34/83

IN THE PRIVY COUNCIL No 16 of 1983

ON APPEAL
FROM THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN

PAUL DOUGLAS LOWE, HERBERT MONTY LOWE, and KEITH LOWE

Appellants

- and -

The COMMISSIONER OF INLAND REVENUE

Respondent

RECORD OF PROCEEDINGS

Blyth Dutton Holloway 9 Lincoln's Inn Fields London WC2A 3DW	Allen and Overy 9 Cheapside EC2V 6AD London SE2
Agents for	Agents for
Bradley Steven & List Timaru New Zealand	Crown Law Office Wellington New Zealand
Solicitors for Appellants	Solicitors for Respondent

IN THE PRIVY COUNCIL No of 1981

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RECORD OF PROCEEDINGS

INDEX OF REFERENCE

PART I

PART II

DOCUMENTS OMITTED FROM THE RECORD

Description of Document	Date
Memorandum of submissions by Counsel moving that conditional leave be given to appeal to Her Majesty in Council	15 August 1979
Reasons for judgment of Roper J on that motion	23 August 1979
Notice of Motion for an Order Fixing Security for Costs on Appeal to the Court of Appeal	14 September 1979
Certificate as to payment of security for costs	27 September 1979
Memorandum of Grounds of Appeal	20 December 1979
IN THE COURT OF APPEAL OF NEW ZEALAND	
Praecipe to set down	Undated
Motion for an Order granting Conditional Leave to Appeal to Her Majesty in Council	26 March 1981
Affidavit of Kenneth Alan Churcher in support	30 April 1981
Order granting conditional leave	4 May 1981
Motion for Order granting final leave	20 July 1981
Affidavit of Russell James Charles List in support	14 July 1981

IN THE PRIVY COUNCIL No of 1981

ON APPEAL
FROM THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN

PAUL DOUGLAS LOWE, HERBERT MONTY LOWE, and KEITH LOWE

Appellants

- and -

The COMMISSIONER OF INLAND REVENUE

Respondent

RECORD OF PROCEEDINGS

No 1

AMENDED CASE STATED

In the Supreme Court of New Zealand

No 1

GR 37/76

IN THE SUPREME COURT OF NEW ZEALAND
TIMARU REGISTRY

Amended Case Stated 10 May 1978

BETWEEN PAUL DOUGLAS LOWE of Timaru Company Director

First Objector

HERBERT MONTY LOWE of Timaru Company Director

Second Objector

KEITH LOWE of Timaru Company Director

Third Objector

In the Supreme Court of New Zealand

A N D THE COMMISSIONER OF INLAND REVENUE

Commissioner

No 1

AMENDED CASE STATED

Amended Case Stated 10 May 1978

- continued

pursuant to section 32 of the Land and Income Tax Act 1954

1 FROM the 1st day of January 1960 the Objectors carried on in partnership a fruiterers' business (hereinafter referred to as "the partnership") until March 1963 when the said business was sold to a company known as Lowes Supermarket Limited. The partnership retained the business premises and let them to the said company. Since the 1st day of April 1963 the partnership has derived income from rent.

2 DURING the year ended on the 31st day of May 1962 the partnership purchased a block of land comprising approximately 10 acres at Gleniti, Timaru for a consideration of $20,024.99. Subsequently the said land was subdivided into 36 housing sections and the partnership offered such sections for sale, the first sale being effected in January 1964.

3 IN furnishing a return of income to the Commissioner for income tax purposes for the year ended on the 31st day of March 1974 it was declared on behalf of the partnership that it had incurred a loss of $2,658.00. Copies of the financial statements furnished in support of the said return are annexed hereto and marked 'A'.

The schedule of assets included in the said financial statements showed that the partnership sold further land during that year and treated the profit from the sale as a capital gain.

4 IN response to enquiries made by the Commissioner by letter dated the 25th day of March 1975 a copy whereof is annexed hereto and marked 'B' the Objectors' accountants replied by letter dated the 10th day of June 1975. A copy of such letter is annexed hereto and marked 'B1'.

Copies of previous correspondence regarding the sale of the said land are also annexed hereto and marked as indicated:

(a) Copies of letters dated the 21st day of October 1970 and the 9th day of July 1973 with annexure from the Objectors' accountants - 'B2' and 'B3' respectively.

(b) A copy of the Commissioner's letter dated the 24th day of August 1973 and a copy of the Objectors' accountants' reply thereto dated the 12th day of December 1973 together with a copy of a statement referred to therein - 'B4' and 'B5' respectively.

5 PARTICULARS of the subdivision costs incurred by the partnership during the years ended on the 31 days of March 1970 and 1971 are as follows:

Year ended 31 March 1970

Hamilton Cartwright Limited - bulldozing land, digging drains etc.	$2,700.00
S.C.E.P.B. Reticulation fees	1,455.00
Timaru City Council - Reserve Fund Contribution	1,582.00
Rates, interest etc.	597.00
Total cost	$6,334.00

Year ended 31 March 1971

Hamilton Cartwright Limited - Formation work, kerbing, roading, sealing etc.	$11,000.00
Bridges & Milward - survey costs	2,174.00
Timaru City Council - permits, drain inspections etc.	672.00
Rates, interest etc.	352.00
Total cost	$14,198.00

6 THE Commissioner considered that the profits derived from the said land made on or after the 10th day of August 1973 were assessable income of the partnership in terms of section 88AA(1)(d) of the Land and Income Tax Act 1954, and notified the Objectors through their accountants to that effect by letter dated the 20th day of June 1975 a copy whereof is annexed hereto and marked 'C'.

Accordingly the Commissioner adjusted the said loss returned by the partnership in respect of the year ended on the 31st day of March 1974 as follows:

Loss as returned	$2,658.00
Less profit on sale of land	15,566.50
Total income	$12,908.50
First Objector's share	$4,302.84
Second Objector's share	$4,302.83
Third Objector's share	$4,302.83

7 SUBSEQUENTLY the Commissioner made assessments of the Objectors' liability to income tax for the year ended on the 31st day of March 1974 including in the assessable income of each Objector the respective sums set forth in the preceding paragraph hereof. Particulars of such assessments are as follows:

	First Objector	Second Objector	Third Objector
Income as returned	$1,710.26	$1,721.52	$2,355.00
Add share of partnership income	4,302.84	4,302.83	4,302.83
Amended assessable income	$6,013.10	$6,024.35	$6,657.83
Income tax	$1,496.95	$1,327.42	$1,694.49

8 THE Objectors objected to the assessments referred to in the preceding paragraph hereof on the grounds set forth in their accountants' letter dated the 7th day of August 1975 a copy whereof is annexed hereto and marked 'D'.

9 THE Commissioner disallowed the said objection and notice of such disallowance was given to the Objectors' accountants by letter dated the 13th day of August 1975 a copy whereof is annexed hereto and marked 'E'.

The Commissioner was thereupon required to state this case.

10 THE Objectors contend: Nil. Despite requests made on 30th July 1976, 19th August

1976 and 6th September 1976 the Objectors have not supplied their contentions.

11 THE Commissioner contends:

(a) That the profits or gains derived from receipts from the sales of the sections at Gleniti on or after the 10th day of August 1973 are subject to the provisions of Section 88AA(1)(d) Land and Income Tax Act 1954 in that there has been:

(i) an undertaking or scheme;

(ii) involving the development or division into Lots of the said land;

(iii) such development or division work not being work of a minor nature;

(iv) carried out on behalf of the taxpayers in relation to the said land and that

(v) the undertaking or scheme was commenced within 10 years of the date on which the said land was acquired by the taxpayers and thus the said profits or gains are assessable as income under the provision of Section 88(1)(cc) under the said Act.

(b) The land at Gleniti was acquired by the taxpayers in June 1961 and the undertaking or scheme involving the development or division into Lots of the said land commenced in 1963 after which the said land was sub-divided into 36 housing sections on behalf of the taxpayers so that by the 31st day of March 1974 $79,521.18 had been expended on the development or division work. The partnership offered such sections for sale, the first sale being effected in January 1964.

12 THE questions for the determination of this Honourable Court are whether the Commissioner, in making the assessments referred to in paragraph 7 hereof, acted incorrectly in including in such assessments the share of profits derived by the partnership from the sale of the said land and if so, then in what respects should such assessments be varied.

Dated at Wellington this 10th day of May 1978

"R Kellaway"

Chief Deputy Commissioner
of Inland Revenue

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

- continued

Exhibit 'A'

LOWE BROS. PARTNERSHIP : TIMARU
BALANCE SHEET AS AT 31ST MARCH 1974

1973					1973		
	CURRENT LIABILITIES					CURRENT ASSETS		
22,344	Commercial Bank : No. 3 Account Overdraft		23,536		1,040	Sundry Debtors	--	
435	Sundry Creditors		400		33,554	Current Account: Lowes Supermarket Ltd	49,932	
4,886	Current Account : C.K. Lowe		4,942			Scott, Bradley & Unwin : Trust Account	4,065	
475	Deposit on Sections		--					
28,140	TOTAL OF CURRENT LIABILITIES			28,878	34,594	TOTAL OF CURRENT ASSETS		53,997
	TERM LIABILITIES					FIXED ASSETS (as per attached Schedule)		
2,153	Loan : H. Lowe			2,133	145,877	Land and Buildings		128,921
5,732	Loan : Mrs C.K. Lowe			5,732				
1,560	Loan : P.D. Lowe		1,560					
1,560	Loan : H. Lowe		1,560	3,120				
4,600	Loan : P.D. Lowe			4,600				
72,000	Mortgage : Perpetual Trustees Co.Ltd			72,000				
13,670	Mortgage : A.L. Hamilton & Others			10,870				
9,500	Loan : Commercial Bank			10 --				
110,755	TOTAL OF TERM LIABILITIES			98,455				
	CAPITAL ACCOUNTS							
	P.D. LOWE							
	Balance as at 1st April 1973			15,619				
	Add Share Capital Profit on Sale of Sections			7,556				
				23,175				
	Less Share Nett Loss for year			886				
15,619	BALANCE AS AT 31ST MARCH 1974.			22,289				
	K. LOWE							
	Balance as at 1st April 1973			12,990				
	Add Share Capital Profit on Sale of Sections			7,556				
				20,546				

'A'

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'A'

- continued

Less Land & Buildings Adjustment: 22A Hobbs Street	6,000		
Less Share Nett Loss for year	886	6,886	
12,990	BALANCE AS AT 31ST MARCH 1974		13,660
	H. LOWE		
	Balance as at 1st April 1973	12,967	
	Add Share Capital Profit on Sale of Sections	7,555	
		20,522	
	Less Share Nett Loss for year	886	
12,967	BALANCE AS AT 31ST MARCH 1974		19,636
		$182,918	$180,471
$180,471			$182,918

We certify that we have prepared the above Balance Sheet and attached Statement of Accounts in accordance with records, information and instructions furnished by Messrs P.D., K., and H. Lowe. Our instructions do not include an audit of the Accounts.

TIMARU.

HUBBARD, CHURCHER, GABITES & CO.

17th February 1975

per: _____

In the Supreme Court of New Zealand

No 1

Amended Case Stated

Exhibit 'A'

- continued

LOWE BROS. PARTNERSHIP : TIMARU
SCHEDULE OF FIXED ASSETS AND DEPRECIATION
AS AT 31ST MARCH 1974

	Cost Price Buildings	Book Value 1.4.73	Additions During Year	Sales During Year	Capital Profit	Ordinary Depreciation	Supplementary Depreciation	Book Value 31.3.74
LAND AND BUILDINGS								
Stafford Street	4,240	13,016				106		12,910
102 Evans Street	34,907	32,032	3,071			873		34,230
22a Hobbs Street	4,700	5,342		6,000	658 reversed			--
100 Evans Street	7,000	9,673				175		9,498
Gleniti : Land		28,517	1,120	41,783	22,667			10,521
Motels	52,827	57,297	6,049			1,056	528	61,762
		$145,877	10,240	47,783	23,325	2,210	528	128,921

LOWE BROS. PARTNERSHIP : TIMARU
FOR YEAR ENDED 31ST MARCH 1974

PROFIT AND LOSS ACCOUNT

1973			1973			
294	General Expenses	152	6,025	Rent : Shops	10,100	
33	Insurance	179	208	Rent : Hobbs Street House	--	
3,918	Interest	8,793	112	Rent : Sundry	--	10,000
176	Legal Expenses re financial reconstructions	--				
893	Rates	1,452				
--	Repairs and Maintenance	102	--	Depreciation : 22A Hobbs Street reversed		658
5,314		10,678				
	DEPRECIATION (as per Schedule)			NETT LOSS FOR YEAR transferred to Capital Accounts		
2,087	Buildings	2,738	352	P.D. Lowe	886	
			352	K. Lowe	886	
			352	H. Lowe	886	2,658
$7,401		$13,416	$7,401			$13,416

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

- continued

Exhibit 'B'

EXHIBIT 'B'

LETTER ON BEHALF OF RESPONDENT TO APPELLANTS' ACCOUNTANTS

25 March 1975

Messrs Hubbard, Churcher, Gabites & Co,
P.O. Box 125,
TIMARU.

Dear Sirs

LOWE BROS PARTNERSHIP
OUR REFERENCE: TU/COY/2
1974 RETURN OF INCOME

I note that the partnership sold further land during the year ended 31 March 1974. Those sales which took place on or after the 10 October 1973 will be subject to the provisions of the Section 88 AA of the Land and Income Tax Act 1954. So that I can determine if any of the sections sold will constitute assessable income would you please let me have the following:

1. The number of sections sold during the year ended 31 March 1974.

2. The date of purchase of this land and the respective cost price of these sections.

3. The date each section was sold and the respective selling price.

In addition would you please let me know the date of commencement of the undertaking or scheme of subdivision, of these particular sections.

In the depreciation schedule you show the book value of land and buildings at the 1 April 1973 to be $145,877.00. However, this figure is substantially greater than the cost price. Please explain.

Please also forward further information concerning the sale of land and buildings at 22a Hobbs Street, Timaru.

Yours faithfully,

"IFB"
(I. F. Beswarick)
Examiner

EXHIBIT 'B1'

APPELLANTS' ACCOUNTANTS' REPLY TO EXHIBIT 'B'

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

- continued

Exhibit 'B1'

10 June 1975

The District Commissioner of Taxes,
Inland Revenue Department,
Private Bag
TIMARU.

Dear Sir,

RE: LOWE BROS. PARTNERSHIP - YOUR REFERENCE TU/COY/2 1974 RETURN OF INCOME

In reply to your letter dated 25th March 1975 we submit the following information :-

1. The number of sections sold during year ended 31st March 1974 was nine.

2. The land was originally purchased in 1961 for use as a market garden but owing to developments which took place in the surrounding areas and to other matters affecting the property at the time, it was decided to subdivide. We have had previous correspondence with your Department on these matters between July to October, 1970 and August to December 1973, which we assume will be on our clients file.

In order to arrive at a cost per section at the commencement of the subdivision we took the initial cost of the land, added the projected cost of the total development, interest on loans, legal fees, rates and other expenses of holding the land, then divided the total thus obtained by the number of sections. This gave a figure of $2,300 which it is realised is an average figure and does not take into account variations in area, but it has been on this basis that capital profit adjustments have been made in the land account to date.

As there are some sections in the block still to be sold the final cost is not yet known but with approximately 80% of the subdivision now disposed of it appears that our calculated cost figure is reasonably correct.

The cost of the Gleniti land plus development and other costs capitalised over the period totalled $79,521.18 to 31 March 1974. It is estimated that there could be a further sum of approximately $4,000 to add to costs in respect of the completion of development work on the unsold sections. This gives a total cost

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B1'

- continued

of $83,521.18 divided by the total number of sections sold and for sale, 36, gives an average cost of $2,320.

3. The legal statements provided by our clients show the date of sale and sale value of the sections sold during year ended 31st March 1974 as follows :

1973				
April	11		4,750	
	19		4,750	10
May	10		3,000	
August	15		4,050	
October	30		4,363	
November	2		4,850	
December	17		5,000	
1974				
January	1		6,000	
March	29		5,301	
			42,064	
Less Legal Fees		106		20
" Commission		175	281	
			$41,783	

The decision to subdivide would have been taken during the 1973 year as the first sale of a section is recorded in January 1964.

The cost price column on the depreciation schedule relates to buildings only in order to show the basis for the depreciation calculation. 30

The entries on the schedule relating to land and buildings at 22A Hobbs Street have not been properly narrated. The property was not sold but has been written out of the partnership books and the depreciation previously claimed has been reversed. This property has been shown as an asset in the partnership books since 1967 but it was pointed out to us during discussion with our clients on the accounts recently that 40 it is in fact owned by Mr Keith Lowe, one of the partners. The entries made in the 1974 accounts remove the asset from the partnership books and his capital account has been debited accordingly.

We apologise for the delay in replying to your correspondence

In the Supreme Court of New Zealand

Yours faithfully,
HUBBARD, CHURCHER & CO.

No 1

Amended Case Stated
10 May 1978

per: 'K A Churcher'

KAC:GC

Exhibit 'B1'

- continued

EXHIBIT 'B2'

Exhibit 'B2'

APPELLANTS' ACCOUNTANTS' REPLY TO AN EARLIER LETTER ON BEHALF OF THE RESPONDENT

21st October 1970

The District Commissioner of Taxes,
Inland Revenue Department,
Private Bag,
TIMARU.

re LOWES SUPERMARKET PARTNERSHIP

We acknowledge receipt of your letter dated 15th July, 1970 ref. T/Coy/3 re 1969 return of income and have discussed this matter with our clients on several occasions in the interim.

The following information is submitted in reply to the questions raised :-

1. The initial deposit on this land was paid in June, 1961 and the purchase was completed several months later. The property was farmland at the date of acquisition.

2. The property was originally purchased for the sole purpose of establishing a market garden to supply the fruiterers & greengrocery business acquired from Mrs. C. K. Lowe by the partnership when it was established in February, 1960. The partnership consisted of three partners and was originally formed to conduct the shop business. However it became necessary to expand as there was insufficient

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B2'

- continued

work in the one shop to keep each partner gainfully occupied The expansion programme included the purchase of the land at Gleniti for the market garden and the establishment of a second shop at Evans Street. There was no intention at the time of purchase of either property that the partnership should become dealers: in land or speculate with either property for profit.

3. The Gleniti property was selected from several properties available for purchase because it was handy to the town area and could be used for the growing of produce and also as a place where cases and other items could be stored for the fruiterers business. Of the properties inspected this land was also found to be the best soil suited to the growing of vegetables. At the date of purchase there was hardly any housing in the area, rates were cheap and it was selected as an ideal property on which to establish a market garden Several seasons were spent in growing vegetables and in developing the land to a good producing unit. Some problems were encountered by the partnership in this regard such as the failure of contractors to keep up with the heavy cultivation programme, weather conditions and its affect on the market price of vegetables. These matters were being corrected over a period as experience was gained, but the garden did not show the expected profits during the initial period.

Our clients wish us to emphasise that at no time during the negotiations for the purdhase of the land did they have the foreknowledge that it was to be taken into the City area. After this change came about the costs of occupation of the land rose thus further reducing the profitability of the garden. Enquiries were also received regularly after the change from parties interested in purchasing the land for housing development but our clients preferred to continue using the ground for their own purposes at that time. It later became clear, when other adjoining properties were subdivided

for sale as housing sections that it would not be possible to continue market gardening with the property for much longer. When an approach was made by Europa (NZ) Ltd., regarding the purchase of a section to be used for the erection of a service station it was finally decided to subdivide and offer the whole property for sale as it would not be a practical proposition to continue using the property for the original purpose. This decision was taken in 1964 when it was seen that other sections from adjoining properties were selling and houses were being erected on those properties. The remaining sections have in fact been slow to sell and the costs of subdivision, rates, mortgage interest and other expenses in connection with the land have been charged to the land account since the decision to sell was made The subdivision is yet to be completed in respect of some of the back sections and in the meantime costs have been estimated in order to arrive at the profits on the sections sold which have been transferred as capital profits in the books.

The partnership was originally formed to conduct the business of fruiterers at such places as may be agreed upon. The fruiterer businesses were subsequently purchased by a company, Lowes Supermarket Ltd., with the exception of the land which was rented by the company from the partnership. The partnership was not formed specifically for the purpose of holding property or as dealers in land, nor has its objects been altered since to include this purpose, although land and buildings are the only assets held by the partnership at the present time, and since the other assets were purchased by the company incorporated in October, 1962.

On behalf of our clients it is submitted that

(a) as the intention and purpose on acquisition of the land at Gleniti was to establish a market garden,

(b) that the land was used and occupied as such until the change in use of the surrounding farmland to housing

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B2'

- continued

sections following the incorporation of the area into the City made it impractical to continue,

(c) that subdivision was the best means of realising the asset in view of the approach from Europa (NZ) Ltd., and the fact that other adjoining properties had been or were in the course of being subdivided,

any profit which may result on the completion of the realisation of the land should be treated as an accretion to capital.

The delay in furnishing this reply is regretted.

Yours faithfully,

HUBBARD, CHURCHER, GABITES & CO.,

Per:

'K A Churcher'

Exhibit 'B3'

EXHIBIT 'B3'

APPELLANTS' ACCOUNTANTS' REPLY TO ANOTHER EARLIER INQUIRY ON BEHALF OF THE RESPONDENT TOGETHER WITH ANNEXURE BEING THE APPELLANTS' LAND ACCOUNT FROM 31 MARCH 1969 TO 31 MARCH 1972

9th July 1973

The District Commissioner of Taxes,
Inland Revenue Department,
Private Bag,
TIMARU.

Dear Sir,

Re - Lowe Brothers Partnership

We acknowledge receipt of your letter dated 16th April 1973, Ref. Tu/Coy/3 and regret this delayed reply, due to pressure of work in our office over recent weeks.

Details of the year-by-year entries to this Land Account in our clients' records, are

shown on the attached statement, and we will be pleased to supply any further information which may be required.

There has been no purchase of land at Gleniti, since the initial purchase during 1961 and our clients have found that some of the sections are proving slow to sell. Land has been purchased for the purpose of extensions to business premises in Evans and Hobbs Streets, which will be retained as business assets and the cost has been capitalised in the respective property accounts.

In reply to the second question, we attach a copy of our letter of 21st October 1970, written in answer to a similar enquiry from your Department in that year. The circumstances relating to the acquisition and disposal of this particular piece of land remain the same. The land wasnot sold to the Company when it formed, in order to save the costs involved in transfer. The Partnership only remains in existence because it owns the land and buildings rented to the Company for its various enterprises and our clients are not engaged in dealing in land for profit as part of their normal business activities.

We therefore submit, that none of the profits on realisation of the Gleniti land should be treated as assessable income.

Yours faithfully,
HUBBARD, CHURCHER, GABITES & CO.

Encl.

Per: 'K A Churcher'

LOWE BROTHERS - PARTNERSHIP

LAND ACCOUNT - GLENITI

1969			
March 31	Opening Balance		37,315.00
	Add Interest on Mortgage	266.00	
	Rates	423.00	
	Spraying	70.00	
	Adjustment for error in original cost price recorded for land - error found when settling mortgage	1,000.00	
	Subdivision costs	740.00	
	Legal costs	154.00	
	Commission	285.00	2,938.00
	Capital profit on sale		1,059.00
			41,312.00
	Less proceeds sale of section		8,400.00
			32,912.00

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B3'

- continued

1970				
March 31	Add	Interest	2.00	
		Rates	540.00	
		Subdivision costs	6,334.00	6,876.00
				39,788.00
1971				
March 31	Add	Rates	565.00	
		Subdivision costs	14,198.00	
		Commission on sale	1,035.00	15,798.00
		Capital profit on sale		6,429.00
				62,015.00
	Less	proceeds sections sold		32,420.00
				29,595.00
1972				
March 31	Add	Rates	612.00	
		Subdivision costs	50.00	
		Legal fees	289.00	
		Commission	205.00	1,156.00
		Capital profit on sales		1,500.00
				32,251.00
	Less	Proceeds of sections sold		6,079.00
				$26,172.00

Exhibit 'B4'

EXHIBIT 'B4'

LETTER OF INQUIRY ON BEHALF OF THE RESPONDENT TO APPELLANTS' ACCOUNTANTS

24 August 1973

Messrs Hubbard, Churcher, Gabites and Co.,
P. O. Box 125,
TIMARU.

Dear Sirs,

LOWE BROTHERS PARTNERSHIP

Our Reference: CH/L/Insp.

The file has been referred for consideration under Section 88(1)C of the Land and Income Tax Act 1954 and the opportunity has been taken to search all records available at both Lands and Survey, for detailsof subdivision; and Lands and Deeds, for information concerning the type of land purchased by the partnership. In addition enquiries have been made at the Timaru City Council's town

planning section.

The following is the result:

8 September 1960 - Timaru Herald - "Boundary Extensions" - Timaru proposes to extend boundaries to include Gleniti and Washdyke.

12 May 1961 - Land Valuation Court - vendor, Mrs Pettigrew, made application to have the 20 acres, 3 roods, 38 perches to be declared "not farm land". This was supported by a valuation by one Charles Gibson Reid, Valuer and Land Agent of Timaru. Copies enclosed.

...

June 1961 - Deposit paid by Lowe Bros.

19 September 1961- Approach by Council to Local Government Commission to include Revels (Gleniti) in Timaru City.

23 November 1961 - Washdyke proposal (Gleniti at same time).

13 March 1962 - Lowe Bros. registered as owners.

25 August 1962 -)Paper cuttings exist
21 December 1962 -)covering the proposed amalgamation.

April 1965 - Surveyed by Bridges, Melward and Fougene for subdivision - DP.24271.

February 1965 - Surveyed for DP.27647.

In addition the partnership returns show the following position

Sales		Per Cent
Year ended 31 March 1961	£20,398	35.52
" " 1962	£19,751	27.94
" " 1963	£ 7,565	19.19
" " 1964	£2,522	

As the sales represent those for the Stafford Street shop before the amalgamation of this business with that of the Supermarket in Evans Street, it appears certain that little

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B4'

- continued

general market garden produce has been sold through this outlet, as the elimination of a producer's margin of profit should have increased the percentage result. Checks with a local market did not disclose any sales of any surplus produce from the partnership.

It appears therefore that the available evidence does not support your clients' contentions as contained in your letter of 21 October 1970 and re-iterated on 9 July 1973.

Before these findings are submitted to the Regional Controller for his direction it is possible you may have further comments to offer in the light of the apparent altered circumstances. In particular you may be able to produce evidence of market gardening activities in the period from date of acquisition to date of instruction to surveyors in 1965. This, of course, would need to be bona fide market gardening and not just the planting of a catch crop to defray standing expenses.

I will be holding the relevant files in Christchurch, so would be pleased if you would direct your reply here.

If you do have any evidence or proof of market gardening activities, and it would help to have a member of the Department view this, Mr E.D. Walker of the Timaru Office would make himself available.

Yours faithfully,

"JAC"

(J.A. Cameron)
Senior Inspector.

