 line 22 - p.467 line 40

(c) The fact that Europa Oil and Europa Refining were separate entities and that the latter was not a subsidiary of the former did not enable the Court to depart from the conclusion reached in the first Europa Oil case.

McCarthy P. 4 A.T.R. 465 480 line 50 - 481 line 2

RECORD

McCarthy P. 4 A.T.R. 483 lines 36-55

(d) Notwithstanding such difference as did exist between the material before the Courts in the present case and that presented in the first Europa Oil case there was in the Court's view too extensive an integration of Europa Oil's orders for crude oil and feedstocks with the arrangements between Europa Refining and Gulf and those between Gulf and Paneast to permit the separation of the buying by Europa Oil from Europa Refining from the ultimate entitlement of Europa Oil to its share of the benefits coming to Paneast.

McCarthy P. 4 A.T.R. 484 line 4 - p.485 line 15

(e) As to the segregation and quantification of the advantage, all that the Commissioner need do is to show that both processes (i.e. segregation and quantification) are possible, the general onus remaining with the taxpayer. Apportionment of business expenditure is a question of fact. The objective is a fair and reasonable assessment. On that basis the f.o.b. payments should be treated as having been expended for the combined total of the values of the feedstocks acquired and the Paneast benefits obtained as a result of those payments. Then the expenditure should be divided in direct proportion to those component values, allowing as deductible the amount thereby attributed to the feedstocks.

RECORD

(f) As to the language of the new s.111, there was a difference of opinion about the meaning of the word "necessarily" in para. (b). McCarthy P. considered that it should be given its usual meaning and not the meaning "clearly appropriate or adapted for", which had been accepted in certain decisions of the High Court of Australia in cases on the corresponding Australian section. Beattie J. preferred the Australian approach to the literal interpretation which had found favour with McMullin J. in the Supreme Court. Richmond J. treated the word as in one sense restrictive in operation yet at the same time conveying a sense of entitlement.

McCarthy P. 4 A.T.R. 486 lines 1 - 39

Beattie J. 4 A.T.R. 499 line 7 - 500 line 36

Richmond J. 4 A.T.R. 496 lines 8 - 30

(g) All of the judges in the Court of Appeal considered that para.(b) of the new s.111 provided a broader basis on which as a company carrying on a business Europa Oil was entitled to deduct certain expenditures. To the extent equivalent to arm's length f.o.b. long term market values the expenditure actually incurred by Europa Oil was necessarily incurred in the course of carrying on its business for the purpose of gaining or producing the assessable income.

McCarthy P. 4 A.T.R. 487 lines 32-45

Richmond J. 4 A.T.R. 497 lines 12-18

Beattie J. 4 A.T.R. 500 lines 28-36

(h) There is nothing in s.110A of the Act to prevent the Court from applying

(1974) 1 T.R.N.Z. 7-8

RECORD

s.111(b) to permit an apportionment of expenditure along the lines indicated by the Court.

(i) In the circumstances the Court had power to declare that expenditure should be apportioned along the lines indicated and also had the power to remit the case to the Supreme Court in order that that Court should determine the quantum of the actual arm's length long term market value of the feedstocks in respect of which the costs were incurred. The Court considered that it was an appropriate case in which to exercise that power. (1974) 1 T.R.N.Z. 5 (1974) 1 T.R.N.Z. 6

(j) As to s.108 of the Act, the Court saw nothing new in the present case and saw no point in restating the discussion which had taken place in the first Europa Oil case and left to the Judicial Committee of the Privy Council to decide, if necessary, whether the views both of the Court of Appeal and of the minority of the Judicial Committee in the first Europa Oil case were to prevail. McCarthy P. 4 A.T.R. 487 line 46 - p.488 line 6

39. In order to appreciate the way in which the Court of Appeal dealt with submissions on the application of s.108 of the Act it is desirable to recapitulate the findings made and conclusions reached by the Courts in the first Europa Oil case.

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40. In the Supreme Court in that case McGregor J. held on the facts before him that when Europa Oil entered into arrangements in 1956 for the supply of petroleum products it was not Europa Oil's purpose to avoid any tax liability. In view, however, of his findings under s.111 of the Act McGregor J. did not consider it necessary to reach any conclusion as to the application of s.108.