Exhibit 'B5'

EXHIBIT 'B5'

APPELLANTS' ACCOUNTANTS' REPLY TO EXHIBIT 'B4' TOGETHER WITH ANNEXURE BEING LETTER ON BEHALF OF APPELLANTS TO THE RESPONDENT DATED 5 DECEMBER 1973

12 December 1973

District Commissioner of Taxes,
Inland Revenue Department,
Private Bag
CHRISTCHURCH.

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B5'

- continued

Dear Sir,

RE: LOWE BROS PARTNERSHIP
YOUR REFERENCE: CH/L/INSP

Further to our letter dated 4th December 1973, we are now in a position to reply on behalf of our clients to your letter dated 24th August 1973.

A statement made on behalf of the Partnership by Mr P.D. Lowe is enclosed. This document sets out in more detail the partnership's approach to this matter and enlarges on the information provided in our earlier correspondence in October 1970 and July 1973. It is unfortunate that the Land Agent with whom the property dealings were discussed is now deceased. A search of the Lawyers files has not disclosed any additional information which might be submitted to corroborate the partners intentions at the time of purchase beyond what has already been stated.

In the attached statement our clients refer to the fact that they had not noticed the published notices regarding the City Boundary extensions on the dates shown in your letter They also have stated to us that they did not know of the declaration made to the Land Valuation Court by the vendor in May 1961. In any case the intention of the partnership in acquiring the land was always to retain it and use it for vegetable growing and as a place to store fruit cases, etc

Regarding the activities in the gardening venture Mr Lowe has given an outline of the poor results obtained and the reasons therefor. Very little income was received which is the reason why there is no reflection in the profit margin shown by the income returns at that time. We asked our clients if any vouchers were available but in view of the length of time most of these cannot now be located. We attach photocopies of a few accounts which were located which show that there was some activity up to October 1962 at least.

We have checked with our client regarding paragraph 3 on page 2 of his statement. There appears to be a sentence missed out here. The third sentence mentions a commercial site and this refers to that sold eventually to Europa Oil as mentioned on page 4. The sentence appears to be typed in out of order and it should follow on at the end of the second paragraph on page 4.

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B5'

- continued

Our clients therefore still maintain that the land was purchased for the purposes stated and not with the intention of subdividing for resale.

Yours faithfully
HUBBARD, CHURCHER, GABITES & CO.

per: 'K A Churcher'

c/- 302 Stafford Street,

TIMARU.

December.
5th ~~November~~ 1973

The District Commissioner,
Inland Revenue Department,
TIMARU.

Dear Sir,

Lowes Supermarket Partnership

I wish to make this statement regarding the property in Wai-iti Road, Gleniti, Timaru. It was originally purchased for use as a garden for vegetable growing to utilize some of our spare time, when at the time the partnership's families depend solely on the income for our shop. It was also intended to use the land to store and utilize the empty cases which accumulate in the shop.

Since we have been in operation the family fruit and vegetable retailing business has been at 302 Stafford Street, Timaru. Over the years the major problem in this type of business had been concerned with chargeable containers e.g. banana cases, apple cases etc have to be stored and resold.

As we had no back yard in our premises, in earlier years we had borrowed Shewan's bake house yard in Canon Street for storage of these bulky cases, until we have sufficient for a railway truck load to be railed to the Oamaru growers. Since the bake house ceased operation some years ago and the land was sold for building shops and offices, we had lost the storage space and because of strict city health regulations, we had to look elsewhere for storage of such cases, on the outskirts of the city

boundary if possible. Therefore we borrowed various places on the outskirts of Timaru. A property in Fairview was used for a long period.

When the partnership was formed, we felt something had to be done, to provide work for us in the slack period. A part time market garden was thought of for mainly growing lettuces, as we understood lettuces grew well in this area. Also we understood that the Oamaru area which is the biggest supplier for vegetables to this area, no longer grew good lettuces (except for a few growers) as a blight developed in the area. Again lettuce needs less work, experience and equipment such as spraying etc, compared with sprouts cauliflower and cabbage. Lettuces too usually fetch a good price early in the Spring. We understood from the advice from experienced people that lettuce does not grow very well in the same patch each year, and that it is best to grow them in an alternate patch and let one patch rest for a season.

Therefore we thought that a garden of about seven or eight acres would be ideal, so that we could grow three to four acres of lettuces to provide us work in our slack period. This would also benefit us by providing our own place to store empty cases which we could use when cutting. A land agent was contacted to look for a suitable site which had to be close to town so that we did not have to cart the cases too far to and from the shop, preferably just on the outskirts of Timaru.

Several sites were looked into through land agents at the time, prior to the purchase of the present property The site we had was more suitable. We agreed to sell them the site on condition that a commercial site be granted by the Levels County Council (later rezoned by the Timaru City Council). Because the land lies to the South it was not greatly suitable for vegetable growing.

On 11th June 1963 an application was made to the City Council for the rates to be reduced for agricultural purposes, but on advice from our lawyer we did not pursue the application when we were informed that our income or a substantial part thereof was not derived from using the land. As the rates had increased so much from the time we had purchased the property and especially since the land had come into the City Boundary, and also as it had failed to produce a good crop, thought was given to selling the land However nothing had been done about it until one

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B5'

- continued

Sunday night when I had a phone call from a Mr Gregan who owned the property next to us and said he intended to subdivide his land for residential sections and asked if I was interested in subdividing our property. If so he would get his surveyor to do the job at the same time. I told him I did not know much about the subdivision or what was involved and had never had given much thought to it.

One Friday night Mr John Milward from Bridges and Milward, Surveyors came into the shop for vegetables. I asked him casually what was involved in subdivision for residential sections as Mr Gregan had approached me about it, and he gave me a brief explanation and said if I was interested to drop into his office sometime when I was free and he would give me a better idea of what was involved and the cost etc.

As they had drawn the scheme plan for the Service Station we went ahead with the subdivision. We obtained a lot of help and advice from Mr Milward and without this, would not have had the confidence to go ahead as we had no experience with subdivisions. Five acres were still retained for vegetable growing but because of pressure of shop work and lack of farm equipment we were prevented from carrying on with this. The rest of the land was let for a couple of years until 1969 when with more housing going up in the area, we were advised to carry on with subdividing.

A property in Salisbury was looked into with seven acres, soil stoney low lying and too far from town. Then a piece of land in Jellico Road was also looked at (new subdivision into housing sections) close to town, but too exposed to the sea to produce early crops. (Had we purchased there we would also have been forced to subdivide as we are now). When the property in Gleniti came on to the market Mr T. Doyle (a land agent now deceased) showed the site to us. We felt this site was more suitable for what we were looking for, high and sunny, facing north, which is good for early crops. The soil was good and the site close to town.

From the time we signed up for the purchase we had no knowledge of when it would come into the city boundary and we had not read of such a scheme in the paper. To us when something of this kind is mentioned in the paper it can mean anything from 10 to 15 years away. The only thing I did raise with the land agent when he showed us the property was that the land was too dear for vegetable

growing. Then he pointed out that no land so near the city would be cheap. He then used a little sales talk and said all we required was £2000, and the Vendor would leave the balance on mortgage at 5 1/2%. This seemed reasonable to us because we did not have to raise much for the purchase, and the sale then seemed reasonable.

Since we took possession of the property it was too late in the season to plant lettuces, therefore a crop of peas was sown for the processing factory, but it did solve our first problem to have a place of our own to store empty cases as was hoped each case would be filled with lettuces when we carted them back.

In February 1962 a contractor was engaged to work the ground for sowing. Owing to the delay of the contractor and bad weather the seeds were not sown until April which was about 6 to 8 weeks later than we intended to. Therefore the cutting was not ready till November when we failed to fetch high prices and shortly the market was flooded with lettuces. With no selling demand, the rest of the crop went to seed and wasted.

Because of no co-operation, land work involved, and past disappointment, we realised that if lettuce was to be grown, our methods to date were unsatisfactory. We would have to equip ourselves with farm implements, tractors and other equipment so that the ground could be worked at any time as required. However with the opening of our supermarket this provided enough work for the three of us and together with the disappointing financial return from the lettuce crop a certain amount of interest was lost in the market garden. We felt that more capital spent on farm equipment without any experience of handling, might cause greater risk.

The following year a crop of potatoes was sown in the hope of a small return, but failed due to dry weather. During that period a land agent advised that he had received an offer to purchase a portion of the land off Wai-iti Road, to be built on. We turned this down as we were not interested in subdividing the land. However, then a representative from Europa Oil approached us to purchase a small piece of the land off Wai-iti Road for a service station and said that a site at the corner of Wai-iti Road and Morgans Road had been turned down by the City Council because it was a corner section and no service station was allowed to be built on a corner section under new regulations.

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'B5'

- continued

Exhibit 'C'

And I make this stagement to be true and accurate to the best of my knowledge and as far as I can remember.

'P Lowe'

P. Lowe

EXHIBIT 'C'

LETTER ON BEHALF OF RESPONDENT TO APPELLANTS' ACCOUNTANTS

IFB:CJW

20 June 1975

Messrs Hubbard, Churcher & Co,
P.O. Box 125,
TIMARU.

Dear Sirs,

LOWE BROS. PARTNERSHIP
OUR REFERENCE: TU/COY/2
YOUR LETTER OF 10 JUNE 1975

As previously advised, those sales which took place on or after the 10 August 1973, (not 10 October 1973 as per my letter of 25 March 1975) are subject to the provisions of Section 88AA of the Land and Income Tax Act 1954.

Subsection (1)(d) being relevant in this particular case, I have calculated the assessable income of the sections sold on or after the 10 August 1973 to be $15,566.50. This is as follows:

Sale price of 6 Sections (15 August 1973 to 31 March 1974)		$29,564.00
Less apportionment of legal fees and commissions		197.50
		$29,366.50
Less cost of sections sold at $2,300.00 per section		13,800.00
Assessable income		$15,566.50

... Enclosed is a notice of allocation of partnership income for the year ended 31 March 1974 incorporating this income.

In the Supreme Court of New Zealand

Yours faithfully,

No 1

Amended Case Stated 10 May 1978

"IFB"
(I. F. Beswarick)
Examiner

Exhibit 'C'

Encl.

- continued

EXHIBIT 'D'

Exhibit 'D'

APPELLANTS' ACCOUNTANTS' LETTER OF OBJECTION ON BEHALF OF APPELLANTS

7th August, 1975

The District Commissioner of Taxes,
Inland Revenue Department,
Private Bag
TIMARU.

Dear Sir

RE : LOWE BROTHERS PARTNERSHIP: TU/COY/2 - PAUL D. LOWE

Further to our letter of the 29th July regarding Notices of Assessment of our clients, issued on 7th July, 1975, relating to the 1974 fiscal year (and 1975 provisional tax).

On behalf of our clients we object to these assessments, upon the ground that no part of the sums so assessed, are, or were, either assessable income or taxable income in the hands of our clients: whether pursuant to s 88(1)(cc), s 88AA, or any other enactment.

In so far as you rely on s 88(1)(cc) of the Land and Income Tax Act 1954:

(a) You are incorrect in including any of the proceeds of the sales of land, referred to in the assessment, in the assessable incomes of our clients.

(b) Our clients did not acquire the land, or any of it, for any purpose, or with any intention, of selling or otherwise disposing of it.

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'D'

- continued

(c) At no time relevant to the assessment did the business of our clients, or any person associated with them, comprise or include dealing in land, and, even if it did, none of the land disposed of was acquired by our clients for the purposes of any such business.

(d) At no time relevant to the assessment did the business of our clients, or of any person associated with them, comprise or include erecting buildings, and, even if it did, the land was not acquired by our clients for the purposes of any such business.

(e) Our clients did not, within ten years of acquiring the land, subject it to any 'undertaking or scheme', within the meaning of that expression as it is used in s 88AA.

(f) Neither did they subject the land to an 'undertaking or scheme', within the meaning of that expression as it is used in s 88AA, at any other time since acquiring it.

(g) Even if our clients had subjected the land to such an undertaking or scheme, whether or not within ten years of having acquired it, they should have been entitled to an allowance for the true value of any land sold - calculated at the moment any scheme alleged by you was entered into or devised - as opposed to its mere original cost.

(h) Even if their intentions, purposes, or activities, or those of any person associated with them, in respect of the land, brought the proceeds of its sale within any part of s 88AA, no profits or gains are capable of calculation by you so as to form part of the assessable or taxable incomes of our clients.

(i) No other circumstances exist, or have existed, which could give rise to a situation in which s 88(1)(cc), or s 88AA, could have any application to any of those proceeds of the sales of any of the land which are mentioned in the Notice of Assessment.

(j) Even if the proceeds of the sales are properly assessable, as you allege, the assessment should have allowed as a deduction - in respect of each parcel of land sold - an amount to cover future and contingent expenditure.

(k) Even if the proceeds of the sales are properly assessable, as you allege, any calculation of profit should have taken full account of inflation in property values generally over the period, and of inflation so far as it reduced the value of money over the relevant period.

(l) Any proceeds of sales of any land by our clients during the relevant period are of a capital nature, and do not form part of their assessable or taxable incomes.

(m) The returns furnished by, or on behalf of, our clients, in respect of the relevant income year, were, and are, correct.

Finally, it is submitted that if any proceeds of section sales are assessable, they should be brought to tax in the year of receipt by our clients and not in the year of sale, or at any other time.

We should be obliged if you would waive payment of the tax pending resolution of this objection.

Yours faithfully,
HUBBRAD, CHURCHER & CO.,

per: "K A Churcher"

KAC:DA

EXHIBIT 'E'

REPLY ON BEHALF OF RESPONDENT DISALLOWING OBJECTION

IFB:MK

13 August 1975

Messrs Hubbard, Churcher, & Co.,
P.O. Box 125,
TIMARU.

Dear Sirs,

In the Supreme Court of New Zealand

No 1

Amended Case Stated 10 May 1978

Exhibit 'E'

- continued

LOWE BROS PARTNERSHIP
OUR REFERENCE: TU/COY/1
YOUR LETTER OF 7 AUGUST 1975

Your objection to your clients 1974 Notice of Assessment, issued on 7 July 1975, has been disallowed as those sections sold on or after the 10 August 1973 are subject to the provisions of Section 88AA(1)(d) of the Land and Income Tax Act 1954. This section provides that the assessable income of any taxpayer shall be deemed to include all profits or gains from the sale or other disposition of land where an undertaking or scheme was commenced within ten years of date of acquisition. In this particular case the properties were acquired in 1961 and two sub-division plans were prepared, one in 1965 and the other in 1969. The undertaking or scheme therefore took place within ten years of acquisition. This was supported by you in your letter of 10 June 1975 in which you advised that the decision to sub-divide would have been taken during the 1963 year as the first sale of a section was recorded in January 1964.

I also advise that sub-section (1)(d) of Section 88AA does not provide that the properties are to be valued at the date the undertaking or scheme commenced.

Also there is no provision in the tax act to accept the income from the sale of properties on a cash basis.

If your clients wish to proceed with their objection, they must make written application within two months of the date of receipt of this letter, stating whether they wish it to be determined by the Taxation Review Authority in accordance with Section 30 of the Land and Income Tax Act 1954 or by the Supreme Court (specifying the registry of that Court) in accordance with Section 32 of that Act.

Please note that an objection does not suspend the liability for payment and additional tax by way of 10% late payment penalty will be incurred when tax is not paid.

Yours faithfully,

"IGW"
(I.G. Wilson)
District Commissioner of Inland Revenue

No 2

In the Supreme Court of New Zealand

AGREED STATEMENT OF FACTS AND ISSUES

No 2

Agreed Statement of facts and issues

The matters set forth in paragraphs 1 to 9, each included, of the Amended Case Stated on behalf of the Commissioner, are agreed as facts by the parties for the purposes of the Case. The parties are, for those purposes only, further agreed that the following also are facts or are the issues, raised by the objections, which this Honourable Court is asked to decide:

1. THE assessment has not been made, and argument will not proceed, on the basis that the land which the objectors have subdivided, and are selling, was a block which had been acquired by them for any purpose, or with any intention, of resale.

2. WHEN the objectors came to dispose of their land, although they could have done so by sale of the whole block, they chose instead to sell it in several smaller parcels.

3. BECAUSE the local authority would not otherwise have permitted the sales of such smaller parcels, the objectors chose to, and planned, committed themselves to, and had carried out, the construction of roads and footpaths through the property, and the provision beneath them of the usual subdivisional services: so that the sections into which the property was divided would be able to be connected to these services.

4. THE sections have been sold by the objectors unimproved.

5. THE FIRST QUESTION is whether, in planning, committing themselves to, and having carried out, the division into lots of the land which they owned, together with the work mentioned in paragraph 3 hereof, the objectors carried on or carried out, or caused to be carried on or carried out, an "undertaking or scheme", within s.88AA(1)(d), which was capable of giving rise to a taxable profit or gain within that enactment.

6. IF the answer to that first question is affirmative, that division and work:

(i) Was not of merely a minor nature.

(ii) Was carried out on behalf of the objectors "in relation to" the sections sold.

In the Supreme Court of New Zealand

No 2

Agreed Statement of facts and issues

- continued

(iii) Was commenced by a decision made, possibly as early as 1963, but at least by April 1965, and in any case within ten years of the date on which the land had been acquired.

7. IN the year in question, ending on 31 March 1974, the six sections which had been sold on or after 10 August 1973 (the date upon which s.88AA(1)(d) became effective) were Lots 9, 10, 11, 17, and 18 on DP 27647, and Lot 9 on DP 24271: which, respectively, realised gross prices of $4,500, $5,000, $5,000, $5,000, $4,000 and $6,000. Xeroxed copies of each deposited plan are annexed hereto.

8. THE SECOND QUESTION, if there was any undertaking or scheme within s.88AA(1)(d), is whether it involved the development or division into lots of "that" land, within that expression where it first appears in subparagraph (i) of paragraph (d) of s.88AA(1).

9. THE THIRD QUESTION is whether any profits which may be held to have been made have been derived "from" the sales, mentioned in paragraph 7 hereof, within s 88AA(1)(d), or whether they have been derived merely on those sales and from such sources as the rise in property values, and the inflation, which occurred during the period between the acquisition of the block and each of these sales; and from the fact the work referred to in paragraph 3 hereof had been carried on or carried out.

10. A NUMBER of sections remain to be sold.

11. THE Commissioner's assessment is based upon the objector's calculation of an average land cost, plus an average share of actual and estimated subdivision and related costs, being attributed to each section. The objectors agree that this is a reasonable and proper accounting approach to the calculation of "profits" for general commercial purposes, but contend that neither it, nor any other method, is appropriate as a basis for valid assessment under the Land and Income Tax Act 1954.

12. THE FOURTH QUESTION is whether, so as to form the basis of a valid assessment, any assessable or taxable profit or gain can be calculated by the method used by the Commissioner, or by any other method; or can be attributed to any particular income year.

13. BETWEEN the date of purchase of the land in June 1961, and the dates on which the sections mentioned in paragraph 7 hereof were

sold, the value of the New Zealand dollar was affected considerably because of inflation.

14. IF, as the answer to the fourth question, it is found that an assessable or taxable profit or gain is capable of calculation, THE FINAL QUESTION is whether the objectors are correct in their contention that the calculation of that taxation profit or gain ought to be amended to take into account the effect of inflation.

15. IF the answer to the final question is such as to require the effect of inflation to be taken into account for taxation purposes, the parties at this stage do not seek a judgment on which of the various formulae is to be adopted. They request that leave be reserved for them, or either of them, to apply, in the event that agreement cannot be reached.

"C K Steven" "D H Simcock"

(C K STEVEN)
Solicitor for the
Objectors

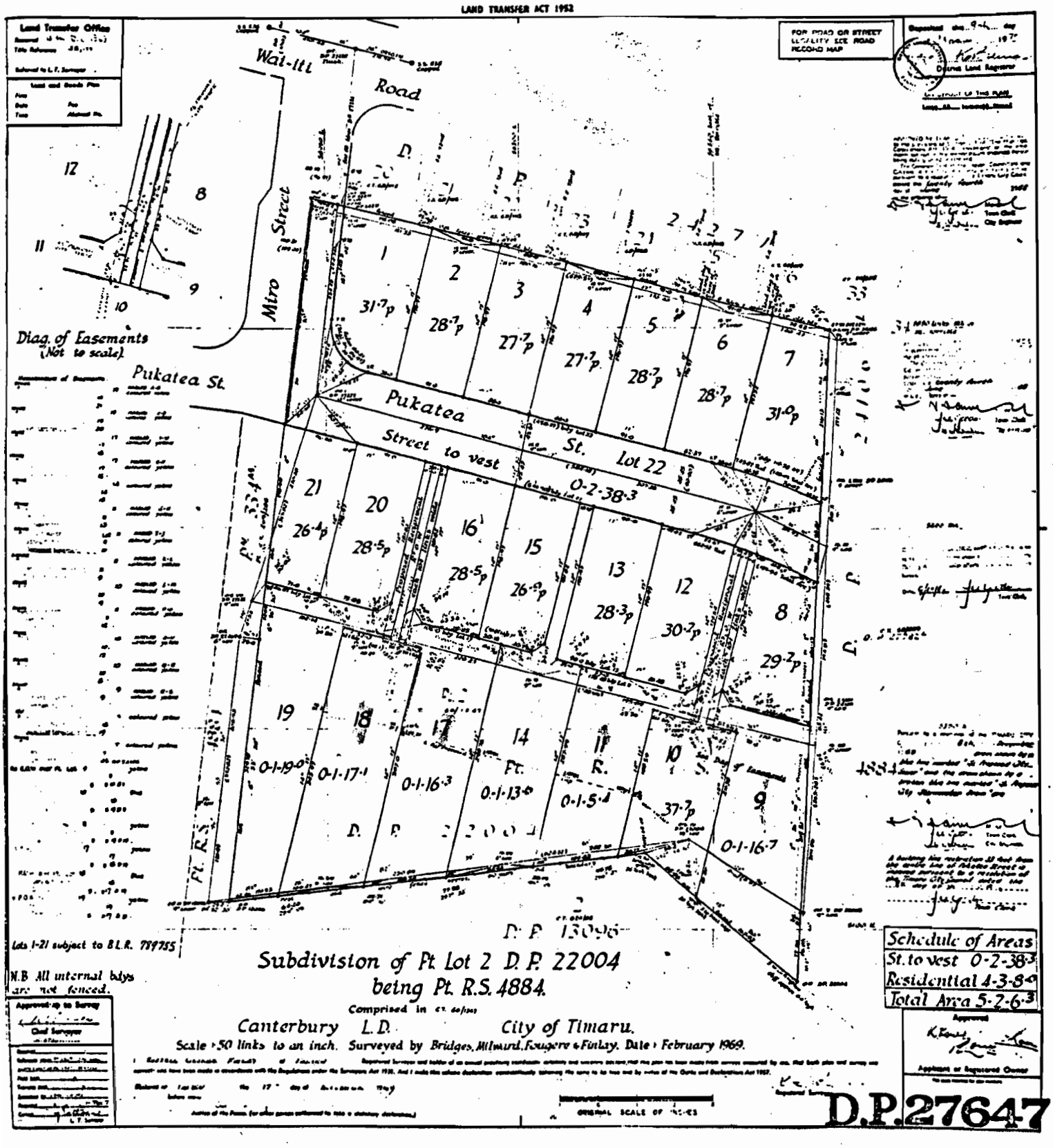
(D H SIMCOCK)
Solicitor for the
Commissioner

In the Supreme Court of New Zealand

No 2

Agreed Statement of facts and issues

First Annexure

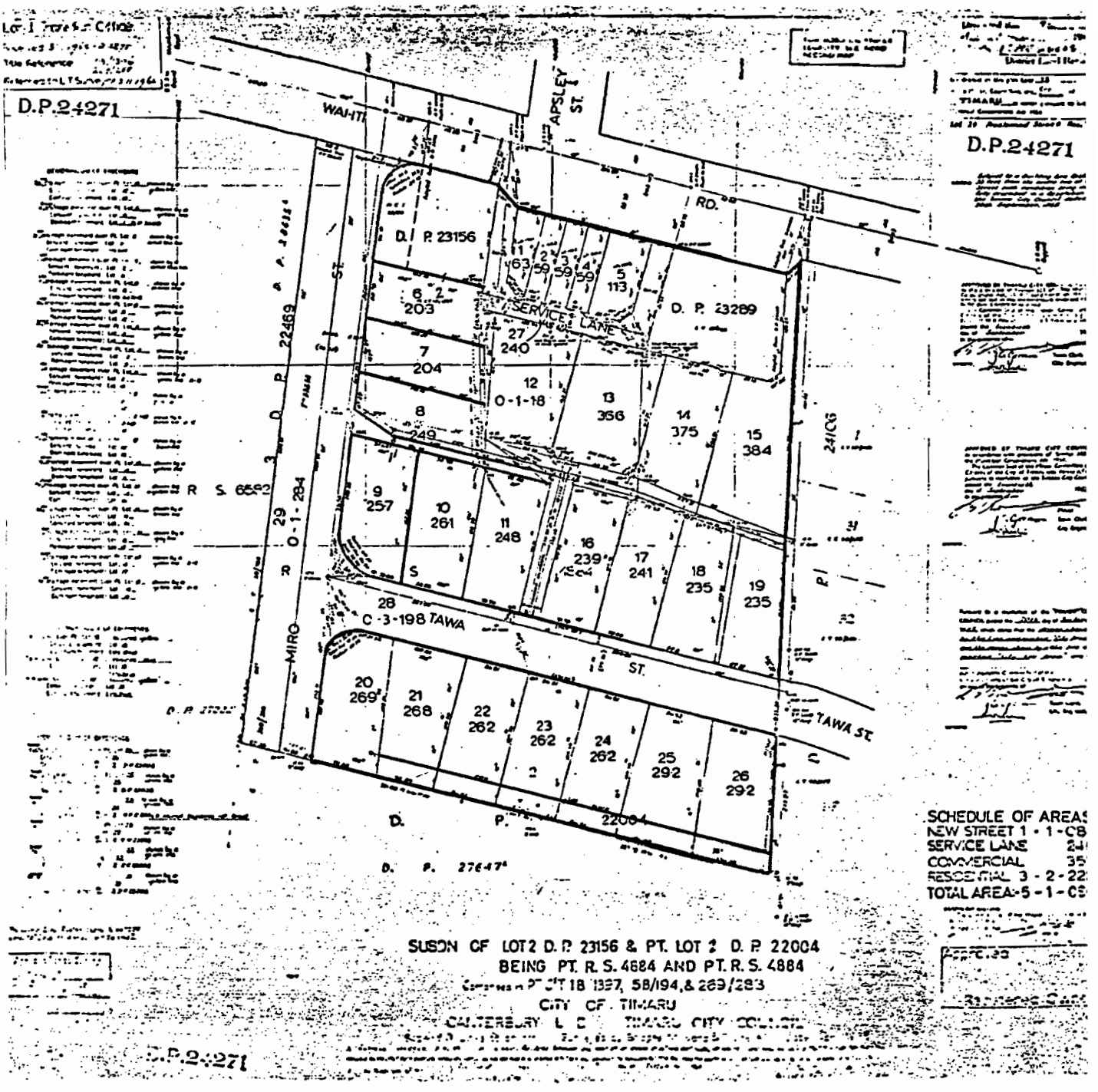


In the Supreme Court of New Zealand

No 2

Agreed Statement of facts and issues

Second Annexure



In the Supreme Court of New Zealand

No 3

AFFIDAVIT OF DONALD THOMAS BRASH IN SUPPORT OF OBJECTION

No 3

Affidavit of Donald Thomas Brash

I, DONALD THOMAS BRASH, economist, say ON OATH that:

1 I HOLD the degree of Bachelor of Arts (1961), and Master of Arts with First Class Honours (1962, from the University of Canterbury; and Doctor of Philosophy in Economics (1966) from the Australian National University.

2 FOLLOWING periods of employment with the Reserve Bank of New Zealand, and the Australian National University, I was employed by the International Bank for Reconstruction and Development, called the World Bank, between 1966 and 1971. For more than a year of that period I was on the staff of the International Finance Corporation, the private sector arm of the World Bank group which is engaged in lending to private companies, making equity investments, and underwriting share issues. For another part of that period I was one of 12 staff of the Commission on International Development which was under the Chairmanship of the former Canadian Prime Minister, Lester Pearson. My responsibility was to advise the Commission on the role of private foreign investment in economic development. For the last two years of my employment with the World Bank group I was employed in the programming and budgeting department, which worked closely with the Bank's President, Mr Robert Macnamara, in controlling the lending programme.

"DB"

3 SINCE 1971 I have been general manager of Broadbank Corporation Limited, Merchant Banker, of Auckland.

4 BETWEEN 1974 and early 1978 I was a member of the Monetary and Economic Council advising the New Zealand Government, and I am currently a member of the New Zealand Planning Council. I am chairman of the Economic Monitoring Group of the latter. I am a member of the Council of the Auckland Chamber of Commerce.

5 MY PUBLICATIONS include <u>New Zealand's Debt Servicing Capacity</u> (1964) University of Canterbury Press: <u>American Investment in Australian Industry</u> (1966) Harvard Univer-

"DB"

sity Press; "American Investment and Australian Sovereignty" in Contemporary Australia (1969) Duke University Press; "Australia as Host to the International Corporation" in the International Corporation (1970) Massachusetts Institute of Technology Press; and "The Cost and Benefits of Foreign Investment: Australia, Canada, and New Zealand" in Direct Foreign Investment in Asia and the Pacific (1971) Australian National University Press.

6 FROM November 1975 until September 1976 I was one of the five members of the Committee of Inquiry into Inflation Accounting, appointed to report to the Minister of Finance, and I helped to prepare its final Report published by the Government Printer (1976).

7 AS A MEMBER of this Committee I heard submissions from a very wide range of organisations and individuals involved in commerce: including the New Zealand Chambers of Commerce, the New Zealand Society of Accountants, the New Zealand Law Society, the New Zealand Manufacturers' Federation, the Reserve Bank of New Zealand, the Stock Exchange Association of New Zealand, and representatives of a number "DB" of large public companies. Listening to, and considering, their submissions and evidence reinforced my own experience of the views of the New Zealand business and commercial community on the relevance of inflation to the calculation of "profits" for commercial purposes.

8 THE COMMITTEE of Inquiry into Inflation Accounting noted, in paragraph 2.23 of its Report, that a unit of currency, such as the New Zealand dollar, has two basic qualities. One quality is as a medium of exchange, by reference to which contractual obligations, such as for payment of a price, can be fixed. The other quality is as a store of value or wealth.

9 IN MY OPINION, there is no serious dispute among the members of the New Zealand business and commercial community that, where the value or wealth quality is not stable from year to year, attempts to calculate "profits" for such commercial purposes as the determination of the amount available for distribution of dividends, or the amount available for reinvestment in the business, cannot meaningfully be made without taking account of that instability.

10 THERE ARE a number of approaches to the ascertainment of commercial "profits" in times of inflation, and there is some dispute over which is the best of them. However, a sound general approach has been devised, and it was favoured by the New Zealand Society of Accountants in its Exposure Draft No 14, pub-

lished in August 1976, and by the Committee of Inquiry into Inflation Accounting in its Report submitted to the Minister of Finance in September 1976. This method, which has the widest support in the New Zealand Commercial community, is what is known as Current Cost Accounting. My own company prepares its accounts in this way. Annexed, marked "A" and "B" respectively, are the 1978 Annual Report and the Supplementary Summary of the Accounts. "DB"

11 NOTWITHSTANDING any dispute over the details of the proper accounting approach, there is a very widespread agreement in New Zealand accounting and commercial circles that what is termed Historical Cost Accounting cannot possibly lead to the ascertainment of a true commercial "profit" figure in times of inflation.

12 THE COMMITTEE of Inquiry into Inflation Accounting, at paragraph 2.24 of its Report, expressed the accepted principle this way:

> So long as prices remain stable it is possible to add together a series of monetary costs or values incurred or received at different points in time and arrive at a total which has a sensible meaning. However, when price levels change a dollar spent in 1970 does not measure the same value as a dollar spent in 1976. Adding together such values in a balance sheet or in the process of matching in the income statement can lead to meaningless accounts. Much the same result, it can be argued, would arise if international companies added currencies of different countries without converting them to a standard currency.

13 THE BUSINESS and commercial community in New Zealand is substantially agreed that the basis for an accounting approach appropriate to the determination of "profits" for commercial purposes, in a time of instability in monetary values, is essentially what the Committee, in paragraph 4.07 of its report, referred to as the "well-offness concept of profit". This concept was based on the definition of income which, in paragraph 4.02 of its report, the Committee accepted:

> Income is the maximum value which the business can distribute during an accounting period and still expect to be as well off at the end of the period as it was

at the beginning.

"DB" 14 BETWEEN 1962 and 1974 the value of the New Zealand dollar diminished markedly as a result of inflation. If, therefore, true "profits" were to be ascertained for commercial purposes for any year or years during this period, adjustment for that inflation would be essential.

15 IN MY OPINION the well-offness concept of profit is in principle applicable equally to the calculation of profits in such non-commercial transactions as the realisation of non-business assets by individual persons. Inflation is a distorting element in that context just as much as it is in the context of commercial transactions.

SWORN at Auckland this 24th day of November 1978 before me: } "Donald T Brash"

"R M Carter"

A Solicitor of the Supreme Court of New Zealand

Broadbank

CHAIRMAN'S REVIEW

RESULTS

Assisted by several exceptional factors, Broadbank's net profit increased from $330,000 in the year to 31 March 1977 to $873,000 in the year to 31 March 1978. This represents a return of 26.7% per annum on year-end shareholders' funds of $3.27 million, and of 1.51% per annum on year-end total assets of $57.92 million.

Directors are particularly pleased with this result. It was achieved despite an intensely competitive financial market, extremely tight monetary conditions during most of the year, and a depressed level of activity in many of the industries served by Broadbank.

There were several factors which contributed materially to the unusually good level of profit for the year, and two deserve particular mention. First, by actively managing the maturity structure of its portfolio of government stock, Broadbank was not only protected from loss when interest rates on these securities rose strongly in the early part of the year, but was actually able to reap profit from that trend. Secondly, the tax provision for the year was reduced (from $312,000 in 1976/77 to $71,000 in 1977/78), despite an increase in pre-tax profit, because of Broadbank's substantially increased involvement in export activities during the year. Our involvement in the export sector is part of a continuing policy and may therefore provide further tax benefits in the years ahead.

The profit was struck using the same accounting treatment as in previous years — with all money market assets stated at the lower of cost or market value, and with a further provision of $50,000 added to the tax-paid contingency reserve (which now stands at $250,000). Naturally, all known bad and doubtful debts have also been written off against income during the year.

THE EFFECTS OF INFLATION

As indicated in my review last year, we are very much aware of the extent to which historical cost accounting distorts the true profitability of companies operating in a high-inflation environment. We regard effective policies to end inflation as vastly more important than any change in the accounting system, but, with inflation continuing, we strongly support whatever change in the accounting system is necessary to enable the public to measure the real effects of inflation on corporate profits.

Without prejudging what particular system of "inflation accounting" is best, we have restated our accounts for the year to 31 March 1978 in accordance with the principles recommended by the Richardson Committee. This restatement shows that the net current cost profit attributable to shareholders for the year was $386,000 after tax. Because almost all of the items in Broadbank's balance sheet are monetary items, the restatement makes relatively little difference to the balance sheet, beyond the fairly small revaluation of money market securities from "lower of cost or market" to "current cost of replacement". As a consequence, we have not included the restated accounts in this annual report, though they will be made available to any interested parties.

What the restated profit figure brings out clearly, however, is that the effect of inflation on financial institutions is just as damaging as that on manufacturing and other companies, and the need to recognise this for tax purposes just as real.

ACHIEVEMENTS

The year just ended was the second year of freedom from artificial controls in the money market, and undoubtedly one of our major achievements was a successful adaptation to the still-more competitive conditions which prevailed. Notwithstanding the very tight monetary conditions, Broadbank was able to maintain and slightly increase the level of credit extended to clients.

We were also able to respond to the needs of clients by switching some of their funding to offshore sources, which were considerably cheaper during the year. In part this was made possible because of a further marked increase in the availability of overseas bank facilities used to finance import/export trade; in part too, we arranged medium term overseas loans and leveraged leases for clients directly.

Related to this expansion in our overseas funding activities was further development of our foreign exchange activities: these became markedly more sophisticated during the year and involve us in both spot and forward markets.

There was a decline in the number of issues underwritten (or placed) during the year, but on the other hand there was a marked increase in the provision of financial advice to clients on a fee-paying basis.

Our creativity in providing finance to new ventures was amply demonstrated when "Sleeping Dogs" was screened. Finance for this, the first full-length feature film made in New Zealand for many years, was arranged by Broadbank and provided by Broadbank in conjunction with the Queen Elizabeth II Arts Council, the Development Finance Corporation, and Television One. We were also successful in putting together a major financial package for one of the country's most dynamic export manufacturing companies.

Finally, there was a pleasing expansion in our investment management activities. Broadbank's minority shareholder, Wells Fargo Bank of San Francisco, is a leader in this area in the United States and we have full access to their methods and approach. At the present time, we manage 16 funds, with assets totalling some $20 million.

THE BUSINESS CLIMATE

I have already alluded to the tight monetary conditions which prevailed through most of the financial year, and this is well illustrated by the graph of Broadbank's 90-day bill selling rate later in this report: in no previous year since the bills market began in New Zealand have rates remained for so long consistently in double figures. This inevitably made life trying for those companies using this market as a source of credit, and provided a challenge to merchant banks.

Another feature of the environment in the last year was the fierceness of competition in financial markets. Trading banks, finance companies, contributory mortgage schemes, other merchant banks, all bid for money vigorously during the year. Trading banks, in particular, testing the freedom granted them in March 1976, pushed interest rates up aggressively. On 1 April 1978, the banks were authorised to draw, accept or endorse bills of exchange, and operate freely in the bills market.

Broadbank welcomes this competition, and specifically welcomes the freedom granted to the banks in March 1976. However, if the trading banks are to be permitted to compete freely, we believe it is important that other financial institutions be given an opportunity to compete with them on an equal footing. At the present time, for example, trading banks have certain marked advantages in foreign exchange dealing as compared with other institutions, and they enjoy government insurance of 100% of the commercial risks involved in export financing (where others enjoy only 85% cover). Some of these inequities could be rectified easily, and we recommend such measures to government.

During the financial year, government introduced a Securities Advertising Bill into the House. This Bill seeks to ensure that all entities, whatever their legal form, provide specified information to potential investors when they seek funds from the public. We have serious misgivings about many of the aspects of the proposed Securities Advertising Bill, but we fully support the principle of adequate financial disclosure on which it is built. Indeed it was in large part a desire to ensure that all merchant banks comply with certain standards of information disclosure that prompted Broadbank to hold discussions with other leading merchant banks in mid-1977. These discussions led to Broadbank's becoming a foundation member of the New Zealand Merchant Banks Association when this was formed in March 1978.

THE FUTURE

Two years ago, shortly after the monetary reforms of March 1976, I suggested that it was too early to assess the full impact of those measures on Broadbank. However, I went on to suggest that, in the longer term, "we face the future with confidence. Merchant banks have prospered in a freely competitive financial system in all English-speaking countries. I have not the slightest doubt that management and staff of Broadbank are equal to the challenge." Everything that has happened in the last two years supports that conviction. Financial results bear this out and, whilst the economy as a whole continues in a depressed state, Broadbank's services are in strong demand and this engenders confidence for the coming year.

A.C. MONTGOMERY
Chairman

SEVEN YEAR FINANCIAL SUMMARY

	1978 $'000	1977 $'000	1976 $'000	1975 $'000	1974 $'000	1973 $'000	1972 $'000
ASSETS							
Fixed Assets	125	120	72	52	-	-	-
Investments	431	425	110	95	417	302	149
Other Assets	23,814	23,170	12,335	6,681	7,715	1,999	526
Acceptances & Other Engagements	33,551	30,009	31,336	23,714	18,811	6,724	5,612
	57,921	53,724	43,853	30,542	26,943	9,025	6,287
LIABILITIES							
Paid Capital	1,300	1,300	1,300	1,000	750	750	500
Reserves	1,971	1,120	790	320	107	34	14
Reserve for Contingencies	250	200	150	100	50	-	-
Deferred Liabilities	583	470	282	31	-	-	-
Term Borrowings (Secured)	1,058	-	-	-	-	-	-
Other Liabilities	19,208	20,625	9,995	5,377	7,225	1,517	161
Acceptances & Other Engagements	33,551	30,009	31,336	23,714	18,811	6,724	5,612
	57,921	53,724	43,853	30,542	26,943	9,025	6,287
PROFIT							
Profit from Trading	944	642	459	413	160	37	26
Taxation	71	312	229	186	87	17	12
NET PROFIT	873	330	230	227	73	20	14

AUDITORS' REPORT

Wilkinson Wilberfoss
CHARTERED ACCOUNTANTS

National Mutual Centre, 37–41 Shortland Street
Auckland 1, New Zealand

The Members,
Broadbank Corporation Limited

We have examined the group financial statements on page 7 to page 11 with the audited financial statements of the companies dealt with thereby.

In our opinion the group financial statements have been prepared in accordance with the provisions of the Companies Act 1955, so as to give a true and fair view of the state of affairs as at 31 March 1978 and the results of the business of the company and its subsidiaries dealt with thereby for the year ended on that date so far as concerns members of the company. 10

According to such information and explanations the group financial statements give the information required by the Act in the manner so required.

Wilkinson Wilberfoss

19 May 1978

Broadbank Corporation Limited and Subsidiary Companies

Consolidated statement of profit and retained earnings for the year ended 31 March 1978

	NOTE	1978	1977
After deducting all expenses including:			
Audit Fees		$8,000	$6,000
Depreciation on Fixed Assets		15,000	13,000
Interest on Deposits		1,950,000	1,615,000
Reserve for Contingencies	1(e)	50,000	50,000
And after receiving income including:			
Interest on Government and Local Body Securities		923,000	389,000
Profit from Trading was		944,000	642,000
Provision for Taxation	1(d)	71,000	312,000
NET PROFIT FOR YEAR		873,000	330,000
Retained Earnings from previous years		880,000	550,000
Amount written off shares in subsidiary company		(22,000)	-
RETAINED EARNINGS AT 31 MARCH 1978		$1,731,000	$880,000

The notes on pages 10 and 11 form part of these accounts.

Broadbank Corporation Limited and Subsidiary Companies

CONSOLIDATED BALANCE SHEET as at 31 Mar

	NOTE	1978	1977
CAPITAL AND RESERVES			
Share Capital	2	1,300,000	1,300,000
Share Premium Reserve		240,000	240,000
Retained Earnings		1,731,000	880,000
		3,271,000	2,420,000
RESERVE FOR CONTINGENCIES	1(e)	250,000	200,000
DEFERRED TAXATION	1(d)	583,000	470,000
TERM BORROWING (SECURED)		1,058,000	
OTHER LIABILITIES			
Bank Overdraft		-	246,000
Other Acceptances		1,301,000	1,936,000
Depositors	3	17,507,000	18,262,000
Sundry Creditors		397,000	88,000
Taxation		3,000	93,000
		19,208,000	20,625,000
		24,370,000	23,715,000
ACCEPTANCES AND OTHER ENGAGEMENTS FOR CUSTOMERS		33,551,000	30,009,000
		$57,921,000	$53,724,000

ch 1978

	NOTE	1978	1977
FIXED ASSETS	4	125,000	120,000
INVESTMENTS IN COMPANIES	1(a)	431,000	425,000
OTHER ASSETS			
Balances with bankers & money at call		3,688,000	1,525,000
Government Stock, Treasury Bills, and Local Body Stock	1(a)	8,012,000	8,630,000
Bank T.C.D.s	1(a)	2,238,000	5,367,000
Commercial Bills	1(a)	5,199,000	5,405,000
Lease Receivables		3,229,000	2,044,000
Secured Loans		1,046,000	-
Sundry Debtors		402,000	199,000
		23,814,000	23,170,000
		24,370,000	23,715,000
LIABILITIES OF CUSTOMERS FOR ACCEPTANCES AND OTHER ENGAGEMENTS		33,551,000	30,009,000
		$57,921,000	$53,724,000

The notes on pages 10 and 11 form part of these accounts.

For and on Behalf of the Board,

A.C. MONTGOMERY
Director

D.A. CLARK
Director

NOTES TO THE ACCOUNTS

1. ACCOUNTING POLICIES

General Accounting Principles

The general accounting principles (1) to (10) appended to the New Zealand Society of Accountants' statement on the disclosure of accounting policies have been adopted by the company.

Particular Accounting Principles:

[a] All securities held, including N.Z. government stock, local body stock, transferable certificates of deposit, debentures, commercial bills, and shares, are stated at the lower of cost or market value, except that;

(i) Where securities were purchased at a premium or a discount, the cost has been adjusted for the proportion of the redemption premium or discount earned to date.

(ii) Shares held in a small joint venture company, with a cost of $24,000, are stated at directors' valuation of $36,000.

[b] Assets held for leasing. Depreciation is calculated on an ascending scale over the terms of the leases in order to provide a constant rate of return on funds over the life of the asset.

[c] Fixed assets are recorded at cost and are written off over their estimated useful lives on a straight line basis as follows:

Furniture & Fittings	10 years
Plant & Equipment	8 years
Motor Vehicles	6 years

[d] Taxation is provided at current rates on earned profits after taking advantage of all current allowances and export incentives but before deducting the non-specific Reserve for Contingencies'. The company is able to account to the Inland Revenue Department on a different basis with the result that part of the taxation provided will not be payable within the coming year. The extent of this deferral is shown under the heading of 'Deferred Taxation'.

[e] Reserve for Contingencies. All known losses are written off against income in the period in which they arise. In addition it is the policy of the company to build up a tax-paid non-specific reserve and to maintain this reserve at a level appropriate to the outstanding commitments of the company.

[f] Consistency. There have been no changes in accounting policies during the year.

2. CAPITAL

Authorised, issued and fully paid capital is 1,300,000 ordinary shares of $1 each.

3. DEPOSITS	**1978**	**1977**
Unsecured	$6,305,000	$4,406,000
Secured	11,202,000	13,856,000
	17,507,000	18,262,000

4. FIXED ASSETS

Furniture, equipment and motor vehicles		
—cost	$178,000	$158,000
—provision for depreciation	53,000	38,000
	125,000	120,000

5. CONTINGENT LIABILITIES

(i) Letters of credit established but not yet drawn under	$2,682,000	$3,560,000
(ii) Underwriting and sub-underwriting commitments	6,000	24,000
(iii) Forward Foreign Exchange Contracts	435,000	-
(iv) Other Guarantees	100,000	-

Guarantees entered into by Broadbank in the normal course of business, such as the endorsement of trade bills of exchange, appear as direct liabilities in the balance sheet.

6. EQUITY ACCOUNTING

Broadbank is the beneficial owner of 40% of the shares in Office Typewriter Company U-BIX Limited. Equity accounting has not been applied as the results of that company are not audited. This does not have a material effect on Broadbank's results for the year.

No 3

Affidavit of Donald Thomas Brash

Exhibit 'B'

We present on the following pages the summarised accounts of Broadbank Corporation and its subsidiaries, provided on the basis of current costs as recommended by the Committee of Inquiry into Inflation Accounting (the Richardson Report).

These accounts comprise:

(a) Current cost consolidated revenue statement for the year ended 31 March 1978;

(b) Current cost consolidated balance sheets as at 31 March 1977 and 1978;

together with explanatory notes, and comparisons with statutory accounts where appropriate.

Fundamental Principles of the Richardson Report

The Richardson Report supports the principles of current cost accounting (i.e. matching current costs against current revenues). In the case of Broadbank this involves several adjustments.

(a) Depreciation must be based upon the current cost of replacing fixed assets, having regard to the useful life of those assets. In the attached accounts total depreciation amounts to $18,000 as compared with $15,000 in the statutory accounts. The difference is relatively small.

(b) Certain monetary assets (called "circulating monetary assets") require more dollar units to maintain operating capacity in times of rising prices. Applied to a company operating in the money market, it is argued that rising prices reduce the operating capacity of monetary assets (in the sense of their ability to service a given volume of customer requirements in real terms) unless further units of cash are made available.

The Richardson Report recommends that the increased cost should be measured and charged against income. In the attached accounts this item is calculated as $3,272,000 for the year (see note 5).

(c) (i) Interest on borrowed funds should not be regarded as a cost in determining the current cost operating profit of the group. From the viewpoint of the group as a whole, it represents a return on funds invested in the assets of the group in the same way as dividends do.

The current cost operating profit of the group therefore represents the income less expenses (excluding interest on borrowing) after allowing for the fixed asset and circulating monetary asset adjustments referred to above.

It is the current cost operating profit of the group determined in this way which the Richardson Report recommends should be the profit to be used for price and income control purposes.

(c) (ii) The profit attributable to the owners of the group should recognise that the adjustments to reflect the current cost of the assets were in part financed by borrowings.

The Richardson Report therefore recommends that after arriving at the current cost operating profit of the group, there should be an adjustment to reflect the fact that a part of the fixed asset and circulating monetary asset adjustments were not financed by shareholders but through the use of borrowed funds. They recommend that this "gain" should be calculated and included in the accounts. In this case, it is calculated to be $2,726,000 (see note 2).

The adjustments in (c) (i) and (c) (ii) above provide the profit attributable to owners (i.e. shareholders) and this represents the surplus available after maintaining the operating capacity of the shareholders' investment in the group. The Richardson Report recommends that this should be the basis for calculating company income tax for the period.

In the Supreme Court of New Zealand

No 3

Affidavit of Donald Thomas Brash

Exhibit 'B'

- continued

BROADBANK CORPORATION LIMITED

SUMMARISED CURRENT COST CONSOLIDATED REVENUE STATEMENT

FOR YEAR ENDED 31 MARCH 1978

(Presented in accordance with recommendations of Richardson Report)

Historical Cost $000		Notes	$000	Current Cost $000
2,991	Historical cost operating profit of group before taxation, depreciation, and interest	1		2,991
15	Less Depreciation		18	
	Circulating monetary asset adjustment	5	3,272	(3,290)
	Add Increase in book value of current assets			72
2,976	Current cost operating deficit of group before taxation			(227)
	Add Increase in capital maintenance reserve financed from borrowings	2	2,716	
2,032	Less Interest on borrowings		2,032	684
944	Profit attributable to shareholders before taxation			457
71	Less provision for taxation			71
873	Profit attributable to shareholders after taxation			386
881	Retained earnings brought forward			911
1,754				1,297
23	Less Goodwill written off			23
1,731	Retained earnings carried forward			1,274

In the Supreme Court of New Zealand

No 3

Affidavit of Donald Thomas Brash

Exhibit 'B'

- continued

BROADBANK CORPORATION LIMITED

SUMMARISED CURRENT COST CONSOLIDATED BALANCE SHEET

AS AT 31 MARCH 1978

(Presented in accordance with recommendations of the Richardson Report)

	Notes	1978 Current Costs $000	1978 Historical Costs $000	1977 Current Costs $000	1977 Historical Costs $000
Liabilities					
Other liabilities and provisions		20,041	20,041	21,295	21,295
Term liabilities		1,058	1,058	-	-
Acceptances for customers		33,551	33,551	30,009	30,009
		54,650	54,650	51,304	51,304
Shareholders' Funds					
Issued capital - ordinary shares		1,300	1,300	1,300	1,300
Capital maintenance reserve	3 & 4	570	-	5	-
Capital reserve		240	240	240	240
Revenue reserves	4	1,274	1,731	911	880
Total		58,034	57,921	53,760	53,724
Assets					
Other assets		23,885	23,814	23,170	23,170
Investments		431	431	425	425
Fixed Assets		239	178	203	158
Less provision for depreciation		72	53	47	38
		167	125	156	120
Customers' liability for acceptances		33,551	33,551	30,009	30,009
Total		58,034	57,921	53,760	53,724

In the Supreme Court of New Zealand

No 3

Affidavit of Donald Thomas Brash

Exhibit 'B'

- continued

NOTES TO CURRENT COST ACCOUNTS

1. Historical Cost Operating Profit is derived from statutory accounts as follows:

	$000
Total pre-tax profit	944
Add back: Depreciation	15
Interest - Bank	82
Depositors	1,950
	2,991

2. Increase in Capital Maintenance Reserve Financed from Borrowings:

	$000
Average total assets (excluding acceptances) calculated on monthly balances is	22,959
Average borrowings (excluding acceptances, taxation and contingency reserve) calculated on monthly balances is	19,011
Proportion of increase financed by borrowings	
$\frac{19,011}{22,959}$ of 3,281 (see note 3)	2,716

3. Movements for the year in Capital Maintenance Reserve comprise the following:

	$000
Balance 31 March 1977	5
Increase in current replacement cost of fixed assets	16
Less "backlog" depreciation (see note 7)	(7)
Circulating monetary asset adjustment (see note 5)	3,272
	3,286
Less gain on borrowings (see note 2)	2,716
	570

4. The adjustment of asset values to replacement cost at 31 March 1977 introduces a Capital Maintenance Reserve of $36,000 made up as under:

	$000
Fixed assets ($120,000 to $156,000)	36

The Richardson Report recommends that the proportion of this reserve attributable to borrowings should be transferred to distributable reserves. The calculation is as follows:

Total "borrowings" (liabilities excluding acceptances, taxation, deferred taxation and contingency reserve)	20,532
Total assets (excluding acceptances)	23,751

$$\frac{20,532 \times 36,000}{23,751} = \$31,000$$

The effect of this adjustment is to increase revenue reserves by $31,000 to $911,000 and decrease capital maintenance reserve from $36,000 to $5,000.

5. Circulating Monetary Asset Adjustment

This figure is calculated by applying a suitable general price index to average circulating monetary assets for the year. Calculated on monthly balances average circulating monetary assets for year (current assets, loans and investments, but excluding acceptances) is $22,412,000. The General Retail Price Index reveals that prices for the March Quarter 1978 were 14.6% higher than for the same quarter in 1977. The adjustment is therefore 14.6% of $22,412,000 = $3,272,000.

6. Depreciation

This figure is calculated on the replacement cost of fixed assets (before accumulated depreciation), apportioned on a straight line basis over the estimated total useful life of each asset.