[1970] N.Z.L.R. 356 line 38

Much of the Commissioner's argument had centred on the proposition that Europa Oil had obtained a "disguised" discount or "in effect" a discount for its purchases of petroleum products by "indirect" means. That view of the facts was not accepted by any of the Judges in the Court of Appeal, nor by any of their Lordships in the Judicial Committee of the Privy Council and has not hitherto been pursued in the Commissioner's submissions in the present case.

[1970] N.Z.L.R. 337 lines 15-36

41. The basic findings of McGregor J. now relevant in the present context may therefore be summarised as follows :

(i) the scheme of locating Paneast in the Bahamas was initiated by Gulf and in fact Gulf insisted in entering into the contracts through the medium of Paneast.

[1970] N.Z.L.R. 338 line 11

p.356 lines 20-23

(ii) There was no suggestion that the Paneast Contracts had the effect of altering the incidence of income tax or of relieving Gulf of any liability for tax.

[1970] N.Z.L.R. 356 lines 23-25

RECORD

(iii) The series of contracts had the purpose and also the effect of facilitating and obtaining increased profitability to Gulf in its trade in fuel oil. [1970] N.Z.L.R. 356 lines 25-27

(iv) The series of contracts had the purpose of avoiding repercussions in Gulf's trade with other purchasers of refined products and in its relations with another oil company. [1970] N.Z.L.R. 356 lines 27-29

(v) The series of contracts had the purpose and effect of avoiding repercussions or difficulties affecting Europa Oil in its New Zealand trade both in regard to competition and in regard to Government regulation of retail petrol prices. [1970] N.Z.L.R. 356 lines 29-31

(vi) Probably included in the purposes was the obtaining of facilities and of advantages in matters of overseas exchange. [1970] N.Z.L.R. 356 lines 31-32

(vii) The purpose of the arrangement in its initial stages was not to avoid tax liability. It would be contradictory with his conclusions that Europa Oil's share of Paneast's profits must be deducted from the cost of Europa Oil's supplies in deciding expenditure deductible for income tax purposes, if His Honour were to hold that the effect of the contracts, agreements, and subsequent [1970] N.Z.L.R. 356 lines 38-43

RECORD

arrangements was to obtain relief from taxation.

(viii) The 1958/1959 subsequent occasions for variation of profit which in effect resulted in a guarantee of a minimum level of profits to Paneast not based on the original contract formula were conducted on an "arm's length" commercial basis. [1970] N.Z.L.R. 333 line 53 - p.334 line 3

42. In the Court of Appeal North P. held :

(i) The Commissioner's argument failed in limine because the arrangements between Gulf and Europa Oil was capable of explanation by reference to ordinary commercial dealings. [1970] N.Z.L.R. 387 lines 47-52

(ii) Once Europa Oil established (as His Honour held it had) that it could not obtain a discount off posted prices in its petroleum products and sales contracts there was no room for the application of s.108. [1970] N.Z.L.R. 388 lines 49-51

(iii) The arrangement made by Gulf and Europa Oil was dictated by Gulf and was intended to give Europa Oil a share in the refining sector of Gulf's overseas earnings. [1970] N.Z.L.R. 388 lines 50-53

(iv) Gulf selected the place where Paneast was to be incorporated. [1970] N.Z.L.R. 388 line 54 - p.389 line 2

(v) There was no commercial reason why Gulf should incorporate Paneast in [1970] N.Z.L.R. 389 lines 7-8

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New Zealand, rather than in the Bahamas, or in the United States of America.