7. Fixed assets are valued at replacement cost. The provision for depreciation includes annual charges against income and "backlog" depreciation. Backlog depreciation arises when replacement cost of fixed assets increases and is the adjustment made to recognise the expired life of those fixed assets.

In the Supreme Court of New Zealand

No 3

Affidavit of Donald Thomas Brash

Exhibit 'B'

- continued

8. Provision for Taxation

The Richardson Report sets out in detail recommendations for the calculation of profit for taxation purposes. It states that the effect of its proposals is that, except to the extent that adjustments made are not acceptable for taxation purposes, taxable profit will be the lesser of historical cost profit or profit attributable to shareholders. In this case, profit attributable to shareholders ($457,000) is lower than historical cost profit ($944,000).

Since government has not yet accepted the recommendations of the Richardson Report for tax purposes however, and since in any case Broadbank's tax provision for the year to 31 March 1978 is very low because of export tax incentives, no adjustment has been made in the provision for taxation.

No 4

No 4

AFFIDAVIT OF WILLIAM WILSON IN SUPPORT OF COMMISSIONER OF INLAND REVENUE

Affidavit of William Wilson

I, WILLIAM WILSON of Auckland, Chartered MAKE OATH and say as follows:

(1) I am a member of the New Zealand Society of Accountants with designation Fellow Chartered Accountant.

(2) Since 1962 I have been a partner in the accounting firm of Barr Burgess and Stewart in which capacity I have specialised in taxation and financial advisory work principally in relation to corporate affairs.

(3) I am a former president of the Auckland Chamber of Commerce and have been a member of several committees of the New Zealand Society of Accountants. Currently I am a director of several public companies including South British Insurance Co. Ltd, Farmers Trading Co. Ltd, Broadlands Dominion Group Ltd and Progressive Enterprises Ltd.

(4) For several years I have been a member of a committee of the New Zealand Society of Accountants responsible for implementation of a form of current cost accounting (referred to as "CCA"). I drafted the Society's submissions to the Committee of In-

quiry into Inflation Accounting and subsequently its submissions to the Minister of Finance. On behalf of the Society I attended a meeting of accounting bodies from eight countries held in London in July 1977 to consider possible agreement on a form of current cost accounting.

(5) I use the term "current cost accounting" as meaning in broad terms an accounting method designed to reflect the effect of changing price levels or inflation on the profit and financial position of a company.

(6) The deficiencies of historical cost accounting are well recognised in accounting circles but to date the accounting bodies in New Zealand and elsewhere have not been able to reach agreement on a form of current cost accounting which would replace historical cost accounts.

(7) At present, I am engaged with the Society's committee in the final stages of issuing "CCA Guidelines" (hopefully in December 1979) which will recommend that all listed public companies include a supplementary CCA statement in their financial statements for periods beginning on or after 1 April 1979. These "CCA Guidelines" will not have the effect on an Accounting Standard and therefore it will not be mandatory for companies to comply with them. The historical cost accounts will continue as the company's accounts and the CCA figures will be for information as a supplementary statement.

(8) Some New Zealand listed companies have already included in their annual financial reports a supplementary statement which reflects changing price levels in some degree. But statements of profit and loss and balance sheets have continued to be presented under the historical cost method.

(9) Auditors continue to report that financial statements drawn up on an historical cost basis give a true and fair view of the state of affairs and the results of the business. Annexed marked "A" is the 1978 annual report of N. Z. Forest Products Ltd one of New Zealand's largest companies. At page 9 is the auditor's report which illustrates this point.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

- continued

(10) In my experience calculations of profits for debenture trust ratios, for profit sharing contracts and for legal contracts generally are still prepared on the historical cost basis.

(11) In my opinion, while there has been considerable research into and development of a CCA form of accounting, current accepted practice in New Zealand is to prepare financial statements and to calculate profits on the historical cost method.

SWORN at Auckland this)
8th day of December) "W Wilson"
1978 before me:)

"[Indecipherable]"

A Solicitor of the Supreme Court of New Zealand

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

Directors' Report

To be presented to Members of the Company at the 42nd Annual General Meeting to be held on Friday, 1st September, 1978.

The Directors present their Annual Report together with the Managing Director's Review and the audited accounts of the Group for the year ended 31st March, 1978.

Accounts

The accounts presented with this report have been prepared in accordance with the accounting principles detailed on page 8 of the report and in a form which, unless otherwise indicated, facilitates a direct comparison with the figures for the previous year.

10

Sales

Sales made and services provided to customers outside of the N.Z. Forest Products Limited Group were $283.8 million. In the table below these are analysed between local and export sales and compared with those for the 1976/77 financial year.

The figures are (in millions of dollars) —

	1978		*1977*	
	Value	*%*	*Value*	*%*
Local	218.5	77.0	197.7	73.9
Export	65.3	23.0	69.7	26.1
	$283.8	100.0	$267.4	100.0

The decrease in the local demand for Company products forecast in the Interim Report became a reality in the second half of the year, while highly competitive prices for pulp and paper on overseas markets is evidenced by the decline in the value of export sales.

Consolidated Net Profit

On page 10 of this report the profit result achieved by the Group, both before and after including the share of profit arising from investments in associated companies, is presented in detail. The profit shown is that achieved from a full year's trading for all companies in the Group.

Key figures and comparisons with those for the previous financial year are (in thousands of dollars) —

	1978	*1977*	*Change*
Operating Profit	28,730	35,322	−6,592 (18.7%)
Dividends, interest and sundry income	3,548	2,920	+ 628
	32,278	38,242	−5,964
Net financing costs	11,467	10,083	+1,384
	20,811	28,159	−7,348
Provision for income tax on current earnings	173	3,776	−3,603
	20,638	24,383	−3,745
Outside shareholders' interests	118	93	+ 25
Group Net Profit for Year	20,520	24,290	−3,770 (15.5%)
Net adjustment to include Group share of tax paid profit for the year of associated companies	−188	1,044	−1,232
Consolidated Net Profit for Year	$20,332	$25,334	−5,002 (19.7%)

The reduction of $6.6 million (18.7%) in operating profit on sales 6.1% higher at $283.8 million reflects lower prices for some exports, the reduced local demand and the time-lag in implementing higher prices. The steadily mounting costs of materials, labour, distribution and financing and the impact of industrial disputes have also contributed to lower profit.

These adverse effects have far outweighed the benefits conferred by taxation allowances and concessions. Nevertheless, the latter are significant. The 5% valuation adjustment on opening stock has resulted in a tax saving of $1.115 million while the incentives granted by Government to encourage increased exports have again been a major factor in the tax provision, benefitting the Company to the extent of $4.474 million. Further savings have arisen from investment allowances on new plant and forestry concessions.

The return on ordinary shareholders' funds is 8.3 cents per dollar as compared with the 11.9 cents per dollar recorded last year.

Trading Conditions

New Zealand is currently in the grip of the deepest recession for many years. Reduced domestic demand has unfortunately coincided with a period of intense competition and low prices in many overseas markets for the main export lines, pulp and paper. The adverse effects of these two factors, experienced mainly in the second half of the year, continue into the opening months of the new financial year.

Inflation, while reducing, is still at too high a level and costs continue to rise at a rate which makes it increasingly difficult to maintain business at acceptable margins when competitors are offering pulp and paper at the lowest price levels prevailing since 1971.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Wood utilisation industries are capital intensive and their success or otherwise depends to a substantial degree on obtaining continuous maximum output from installed plant. Productivity is the key to profitability.

While reduced demand has necessitated the operation of some plants at below capacity levels it is the present intention to maintain output from the major Kinleith pulp mills at maximum level. The additional paperboard machine at Whakatane and the plywood mill at Kinleith, both commissioned last year, are not yet operating at profitable levels. The development of markets to absorb maximum output from these plants and thus improve the return on the funds invested is a priority target.

The year has certainly been one which presented many problems. At least in the first half of the current financial year, similar pressures are anticipated to continue. No immediate upturn in the level of business can be expected, although later in the year some improvement could stem from Government efforts to improve confidence and stimulate domestic business activity. There are now some hopeful signs of an improved return from exports of pulp and paper. Indications are that the surplus international stocks of these products are declining and that by the end of this calendar year a better balance between supply and demand should lead to an improvement in prices and profitability.

The Directors reiterate their statement of last year that their objective is to attain a much higher level of profitability. While circumstances have mitigated against an improvement in the year to 31st March, 1978 the objective remains unchanged and no effort will be spared by the Board and management to achieve this goal as quickly as possible.

Appropriations

Until the actual apportionment of the 1977 final dividend/distribution between payments made from the Share Premium Account and unappropriated profit could be established the full sum of $9.538 million was charged against unappropriated profit. An adjustment of $4.630 million has since been made for the sum paid from the Share Premium Account.

After taking this sum into account, adding profit for the year and transferring $1.247 million from the Realised Capital Profit Reserve (see Notes to the Accounts — Note 7) there remained available for distribution the sum of $26.876 million.

Of this sum $4.995 million was appropriated for the interim dividend paid in February 1978 and $5.686 million has been provided for the final dividend/distribution, while $11 million has been transferred to the Development Reserve.

The balance of $5.195 million has been carried forward as unappropriated profit.

Capital and Shares

During the year 91,175 ordinary shares were issued — 32,277 to staff in terms of the Company's Staff Share Option Plan and the balance in consideration for acquisitions. At the 31st March, 1978 issued and paid up capital was $74,440,150 in $1 shares of which 68,875,648 were ordinary shares and 5,564,502 cumulative preference shares.

Directors are aware that many holders of cumulative preference shares are concerned at the market value of this class of share and the level of dividend payable. Work is proceeding on proposals to convert preference shares to ordinary shares and it is anticipated that it will be possible to give an outline of the plan to shareholders at this year's Annual General Meeting. Subsequently detailed proposals will be submitted to class meetings of shareholders of each class.

Details of other proposed changes in the nominal capital of the Company are given in the memorandum enclosed with this report providing details of the Special Business to be dealt with at the Meeting.

Shareholders' Funds

In the Consolidated Balance Sheet shareholders' funds are now recorded at $245.583 million, an increase of $12.313 million.

In addition to the transfer of $11 million from unappropriated profit to the Development Reserve other significant movements in Reserves include $4.630 million utilised from the Share Premium Account for the 1977 final distribution to shareholders. A corresponding increase is reflected in the Capital Replacement Fund. A Government revaluation of land has been recorded as an increase of $2.384 million in the Land Revaluation Reserve.

Other movements in Reserves and unappropriated profit balances are detailed in the Notes to the Accounts.

Finance

At the beginning of the year there remained available $US4 million of the $US70 million overseas bank facility. This sum was drawn down in September 1977.

The loan which was arranged early in 1975 at a time when funds were in short supply would, from March 1978, have attracted a margin of 1⅜% over the cost to the banks of borrowed funds to service the loan. Such a margin would have been substantially higher than the margin applying under today's economic conditions and ways and means of reducing the cost of finance were sought.

In a quite involved exercise arrangements were made for the repayment in March 1978 of the whole of the original $US70 million loan and for its replacement by further borrowings. A loan of $US50 million has been arranged with a syndicate of overseas banks at a margin over the London Interbank Rate of ¾% and with more favourable terms than for the previous loan. The new loan is repayable in seven instalments during the period July 1980 to July 1983. The balance of the finance has been secured by a $US25 million issue of Eurobonds, with a nominal 8 year maturity and bearing interest at 9% per annum.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

These arrangements provide a mixture of fixed and variable interest terms, an improved spread of maturities and, with the lower margin on the new loan, a considerable saving in finance costs.

The offer of bonds was heavily oversubscribed. This successful entry into the Eurobond market has established the Company's name and credit standing in that market and provided access to a source of funds for possible future requirements.

In 1976 a provision of $10 million was made to cover potential losses, then unrealised, arising from adverse exchange variations. The actual loss realised on repayment of the $US70 million loan, after allowing for tax deductions, was $6.475 million. However, it is of interest that over the period from 1971 to 1978 on two major offshore borrowings of some $US100 million the total net loss as a result of exchange variations has been $1.7 million. This loss has been more than offset by gains arising from the lower interest rates prevailing overseas during part of this period.

There remains in the Provision for Exchange Fluctuation a balance of $3.306 million which is being retained as a provision against possible future losses on the current major loans and other overseas indebtedness.

Dividends/Distributions

Since 1976 it has been the practice to make distributions from the Share Premium Account in lieu of a final dividend. The Directors propose to continue such payments and will be recommending for the approval of members that, except in the case of shareholders who have elected to receive their dividends from profit, the final payment for the year ended 31st March, 1978 be made from the Share Premium Account at the rate of--

8 cents per share on ordinary shares which, with the interim dividend paid in February last of 7 cents per share, will give a total payment for the year of 15 cents per share

and 3.125 cents per share on cumulative preference shares making, with the interim dividend at the same rate, a total payment for the year on this class of share of 6.25 cents per share.

The increase of 1 cent per share in the total dividend/distribution for the year on ordinary shares implements the intention, conveyed to the last Annual General Meeting, to progressively improve the return to shareholders provided annual profit justifies this step. While profit for 1977/78 was lower than for the previous year Directors are confident that the higher payout this year is justified.

At the recommended rates dividends and distributions will require the payment to shareholders of a total of $10.681 million for the year, which is equivalent to approximately 52% of the consolidated net profit.

It is the intention to continue the practice of making a portion of the annual distributions to members from the Share Premium Account while the balance in this account permits such payments. Distributions from this source are free of income tax in the hands of individual New Zealand shareholders. To facilitate future distributions a resolution to set free a further $22 million from the Share Premium Account will be submitted to the Annual General Meeting.

Subject to the approval of the Annual General Meeting to the recommended payment, cheques for final dividends/distributions will be paid to shareholders within one week of that meeting.

Subsidiary and Associated Companies

The operations of our subsidiary and associated companies have been reviewed by the Managing Director in his report. It is noteworthy that the subsidiary companies, especially those engaged in merchandising and retailing, have provided an increasing proportion of Group profit. The benefit of diversification into these areas is now being demonstrated.

All operating associated companies, with two exceptions, continued to trade profitably. Unfortunately the delayed installation of new plant by N.Z. Particle Board Limited coincided with the severe downturn in the building industry. Below capacity operation and higher costs have resulted in this company recording a loss for the year. The motor industry in New Zealand has suffered a severe reverse from the decline in economic activity and restrictive Government policies. Nissan Datsun Holdings Limited is no exception. The Company's share of these losses has been taken into account in making the equity adjustment in the accounts and the overall profit from this source this year of $533,000 compares with $1.669 million in the previous year.

An interest has been acquired in two companies whose activities complement those of other companies in the Group. Office Typewriter Co. Limited (49% interest) is a long established Auckland based stationery supplier, the promoter of the Rotoscan revolving filing system and New Zealand distributor of the U. Bix photocopier. Paperboard used in the manufacture of the Rotoscan filing system and copier papers are supplied by NZFP. The association will enable the further development of new products and the extension of Office Typewriter Company's export potential.

The 50% interest in Western Reinforcing Limited provides to our subsidiary, Russell and Somers Limited, an entry into a company engaged in the bending and placing of reinforcing steel and complements the merchandising activities of the steel division of Russell and Somers Limited.

Articles of Association

It has become necessary to alter the Company's Articles of Association to recognise proposed changes in nominal capital, to bring them into line with recent legislation and the current listing regulations of the Stock Exchange Association of New Zealand and to modernise some outmoded provisions.

Details of the proposed resolutions and the reasons for the alterations are given in the enclosed memorandum of Special Business for the Annual General Meeting.

Directors

At the 1977 Annual General Meeting Sir Reginald Smythe retired in accordance with the Articles of Association after 42 years with the Company. In the period from 1935 when he attended the first general meeting of NZFP as Secretary of the newly formed company until his retirement as Chairman of Directors he devoted himself completely to the interests of the Company, its shareholders and its people. His personal efforts played a major role in its growth from small beginnings to that of the largest company in New Zealand.

The meeting placed on record the outstanding contribution made by Sir Reginald to the Company and to the promotion of the forest industries of the country.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

On 30th June, Mr. A. W. Mackney will retire from his executive appointment as Managing Director and Messrs J. T. Currie and D. O. Walker will become Joint Managing Directors. Subject to re-election at the Annual General Meeting Mr. Mackney will continue in office as a Director of the Company.

The casual vacancy created by Sir Reginald's retirement has been filled by the appointment as a Director of Mr. C. J. Keppel. In accordance with the requirements of the Articles of Association Mr. Keppel will retire at the Annual General Meeting and, being eligible, offers himself for election.

The four Directors retiring by rotation this year are Messrs A. W. Mackney, B. H. Picot, L. N. Ross and A. G. Wilson. All these gentlemen, being eligible, offer themselves for re-election.

Auditors

It will be necessary for the Annual General Meeting to record that the joint Auditors Gilfillan, Morris & Co. and Hunt, Duthie & Co. continue in office pursuant to Section 163 (3) of the Companies Act 1955.

The meeting will also be requested to authorise the Directors to determine the remuneration of the Auditors.

Appreciation

The year has not been an easy one for our executives and staff. I wish to acknowledge and express on behalf of both the Directors and shareholders an appreciation of the continuing support and professional dedication of our people. Without their loyal support and that of the Company's associates and customers it would not have been possible to achieve a result which, under today's conditions, is acceptable even though perhaps a little disappointing in view of the efforts required to attain it.

General

The down-turn in profitability during the past year has illustrated all too clearly, that the NZFP Group cannot isolate itself from economic conditions either at home or abroad. Every effort is being made to counter the effects of the world-wide recession by increased efficiency wherever possible, by a strict control of costs, and by pursuing technical developments and new products in prospectively profitable areas.

The Company's financial position remains sound, and as economic conditions generally improve the Group is well placed to take full advantage of them. Your Board has complete confidence in the future of NZFP.

We suggest to members that for a more detailed report of the Group's operations they turn to the Managing Director's Review commencing on page 28 of this Report and also to the financial information provided on pages 8 to 27.

Auckland,
1st June, 1978.

For and on behalf of the Board,
A. G. Wilson,
Chairman of Directors.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Significant Accounting Policies

GENERAL ACCOUNTING PRINCIPLES

The general accounting principles recommended by the New Zealand Society of Accountants for the measurement and reporting of profit and the financial position on an historical cost basis are followed by the Group with the exception that the majority of land and some buildings and forest assets are recorded at valuation (see Fixed Assets below for further details).

PARTICULAR ACCOUNTING PRINCIPLES

Basis of Consolidation

All significant inter-company items and transactions are eliminated in preparing the consolidated accounts, which include the accounts of all subsidiary and associated companies.

Subsidiary Companies

These are companies in which N.Z. Forest Products Limited either directly or indirectly holds more than 50% of the issued share capital.

Premium on Acquisition

The excess of the cost of the shares in subsidiary companies over the book value of the net assets acquired is written off against profit in the year of purchase.

Trading Results

The turnover and earnings of subsidiary companies are included in the Consolidated Group Accounts from the date of acquisition.

Associated Companies

These are companies in which the Group has a substantial shareholding but not a controlling interest and in whose commercial and financial policy decisions it participates.

Equity Accounting

Investments in associated companies are dealt with on an equity accounting basis in the Consolidated Accounts. This approach records the Group share of associated company profits in the Consolidated Statement of Profit, the share of post-acquisition retained profits and reserves as an addition to Shareholders' Funds and the share of the post-acquisition increase in net assets as an addition to the Investment in Associated Companies in the Consolidated Balance Sheet.

The latest available audited accounts for each company are used, which for some companies are up to 12 months earlier than the Group's balance date. Accordingly provision is made for post balance date losses where applicable.

Foreign Currency

Purchases from overseas are recorded at the cost in New Zealand currency at the time of payment. Overseas trade debtors are recorded at the rates of exchange ruling on balance date, with currency variations transferred to profit. Other overseas assets and liabilities are converted to N.Z. currency at the rates of exchange ruling on balance date. Potential or realised exchange losses on overseas loans are charged to revenue through the Provision for Exchange Fluctuation.

Development Reserve

Profit retained for development purposes is progressively transferred to this reserve.

Realised Capital Profit Reserve

Profit identified as available for tax free distribution to shareholders is transferred to this reserve.

Financial Charges

Interest payments and other financing costs are normally absorbed against profit for the year to which they relate. However in some years these costs are inflated by charges for financing expansion projects which have not contributed to profit. In these years a proportion is capitalised as a cost of the asset. Capitalisation ceases when plant becomes operational and in the case of forestry when the forest is considered established (up to two years after planting).

Fixed Assets

Land

Land is recorded at the higher of original cost or the latest Government Valuation. Forest land includes the cost of the permanent arterial forest roads.

Forests (excluding land)

These are recorded at the original cost of establishment. New forest areas are considered established at a maximum of two years after planting and thereafter no further costs are capitalised.

The annual costs of maintenance, protection and management of the forest and also the replanting of clear-felled areas (regarded as the cost of replacing the wood extracted during the year) are charged against the current year's profit.

Other Fixed Assets

Other fixed assets are recorded at original cost less depreciation.

Note: The only exceptions to this policy are subsidiary companies which had revalued fixed assets prior to joining the Group. In these cases, land is retained at the pre-acquisition value until this value is exceeded by Government Valuation, while buildings and forests are recorded at pre-acquisition book value plus later additions at cost (less depreciation in the case of buildings).

Leased Assets

Lease rental payments are treated as current operating costs and are charged against current profit.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Depreciation

For accounting purposes depreciation is calculated using straight-line rates which write off the original cost of assets over their expected useful lives. These are:

	Years
Buildings in permanent materials	50
Other buildings	40
Paper, paperboard and wallboard mills	25
Pulp mills, wastepaper plants and major services (water, effluent, steam, etc.)	20
Multiwall bag and wallboard remanufacturing plants	15
Sawmills and wood preparation equipment	12
Logging trucks, haulers, loaders and electric fork trucks	11
All other vehicles (except motor cars) and office machines	6
Motor cars	5
Chain saws	3

Residual values are assumed to be nil

Depreciation is charged from the time assets become operational.

For taxation purposes the Group claims the maximum depreciation allowed by the Inland Revenue Department. The timing differences between accounting and taxation records are accounted for through a provision for deferred taxation.

Income Tax

Group profit is charged with both current and deferred tax. Current tax which is payable within 12 months is calculated at 45 per cent (the rate of company taxation) after deducting from profit all non-taxable income, tax incentive allowances and timing differences. Deferred taxation is calculated at 45 per cent of the timing differences using the "Liability" method.

Current Assets

Stocks

Manufactured and partly manufactured stocks are recorded at the lower of cost (using the F.I.F.O. method) or the expected realisable value. Cost includes direct labour and material plus mill and site overheads.

Production materials and consumable stores are recorded at cost into store using the Weighted Average method at Kinleith and the F.I.F.O. method at other locations.

Short Term Investments

These are recorded at the lower of cost or expected realisable value.

Debtors

These are recorded at expected realisable value.

Research and Development

Expenditure on research and development is written off in the year in which the expenditure is incurred.

CHANGES IN ACCOUNTING POLICY

There has been no significant change in accounting policy during the year.

Auditors' Report

Gilfillan, Morris & Co.
Hunt, Duthie & Co.
CHARTERED ACCOUNTANTS

The members
N.Z. Forest Products Limited

We have obtained all the information and explanations that we have required. In our opinion proper books of account have been kept by the Company so far as appears from our examination of those books. In our opinion, according to the best of our information and the explanations given to us and as shown by the books, the Balance Sheet, with the Notes thereto, is properly drawn up so as to give a true and fair view of the state of the Company's affairs as at 31st March, 1978.

We have also examined the annexed Group Accounts comprising a Consolidated Balance Sheet and Consolidated Statement of Profit with the audited accounts of the companies dealt with thereby. In our opinion the Group Accounts together with the Notes thereto have been prepared in accordance with the provisions of the Companies Act 1955 so as to give a true and fair view of the state of affairs and the results of the business of the Company and its subsidiaries dealt with thereby so far as concerns members of the Company.

According to such information and explanations the Accounts, the Balance Sheet and the Group Accounts give the information required by the Act in the manner so required.

We have also examined the annexed Source and Use of Funds Statement which in our opinion fairly presents the information therein.

Gilfillan Morris & Co.

Hunt Duthie & Co

Auckland, New Zealand.
1st June, 1978.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Consolidated Statement of Profit for the year ended 31st March 1978.

		1978 ($000)		1977 ($000)
GROUP SALES AND SERVICES		$283,804		$267,454
Operating profit before depreciation		42,937		48,474
Deduct depreciation		14,207		13,152
OPERATING PROFIT FOR THE YEAR		28,730		35,322
Other Income				
Company Dividends — Associated companies	721		625	
Other	225		231	
Interest on Investments — Government and Local Body Stock	24		12	
Company	290		220	
Other	526		455	
Sundry Income	1,762		1,377	
		3,548		2,920
		32,278		38,242
Other Expenditure				
Interest on debentures, mortgages and other fixed loans	10,596		10,910	
Interest on bank overdraft and short term borrowings	900		791	
Cost of securing loan monies	979		32	
	12,475		11,733	
Less capitalised as a cost of expansion projects	1,008		1,650	
		11,467		10,083
		20,811		28,159
Provision for taxes on current income (Note 10) — Deferred	4,152		3,493	
Current (Net Rebate)	(3,979)		283	
		173		3,776
		20,638		24,383
Less outside shareholders' interests in profits of subsidiary companies		118		93
GROUP NET PROFIT FOR THE YEAR — Including dividends only from associated companies		20,520		24,290
Less dividends from associated companies (as above)		721		625
		19,799		23,665
Add Group share of profit for the year of associated companies				
Share of pre-tax profits	1,127		2,616	
Share of provisions for taxation	594		947	
		533		1,669
CONSOLIDATED NET PROFIT FOR THE YEAR — Including Group share of profit from subsidiary and associated companies		$20,332		$25,334

The notes and information on pages 8 to 23 are an integral part of and are to be read in conjunction with this Consolidated Statement of Profit.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Consolidated Appropriation Account for the year ended 31st March 1978.

		1978 ($000)		1977 ($000)
UNAPPROPRIATED PROFIT 1st April 1977				
N.Z. Forest Products Limited and subsidiary companies	3,396		2,096	
Associated companies	1,999		1,185	
		5,395		3,281
Increased by				
Consolidated Net Profit for the year		20,332		25,334
Extraordinary Items		—		−181
Transfer from Realised Capital Profit Reserve		1,247		−325
Reversal of 1977 appropriation in respect of the portion of final 1977 dividend/distribution paid from Share Premium Account		4,630		3,003
		31,604		31,112
Reduced by				
Transfer to Capital Replacement Fund of an amount equivalent to the distribution from Share Premium Account	4,630		3,003	
Other transfers	98		—	
		4,728		3,003
To Give		26,876		28,109
From which has been appropriated				
Interim dividend paid February 1978 — On Preference Shares	174		174	
On Ordinary Shares	4,821		3,687	
	4,995		3,861	
Provision final dividend/distribution payable September 1978 — On Preference Shares	174		174	
On Ordinary Shares	5,512		5,503	
	5,686		5,677	
Total dividend/distribution	10,681		9,538	
A sum to write off the excess cost of shares in a new subsidiary over the book value of the net assets acquired	—		176	
Transfer to Development Reserve	11,000		13,000	
		21,681		22,714
UNAPPROPRIATED PROFIT 31st March 1978		$5,195		$5,395
N.Z. Forest Products Limited and subsidiary companies	3,517		3,396	
Associated companies	1,678		1,999	
		$5,195		$5,395

The notes and information on pages 8 to 23 are an integral part of and are to be read in conjunction with this Consolidated Appropriation Account.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

N.Z. Forest Products Limited and Subsidiary Companies

	1978 ($000)		1977 ($000)	
AUTHORISED CAPITAL (Note 1)		$100,000		$100,000
PAID UP CAPITAL (Note 1)				
Preference	5,565		5,565	
Ordinary	68,875		68,784	
		74,440		74,349
RESERVES				
Development Reserve (Note 2)	85,000		74,000	
Share Premium Account (Note 3)	33,506		38,057	
Capital Replacement Fund (Note 4)	7,633		3,003	
Land Revaluation Reserve (Note 5)	38,900		36,516	
Realised Capital Profit Reserve (Note 6)	909		1,950	
	165,948		153,526	
Unappropriated Profit (Note 7)	5,195		5,395	
		171,143		158,921
TOTAL SHAREHOLDERS' FUNDS		245,583		233,270
OUTSIDE SHAREHOLDERS' INTERESTS IN SUBSIDIARY COMPANIES		739		645
PROVISION FOR DEFERRED TAXATION (Note 10)		31,969		25,915
LONG TERM LIABILITIES				
Debentures (Note 8)	47,767		48,593	
Mortgages (Note 9)	3,320		3,631	
Provision for Exchange Fluctuation (Note 11)	3,306		585	
Overseas Loans (Note 12)	77,923		75,907	
Other Long Term Liabilities (Note 13)	14,450		9,330	
		146,766		138,046
CURRENT LIABILITIES				
Bank Overdraft — Secured to $2,900,000	7,721		8,396	
Sundry Creditors	33,498		26,854	
Provision for Dividend/Distribution	5,686		5,677	
Provision for Current Taxation (Note 10)	140		161	
	47,045		41,088	
Term Liabilities repayable before 1st April 1979	4,752		5,257	
		51,797		46,345
		$476,854		$444,221

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Consolidated Balance Sheet as at 31st March 1978.

		1978 ($000)		1977 ($000)
FOREST ASSETS (Note 14)		80,352		74,663
OTHER FIXED ASSETS (Note 15)				
Land	14,672		14,328	
Buildings	56,375		55,109	
Vehicles and Mobile Equipment	14,120		11,413	
Plant, Machinery and Other Assets	152,810		148,082	
Capital Work in Progress	9,047		12,312	
		247,024		241,244
TOTAL FIXED ASSETS		327,376		315,907
LONG TERM INVESTMENTS				
Associated Companies (Note 17)	9,407		7,799	
Other Long Term Investments (Note 18)	6,848		6,665	
		16,255		14,464
CURRENT ASSETS				
Stocks — Production Materials	25,765		20,385	
Partly Manufactured Goods	3,303		2,441	
Manufactured Goods	46,718		35,202	
	75,786		58,028	
Debtors including Prepayments	45,818		48,634	
Export Incentive Tax Rebate (Note 10)	4,321		—	
Bank Balances, Cash and Call Deposits	1,707		2,088	
Land held for Subdivision	3,191		2,754	
	130,823		111,504	
Short Term Investments (Note 19)	2,400		2,346	
		133,223		113,850
		$476,854		$444,221

The notes and information on pages 8 to 23 are an integral part of and are to be read in conjunction with this Balance Sheet.

For and on behalf of the Board,
A. G. WILSON, Chairman
L. N. ROSS, Deputy Chairman

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

N.Z. Forest Products Limited

		1978 ($000)		1977 ($000)	
AUTHORISED CAPITAL (Note 1)			$100,000		$100,000
PAID UP CAPITAL (Note 1)					
Preference		5,565		5,565	
Ordinary		68,875		68,784	
			74,440		74,349
RESERVES					
Development Reserve (Note 2)		85,000		74,000	
Share Premium Account (Note 3)		33,487		38,027	
Capital Replacement Fund (Note 4)		7,633		3,003	
Land Revaluation Reserve (Note 5)		27,737		26,137	
Realised Capital Profit Reserve (Note 6)		—		1,116	
		153,857		142,283	
Unappropriated Profit (Note 7)		2,729		2,584	
			156,586		144,867
TOTAL SHAREHOLDERS' FUNDS			231,026		219,216
PROVISION FOR DEFERRED TAXATION (Note 10)			21,224		16,677
LONG TERM LIABILITIES					
Debentures (Note 8)		47,767		48,593	
Mortgages (Note 9)		2,482		2,684	
Provision for Exchange Fluctuation (Note 11)		3,305		613	
Overseas Loans (Note 12)		77,923		75,907	
Other Long Term Liabilities (Note 13)		13,927		8,743	
			145,404		136,540
CURRENT LIABILITIES					
Bank Overdraft — Secured to $2,850,000		6,779		7,302	
Sundry Creditors		27,845		20,881	
Provision for Dividend/Distribution		5,686		5,677	
Provision for Current Taxation (Note 10)		31		31	
		40,341		33,891	
Term Liabilities repayable before 1st April 1979		4,558		4,980	
			44,899		38,871
			$442,553		$411,304

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Balance Sheet as at 31st March 1978.

		1978 ($000)		1977 ($000)
FOREST ASSETS (Note 14)			63,424	57,986
OTHER FIXED ASSETS (Note 15)				
Land	9,073		9,360	
Buildings	41,182		40,247	
Vehicles and Mobile Equipment	11,277		8,816	
Plant, Machinery and Other Assets	113,262		111,384	
Capital Work in Progress	7,441		11,120	
		182,235		180,927
TOTAL FIXED ASSETS		245,659		238,913
LONG TERM INVESTMENTS				
Subsidiary Companies (Note 16)	29,970		30,010	
Associated Companies (Note 17)	6,972		5,315	
Other Long Term Investments (Note 18)	4,758		4,683	
		41,700		40,008
CURRENT ASSETS				
Stocks — Production Materials	13,943		11,520	
Partly Manufactured Goods	1,818		1,106	
Manufactured Goods	26,931		20,170	
	42,692		32,796	
Debtors including Prepayments	29,864		33,353	
Export Incentive Tax Rebate (Note 10)	4,321		—	
Bank Balances, Cash and Call Deposits	132		321	
	77,009		66,470	
Short Term Investments (Note 19)	2,327		2,272	
		79,336		68,742
LOANS TO SUBSIDIARY COMPANIES		75,858		63,641
		$442,553		$411,304

The notes and information on pages 8 to 23 are an integral part of and are to be read in conjunction with this Balance Sheet.

For and on behalf of the Board,
A. G. WILSON, Chairman
L. N. ROSS, Deputy Chairman

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

Notes to the Accounts

1. CAPITAL

	1978 $000	1977 $000
Authorised Capital		
4,000,000 Preference 'A' Shares of $1 each	4,000	4,000
6,000,000 6 25% Cumulative Preference Shares of $1 each	6,000	6,000
90,000,000 Ordinary Shares of $1 each	90,000	90,000
	$100,000	$100,000
Paid Up Capital		
No Preference 'A' Shares have been issued	—	—
5,564,502 6.25% Cumulative Preference Shares of $1 each fully paid	5,565	5,565
68,875,648 Ordinary Shares of $1 each fully paid	68,875	68,784
	$74,440	$74,349

During the year 91,175 Ordinary Shares were issued, 58,898 in payment of purchase consideration for shares in other companies plus 32,277 in terms of the Staff Share Option Plan.
At 31st March 1978 the only options outstanding were in respect of 1,700,013 Ordinary Shares in terms of the current Staff Share Option Plan under which option holders are entitled to purchase shares progressively over a 10 year period. Prices are established at 75 per cent of the market value at the time of granting the options.

2. DEVELOPMENT RESERVE

	$000
At 1st April 1977	74,000
Transfer from Unappropriated Profit	11,000
At 31st March 1978	$85,000

This represents earnings which have been retained to partially finance development projects. Transfers have been made from unappropriated profit progressively since 1954.

3. SHARE PREMIUM ACCOUNT

	Holding Company $000	Consolidated $000
At 1st April 1977	38,027	38,057
Increased by the premium on shares issued during the year	90	90
	38,117	38,147
Reduced by 1977 final dividend paid as a distribution from Share Premium Account	4,630	4,630
	33,487	33,517
Associated companies	—	−11
At 31st March 1978	$33,487	$33,506

This account accumulates the amounts by which the price of shares issued has exceeded the par value of $1 per share. In 1976 approval was obtained to distribute $15,000,000 from this account to shareholders. Of this amount $7,633,000 had been distributed prior to 31st March 1978 in substitution for taxable dividends and a further amount will be required to meet the proposed 1978 final dividend/distribution. Such distributions are tax free in the hands of shareholders resident in New Zealand.

4. CAPITAL REPLACEMENT FUND

	$000
At 1st April 1977	3,003
Transfer from Unappropriated Profit	4,630
At 31st March 1978	$7,633

The Supreme Court approval to make distributions from the Share Premium Account was conditional upon an equivalent amount being transferred from revenue sources to a Capital Replacement Fund. This fund equates the amount distributed to 31st March 1978.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

5. LAND REVALUATION RESERVE

	Holding Company $000	*Consolidated $000*
At 1st April 1977	26,137	36,516
Adjustments to Government Valuation during the year		
Holding Company & subsidiary companies	1,600	2,313
Associated companies	—	71
At 31st March 1978	$27,737	$38,900

This account represents the reserve created by the write up of land from cost to Government Valuation in accordance with procedures explained under the Group's sign ficant accounting policies.

6. REALISED CAPITAL PROFIT RESERVE

	Holding Company $000	*Consolidated $000*
At 1st April 1977	1,116	1,950
Increased by		
Transfers to Holding Company from subsidiaries	131	—
Net capital profits for the year		
Subsidiary companies	—	—5
Associated companies	—	211
	1,247	2,156
Reduced by		
Transfer to Unappropriated Profit	1,247	1,247
At 31st March 1978	Nil	$909

This reserve accumulates capital profits which the Inland Revenue Department has accepted as being available for tax-free dividends to shareholders resident in New Zealand. Subsidiary and associated company capital profits become available only when transferred to the Holding Company.
Due to capital losses sustained on the repayment of overseas loans there are currently no funds available for distribution from this reserve to shareholders of the Holding Company.

7. UNAPPROPRIATED PROFIT

		Holding Company $000	*Consolidated $000*
At 1st April 1977		2,584	5,395
Increased by			
Net profit for the year		20,543	20,332
Transfer from Realised Capital Profit Reserve		1,247	1,247
Other transfers		36	—98
		24,410	26,876
From which has been appropriated			
Interim dividend paid February 1978	4,995		
Provision for final dividend/ distribution payable September 1978	5,686		
Total dividend/distribution	10,681		
Transfer to Development Reserve	11,000		
		21,681	21,681
At 31st March 1978		$2,729	$5,195

At this stage the full amount of the 1978 final dividend/distribution has been charged against Unappropriated Profit. An appropriate adjustment to the Share Premium Account and Capital Replacement Fund will be required when the amount paid from Share Premium Account has been determined.

The Holding Company's profit of $20,543,000 includes dividends of $45,000 declared by subsidiaries from the profits of previous years.
$20,498,000 of the consolidated profit has been dealt with in the books of N.Z. Forest Products Limited.

8. DEBENTURES

The Company's liability at 31st March 1978 under Secured First Debentures was

	1978 *$000*	1977 *$000*
First to Twelfth Issues —		
Interest range 6.5% to 12% — repayable		
1978 to 1982	10,095	10,994
1983 to 1987	11,516	10,766
1988 to 1992	8,470	8,470
1993 to 1998	7,123	7,123
1999 to 2004	12,139	12,139
	49,343	49,492
Less classified as a current liability — payable before 1st April 1979	1,576	899
	$47,767	**$48,593**

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

8. DEBENTURES (continued)

The N.Z. Forest Products Limited Debenture Stock has been issued in terms of a Debenture Trust Deed dated 25th November 1965 as modified by a Supplemental Trust Deed dated 2nd August 1972 and is secured over the assets of the parent and guarantor subsidiary companies.

9. MORTGAGES

The balances outstanding at 31st March 1978 under first mortgages on company housing were

	1978 *$000*	1977 *$000*
Table mortgages repayable progressively to 1987 — average interest rate 5.4%	538	729
Term mortgage repayable 1991 — interest rate 9.5%	2,019	2,075
Other mortgages — deferred land purchase	46	50
	2,603	2,854
Less classified as a current liability — payable before 1st April 1979	121	170
Total — N.Z. Forest Products Limited	2,482	2,684
Subsidiary companies — mortgages on residential and industrial properties repayable progressively to 1992 — average interest rate 7.5%	931	1,134
Less classified as a current liability — payable before 1st April 1979	93	187
	838	947
Total — Consolidated Balance Sheet	$3,320	$3,631

Certain of the above balances are also collaterally secured by debentures of the Company.

10. PROVISIONS FOR TAXATION

Tax charged against current income

Current

Income tax payable by the Group has been calculated as follows

	1978 *$000*	1977 *$000*
Profit before tax	$20,811	$28,159
Less		
Export Market Development and Export Incentive Allowances	9,943	12,188
Forestry Incentive Allowances	3,466	4,096
Investment Allowance	2,742	3,038
Trading Stock Valuation Adjustment Allowance	2,478	—
Other Allowances	932	—
	19,561	19,322
Timing differences (mainly depreciation)	3,156	16,519
Non-taxable income	867	445
	$23,584	$36,286
Taxable income (loss)	($2,773)	($8,127)
Tax at 45% (loss)	(1,248)	(3,657)
Future tax benefits		
Carried forward	—	3,940
Applied against current tax	(2,731)	—
Charge for current tax (net rebate)	($3,979)	$283
Made up of		
Export Incentive Rebate due from the Inland Revenue Department and recorded as a current asset.		
(45% of $9,603,000)	(4,321)	—
Current tax payable	342	283
Charge for current tax (net rebate) — as above	($3,979)	$283

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

10. PROVISIONS FOR TAXATION (continued)

	1978 $000	1977 $000
Deferred		
Tax has also been charged against current income in respect of timing differences which will reverse in future years.		
Timing differences for the year	$3,156	$16,519
Tax at 45%	1,421	7,433
Future tax benefits		
Transferred from current tax	—	(3,940)
Applied against current tax	2,731	—
Charge for deferred tax	$4,152	$3,493

Current Tax Liability			1978 $000		1977 $000
After allowing for payments already made, the tax payable before 1st April 1979 is					
N.Z. Forest Products Limited — 1972/73 tax			31		31
Subsidiary companies —					
Terminal tax	93		114		
1972/73 tax	16		16		
		109		130	
Provision at 31st March 1978		$140		$161	

Deferred Tax Liability		Holding Company $000		Consolidated $000
At 1st April 1977		16,677		25,915
Deferred tax adjustment for the current year	3,963		4,152	
Reduction in provision for tax benefits on unrealised exchange losses — due to favourable exchange rate movements during the year	1,863		1,863	
Other adjustments	(1,279)		39	
		4,547		6,054
Provision at 31st March 1978		$21,224		$31,969

10. PROVISIONS FOR TAXATION (continued)

		Holding Company $000	Consolidated $000
Made up of			
Timing differences between accounting and taxation records.			
Depreciation		58,755	82,890
Exchange losses		(329)	(329)
Long service leave		(1,066)	(1,359)
		57,360	81,202
Tax at 45%		25,812	36,541
1972/73 taxation deferred		31	47
Future taxation benefit			
Available at 1st April 1977	3,903		
Exchange losses provided at 31/3/77 and realised during the year	3,334		
Other taxation benefits	113		
	7,350		
Applied against current income for the year	2,731		
Remaining at 31st March 1978		(4,619)	(4,619)
Provision as above		$21,224	$31,969

11. PROVISION FOR EXCHANGE FLUCTUATION

	Holding Company $000	Consolidated $000
At 1st April 1977	613	585
Increased by favourable currency movements (net of taxation) during the year	2,692	2,721
At 31st March 1978	$3,305	$3,306
Appropriated from revenue reserves at 31st March 1976		10,000
Reduced by		
Realised exchange losses (net of tax)	6,159	
Losses (net of tax) arising on conversion of overseas loans to New Zealand currency at exchange rates ruling on 31st March 1978	535	
		6,694
Provision as above		$3,306

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

12. OVERSEAS LOANS

	1978 $000	1977 $000
Unsecured loans arranged to assist in financing expansion programmes		
Overseas bank loan U.S. $70 million repaid during the year	—	69,016
Overseas bank loan U.S. $50 million repayable progressively between 1980 and 1983. Interest on roll-over basis currently 8.25%	49,140	—
Overseas bond issue U.S. $25 million repayable 1986 — fixed interest rate 9%	24,570	—
Other overseas loans repayable progressively between 1978 and 1981.		
Interest on roll-over basis — 1977/78 average 7.59%	3,538	5,218
Fixed interest averaging 6.64%	3,100	5,257
	80,348	79,491
Less classified as a current liability — payable before 1st April 1979	2,425	3,584
	$77,923	$75,907

During the year the U.S. $70,000,000 overseas bank loan was repaid. It was replaced by a further overseas bank loan of U.S. $50,000,000 on more favourable terms and a Eurodollar bond issue of U.S. $25,000,000.

Interest Capitalised

Because of a high investment in expansion projects which had not contributed to profit, $1,008,000 of the interest paid during the year on overseas loans has been capitalised as part of the cost of the projects.

13. OTHER LONG TERM LIABILITIES

	1978 $000	1977 $000
Secured Loans		
Bank Loan repayable between 1978 and 1982 interest rate 1977/78 11%	10,000	5,000
Housing Corporation — bridging finance provided for purchase of shares in N.Z. Maritime Holdings Limited repayable 1978 — interest rate 6%	436	763
Unsecured Loans		
Employee home ownership principal payments held on behalf of employees	2,861	2,385
Long service leave	1,066	922
	14,363	9,070
Less classified as a current liability — payable before 1st April 1979	436	327
Total — N.Z. Forest Products Limited	13,927	8,743

13. OTHER LONG TERM LIABILITIES (continued)

	1978 $000	1977 $000
Total N.Z. Forest Products Limited	13,927	8,743
Subsidiary Companies		
Secured Loans		
Bank loans	200	40
Housing Corporation bridging finance	20	35
Unsecured Loans		
Arranged to assist in financing the purchase of plant and equipment	—	240
Employee home ownership principal payments held on behalf of employees	107	98
Long service leave	293	254
Other	3	10
	14,550	9,420
Less classified as a current liability — payable before 1st April 1979	100	90
Total — Consolidated Balance Sheet	$14,450	$9,330

14. FOREST ASSETS

	1978 $000	1977 $000
Forest (excluding land) at cost	32,238	29,285
Land at cost (recent purchases)	5,076	4,131
Land at valuation	26,110	24,570
Total — N.Z. Forest Products Limited	63,424	57,986
Subsidiary companies		
Forest (excluding land) at cost	6,197	6,043
Land at cost (recent purchases)	11	11
Land at valuation	10,720	10,623
Total — Consolidated Balance Sheet	$80,352	$74,663

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

15. OTHER FIXED ASSETS

N.Z. Forest Products Limited

	At Cost	At Valuation	Depreciation	Book Value
	$000	*$000*	*$000*	*$000*
Land	3,548	5,525	—	9,073
Buildings	52,438	—	11,256	41,182
Vehicles & Mobile Equipment ...	22,538	—	11,261	11,277
Plant, Machinery & Other Assets ...	171,930	—	58,668	113,262
Work in Progress ...	7,441	—	—	7,441
At 31st March 1978	**$257,895**	**5,525**	**81,185**	**182,235**
Previous year ...	$236,508	5,217	71,918	169,807
Work in Progress ...	11,120	—	—	11,120
At 31st March 1977	$247,628	5,217	71,918	180,927

The estimated cost of completing capital work in progress at 31st March 1978 was $19,829,000 (1977 $25,904,000) of which $17,610,000 (1977 $17,673,000) was committed at that date. These figures include all amounts contracted for and all projects authorised by the Directors.

N.Z. Forest Products Limited and Subsidiary Companies

	At Cost	At Valuation	Depreciation	Book Value
	$000	*$000*	*$000*	*$000*
Land	4,014	10,658	—	14,672
Buildings	66,996	4,456	15,077	56,375
Vehicles & Mobile Equipment ...	29,184	—	15,064	14,120
Plant, Machinery & Other Assets ...	228,397	—	75,587	152,810
Work in Progress ...	9,047	—	—	9,047
At 31st March 1978	**$337,638**	**15,114**	**105,728**	**247,024**
Previous year	$311,723	10,543	93,334	228,932
Work in Progress ..	12,312	—	—	12,312
At 31st March 1977	$324,035	10,543	93,334	241,244

The estimated cost of completing the Group capital work in progress at 31st March 1978 was $20,881,000 (1977 $27,755,000) of which $18,269,000 (1977 $19,444,000) was committed at that date. These figures include all amounts contracted for and all projects authorised by the Directors.

16. SHARES IN SUBSIDIARY COMPANIES

	$000
The shares are recorded in the N.Z. Forest Products Limited Balance Sheet at the book value of net assets acquired	$29,970

17. SHARES IN ASSOCIATED COMPANIES

The latest audited accounts have been used covering the respective accounting periods set out below

	Financial Year Ended
Board Fabricators Limited (50%) ; Paper Coaters (NZ) Limited (50%) ; Paperboard Packaging Pty. Limited (49%) ; Fibre Products New Zealand Limited (33⅓%) ; Nelson Pine Forest Holdings Limited (25%)	31/3/78
Williamson Jeffery Limited (33⅓%)	30/6/77
N.Z. Particle Board Limited (50%)	30/4/77
New Zealand Perlite Limited (50%) ; Carter (Kumeu) Limited (50%) ; Donn Pacific Limited (40%) ; West Coast Resources Limited (40%) ; Nissan Datsun Holdings Limited (28%) ...	31/3/77

Post balance date losses have been incorporated, where applicable.

The latest audited accounts available for Office Typewriter Company Limited and Western Reinforcing Limited were for the years ended 30th April 1977 and 31st March 1977 respectively — in both cases prior to becoming associated companies.

	1978	1977
	$000	*$000*
Investments at cost		
Total — N.Z. Forest Products Limited	**6,972**	5,315
Share of post-acquisition increase in net assets of the associated companies	**2,435**	2,484
Total — Consolidated Balance Sheet	**$9,407**	**$7,799**

The net tangible asset backing supports this value of $9,407,000.

In the Supreme Court of New Zealand

No 4

Affidavit of William Wilson

Exhibit 'A'

- continued

18. OTHER LONG TERM INVESTMENTS

		$000
Investments in Companies — at cost		
N.Z. Maritime Holdings Limited		1,131
Other company investments		27
		1,158
Asset backing is at least equal to the $1,158,000 invested in these companies which are not quoted on the Stock Exchanges. The Directors consider the investments to be fairly valued at cost.		
Suspensory Loans and Mortgages — at cost		1,212
Loans to employees purchasing houses and sections from the Company.		
Insurance Policies — at premium cost to date		609
Endowment insurance taken out as collateral security for mortgage loans on employee housing at Tokoroa. The policies have a face value of $1,512,000.		
Secured Advances — at cost		1,779
Total — N.Z. Forest Products Limited		4,758
Subsidiary Companies		
Secured advances — at cost	854	
N.Z. Maritime Holdings Limited	50	
Other company investments	50	
Insurance policies — at premium cost to date	140	
Suspensory loans and mortgages — at cost	945	
Other	51	
		2,090
Total — Consolidated Balance Sheet		$6,848

19. SHORT TERM INVESTMENTS

	Holding Company $000	*Consolidated $000*
Short term investments — at cost		
Government Stock and Local Body Securities	255	257
Company investments	2,061	2,132
Other investments	11	11
	$2,327	$2,400
Market value at 31st March 1978		
Quoted — at Stock Exchange quotation nearest to 31st March 1978		
(Cost $2,015,000)	2,224	
(Cost $2,084,000)		2,296
Unquoted — considered by the Directors to be fairly valued at cost	312	316
	$2,536	$2,612

20. GENERAL

	Holding Company $000	*Consolidated $000*
Contingent Liabilities		
Amount uncalled on shares in subsidiary companies	14	—
Amount uncalled on shares in other companies	285	285
Advances guaranteed	8,528	7,843
H.M. Customs & Harbour Board bonds	90	90
Other bonds	661	661
Bills discounted	4,961	4,991
	$14,539	$13,870

Directors Fees

Paid during year to 31st March	*$000*	*$000*
1978	**$44**	**$47**
1977	$40	$43

Audit Fees & Expenses

Payable for year to 31st March	*$000*	*$000*
1978	**$55**	**$118**
1977	$55	$112

Bank Stock

At 31st March 1978 Bank Stock to a nominal value of $14,250,000 was held by New Zealand trading banks as security for overdraft and other facilities available to the N.Z. Forest Products Limited Group.

In the Supreme Court of New Zealand

No 5

No 5

AFFIDAVIT OF GEOFFREY JOSEPH SCHMITT IN SUPPORT OF COMMISSIONER OF INLAND REVENUE

Affidavit of Geoffrey Joseph Schmitt

I, GEOFFREY JOSEPH SCHMITT of Hamilton, Professor of Management Studies, MAKE OATH and say:

(1) I am a Professor of Management Studies and Dean of the School of Management Studies at the University of Waikato. I hold the degrees of M.A. in Economics and B.Com. of the University of New Zealand. In addition I hold a Diploma in Public Administration of Victoria University of Wellington and also am a fellow of the New Zealand Society of Accountants (F.C.A.) and of the Cost and Management Accounting Division of the Society (M.C.A.).

(2) My experience includes periods as a Research Officer of the Treasury concerned with economic monetary and taxation policy and in the employ of Tasman Pulp and Paper Company Limited including five years as Managing Director. I am a member of the Board of Research and Publications of the New Zealand Society of Accountants and Chairman of the Advisory Committee of the Waikato University's Inflation Accounting Project.

(3) Current commercial practice in New Zealand is not to take account of inflation in calculating the profits of a business other than in the exceptional ways described in paragraphs (5) and (6).

(4) "Inflation" may be defined in general terms as a change in the general level of prices according to a weighted average or index.

(5) In respect of fixed assets businesses often revalue assets upwards over cost. No effect on the calculation of profits follows directly from an adjustment in the value of fixed assets. However, it is accounting practice for depreciation to be calculated against the increased value and this will affect the calculation of profits. For tax purposes depreciation may only be calculated against the cost price of the asset.

(6) Businesses sometimes adjust the value of current assets but only where the realisable value falls below cost.

(7) Almost without exception the accounts of public companies prepared according to the requirements of the Companies Act 1955 are prepared on the basis of historic cost.

(8) While companies may use current cost accounting in the preparation of their published accounts the adoption of current cost accounting is a departure from general accounting principles which is required to be disclosed under the statement on disclosure of accounting principles issued by the New Zealand Society of Accountants.