(vi) Before s.108 could apply the purpose of the arrangement must have been the avoidance of tax in New Zealand, and there was no support for that conclusion from an examination of the voluminous documents. [1970] N.Z.L.R. 389 lines 8-15

43. The learned President shared the doubt of Dixon C.J. expressed in Cecil Bros Pty Ltd. v. Federal Commissioner of Taxation (1964) 111 C.L.R. 430 whether, where the Commissioner sought to increase a taxpayer's assessable income by denying an outgoing to which it was entitled, s.108 could have any application. [1970] N.Z.L.R. 389 lines 18-24

44. Section 108 had no more effect than to destroy the arrangement Europa Oil had with Gulf and it was still necessary for the Commissioner to demonstrate that the annihilation of the arrangement resulted in taxable income reaching Europa Oil. North P. could not see how the Commissioner could overcome that further difficulty. [1970] N.Z.L.R. 389 lines 24-30

45. The other members of the Court gave reasons which may be summarised as follows :

TURNER J.

(a) The Commissioner failed to show a taxable situation once the contracts separately or together, as constituting an arrangement, were annihilated without substituting other hypothetical transactions. [1970] N.Z.L.R. 413 line 50 - p.414 line 40

RECORD

(b) It was not possible to predicate tax alteration or relief when the challenged transactions were surveyed through the complicated jungle of countervailing commercial considerations which surrounded them. [1970] N.Z.L.R. 414 line 40 - p.415 line 3

McCARTHY J.

(a) If Europa Oil could not secure a discount or other benefit receivable in New Zealand it was impossible to say that s.108 could apply. [1970] N.Z.L.R. 430 lines 6-12

(b) If there was a valid deduction under s.111 it was difficult to see how s.108 could have application. [1970] N.Z.L.R. 430 lines 13-15

(c) On His Honour's view of the facts the arrangements were a sensible commercial arrangement and the "predication" (Newton v. Commissioner of Taxation of the Commonwealth of Australia [1958] A.C. 450) test was not met. [1970] N.Z.L.R. 430 lines 25-41

46. In the Judicial Committee of the Privy Council only the minority (Lord Donovan and Viscount Dilhorne) had to consider s.108. They did so in these terms :

(i) The Commissioner's contentions based on s.108 were 'hopeless'. The statute conferred freedom of tax in respect of the dividend received from a foreign subsidiary and liability to tax could not be created by receiving the very thing recognised by the statute. [1971] A.C. 783 B-C

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(ii) If that which was relieved from tax was an arrangement, part of which produced tax-free income, that part could not be annihilated and yet preserve the income. [1971] A.C. 783 C-D

(iii) On all issues raised they agreed with the conclusions of the Court of Appeal. [1971] A.C. 783 F-G

47. In the present case McMullin J. made three comments on Europa Oil's submissions under s.108 which may be summarised as follows :

(i) The "Pan Eastern Arrangement" was not an ordinary commercial transaction because of the incorporation of Pan Eastern in the Bahamas. 3 A.T.R.535 lines 25-45

(ii) Section 108 may avoid a transaction and consequently a deduction allowable under s.111. 3 A.T.R.535 line 45 - p.536 line 43

(iii) Section 108 may apply even though Paneast is a non-resident Company not controlled in New Zealand and even though the income of Paneast is not derived in New Zealand. 3 A.T.R.536 lines 43-53

48. Of those findings only the first dealt with a factual situation; that finding may be summarised as follows :

The selection of the Bahamas as the place where Paneast was to be incorporated was a selection which can be reasonably explained only in terms of avoiding New Zealand income tax, and no satisfactory commercial reasons had been given.

RECORD

49. In the Court of Appeal certain specific findings were sought from the Court with respect to the application of s.108, in particular the findings numbered 'K' and 'L'. Finding 'L', with which the Court agreed, was that the 1964 contracts were negotiated at arm's length between Mr Todd and Gulf. Finding 'K' was dealt with in the concluding passage of the judgment where the President (with whose judgment the other members agreed) dismissed McMullin J.'s finding for the reasons that - 4 A.T.R.474 line 37 and line 43

(a) the matter was fully argued before the Court of Appeal and the Privy Council in the first Europa Oil case; 4 A.T.R.487 line 46 - p.488 line 6

(b) the Court of Appeal was unanimous that the Commissioner could not avail himself of s.108 and the minority in the Privy Council had observed the argument as hopeless;

(c) it had not been contended before McMullin J. that there was anything in the asserted changes in circumstance and the amendments to the legislation which advanced the argument for the Commissioner relating to s.108.