(9) To the best of my knowledge only one New Zealand public company publishes its official accounts on the basis of current cost accounting although some companies publish supplements which provide figures calculated on the basis of current cost accounting.

SWORN at Auckland this)
9th day of December) "G.J. Schmitt"
1978 before me:)

"J.J. Shaw"

A Solicitor of the Supreme Court of New Zealand

No 6

NOTES OF EVIDENCE TAKEN BEFORE THE HON. MR JUSTICE ROPER

Hearing: 13 December 1978

Counsel: A.P. Molloy and C.K. Steven for Objectors
D Simcock and T.M. Gresson for Commissioner

MR MOLLOY OPENS AND CALLS:

RUSSELL GEORGE FINLAY (SWORN)

I am a Registered Surveyor and I live in Timaru. I am a member of the N.Z. Institute of Surveyors and a partner in the firm of Milward Fougere & Finlay. I started with that firm in 1958 and have been a partner since 1964. In April 1965 my firm surveyed for subdivision a block of

In the Supreme Court of New Zealand

No 6

Notes of evidence

- continued

land owned by the Lowe brothers at Gleniti. I handled the land transfer part of it, that is the pegging of the sections on the site on completion of placing construction works. I did work for a Mr Pettigrew. He was a previous owner of the same block of land. We undertook a subdivision for Mr Pettigrew in about 1960-61 simply subdividing his existing block into two 10 acre allotments, one of which was subsequently bought by Lowe brothers. The typography of the block had not altered between the time I surveyed for Pettigrew and the time I surveyed for the Lowes in 1965. The typography, basically Wai-iti Road extends for the full length of the northern boudnary. From the road frontage the land falls to the south to a gully approx. 5 chains in from Wai-iti Road, the gully running parallel to Wai-iti Road. From there the land rises again to the south until it is about at the same level as Wai-iti Road and from there falls again to the south to the southern boundary which is the City Council's Centennial Reserve. The sections in the valley area parallel with Wai-iti Road have an obstructed outlook being in a depression. They look on to the rear of the commercial sites fronting Wai-iti Road and to the south they are overshadowed by houses fronting Tawa Street.

BENCH: That depressed area, the City drain? Yes through there, precisely.

COUNSEL: I surveyed the plans DP 24271 and 24677. Some filling was required in order to construct the road, particularly along Miro Street, the western boundary of the block.

BENCH: Lots 1-5 is a commercial area is it with a service land round it? Yes it is. What is the drop from Wai-iti Road to that depressed area? Going on memory, approx. 20-25 feet.

COUNSEL: Witness ref. to Lot 9 on the corner of Miro and Tawa Streets. That lot was in the area of the fill and also Lots 7 and 8 further to the north were subject to some filling in order to lift the level of Miro Street where it went through the gully. It was a modest level of fill, round about 3 or 4 feet. The roading is shown on the plans. As at 1961 none of this land would have been able to have been sold off without the road. From memory I think in 1961 there were no main trunk sewer and stormwater drains available in which case the subdivision would not have been acceptable to the local authority at that time. A subdivision could have been executed only in a very minor way. The sections fronting Wai-iti

Road could have been taken off separately but of course being commercial allotments there would probably be little point in doing that with without the support of the residential allotments in that area.

In the Supreme Court of New Zealand

No 6

XXD:

No questions.

Notes of evidence

- continued

No 7

10 REASONS FOR JUDGMENT OF ROPER J.

No 7

Hearing: 13th December 1978

Judgment: 8 June 1979

Judgment of Roper J

Counsel: A.P. Molloy and C.K. Steven for Objectors
D. Simcock and T.M. Gresson for Commissioner

This case stated pursuant to s 32 of the Land and Income Tax Act 1954 has required
20 consideration of some difficult questions of tax law and I regret that because of the pressure of other business my decision has been so long delayed.

From 1960 the Objectors carried on a fruiterers business in partnership. In March 1963 they sold the business to a company, Lowes Supermarket Ltd., but retained the business premises, which they let to the company, so from the 1st April 1963 they have derived
30 income from the rents. During the year ended 31st May 1962 they purchased a 10 acre block at Gleniti, Timaru for $20,000 which they subsequently subdivided into 36 housing sections. The sections were then offered for sale and the first was sold in January 1964.

The Objectors return of income for the year ended 31st March 1974 declared a loss of $2,658, and the accounts filed in support showed that they had sold further Gleniti
40 land during that year, the profit from the sales being treated as a capital gain. On the 25th March 1975 the Department's Examiner wrote to the Objectors' Accountants intimating that the sales of Gleniti land might be subject to the provisions of s 88AA of the Act and seeking details of the number of sections sold and their selling prices, the date of the Objectors' purchase of the land and the cost, and the date of subdivision. The

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

Accountants supplied the following information by letter of the 10th June:-

1. The number of sections sold during year ended 31st March 1974 was nine.

2. The land was originally purchased in 1961 for use as a market garden but owing to developments which took place in the surrounding areas and to other matters affecting the property at the time, it was decided to subdivide. We have had previous correspondence with your Department on these matters between July to October, 1970 and August to December 1973, which we assume will be on our clients file

   In order to arrive at a cost per section at the commencement of the subdivision we took the initial cost of the land, added the projected cost of the total development, interest on loans, legal fees, rates and other expenses of holding the land, then divided the total thus obtained by the number of sections. This gave a figure of $2,300 which it is realised is an average figure and does not take into account variations in area, but it has been on this basis that capital profit adjustments have been made in the land account to date.

   As there are some sections in the block still to be sold the final cost is not yet known but with approximately 80% of the subdivision now disposed of it appears that our calculated cost figure is reasonably correct.

   The cost of the Gleniti land plus development and other costs capitalised over the period totalled $79,521.18 to 31 March 1974. It is estimated that there could be a further sum of approximately $4,000 to add to costs in respect of the completion of development work on the unsold sections. This gives a total cost of $83,521.18 divided by the total number of sections sold and for sale, 36, gives an average cost of $2,320.

3. The legal statements provided by our clients show the date of sale and

sale value of the sections sold during year ended 31st March 1974 as follows:

1973			
April	11		4,750
	19		4,750
May	10		3,000
August	15		4,050
October	30		4,363
November	2		4,850
December	17		5,000
1974			
January	1		6,000
March	29		5,301
			42,064
Less Legal Fees		106	
" Commission		175	281
			$41,783

The decision to subdivide would have been taken during the 1973 year as the first sale of a section is recorded in January 1964.

The reference to "1973" in the last paragraph above was obviously intended to be "1963".

Further correspondence followed (copies of which are annexed to the Case) and in the result the Commissioner determined that the profits derived from sales of Gleniti land made on or after the 10th August 1973 were assessable income in terms of s.88AA(1)(d) of the Act. He assessed the Objectors accordingly.

The Objectors' Accountants challenged the assessment by letter of the 7th August 1975 as follows:-

"On behalf of our clients we object to these assessments, upon the ground that no part of the sums so assessed, are, or were, either assessable income or taxable income in the hands of our clients: whether pursuant to s 88(1)(cc), s 88AA, or any other enactment.

In so far as you rely on s. 88(a)(cc) of the Land and Income Tax Act 1954:

(a) You are incorrect in including any of the proceeds of the sales of land, referred to in the assessment, in the assessable incomes of our clients.

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

(b) Our clients did not acquire the land, or any of it, for any purpose, or with any intention, of selling or otherwise disposing of it.

(c) At no time relevant to the assessment did the business of our clients, or any person associated with them, comprise or include dealing in land, and, even if it did, none of the land disposed of was acquired by our clients for the purposes of any such business.

(d) At no time relevant to the assessment did the business of our clients, or of any person associated with them, comprise or include erecting buildings, and, even if it did, the land was not acquired by our clients for the purposes of any such business.

(e) Our clients did not, within ten years of acquiring the land, subject it to any 'undertaking or scheme', within the meaning of that expression as it is used in s 88AA.

(f) Neither did they subject the land to an 'undertaking or scheme', within the meaning of that expression as it is used in s 88AA, at any other time since acquiring it.

(g) Even if our clients had subjected the land to such an undertaking or scheme, whether or not within ten years of having acquired it, they should have been entitled to an allowance for the true value of any land sold - calculated at the moment any scheme alleged by you was entered into or devised - as opposed to its mere original costs.

(h) Even if their intentions, purposes, or activities, or those of any person associated with them, in respect of the land, brought the proceeds of its sale within any part of s 88AA: no profits or gains are capable of calculation by you so as to form part of the assessable or taxable incomes of our clients.

(i) No other circumstances exist, or have existed, which could give rise to a situation in which s 88(1)(cc), or s 88AA, could have any applicat-

ion to any of those proceeds of the sales of any of the land which are mentioned in the Notice of Assessment.

(j) Even if the proceeds of the sales are properly assessable, as you allege, the assessment should have allowed as a deduction - in respect of each parcel of land sold - an amount to cover future and contingent expenditure.

(k) Even if the proceeds of the sales are properly assessable, as you allege, any calculation of profit should have taken full account of inflation in property values generally over the period, and of inflation so far as it reduced the value of money over the relevant period.

(l) Any proceeds of sales of any land by our clients during the relevant period are of a capital nature, and do not form part of their assessable or taxable incomes.

(m) The returns furnished by, or on behalf of, our clients, in respect of the relevant income year, were, and are, correct.

Finally, it is submitted that if any proceeds of section sales are assessable, they should be brought to tax in the year of receipt by our clients and not in the year of sale, or at any other time."

The Commissioner's letter of the 13th August disallowing the objection reads in part:-

"Your objection to your clients 1974 Notice of Assessment, issued on 7 July 1975, has been disallowed as those sections sold on or after the 10 August 1973 are subject to the provisions of Section 88AA(1)(d) of the Land and Income Tax Act 1954. This section provides that the assessable income of any taxpayer shall be deemed to include all profits or gains from the sale or other disposition of land where an undertaking or scheme was commenced within ten years of date of acquisition. In this particular case the properties were acquitted in 1961 and two subdivision plans were prepared, one in 1965 and the other in 1969. The undertaking or scheme therefore took place within ten years of acquisition.

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

This was supported by you in your letter of 10 June 1975 in which you advised that the decision to sub-divide would have been taken during the 1963 year as the first sale of a section was recorded in January 1964."

The basic facts which I have summarised above were accepted by both parties for the purposes of this Case, and for that limited purpose it was further agreed:-

"1. THE assessment has not been made, and argument will not proceed, on the basis that the land which the objectors have subdivided, and are selling, was a block which had been acquired by them for any purpose, or with any intention, of resale.

2. WHEN the objectors came to dispose of their land, although they could have done so by sale of the whole block, they chose instead to sell it in several smaller parcels.

3. BECAUSE the local authority would not otherwise have permitted the sales of such smaller parcels, the objectors chose to, and planned, committed themselves to, and had carried out, the construction of roads and footpaths through the property, and the provision beneath them of the usual sub divisional services: so that the sections into which the property was divided would be able to be connected to these services.

4. THE sections have been sold by the objectors unimproved."

Other facts were agreed but it is not necessary to refer to them at this point.

The question posed for determination in the Case is simply whether the Commissioner acted incorrectly in including in the assessments the share of profits derived by the Objectors from the sale of the Gleniti land, and if so in what respects should the assessments be varied. However, Counsel were not content with such a seemingly colourless enquiry and have agreed upon five questions that may require an answer.

The first as posed by Counsel is that:-

"THE FIRST QUESTION is whether, in planning, committing themselves to, and having carried out, the subdivision into lots of the land which they owned, together with

the work mentioned in paragraph 3 hereof, the objectors carried on or carried out, or caused to be carried on or carried out, an "undertaking or scheme", within s.88AA (1(d), which was capable of giving rise to a taxable profit or gain within that enacement."

I shall now proceed to consider that question. Section 88AA of the Land and Income Tax Act 1954 (being now s.67 of the Income Tax Act 1976) was inserted by s.9 of the Land and Income Tax Amendment Act 1973, with application to profits or gains derived from sales or other dispositions of land made on or after the 10th August 1973.

Section 88AA, as first enacted, provided for five categories of land transaction from which profits or gains were deemed to be assessable income. (A sixth class was added by a later amendment but it has no relevance to these proceedings).

The scheme of s.88AA was to make profits or gains from the sale or other disposition of land assessable income in the following cases:-

Subsection 1(a) Where the land was acquired for the purpose of resale or disposition, although that may not have been the sole purpose.

1(b) Where the taxpayer was in the business of dealing in land, and the land was acquired for the purpose of that business and was sold within 10 years of its acquisition.

1(c) Where the taxpayer was in the business of erecting buildings, has carried out improvements to the land, and acquired it for the purpose of erecting buildings, and sells or disposes of it within 10 years of completing the improvements, which must be of more than a minor nature.

1(d) Which is the paragraph of s 88AA we are primarily concerned with in this case reads:-

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- concerned

(1) For the purposes of paragraph (cc) of subsection (1) of section 88 of this Act, the assessable income of any taxpayer shall be deemed to include -

(d) All profits or gains derived from the sale or other disposition of land where -

(i) An undertaking or scheme, whether or not an adventure in the nature of trade or business involving the development or division into lots of that land has been carried on or carried out, and the Commissioner is satisfied that the development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land; and

(ii) That undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer."

1(e) Deals with the case where (a) to (d) above do not apply and covers the situation where a scheme of development or subdivision is carried out more than 10 years after acquisition. To be caught by this paragraph the development or division work must be of a substantial nature involving significant expenditure.

Subsection (3) of s.88AA excludes the application of subs 1(d) where the land sold was part of a larger area (not exceeding 4500 square metres) which was occupied by the taxpayer as residential land; and subs (4) excludes its application where the land was farm land and the lots after subdivision are capable of being worked as economic farming units.

Subsection (7) provides:-

> "This section shall apply where the land sold or otherwise disposed of constitutes the whole or part of any land to which this section applies or the whole or part of any such land together with any other land."

The remaining subsections of s.88AA appear to have no relevance in the present enquiry.

The only other section of the Act which is relevant at this point is s.88(1)(c) and (cc) which read:-

> "(1) Without in any way limiting the meaning of the term, the assessable income of any person shall for the purposes of this Act be deemed to include, save so far as express provision is made in this Act to the contrary, -
>
> (c) All profits or gains derived from the sale or other disposition of any personal property or any interest therein (not being property or any interest therein which consists of land within the meaning of section 88AA of this Act), if the business of the taxpayer comprises dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit:
>
> (cc) All profits or gains derived from the sale or other disposition of any land within the meaning of section 88AA of this Act, being profits or gains to which that section applies."

Before the enactment of s 88AA profits or gains from isolated land deals, where the taxpayer was not a dealer in land, were assessable, if at all, under s.88(1)(c) which, before the 1973 Amendment, read:-

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

"(1) Without in any way limiting the meaning of the term, the assessable income of any person shall for the purposes of this Act be deemed to include, save so far as express provision is made in this Act to the contrary, -

(c) All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit.

Section 88(1)(c), and more particularly the third limb thereof, has posed problems for the Commissioner in the past and Mr Gresson, who argued the First Question conceded that it was because of those difficulties that the Commissioner had not assessed the Objectors under that section, for the third limb as amended in 1973 still applies to land transactions.

In cases decided under the third limb of s.88(1)(c) our Courts have consistently taken the stand the sale of a capital asset is not a profit making undertaking or scheme merely be cause it is realised in the most advantageous manner, and that in order to come within the third limb the undertaking or scheme must produce income and not a capital gain. In Eunson v. C.I. (1963) N.Z.L.R. 278 a farmer sold land surplus to his requirements by subdividing and selling in lots. At p. 280 Henry J, said:-

"The third limb, is in my view, a specific provision for ensuring that assessable income does include profits in the nature of income earned or derived from the carrying out of schemes and undertakings. If the Legislature meant to tax all profits from the sale of land the three limbs of s.88(3) would be unnecessary and the subsection would proceed no further than the opening words, namely, "All profits or gains derived from the sale or other disposition of any real or personal property or any interst therein". The third limb catches some residue of methods of earning profits which are neither a business nor the realisation of property bought for the purpose of sale. It is not necessary for this Court to attempt to define the ambit of the third

limb of s.88(c). It is the duty of this Court to do no more than to determine whether or not the present transactions are within the statute. In my view they are not. Each case is only an instance of the application of the words of the statute: per Lord Loreburn, John Stewart and Son (1912) Ltd. v. Longhurst (1971) A.C. 249, 255. The appellant did no more than to dispose of a capital asset comprising part of his farming land. He concluded, for reasons sufficient for himself, that he should realise the capital value of this asset which he no longer desired to keep for the original purpose for which it was acquired, namely, farming. The appellant put hismind to the question of disposing of this asset to the best advantage, and, on advice, decided that it would be to his advantage to sell an area in eight small lots and to retain two lots for his own purposes as previously stated. I cannot see that by doing this he was carrying on or carrying out a scheme entered into or devised for the purpose of making a profit. He did not enter into any scheme at all nor did he devise any scheme. He merely disposed of a surplus capital asset by eight separate sales instead of one sale of the whole. To effect those sales the law required a survey of the land and the preparation of a Land Transfer survey plan. That is only a machinery requirement necessary for the purpose of giving title. The subsection applies to real and personal property. Far too much emphasis was placed on the legal requirements necessary to give title to land when it is sold from a parent title. Those legal requirements are not "a scheme". They are not "devised" by the owner of the land. I can see no difference in kind between the uncomplicated and straightforwardsale of surplus land in surveyed lots and the sale of any other assets in respect of which the owner decides he will get a better price if he sells by means of a number of sales of parts rather than the sale of the whole in one lot. The words used in s.88(c) are inapt to include the bona fide sale at an enhanced price of a capital asset which does not come within the first two limbs of s.88(c). I think it matters not whether the sale is in one lot or in several. The interposition of a survey and incidental steps to give title do not create a scheme which is either devised or entered into. If the State wishes to gather up such a well-known method of disposing of land held as a capital asset into the taxation net, more explicit words than those used

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

in s.88(c) are necessary. A violent departure from the general principles of taxing income ought not to be adopted as a matter of construction unless the words used clearly and unequivocally require their application to the particular facts."

Again in C.I.R. v. Walker at p. 339 of the same volume of the reports a farmer purchased 63 acres from one Pennington intending to add 60 acres to his existing holding and selling off the balance after subdivision thereof. The Court of Appeal (North and Turner JJ., Gresson P. dissenting) held that it was the taxpayer's dominant purpose in buying the whole property which mattered, and as the sale of the surplus three acres was but a necessary incidental step in fulfilment of his real or dominant purpose of enlarging his farm, any profit on the sale of the sections was not taxable. At p.361 North J. said:-

> "No doubt the third limb is wider in its application than the second, but in giving a meaning to the word "purpose" in both clauses it is as well to bear in mind that we are dealing with a taxing statute aimed at requiring persons to pay tax on income as distinct from what may loosely be described as gains derived from a capital source. Pennington, for example, could have subdivided his 63 acres and sold the whole in sections without being called upon to pay income tax on any part of the proceeds. He would merely have been exercising the right possessed by every property owner of selling his land, either in one block or in portions, as he thought most profitable to himself."

Mr Gresson submitted that in enacting s.88AA(1)(d) the Legislature intended to tax profits or gains whether they were of an income or capital nature. Mr Molloy's answer to that was that for the Court to conclude that the paragraph in question introduced a tax on capital gains would amount to a radical and unjustifiable departure from the well established and rather obvious principle that income tax is a tax on income. It is of course well established that such a departure would only be justified where the words of the statute clearly and unequivocally required such a construction. Mr Molloy cited a number of authorities to that effect but I need refer to only one. In Smith v. C.I.R. (1969) N.Z.L.R. 565 Haslam J. said at p. 570:-

> "I think that counsel for the objectors are correct in submitting that wherever Parliament has intended to convert a

form of capital gain into assessable income, clear and unmistakable language has been used for that purpose, e.g. s.88(1)(d) relating (inter alia) to premiums derived by the owner of land from a lease or payments for goodwill of a business. As Viscount Sumner observed in Levene v. Commissioners of Inland Revenue (1938) A.C. 217; (1928) All E.R. Rep. 746: "... the subject ought to be told in statutory and plain terms when he is chargeable and when he is not" (ibid., 227; 751)."

Although I do not think he intended it as one of his main arguments Mr Gresson did place some reliance on the circumstance that ss.88 and 88AA are "deeming" enactments, and submitted that the "deeming" provisions were sufficient to convert all of the categories in s.88AA into assessable income, although the profits or gains may have come from the realisation of a capital asset. I agree with Mr Molloy that the fact that these are "deeming" provisions is no substitute for the clear and unmistakable language necessary to bring a capital gain within the definition of income. Several of the categories contained in s.88, and perhaps s.88AA, are clearly assessable as income without the need to be "deemed" as such, and, as Mr Molloy pointed out, s.88(1)(d), by deeming goodwill to be income, serves to bring in an item which would otherwise be capital, but does so in a clear and unequivocal manner.

The intention of the legislature must of course be determined on the plain ordinary meaning of the words of the paragraph, a proposition which is easy to state but sometimes difficult to apply. In the present case the plain ordinary meaning of s.88AA(1)(d) appeared tolerably clear at a first reading, namely, that it imposed a tax on capital gains, but Mr Molloy's contrary submission certainly caused me to think that the matter was not so clear cut as I had believed. (As an aside it is interesting to note that in Molloy on Income Tax at p. 147 the learned author expresses the view that prima facie paragraphs (d) and (e) of s.88AA(1) could be said to introduce a tax on capital gains; while the joint authors of Commerce Clearing House N - Z Income Tax Law and Practice (Messrs Simcock & Rooke) express the view at paragraph 11-650 that paragraph (d) does not expressly tax capital gains and that the section is directed only at undertakings or schemes entered into for profit!)

I accept Mr Gresson's submission that the subdivision of land into lots is "a scheme", and I did not understand Mr Molloy to dispute

that. What he did dispute was that "a scheme" which comprised nothing more than the mere subdivision of land, not acquired for a purpose, or with an intention, of disposition, was caught by paragraph (d).

At first sight there appeared to be some force in Mr Molloy's argument that if mere subdivision was the object of the Legislative intention it was quite unnecessary to include in paragraph (d) the words "undertaking or scheme, whether or not in the nature of trade or business involving...", when it would have been enough to say "all profits or gains derived from the development or division into lots of that land." Of course Mr Molloy's suggested amendment would have the effect of enlarging the paragraph's scope and would not meet one of the difficulties the Commissioner had faced with s.88(1)(c).

In interpreting paragraph (d) I think it necessary to consider the cases decided under the third limb of s.88(1)(c) or its equivalent in other jurisdictions. It seems clear that the words in paragraph (d) "whether or not an adventure in the nature of trade or business" were inserted to overcome the earlier decisions that in order for a subdivision to come within the meaning of "undertaking or scheme" in the third limb the subdivision activity must amount to a trading or dealing activity.

In McClelland v. Commissioner of Taxation of the Commonwealth of Australia (1971) 1 All E.R. 969 the Privy Council considered s.26(a) of the Commonwealth Act, which is similar to s.88(1)(c). There the taxpayer became beneficially entitled together with her brother in equal undivided shares in a block of land. The taxpayer later purchased her brother's interest in the land and subdivided the block into three portions, selling one of those portions in order to pay her brother for his share. At p.974 Lord Donovan referred to "a considerable body of judicial authority to the effect that a land owner may develop and realise his land without making a profit which partakes of the character of income; even though he goes about the realisation in an enterprising way so as to secure the best price" and continued:-

> "Do these facts disclose a 'profit-making undertaking or scheme' within the meaning of s.26(a)? It is clear in the first place that not all such undertakings or schemes are caught by the section. Otherwise every successful wager

would be within it. So also would the purchase of investments bought by a private investor as a hedge against inflation and sold - perhaps long afterwards - at more than the purchase price. The participator in a lottery would also be liable if he drew the winning ticket. The undertaking or scheme, if it is to fall within s.26(a), must be a scheme producing assessable income, not a capital gain. What criterion is to be applied to determine whether a single transaction produces assessable income rather than a capital accretion? It seems to their Lordships that an 'undertaking or scheme' to produce this result must - at any rate where the transaction is one of acquisition and re-sale - exhibit features which give it the character of a business deal. It is true that the word 'business' does not appear in the section; but given the premise that the profit produced has to be income in its character their Lordships think the notion of business is implicit in the words 'undertaking or scheme'."

Paragraph (d) was obviously enacted to overcome the difficulties experienced with s.88(1)(c). Looking at it in that light I accept Mr Gresson's submission that a mere subdivision is a scheme within the terms of paragraph (d). Whereas it was formerly necessary to show that the scheme produced assessable income, the use of the words "whether or not an adventure in the nature of trade or business" make it immaterial in the light of the earlier authorities whether the profit is income or a capital gain. If that is not the effect of paragraph (d), it is not much improvement on s.88(1)(c).

I agree with Mr Molloy that the paragraph is not happily worded, perhaps because the draughtsman was intent on overcoming the deficiencies in s.88(1)(c), rather than for the reasons advanced by Mr Molloy, namely, that the Legislature may have intended a capital gains tax and in attempting to achieve that by stealth thwarted its object, but for all that I am not in the kind of doubt expressed by Viscount Simon in Russell (Inspector of Taxes v. Scott (1948) A.C. 422 at p.433:-

> "I must add that the language of the rule is so obscure and so difficult to expound with confidence that - without seeking to apply any different principle of construction to a Revenue Act than would be proper in the case of legislation of a different kind - I feel that the

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

taxpayer is entitled to demand that his liability to a higher charge should be made out with reasonable clearness before he is adversely affected. In the present instance, this reasonable clearness is wanting."

I therefore answer the First Question in the affirmative.

Following on that affirmative answer Counsel were agreed on these additional facts:-

"If the answer to that first question is affirmative, that division and work:

(i) Was not of merely a minor nature.

(ii) Was carried out on behalf of the objectors "in relation to" the sections sold.

(iii) Was commenced by a decision made, possibly as early as 1963, but at least by April 1965, and in any case within ten years of the date on which the land had been acquired.

In the year in question, ending on 31st March 1974, the six sections which had been sold on or after 10 August 1973 (the date upon which s.88AA(1)(d) became effective) were Lots 9, 10, 11, 17 and 18 on DP 27647, and Lot 9 on DP 24271: which, respectively, realised gross prices pf $4,500, $5,000, $5,500, $5,000, $4,000 and $6,000."

That brings me to the Second Question which reads:-

"THE SECOND QUESTION, if there was any undertaking or scheme within s.88AA(1)(d), is whether it involved the development or division into lots of "that" land, within that expression where it first appears in sub-paragraph (i) of paragraph (d) of s.88AA(1)."

I am not sure that I mastered Mr Molloy's subtle argument on this question and effluxion of time hasn't helped matters. I am comforted by his comment that in any event "there was not much in it for the taxpayer". This is my understanding of the issue. In the year in question six lots were sold, five on one subdivisional plan (D.P. 27647) but only one (Lot 9) on subdivisional plan D.P. 24271. It follows said Mr Molloy that the sale of Lot 9 being the only lot sold from D.P. 24271, and the only one we are concerned with in this

Question, is not caught by paragraph (d), because "that land", being Lot 9, has not been divided into lots, and it is the land sold which must be divided into lots, not the land originally acquired. I may be wrong but it seems to follow from that argument that if a taxpayer sells only one lot in each financial year he would never be liable under paragraph (d), and that seems a curious result.

Both Counsel seemed to argue on the basis that the word "land" where first used in the pargraph referred solely to the land sold or disposed of, but I have reservations about that approach. The word "land" is qualified by what follows. It must be "land" which has been the subject of an undertaking or scheme involving development or division into lots, and if a profit is derived from the sale of such land, whether the whole or a part (see s.88AA(7)) it is caught by the paragraph.

I answer the Second Question in the affirmative.

The Third Question reads:-

> "THE THIRD QUESTION is whether any profits which may be held to have been made have been derived "from" the sales, mentioned in paragraph 7 hereof, within s.88AA(1)(d), or whether they have been derived merely on those sales and from such sources as the rise in property values, and the inflation, which occurred during the period between the acquisition of the block and each of these sales; and from the fact the work referred to in paragraph 3 hereof had been carried on or carried out."

This question appears to involve an exercise in semantics. Unlike s.88(1)(c), which deems to be income "all profits or gains derived from the carrying on or carrying out of the undertaking or scheme", paragraph (d) of s.88AA(1) refers to the "profits or gains derived from the sale ... of the land." Mr Molloy argued that in the instant case the profits which are said to attract tax arose not "from" the sale but "on" the sale, the profit being there already, with the sale providing the occasion for its arising. In other words the market value was realised "on" sale not "from" it.

In my opinion the short answer is that in the income tax field we are concerned with "realised" profits; and a profit, that is the amount by which the proceeds of sale

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

exceed cost price after deducting expenses relating to subdivision and sale, only arises after there has been an actual sale. The land may have had a profit potential but the profit was only derived and only became taxable once the land had been sold, that is it was derived "from" the sale.

On the Third Question I conclude that any profits which may be held to have been made have been derived "from" the sales.

The Fourth Question reads:-

"THE FOURTH QUESTION is whether, so as to form the basis of a valid assessment, any assessable or taxable profit or gain can be calculated by the method used by the Commissioner, or by any other method; or can be attributed to any particular income year."

and for the purpose of this question these further facts are agreed:-

"A number of sections remain to be sold.

The Commissioner's assessment is based upon the objector's calculation of an average land cost, plus an average share of actual land estimated subdivision and related costs, being attributed to each section. The objectors agree that this is a reasonable and proper accounting approach to the calculation of "profits" for general commercial purposes, but contend that neither it, nor any other method, is appropriate as a basis for valid assessment under the Land and Income Tax Act 1954."

And further I allowed Mr Molloy to call evidence from a surveyor, Mr Finlay, concerning the topography of the subdivided land. Mr Finlay described it thus:-

"The topography, basically Wai-iti Road extends for the full length of the northern boundary. From the road frontage the land falls to the south to a gully approximately 5 chains in from Wai-iti Road, the gully running parallel to Wai-iti Road. From there the land rises again to the south until it is about at the same level as Wai-iti Road and from there falls again to the south to the southern boundary which is the City Council's Centennial Reserve. The sections in the valley area parallel with Wai-iti Road have an obstructed outlook being in a depression. They look on to the rear of the commercial

sites fronting Wai-iti Road and to the south they are over-shadowed by houses fronting Tawa Street."

He then went on to explain that several of the lots had required modest fill, and that roading was required to make some lots saleable.

Mr Molloy submitted that in the circumstances of this case it was not possible to determine whether a profit had been made in the year in question, nor in any other single year, and that the profit could only be determined when all of the lots had been sold.

In the present case the Commissioner's assessment was based on the Objectors' own calculation of costs in relation to each section, and, said Mr Simcock, the Commissioner had no information to indicate that such calculations were not a reasonable basis for formulating an assessment. Mr Molloy submitted that that was no answer because the Objectors own financial records were not binding upon them and consequently they rejected the assessment made upon those records. There is some authority for that stand but I do not think it goes as far as Mr Molloy would have it. In The Federal Commissioner of Taxation v. Thorogood (1927) 40 C.L.R. 454 the High Court rejected a submission made on behalf of the Commissioner that the decided cases had established, as a rule of law, that if a taxpayer in his books represents the transactions for the year as resulting in a stated profit, the taxpayer was bound by that, unless the Commissioner saw sufficient reason to relax the situation and permit enquiry into the actual results. For Thorogood it had been contended before the Board of Review that whatever the method of accountancy, or other collateral circumstances, a taxpayer can always require the Commissioner to assess according to the actual receipts of the year. Isaacs A.C.J. referred to the "extreme" view of both parties and said at p. 458:-

> "The primary material on which an assessment has to be made is necessarily the return furnished by the taxpayer himself; and to test its accuracy the first field of investigation is ordinarily the taxpayer's own information and his books and vouchers. No doubt he is free to select his own method of accountancy, but, if by that method there appears to be a greater liability for income tax than his returns disclose, he cannot complain if the Commissioner, in protection of the Public Treasury and in justice to other taxpayers, holds him to his own accounts

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

unless he satisfactorily proves them erroneous."

The question is whether it is possible in the circumstances of this case to find a method of calculating profit which is reasonable and commercially acceptable. In Bedford Investments Ltd. v. C.I.R. (1955) N.Z.L.R. 978 the taxpayer purchased a property which it subdivided into nine lots, selling eight and retaining the ninth. The greater part of the profit was represented by the value of the ninth lot. At p.980 McGregor J. stated the following facts:-

> "The financial result of the transaction up to the time of hearing was that the total cost of the land to the appellant, including stamp duties, survey fees, and legal expenses, amounted to £33,112.15s.2d. Expenditure in connection with the eight lots sold amounted to £1,185.6s., making a total expenditure of £34,298.1s.2d. As stated, the eight lots sold realized £34,280; so that the appellant had become the owner of the remaining lot 9 at a net expenditure of £18.1s.2d.
>
> The Commissioner of Inland Revenue claimed that the appellant company had derived a profit from the transactions of £2,682. 19s.4d., and claimed that this profit should be included in the appellant's assessable income for the year ended March 31, 1954, on the basis that such profit was assessable under s.79(1)(c) of the Land and Income Tax Act, 1923, as enacted by s.10 of the Land and Income Tax Amendment Act, 1951.
>
> The Commissioner arrived at the profit figure of £2,682.19.s.4d. through calculating the cost to the appellant of the eight lots sold by apportioning the total cost of the whole block of land proportionately to the amount shown on the valuation roll as being the capital value of the lots sold, on the one hand, and the amount shown on the roll as being the capital value of the lot retained by the appellant, on the other. In other words, the Commissioner calculated the cost of the eight lots by multiplying the total cost by a fraction - of which the numerator was the Government value of the eight sections sold, and the denominator was the Government value of the total nine lots."

and went on to say at p. 983:-

"In my opinion, the original cost price of the whole block of land, and the Government valuation of the whole block of land, are both facts or matters of information in the possession of the Commissioner, and are matters for consideration as relevant circumstances The assessment was not an arbitrary one, but was based on substantial foundations of fact, and was something more than a matter merely of the Commissioner's opinion, which, in some cases, in the view of Isaacs J., in itself might be sufficient.

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

Although the validity of the Commissioner's mode of assessment did not arise for consideration in C.I.R. v. Walker (1963) N.Z.L.R. 339 C.A. all members of the Court referred to the practical difficulty of calculating a profit in the circumstances of that case. At p. 357 Gresson P. said:-

"I desire in conclusion to make a brief reference to the way in which the Commissioner computed the profit on the sale of the frontage land. The profit - if there was a profit - must consist of the amount by which the proceeds of sale of this land exceeded its cost price after deducting expenses relating to the subdivision and the sales. To assess the cost of the frontage land as being the same proportion of the cost of the whole as the ultimate realisation of the frontage land bore to the total gain on the sale of it all, does not appear to me to be justifiable. Moreover, neither the realisation of the frontage land nor the total gain has been wholly ascertained in terms of money paid, but is in part based upon values attributed to sections. The whole process is, in my opinion, too theoretical to be valid."

and North J. at p. 363:-

"I have said nothing about the practical difficulty that would arise in calculating the profit, if the transaction had been caught by the section. At the moment I find some difficulty in seeing the justification for attributing to the frontage land a proportion of the total cost of the block, but that is a problem which does not arise here."

and Turner J. at p. 368:-

"Like my brother North, I desire to leave open (notwithstanding the decision of McGregor J. in Bedford Investments Ltd. v.

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

Commissioner of Inland Revenue (supra), the question whether there may not be still another and separate ground on which this appeal falls independently, if presented under the third sub-heading of s.88(c) - the practical difficulty of making any assessment of the profit or gain which is to be made the subject of tax. To ascertain a profit or gain, it is necessary to be able to calculate the sum which the taxpayer derived in money from the transaction or by which the taxpayer's assets were thereby increased in value. It seems to me impossible in the case before us to make such a calculation as a matter of mathematics, and I would prefer to leave open for argument, in a case in which the matter directly arises, the question whether the Commissioner is in some way empowered arbitrarily to fix the figures from which such a calculation could be made, or whether, not empowered to do so, he is faced with a difficulty in calculation in this case which is fatal to assessment."

S similar difficulty was referred to by Windeyer J. in Elsey v. F.C.T. (1969) 121 C. L.R. 99. He said at p. 110:-

"I should add that no question was raised by the notice of objection or by counsel as to the Commissioner's manner of assessing what he said was profit from the sales of Esso and of lot 7. Nevertheless, if I had thought that there was in the prices realized any element of assessable income, I would be far from satisfied that it was correctly calculated. The Commissioner seems to have assumed that the price which the taxpayer paid for lots 1 to 7 inclusive represented an average of so many dollars per perch and that he could attribute this to the two areas sold and then subtract the result in each case from the price realized. That seems to me artificial. The case is quite unlike a sale of agricultural land of a more or less uniform kind - which can be seen as a sale at an average price per acre. It is also quite unlike a sale of vacant land having a frontage to a street and a uniform depth - which can be seen as a sale at a price of so much per linear foot. Here part of the total area had a river frontage, parts a frontage to a main road, parts to a side road, parts, lots 5, 6 and 7, were accessible through a cul-de-sac. To regard each

perch of the whole as equal in value to every other perch and as bought for the same price seems to me an altogether untenable proposition."

A number of other cases bearing on this issue were cited by both Counsel. In some the Commissioner's mode of assessment of profit from the sale of subdivided land was accepted, in others challenged, or rejected but I see no point in referring to them in detail. There is little help to be gained from them because the question of whether a profit can be assessed year by year must depend upon the facts and circumstances of the individual case under review. In some cases the facts and circumstances will provide a reasonable basis for the assessment of profit by reasonable methods, and in others the Commissioner might be driven to an arbitrary assessment, which, both Counsel agreed, would be unacceptable. It is unnecessary to go into the details but in neither the Walker case nor the Elsey case was the Court concerned with anything like a normal subdivision into housing lots of the whole of the subject land. In the instant case the Gleniti land was acquired as part of land previously used as farm land and was purchased initially for agricultural purposes. The whole has been subdivided, and although the topography might make some lots more attractive than others as building sites the evidence indicates that the only development necessary, apart from roading, was modest fill on some sections. There is really nothing to distinguish it from thousands of other subdivisions, and in that regard it must be of some relevance that it has taken 15 years for the problem adverted to in Walker's case to arise in a direct way.

I see no real difficulty in this present case in assessing the year by year profit in a reasonable way. The method of assessment adopted by the Commissioner in determining the cost price of the lots sold was by taking an average land cost plus an average share of actual and estimated subdivisional expenditure. The Objectors' own calculation of costs per section was accepted, and there is nothing to suggest that such calculations did not provide a reasonable basis for formulating an assessment. Further the mode of calculation was in accord with the decided cases (see Bedford Investments Ltd. v. C.I.R. (supra); Chapman v. F.C.T. (1968) 117 C.L.R. 167; and Elsey v. F.C.T. (supra) in so far as Windeyer J. appeared to endorse acceptance of average land costs as appropriate in the case of agricultural land of a more or less uniform kind.)

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

As for Mr Molloy's submission that the profits can only be established after all lots have been sold, I adopt Mr Simcock's arguments that such a procedure would be inconsistent with the Act, which taxes income on an annual basis, and would lead to the absurd result that the profit would never be assessed if the taxpayer, for whatever reason, did not complete the sale of all lots.

My answer to the Fourth Question is that on the facts and circumstances of this case a valid assessment of taxable profit or gain on an annual basis can be calculated by the method used by the Commissioner.

Having found that an assessable profit or gain is capable of calculation I am required to answer the Final Question which is "whether the Objectors are correct in their contention that the calculation of that taxation profit or gain ought to be amended to take into account the effect of inflation."

Counsel were agreed that if I should conclude that inflation should be taken into account I was not required to determine which of the various formulae should be adopted.

For the purpose of this question Counsel were agreed, not surprisingly, that between 1961, when the land was purchased, and the dates upon which the lots in question were sold, the value of the New Zealand dollar was affected considerably by inflation.

In addition I have been required to consider three affidavits concerning the commercial worlds current use of, and thinking on, "current cost accounting" (or "inflation accounting") and "historical cost accounting". A few extracts will indicate their tenor. Dr Brash, an economist, whose affidavit was filed in support of the Objectors, deposed:-

> "In my opinion, there is no serious dispute among the members of the New Zealand business and commercial community that, where the value or wealth quality is not stable from year to year, attempts to calculate "profits" for such commercial purposes as the determination of the amount available for distribution of dividends, or the amount available for re-investment in the business, cannot meaningfully be made without taking account of that instability.
>
> Notwithstanding any dispute over the details of the proper accounting approach, there is a very widespread agreement in New Zealand accounting and commercial circules that what is termed Historical

Cost Accounting cannot possibly lead to the ascertainment of a true commercial "profit" figure in times of inflation.

Between 1962 and 1974 the value of the New Zealand dollar diminished markedly as a result of inflation. If, therefore, true "profits" were to be ascertained for commercial pruposes for any year or years during this period, adjustment for that inflation would be essential.

In my opinion the well-offness concept of profits is in principle applicable equally to the calculation of profits in such non-commercial transactions as the realisation of non-business assets by individual persons. Inflation is a distorting element in that context just as much as it is in the context of commercial transactions."

Professor Schmitt of Hamilton, Professor of Management Studies, (for the Commissioner) deposed:-

"3. Current commercial practice in New Zealand is not to take account of inflation in calculating the profits of a business other than in the exceptional ways described in paragraphs (5) and (6).

4. "Inflation" may be defined in general terms as a change in the general level of prices according to a weighted average or index.

5. In respect of fixed assets businesses often revalue assets upwards over cost. No effect on the calculation of profits follows directly from an adjustment in the value of fixed assets. However it is accounting practice for depreciation to be calculated against the increased value and this will affect the calculation of profits. For tax purposes depreciation may only be calculated against the cost price of the asset.

6. Businesses sometimes adjust the value of current assets but only where the realisable value falls below cost.

7. Almost without exception the accounts of public companies prepared according to the requirements of the Companies Act 1955 are prepared on the basis of historic cost.

8. While companies may use current cost accounting in the preparation of their published accounts the adoption of current cost accounting is a departure from

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

general accounting principles which is required to be disclosed under the statement on disclosure of accounting principles issued by the New Zealand Society of Accountants.

9. To the best of my knowledge only one New Zealand public company publishes its official accounts on the basis of current cost accounting although some companies publish supplements which provide figures calculated on the basis of current cost accounting.

Mr W. Wilson of Auckland, a Chartered Accountant (also for the Commissioner) deposed:-

"The deficiencies of historical cost accounting are well recognised in accounting circles but to date the accounting bodies in New Zealand and elsewhere have not been able to reach agreement on a form of current cost accounting which would replace historical cost accounts.

Auditors continue to report that financial statements drawn up on an historical cost basis give a true and fair view of the state of affairs and the results of the business.

In my experience calculations of profits for debenture trust ratios, for profit sharing contracts and for legal contracts generally are still prepared on the historical cost basis.

In my opinion, while there has been considerable research into and development of a CCA form of accounting, current accepted practice in New Zealand is to prepare financial statements and to calculate on the historical cost method."

The problem Mr Molloy faced on this question was that he was obliged in large measure to base his argument on a critical analysis of a case which he accepted was against him. The case was Secretan v. Hart (1969) 3 All E.R. 1196 heard by Buckley J. There the taxpayer was assessed to capital gains tax on a sale of shares and he claimed that his original purchase price should be multiplied by a suitable factor to take account of the change in the value of money between the times of purchase and sale. At p. 1197 Buckley J. said:-

"It is a point of view with which, I think, any taxpayer would feel a certain degree of sympathy, for it is very irritating to think that if one buys a piece

of property - say, for instance, a plot of land - and holds it for a number of years during which nothing occurs to affect the market value of that piece of land at all, but the price for which it is sold exceeds the price originally paid for it because of a change in the value of money, one will then be taxed on a gain which, it is true, in a sense, one has made but to which one has not contributed in any way and which has not been brought about by any circumstance other than merely a change in the value of money. But one has to look at the Act and see in what way this tax is charged, in what circumstances liability arises and what the liability is."

and further at p. 1199:-

"If the intention had been that the effects of inflation were to be taken into account in determining whether or not a capital gain had been made, and the amount of such a gain, there would clearly have been in the Act some explicit statement to that effect and some machinery provided for ascertaining the effect of inflation on the relevant considerations. There is nothing anywhere in the Act of that kind. What is referred to in sub-para.4(1)(a) of Sch. 6 is "the amount or value of the consideration" given by the taxpayer "for the acquisition of the asset". The time which is looked at for the purpose of discovering what sum is a legitimate deduction is the time when he gave the consideration for the acquisition of the asset; and it is the consideration which he then gave in terms of money, or, if it was not given in money, turned into terms of money as at that date, which is the legitimate deduction.

If support for this view is required, I think some support is to be found in para.4(1)(b) of Sch. 6, where there is a reference to the amount of expenditure incurred by the taxpayer "for the purpose of enhancing the value of the asset". The amount of such expenditure can be discovered only by looking at the bills which he paid, for whatever he did or had done, for the purpose of enhancing the value of the asset. There is no suggestion there that any adjustment is to be made to take account of inflation. Indeed, if the taxpayer's submission were the right one, it seems to me that it would lead to conclusions of the utmost

In the Supreme Court of New Zealand

No 7

Judgment of Roper J

- continued

difficulty and confusion in the administration of this Act, for the value of the pound fluctuates constantly, and it would involve complicated research and calculation to arrive at the amount of profit made in respect of any particular asset before a capital gain could be discovered on the lines that the taxpayer suggests ought to be adopted."

Mr Molloy made the following points:-

1. That whereas the English statute made specific provision for the calculation of the taxable gain, in the instant case it was simply a matter of assessing "profit", and that that term should be used in its accepted business sense. As for that I am by no means satisfied that at the present time the commercial practice in New Zealand is to assess "profit" on a current cost accounting basis.

2. That the present legislation has been on foot for some 60 years and it is reasonable to assume that the Legislature did not foresee changes in the value of money, but did not intend that inflation ravaged "profit" should be taxable - only true "profits".

3. Buckley J's. argument that the Act would have laid down machinery to deal with inflation cannot be supported because our Act does not even define "income". As no method of computation of income is laid down, adjustment for inflation is open.

4. That administrative difficulty is an irrelevant consideration. Conversion factors are applied to exchange rates and the same could be done to counter the effects of inflation.

5. The question of continuing fluctuation in the value of the dollar does not arise, or at least is not insurmountable, because the decline in the value of money has been constant.

Mr Molloy made further detailed submissions but nothing he said convinced me that I should answer this question in the affirmative.

In the decided cases under s.88(1)(c) or its Australian equivalent the profit from the sale of land by a person not in the business of dealing in land has always been computed on the basis of the purchase price, and it would be a bold step to depart from that accepted and well established basis. Like

Buckley J., whose reasoning I adopt, I feel sympathy with the Objectors but feel unable to come to the conclusion that their view is the correct one.

In the Supreme Court of New Zealand

I therefore answer "No" to the Final Question.

No 7

I require memoranda from Counsel on the question of costs.

Judgment of Roper J

- continued

Solicitors:

Scott Bradley & Unwin, Timaru, for Objectors
Crown Solicitors Office, Timaru for Commissioner

No 8

ORDER OF ROPER J ANSWERING AGREED QUESTIONS AND RESERVING COSTS

No 8

Formal judgment

THIS CASE STATED having come on for hearing on 13 December 1978 before His Honour Mr Justice Roper

After hearing the evidence then adduced and Mr A P Molloy and Mr C K Steven for the Objectors and Mr D Simcock and Mr T M Gresson for the Commissioner

IT IS ADJUDGED that:

1 THE ANSWER to the question whether, in planning, committing themselves to, and having carried out, the subdivision into lots of the land which they owned, together with the work mentioned in paragraph 3 of the Statement of Agreed Facts and Issues, the objectors carried on or carried out, or caused to be carried on or carried out, an "undertaking or scheme", within Land and Income Tax Act 1954 s 88AA(1)(d), which was capable of giving rise to a taxable profit or gain within that enactment:

IS AFFIRMATIVE

2 THE ANSWER to the question whether that undertaking or scheme within s 88AA(1)(d) involved the development or division into lots of "that" land, within that expression where it first appears in sub-paragraph (i) of paragraph (d) of s 88AA(1):

IS AFFIRMATIVE

In the Supreme Court of New Zealand

No 8

Formal judgment

- continued

3 THE ANSWER to the question whether any profits which may be held to have been made have been derived "from" the sales, mentioned in paragraph 7 of the Statement of Agreed Facts and Issues, within s 88AA (1)(d), or have been derived merely on those sales and from such sources as the rise in property values, and the inflation, which occurred during the period between the acquisition of the block and each of these sales; and from the fact that the work referred to in paragraph 3 of the Agreed Statement of Facts and Issues had been carried on or carried out: is that any profits which may be held to have been made have been DERIVED "FROM" THE SALES.

4 THE ANSWER to the question whether, so as to form the basis of a valid assessment, any assessable or taxable profit or gain can be calculated by the method used by the Commissioner, or by any other method; or can be attributed to any income year: is that on the facts and circumstances of this case a valid assessment of taxable profit or gain on an annual basis CAN BE CALCULATED by the method used by the Commissioner.

5 THE ANSWER to the question whether the Objectors are correct in their contention that the calculation of that taxation profit or gain ought to be amended to take into account the effect of inflation: IS "NO".

6 Counsel are to submit memoranda on the question of costs.

DATED the 8th day of June 1979

BY THE COURT

"I R Harrison"

DEPUTY REGISTRAR

No 9

In the Court of Appeal of New Zealand

NOTICE OF MOTION ON APPEAL

No 9

CA No 112/79

Notice of Motion on Appeal

IN THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN PAUL DOUGLAS LOWE of Timaru company director

FIRST APPELLANT

HERBERT MONTY LOWE of Timaru company director

SECOND APPELLANT

KEITH LOWE of Timaru company director

THIRD APPELLANT

A N D THE COMMISSIONER OF INLAND REVENUE

RESPONDENT

TAKE NOTICE that this Honourable Court WILL BE MOVED by counsel for the appellants at the first sitting of the civil division thereof to be held after the expiration of fourteen days from the date of service of this notice of motion or so soon thereafter as counsel may be heard

ON APPEAL from the whole of the judgment of the Supreme Court of New Zealand perfected on 28 June 1979 according to the reasons for judgment delivered by His Honour Mr Justice Roper on 8 June 1979 and on the basis of which, in proceedings No GR 37/76 (Timaru Registry), it was determined that the Respondent acted correctly in assessing the Appellants to income tax on the proceeds of certain sales of land.

UPON THE GROUNDS that the judgment is erroneous in fact and in law

DATED 13 September 1979

"ANTHONY P MOLLOY"

[ANTHONY P MOLLOY]
Counsel for the Appellants

In the Court of Appeal of New Zealand

No 9

Notice of Motion on Appeal - continued

TO The Registrar of the Court of Appeal of New Zealand, and

TO The Respondent and its solicitor Michael Cuthbert Gresson, and

TO The Registrar of the Supreme Court at Timaru.

THIS NOTICE OF MOTION ON APPEAL is filed by CHRISTOPHER KEITH STEVEN solicitor for the Appellants whose address for service is at the offices of Messrs CASTLE POPE AND PARTNERS Solicitors, Brandon House, Wellington.

No 10

No 10

JUDGMENT OF COOKE J

Judgment of Cooke J

Coram: Cooke J. (presiding)
Richardson J.
McMullin J.

Hearing: 9 and 10 February 1981

Counsel: A.P. Molloy for Appellants
P.J.H. Jenkin and T.M. Gresson for Respondent

Judgment: 13 March 1981

The taxpayers are partners who began business as fruiterers in a shop in Timaru in 1960. They sold this business in 1963 but retained the premises and let them to the purchaser and have since derived income from rent. In 1961 they had bought a block of ten acres at Gleniti for $20,024.99. The city boundaries were extended about that time to include this land, but the taxpayers say that their intention was to acquire it for market gardening and storage; and for the purposes of these proceedings it has been agreed that 'The assessment has not been made, and argument will not proceed, on the basis that the land which the Objectors have subdivided, and are selling, was a block which had been acquired by them for any purpose, or with any intention of resale'. In 1963 they decided to subdivide and sell the land. The project has been carried out over a period of more than ten years.

There were two subdivisional plans, namely deposited plan 24271 covering land immediately to the south of Wai-iti Road

and deposited plan 27647 covering the adjoining land further to the south again. The taxpayers had the necessary roads, footpaths and services constructed and provided. The first section was sold in January 1964. By 31 March 1974 about 80 per cent of the whole subdivision had been sold. It is agreed that there were 36 housing sections in all, so apparently only about eight then remained to be sold.

Section 9 of the Land and Income Tax Amendment Act 1973, which was concerned with profits or gains from land transactions and is now re-enacted with some additions in s 67 of the Income Tax Act 1976, was declared to apply with respect to any profit or gain derived from any sale or other disposition made on or after 10 August 1973. Inter alia it inserted a new section 88AA in the Land and Income Tax Act 1954. In the new section the following were the provisions primarily material to the present case:

> (1) For the purposes of paragraph (cc) of subsection (1) of section 88 of this Act, the assessable income of any taxpayer shall be deemed to include -
>
> ...
>
> (d) All profits or gains derived from the sale or other disposition of land where -
>
> (i) An undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land has been carried on or carried out, and the Commissioner is satisfied that that development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land; and
>
> (ii) That undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer:

In the year ended 31 March 1974 six of the sections were sold after 10 August 1973, namely lots 9, 10, 11, 17 and 18 on deposited plan 27647 and lot 9 on deposited plan 24271. Their respective prices were $4500, $5000, $5500, $5000, $4000 and $6000. The Commissioner considered that the partners derived from these sales profits or gains falling

In the Court of Appeal of New Zealand

No 10

Judgment of Cooke J

- continued

within (d) and made assessments accordingly. In the partnership accounts furnished to the Commissioner a capital gain from sale of Glen-iti land of $22,667 was shown for that year, though the partners did not treat it as assessable. The Commissioner wrote asking for certain information, including the date of purchase of the land and the respective cost prices of the sections. The accountants for the partnership replied to the effect that an average cost per section of $2300 had been arrived at after taking into account the initial cost of the land and the projected cost of the total development and incidental expenses; that, although the average cost did not take into account variations in area, it was on this basis that capital adjustments had been made in the land account to date; and that with 80 per cent of the subdivision now disposed of it appeared that the calculated cost figure was reasonably correct. The Commissioner accordingly made assessments on this basis. The taxpayers objected, contending in short that there was no taxable profit from sales of the land in the year in question. After disallowance the objections were referred directly to the Supreme Court under s.32 of the Land and Income Tax Act 1954. Roper J. upheld the assessments in a judgment delivered on 8 June 1979 and the objectors appeal.