RECORD

CONTENTIONS TO BE URGED BY THE APPELLANT

A. As to the three years ended 31 March 1966, 31 March 1967, 31 March 1968 (the first 3 year period)

None of the assessments issued by the Commissioner can be supported under s.111 of the Act because :

(a) On the evidence the 1964 contracts between Europa Refining and Gulf were contracts for the purchase and sale of feedstocks (with an option in respect of finished products) and the marine transportation thereof.

(b) On the evidence the 1964 contracts between Gulf and Paneast were contracts for purchase and processing of crude oil, the sale of the production from such processing and of crude oil, under which the net profits were shared equally between Gulf and Europa Oil.

(c) The purpose for which Europa Oil incurred the expenditure which it claims to be entitled to deduct in calculating its assessable income under s.111 was not a dual purpose, but for the sole purpose of procuring delivery at its coastal terminals in New Zealand of petroleum products from the New Zealand Refinery at Marsden Point for which it paid a composite consideration by advances to or for the benefit of Europa Refining.

(d) Europa Oil and Europa Refining were separate entities. Only Europa Refining was a party to the 1964 contractual arrangements with Gulf for the purchase of Refinery feedstocks. Whenever Europa Oil purchased petroleum products, it was under no prior obligation either to Europa Refining or to Gulf to acquire its supplies from Europa Refining.

(e) Europa Oil was under no obligation to purchase its supplies from Europa Refining.

(f) It was no part of the contractual arrangements under which Europa Oil acquired its petroleum products that some advantage, not identifiable as, or related to the production of assessable income, was gained.

(g) If, contrary to the foregoing contentions, it may be held that there was a dual purpose for the expenditures incurred by Europa Oil, the Commissioner has not shown that part of those expenditures can be segregated and quantified, so that part of the expenditures ought to be considered as consideration for some collateral advantage gained as part of the contractual arrangements under which the petroleum products were acquired.

(h) There is no justification in law or in fact for treating the share of processing profits received or receivable by Europa

Oil (through its subsidiary) from Paneast as the measure of the consideration paid by Europa Oil for that very advantage.

(i) If (contrary to the foregoing contentions) it should be held that there was a dual purpose for the purchase of petroleum products by Europa Oil and if it should be held that the assessments made by the Commissioner were not correct, then, without prejudice to the foregoing contentions,

(i) The correct mode of apportionment to be applied for determining what part of the expenditures incurred by Europa Oil in the purchase of petroleum products was exclusively incurred in the production of its assessable income in any income year is to allow as deductible so much of the expenditure as represents the actual arm's length long term market values of those products; but, if that contention be not accepted, then (without prejudice to the foregoing contentions)

(ii) a formula of apportionment is the correct approach to be adopted in ascertaining the allowable deductions; and, in either case,

(iii) the Court of Appeal possesses the power which in the circumstances of

this case it was justified in exercising of remitting the case to the Supreme Court in order that that Court should receive evidence for the purpose of determining the actual arm's length long term market values.

B. As to the three years ended 31 March 1969, 31 March 1970, 31 March 1971 (the second 3 year period)

None of the assessments issued by the Commissioner can be supported under s.111 (as amended) of the Act because in addition to the foregoing contentions (a) to (h) inclusive relative to s.111 as originally worded :

(a) The only purpose for which Europa Oil incurred the expenditure which it claims to be entitled to deduct was the gaining or producing of assessable income in each of the years in question and to that extent the entire expenditure is deductible pursuant to s.111(a) of the Act.

(b) The entire expenditures were necessarily incurred by Europa Oil in carrying on its business as a wholesaler of petroleum products, which business was carried on for the purpose of gaining or producing assessable income in each of the years in question and to that extent are deductible pursuant to s.111(b) of the Act.

(c) If (contrary to the foregoing contentions) it should be held that there was a dual purpose for the purchase of petroleum products by Europa Oil and if it should be held that the assessments made by the Commissioner were not correct, then, without prejudice to the foregoing contentions,

(i) the principle of apportionment adopted by the Court of Appeal is correct; and

(ii) the Court of Appeal possessed the power which in the circumstances of this case it was justified in exercising of remitting the case to the Supreme Court in order that that Court should receive evidence for the purpose of determining the actual arm's length long term market values.

C. As to s.108

(a) That s.108 has no application to the facts of this case because what was arranged was a commercial bargain negotiated at arm's length which did not have the purpose or effect designated by the section. The transactions constitute ordinary commercial or business dealings.

(b) In all cases in Australia (under the corresponding statutory provision of the Commonwealth Act) or in New Zealand under s.108, where the Commissioner has succeeded, the 'arrangement' has varied or affected

an existing source of income. The present case is not in this category. Here the 'arrangements' produced the new source of income, and without the 'arrangement' there would be no income.

(c) The Commissioner seeks to deny to Europa Oil under s.108 a deduction to which Europa Oil is entitled under s.111. Once a taxpayer becomes entitled to a deduction under s.111, there can be no room for the operation of s.108 to disallow the same expenditure.

(d) That the Act envisages arrangements which may produce non-taxable income. This is the case in respect of the dividends received from Paneast by A.M.P. and then from A.M.P. by Europa Oil. Where the Act confers such a freedom from tax, s.108 cannot apply to create a liability for tax.

(e) That the taxpayer must be a party to the 'contract, agreement, or arrangement' which it is sought to have declared void. In the 1964 contracts Europa Oil was not a party to the arrangements between Europa Refining and Gulf.

(f) That the 'contract, agreement, or arrangement' which it is sought to have declared void must be between parties or relate to a subject matter which is or are properly subject to the Act and to the jurisdiction of the New Zealand Court. In this case Gulf and Paneast are both outside the jurisdiction and in particular it is not

competent for the New Zealand Court to declare void the incorporation of Paneast as a separate legal entity created by the law of the Bahamas Islands.

The appellant humbly submits that to the extent that it did not wholly allow the appeal of the Appellant against the judgment of the Supreme Court the decision of the Court of Appeal was wrong and that this appeal should be allowed with costs for the following among other

REASONS

(a) The Commissioner's assessments cannot be supported under s.111 (as originally enacted) of the Act Because :

(i) the expenditures incurred by Europa Oil in the acquisition of its trading stock were incurred exclusively in the production of the assessable income for the income year in question;

(ii) the Commissioner has failed to show that as part of the contractual arrangement under which it acquired its trading stock Europa Oil gained some advantage, not identifiable as, or related to the production of the assessable income;

(iii) the Commissioner has further failed to show that if any such advantage was gained, part of the expenditure incurred by Europa Oil can be

segregated and quantified and ought accordingly to be considered as consideration given by Europa Oil for that advantage.

(b) The Commissioner's assessments cannot be supported under s.111 (as amended) of the Act because :

(i) the expenditures incurred by Europa Oil in the acquisition of its trading stock were incurred exclusively in gaining or producing the assessable income for an income year;

(ii) the expenditures incurred by Europa Oil in the acquisition of its trading stock were necessarily incurred in carrying on its business for the purpose of gaining or producing assessable income for an income year.

(c) Insofar as the decision of the Court of Appeal held against the Appellant on each of the Appellant's submissions under s.111 (as originally enacted) and under s.111 (as amended) respectively it was wrong.

(d) The Commissioner's assessments cannot be supported under s.108 of the Act because

(i) Section 108 is not applicable because the arrangements were in each year ordinary business dealings

(ii) Section 108 is not applicable because it is the arrangement which

the Commissioner contends is void that in each year produced the income

(iii) If the deduction is allowable under s.111 it cannot be disallowed as void under s.108

(iv) Section 108 is not applicable because the Act envisages that a taxpayer may receive non-taxable income and freedom from income tax in respect of dividends from Paneast is conferred by the Act itself

(v) Transactions cannot be avoided by s.108 unless the taxpayer is a party thereto

(vi) Transactions cannot be avoided by s.108 unless the parties thereto are subject to the Act or to New Zealand jurisdiction.

(e) The decision of the Court of Appeal in favour of the Appellant with respect to s.108 was correct.

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