We have had the benefit, as did Roper J., of a full and carefully presented argument by Mr Molloy on behalf of the taxpayers, but in the end the Judge's decision appears to me, with respect, to be a commonsense and correct one. I am in substantial agreement with his reasoning but will put the main points in my own way in deference to the argument that we heard. It is convenient to deal with them in the order adopted by counsel for the appellants in this Court.

Capital Profits

The appellants contend that s.88AA(1)(d) is limited to certain profits or gains that are income in the ordinary sense and does not extend to capital profits or gains; and they say that the proceeds of the sales of their sections were nothing more than a conversion into cash or realisation of parts of a capital asset.

The Courts lean against construing income tax statutes as catching capital gains unless there is plain language to that effect. The line between income and capital, however, can be a fine one. In combination these factors had led, before the 1973 Act, to some difficult

cases about land subdivision. Two of them should be specifically mentioned.

In McClelland v. Commissioner of Taxation 1971 1 All E.R. 969, a case from Western Australia, a brother and sister were each entitled under a will to a half share in the proceeds of the sale of certain land having development potential; the will left legacies to others. The sister wished to retain the land but required finance to do so. Accordingly she obtained from her brother an option to buy out his share for L.40,000, and agreed to sell some of the land to outside purchasers for L.150,000. Out of a deposit of L.50,000 received from the purchasers she paid L.40,000 to her brother in exercise of her option and L.10,000 to the executors as a security required by them for the legacies. Thus she was left with the balance of both the purchase price and the land. The Commissioner assessed her to tax under a statute which brought in 'profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale, or from the carrying on or carrying out of any profit-making undertaking or scheme ...' In addition the Commissioner contended that the profit made by the appellant was income and not capital according to the commonly accepted notions or income, since she had engaged in a venture in the nature of trade. A majority of their Lordships in the Privy Council held that the profit was not assessable. They held that to fall within the statutory provision an undertaking or scheme must be one producing assessable income, not a capital gain; and that the test, at any rate in the case of a single transaction of acquisition and resale, was whether it exhibited features giving it the character of a business deal. They regarded the purchase of the brother's interest as simply a means to an end, i.e. the retention of the more valuable land. Similarly they held that the profit was not income according to ordinary concepts since it was not an adventure in the nature of trade. The minority held that the profit fell within both limbs of the statutory provision and could not be excluded as being proceeds of a mere realisation or change of investment or from an enhancement of capital: the elaborate scheme went beyond realisation. That this was something of a knife-edge decision is suggested, not only by the three to two division in the Privy Council, but also by the fact that when the judgments in the High Court of Australia are taken into account it is found that in all there were five Judges on each side.

In the Court of Appeal of New Zealand

No 10

Judgment of Cooke J

- continued

In this country the leading case was Commissioner of Inland Revenue v. Walker 1963 N.Z.L.R. 339. It arose under the then s.88(c) of the Land and Income Tax Act 1954, which included in the assessable income

> All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit:

The taxpayer bought a block of 63 acres with the intention of adding most of it to adjoining farm land owned by him so as to make one economic unit. Three acres of the block, being within the city and having a road frontage, were suitable for subdivision for housing. He also had the intention, which he carried out, of subdividing and selling that part, leaving him with 60 acres of farm land thus acquired in effect at a reasonably cheap cost. The Commissioner assessed him on the profits from the subdivision. A majority of the Court of Appeal, North and Turner JJ., held that the test was dominant purpose and that Henry J. had been justified in finding in the Supreme Court that the taxpayer's dominant purpose was the acquisition of farm land, the intention of selling city sections being merely incidental. North J. observed in the course of his judgment at p.361 with reference to the word 'purpose' in the Act that it was as well to bear in mind that the Court was dealing with a taxing statute 'aimed at requiring persons to pay tax on income as distinct from what might loosely be described as gain derived from a capital source'. He said that the original vendor could have subdivided his 63 acres and sold the whole in sections without being called upon to pay income tax on any part of the proceeds: he would merely have been exercising the right possessed by every property owner of selling his land, either in one block or in portions, as he thought most profitable to himself. But Gresson P. and the Stipendiary Magistrate who originally heard the objection thought that the Commissioner's view should prevail: the Court could look at the taxpayer's purpose of subdividing and selling the three acres; moreover, the profits were derived from a scheme entered into for the purpose of making a profit. Again the differences of judicial

opinion bring out that the case was not an easy one.

Against that background and not long after McClelland's case the New Zealand Parliament enacted in 1973 the legislation now relevant. The present case is not concerned with an Act passed earlier in the same year, the Property Speculation Tax Act 1973 (repealed in 1979), but that Act may be mentioned in passing as part of the general legislative pattern. It imposed a tax on profits derived from the buying and selling of land for speculative purposes. Sales within two years of the acquisition of the land attracted the tax unless within an exemption (e.g. land acquired as a residence but sold not principally for the realisation of profit and because of changed circumstances). Development or subdivision was not a condition of liability to that tax, and the making of improvements could in some cases result in exemption from it (s.20). That was a speculation tax and, although that Act did not specifically refer to capital gains, an assessable profit obviously could not have escaped the tax on the ground that it was a capital gain.

Then came the Amendment to the Land and Income Tax Act with which this case is concerned. Section 9(2) and (3) of the Amendment Act respectively amended s.88(1)(c) of the principal Act (under which Walker's case had arisen) by confining the first two limbs of that paragraph to personal property and added a new paragraph (cc) to s.88 covering 'All profits or gains derived from the sale or other disposition of any land within the meaning of section 88AA of this Act, being profits or gains to which that section applies'. Section 9(1) inserted s.88AA into the principal Act. This new section specified quite elaborately in paragraphs (a) to (e) five categories of cases in which 'All profits or gains derived from the sale or other disposition of land' were to be deemed to be included in assessable income. There were also some no less elaborate provisions having the effect of creating exceptions from those categories.

For present purposes it is enough to indicate the general scope of some of the categories very briefly. The first four related respectively to sales of (a) land acquired for the purpose of sale; (b) land acquired by persons in the business of dealing in land; (c) land acquired by persons in the business of erecting buildings; (d) land subject to an undertaking or scheme of development or subdivision, not being work of a minor nature, and commenced within ten years of the acquis-

ition of the land - this is the category relevant for the present case. Category (e) applied only if the profits or gains were not included in the assessable income under any of the previous categories. It covered undertakings or schemes of development or division involving significant expenditure on earthworks etc. or on any other work customarily undertaken in major projects. Paragraphs (d) and (e) both had the important words in relation to the undertakings or schemes to which they referred 'whether or not an adventure in the nature of trade or business'. By contrast these words did not appear in (a), (b) or (c). In this case we do not have to interpret those paragraphs.

As to the statutory exceptions, there were only two to catetories (d) and (e). They were specified in s.88AA(3) and (4) in complicated terms which may be very briefly summarised as follows: profits were not to be assessable under (d) or (e) if they arose from the subdivision of land occupied by the taxpayer for residential land or for farming; in the latter case the land sold had to be an economic farming unit and to be sold for use in farming.

There were incidental provisions in the new section which need not be gone into now. It is the general character of the section that is significant. Patently it laid down a series of detailed rules prescribing circumstances in which profits from the sale of land were to be assessable to income tax. To describe it as a code on the subject would not be strictly accurate. The specific provisions in s.88 of the principal Act listing what was to be deemed to be included in the assessable income were 'without in any way limiting the meaning of the term', and in theory it is conceivable that some profit from a land sale might arise which was not within any of the paragraphs of the new s.88AA(1) but was nevertheless income in the ordinary sense or within, for instance, the last limb of s.88(1)(c). But the new section was at least closely akin to a code. To construe it as if none of its paragraphs caught anything that was not income according to ordinary concepts, as the argument for the appellants would require, would reduce it to a rather futile exercise.

We are concerned here with the paragraph (d). In the light of the wording, context and background of that paragraph, it seems to me, with all respect to the argument, altogether unrealistic to suggest that profits falling within the natural meaning of its specific and

detailed language were nevertheless not within it if they were to be classified as capital profits. The provision originated in New Zealand, evidently not being copied from any overseas precedent, and shows, I think, a clear intention on the part of the New Zealand legislature to make the profits of taxpayers who subdivided or developed land liable to income tax in certain circumstances even if they would not have been taxable under the principles applied in such cases as McClelland and Walker. The sometimes difficult distinctions on which those cases turned were not to be relevant under (d).

The exception of certain dispositions of farm land for farming purposes throws some light on the policy of the legislature. It suggests that, by contrast, Parliament had in mind, for example, vendors who were able to make profits by schemes of development or subdivision which took advantage of the growing community's need for urban expansion into rural land. In defined circumstances they were to contribute some share of their profits to the community. And both exceptions are consistent with an intention that a profit should not automatically escape (d) or (e) merely because it was a capital profit; for cases within the exceptions would normally be instances also of capital profits.

But I do not base any conclusion on the exceptions. The crucial point is that the phrase 'whether or not an adventure in the nature of trade or business' reflects the very language used in McClelland's case to describe undertakings or schemes giving rise to income according to ordinary usages and concepts. The only reasonable inference is that for the future Parliament was ruling out that criterion in cases falling within (d) or (e).

Mr Molloy went close to conceding, if he did not quite take the final step, that in (d) Parliament must have meant to tax capital profits. But he argued that, if so, the draftsman had chosen an inapt formula and the wrong target. Stressing the traditional judicial reluctance to treat income tax Acts as covering gains that would not naturally be regarded as income, Mr Molloy argued in substance that there should have been an express statement that profits or gains within (d) were to be assessable notwithstanding they were or might be capital gains. I think that this was not the only way in which the same result could be achieved and that the way chosen was effective. When its context and manifest de-

In the Court of Appeal of New Zealand

No 10

Judgment of Cooke J

- continued

rivation are borne in mind, the crucial phrase in fact chosen leads irresistibly to the conclusion that whether or not a gain should be classified as a capital one in the ordinary sense is irrelevant in deciding whether it falls within (d).

The Land and the Scheme

In this Court the second contention for the appellants invoked the point that, on the wording of s.88AA(1)(d), profits derived from the sale of land were not caught unless the scheme involved the development or division into lots of 'that' land. It was contended that the wording did not catch a sale of a lot which was neither itself developed (as distinct from the carrying out of development work 'in relation to' it, an expression used later in the first subparagraph) nor itself divided into lots. On this interpretation profits from the sale in one year of any number of lots would escape tax if the lots were not themselves developed and none of them were adjacent one to the other. Mr Molloy accepted that the contention does not affect the year actually in question in this case, because lot 9 on deposited plan 24271 had some filling and each of the lots sold from deposited plan 27647 was adjacent to another lot sold in the same tax period. But he expressed the hope that the Court would express an opinion on the question as it could arise in relation to other years.

Like Roper J. I do not think that the statutory wording compels such a capricious result as would follow from this contention on the part of the appellants. If there has been a scheme involving the division of land into lots, it is not unnatural to say in a general way that profits have been derived from the sale of that land although only some of the lots have been sold. A narrower and more pedantic interpretation is also possible; but the broader interpretation is preferable as harmonising with, perhaps even required by, s.88AA(7), which provides:

> (7) This section shall apply where the land sold or otherwise disposed of constitutes the whole or part of any land to which this section applies or the whole or part of any such land together with any other land.

Computation of Profit

The third contention may be summarised as being that the section did not apply unless

the existence and amount of profits or gains could be ascertained with mathematical certainty, which was impossible in this case; or alternatively (an alternative approach developed in the course of Mr Molloy's argument) that at any rate the Commissioner had not achieved sufficient accuracy to justify the present assessment. In support Mr Molloy pointed to such factors as the obvious variation in the sizes, topography and prices of the sections; the impossibility of attaining absolute precision as to the results of the venture as a whole unless and until all sections had been sold (or further attempts to sell abandoned) and all costs incurred; and the inevitability of having to fall back on some apportionment of costs when land has been bought in block and sold in sections after expenditure on roading and other services.

The factual material against which these arguments are put forward in the present case is meagre. In answer to the Commissioner's enquiry as to the date of purchase of the land and the respective cost prices of the sections the accountants said in a letter of 10 June 1975:

> In order to arrive at a cost per section at the commencement of the subdivision we took the initial cost of the land, added the projected cost of the total development, interest on loans, legal fees, rates and other expenses of holding the land, then divided the total thus obtained by the number of sections. This gave a figure of $2,300 which it is realised is an average figure and does not take into account variations in area, but it has been on this basis that capital profit adjustments have been made in the land account to date.
>
> As there are some sections in the block still to be sold the final cost is not yet known but with approximately 80% of the subdivision now disposed of it appears that our calculated cost figure is reasonably correct.
>
> The cost of the Gleniti land plus development and other costs capitalised over the period totalled $79,521.18 to 31 March 1974. It is estimated that there could be a further sum of approximately $4,000 to add to costs in respect of the completion of development work on the unsold sections. This gives a total cost of $83,521.18 divided by the total number

of sections sold and for sale, 36, gives an average cost of $2,320.

The suggestion that a further $4000 might be incurred in development costs was evidently not pursued. No mention was made of it in the evidence or the case stated or the agreed statement of facts. I will not refer to it again.

Some very limited evidence was called for the objectors before Roper J. It was from Mr R.G. Finlay, the registered surveyor who had been engaged by the objectors for the subdivision. He said:

> The topography, basically Wai-iti Road extends for the full length of the northern boundary. From the road frontage the land falls to the south to a gully approx. 5 chains in from Wai-iti Road, the gully running parallel to Wai-iti Road. From there the land rises again to the south until it is about at the same level as Wai-iti Road and from there falls again to the south to the southern boundary which is the City Council's Centennial Reserve. The sections in the valley area parallel with Wai-iti Road have an obstructed outlook being in a depression. They look on to the rear of the commercial sites fronting Wai-iti Road and to the south they are overshadowed by houses fronting Tawa Street.
> BENCH: That depressed area, the City drain? Yes through there, precisely.
> COUNSEL: I surveyed the plans DP 24271 and 24677. Some filling was required in order to construct the road, particularly along Miro Street, the western boundary of the block.
> BENCH: Lots 1-5 is a commercial area is it with a service lane round it? Yes it is. What is the drop from Wai-iti Road to that depressed area? Going on memory, approx. 20-25 feet.
> COUNSEL: Witness ref. to Lot 9 on the corner of Miro and Tawa Streets. That lot was in the area of the fill and also Lots 7 and 8 further to the north were subject to some filling in order to lift the level of Miro Street where it went through the gully. It was a modest level of fill, round about 3 or 4 feet. The roading is shown on the plans. As at 1961 none of this land would have been able to have been sold off without the road. From memory I think in 1961 there were no main trunk sewer and stormwater drains available in which case the sub-

division would not have been acceptable to the local authority at that time. A subdivision could have been executed only in a very minor way. The sections fronting Wai-iti Road could have been taken off separately but of course being commercial allotments there would probably be little point in doing that without the support of the residential allotments in that area.
XXD: No questions.

The agreed statement of facts and issues includes the following paragraph:

> 11. THE Commissioner's assessment is based upon the objector's calculation of an average land cost, plus an average share of actual and estimated subdivision and related costs, being attributed to each section. The objectors agree that this is a reasonable and proper accounting approach to the calculation of "profits" for general commercial purposes, but contend that neither it, nor any other method, is appropriate as a basis for valid assessment under the Land and Income Tax Act 1954.

As to the argument that mathematical certainty is essential, it is true that, as Mr Molloy pointed out, the 1973 Amendment Act did not expressly empower the Commissioner to assess profits under (d) on the basis of an estimate or discretionary judgment by him. It is also true that s.88AA(5) did expressly provide that for the purposes of paragraph (e) of subs.(1) the Commissioner 'may ascertain the value of any land at the date of the commencement of any undertaking or scheme referred to in that paragraph in such manner as he thinks fit'. But (e) differed from (d) in ways material to the present point. Under both paragraphs the profits had to be derived from the sale or other disposition of land and there had to be an undertaking or scheme involving the development or division into lots of that land. Under (d), however, the date of the acquisition of the land by the taxpayer could be all-important, as (d) did not apply unless the undertaking or scheme was commenced within ten years of that date. Whereas under (e), although there was no time limit, the profits were caught only to the extent that they were derived from the carrying on or the carrying out of the undertaking or scheme. We are not now directly concerned with (e), as the Commissioner has not sought to found his assessment on that paragraph; but it would appear that for the purposes of (e) it may be necessary to compare the price ultimately received

from sales with the value of the land at the date of the commencement of the scheme. The initial cost to the taxpayer at the time of acquisition would not necessarily be a yardstick under (e). That accounts for subs.(5). In any event that subsection may have been only inserted out of caution. It does not seem credible that the legislature referred only to (e) in that subsection because mathematical certainty was meant to be essential under (d). Rather, the absence of any special legislative machinery for computing profit under (d) indicates that ordinary methods were envisaged.

As to ordinary methods, it is a well-settled principle of income tax law, that, in the words of 23 Halsbury's Laws of England, 4th ed. para.258, 'The profits are to be arrived at on ordinary commercial principles, subject to such provisions of the Income Tax Acts as require a departure from ordinary principles, for example the prohibition of certain deductions ...' The principle was recognised and cases on it reviewed in this Court in Commissioner of Inland Revenue v. National Bank of New Zealand (1976) 2 T.R.N.Z. 70. In that case the method of accounting followed by the taxpayer, although commercially acceptable, was found on the considerable body of evidence to be not in accord with the Income Tax Act; it excluded debts which, although doubtful, were on the evidence of some considerable value, and so failed to give a true view of the annual earnings and was inconsistent with the statutory scheme regarding deductions. The judgments in no way question, however, that some degree of estimation may be necessary or proper in arriving at profits; and a number of leading cases confirm that this is indeed so. I will give three examples.

In Sun Insurance Office v. Clark 1912 A.C. 443 a fire insurance company was held entitled to carry forward to the succeeding year a certain percentage of its premium receipts as an allowance to meet unexpired risks on outstanding policies. The tenor of the speeches may be indicated by two quotations Viscount Haldane said at p.455:

> It is plain that the question of what is or is not profit or gain must primarily be one of fact, and of fact to be ascertained by the tests applied in ordinary business. Questions of law can only arise when (as was not the case here) some express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its be-

ing impracticable to ascertain the facts sufficiently, some presumption has to be invoked to fill the gap.

Lord Atkinson said at pp.461-2:

> Having regard, therefore, to the fact that companies carrying on this kind of business are, under the decision of your Lordships' House, clearly entitled to object to their receipts being treated as per se their profits and gains without theproper deduction having been made of the cost of earning those receipts, it is obvious that the amount of the taxable profits and gains can only be ascertained by some system of averages or estimation, or by some other practical rule of thumb based upon experience and the facts of different cases.

In Ostime v. Duple Motor Bodies Ltd 1961 2 All E.R. 167 it was common ground that in computing the profits of a company which produced motor vehicles some value must be attributed to work in progress. The Crown were held not entitled to compel the company to change from its long-followed 'direct cost' method to an 'on-cost' method (which included an allowance for overheads). Viscount Simonds said at p.170 that the practice of accountants could not by itself determine the amount of profits and gains of a trade for tax purposes; but that it had been found as a fact in the case stated that either method showed the full amount of profits and gains of the trade '... and I see no impossibility in this when I remember how elaborate and artificial are the methods of accountancy. The important thing is that the method which is in fact adopted should not violate the taxing statute. Different results may be reached by different methods, neither of which does so.'

To take one other illustration in the House of Lords, in B.S.C. Footwear Ltd v. Ridgway 1972 A.C. 544 the question was what deduction for the value of unsold stock should be made in assessing the profits of shoe retailers. A majority of their Lordships held that the company's method should be changed, on the ground stated by Lord Morris of Borth-y-Gest at p.559-60:

> While the commissioners gave too exalted a status to the formula 'cost or market value' when they described it as 'established law' they ultimately had to decide whether the company's method of

In the Court of Appeal of New Zealand

No 10

Judgment of Cooke J

- continued

accounting was one that did or did not truly produce the figure of profits and gains of the company for tax purposes. If the commissioners considered that there were serious objections to the method of accountancy adopted by the company then in spite of the fact that for a long period it was not challenged I think that the commissioners were warranted in declining to endorse it. Ultimately as between the Crown's method and the company's method it has to be decided which of the two is the better calculated to show the full amount of profits and gains.

Such authorities show that in ascertaining commercial profits absolute precision is not possible. While not decisive, established accountancy practice has an important bearing. More than one mode of ascertainment may be acceptable both commercially and for tax purposes, but the one habitually followed by the taxpayer will not prevail if the Commissioner's method gives a truer picture. It seems to me that there is no sound reason for not adopting a similar approach to the ascertainment of the capital profits of a business, if capital profits are taxable, especially when a scheme carried out over a period of years is under consideration. So I cannot accept that the legislature intended mathematical certainty to be a condition of an assessment under (d).

Turning then to the alternative argument, one must bear in mind that on the hearing and determination of these objections the burden of proof was on the objectors: Land and Income Tax Act 1954, s.32(10); Inland Revenue Department Amendment Act 1960, s.20. All three members of this Court in Walker's case left open the possibility that the assessment there might be, in the words of Gresson P. in 1963 N.Z.L.R. at p.357, 'too theoretical to be valid'. North J.'s observations are at p.363, Turner J.'s at p.368. The same possibility was adverted to by Menzies J. in Chapman v. Federal Commissioner of Taxation (1968) 117 C.L.R. 167, 171-2. I accept that a case might arise in which the objector could discharge the onus by showing that the Commissioner's assessment was no more than an arbitrary conjecture or was demonstrably unfair. This may amount to much the same as saying that initially or at the threshhold there is an onus on the Commissioner to point to what is prima facie a proper assessment, but I prefer the first way of putting it, as fitting the Act better.

There is no need here to try to define that type of case more precisely. Walker's case, where a few sections with road frontage and zoned for housing were sold as an incident of a scheme of acquiring a much larger block of farm land at a reasonable price, was one in which the computation of profit was probably significantly more difficult than it is here. And here too there is an important feature altogether absent from Walker's case. The Commissioner has adopted the taxpayers' own mode of computation, as explained by their accountants, a mode which the accountants regarded as reasonably correct in the light of the sale of four-fifths of the subdivision. Further it is expressly agreed that it was a reasonable and proper accounting approach to the calculation of 'profits' for general commercial purposes. The purposes of the accounts can only have been to ensure equity between the partners and to indicate to the partners the general progress of their partnership ventures; the accounts were not binding on the partners as against the Commissioner. But in the circumstances it could not be said that prima facie the Commissioner acted arbitrarily or unreasonably or in an impractical or unduly theoretical way in adopting what was put before him.

It would have been open to the taxpayers to endeavour to show by sufficiently explicit evidence that the method adopted was nevertheless not a fair or reliable method of ascertaining profit from sales in the period in question. But, in my view, such evidence as they did call was quite inadequate for that purpose.

Of the six lots sold in that period it would seem from the surveyor's evidence that only one (lot 9 on deposited plan 24271) had any fill, and that of a 'modest level' only. For reasons unexplained by the evidence-although one notes that it is a corner site - that lot also realised the highest price ($6000) of the six. The others, whose prices ranged from $4000 to $5500, were all on the southern boundary of the block, adjacent to the City Council's Centennial Reserve. The surveyor said that the commercial lots fronting Wai-iti Road could have been taken off separately, and correspondence annexed to the case stated indicates that they were sold to the Europa oil company for a petrol station site; but he added that there would probably be little point in doing that without the support of the residential allotments in the area. How the sale of the commercial lots was dealt with in the partnership accounts does not appear. The surveyor also said that as at 1961 none of 'this land' (referring apparently

In the Court of Appeal of New Zealand

No 10

Judgment of Cooke J

- continued

to the subdivision generally and allowing for some very minor exception) could have been sold off 'without the road'. He emphasised that in 1961 no main trunk sewer and storm water drains were available and that without them the local authority would not have approved the subdivision. These fragments of information and such others as can be gathered from the case stated and agreed statement fall well short, I think, of showing that a system of averaging the cost of acquisition and other costs would be unfair to the taxpayers, either by producing an artifically high profit from the sale of the six sections or otherwise. On the contrary it is not unreasonable to infer that if unfairness did exist accountancy evidence to show it would have been forthcoming.

Section 88AA(7) contemplated that profits might be assessed notwithstanding that the whole of the land in the scheme had not been sold. 'A profit on a sale arises if the sale proceeds exceed the purchase price ...' Holden v. Inland Revenue Commissioner 1974 A.C. 868, 875, per Lord Wilberforce delivering the judgment of the Judicial Committee (1974 2 N.Z.L.R. 52, 56). On the very limited factual material made available to the Court in the present case, I do not think that the objectors have shown that the Commissioner was wrong in taking that concept as his starting point and applying it to a system of averaged costs, based initially in part on projections, as the taxpayers themselves had done. It is hardly necessary to add that we are not called upon to forecast the results of cases with different facts or fuller evidence.

It should be recorded that counsel for the Commissioner stated as part of his submissions in this Court that if events in years after 1973-4 were to show that the assessments now in question were too high, it would be a proper case for exercise of the powers to amend assessments conferred on the Commissioner formerly by s.22 of the 1954 Act and now by s.23 of the 1976 Act.

Inflation

The fourth contention for the appellants lacked nothing in boldness. It was that there there was no profit for the purpose of paragraph (d) - or the other paragraphs of subs. (1) - until inflation had been eliminated. To assist this contention an affidavit had been obtained from the economist Dr D.T. Brash, emphasising and expanding on the theme that 'Notwithstanding any dispute over the details of the proper accounting approach, there is very widespread agreement in New Zealand

accounting and commercial circles that what is termed Historical Cost Accounting cannot possibly lead to the ascertainment of a true commercial "profit" figure in times of inflation'. The Commissioner countered with two affidavits. It is enough to mention their main points. Mr William Wilson, a leading Auckland chartered accountant, deposed that while there has been considerable research into and development of current cost accounting, current accepted practice in New Zealand (as at December 1978) was to prepare financial statements and to calculate profits on the historical cost method. In an affidavit sworn in the same month, Mr G.J. Schmitt, Professor of Management Studies at the University of Waikato, said that almost without exception (he knew of only one exception) 'the accounts of public companies prepared according to the requirements of the Companies Act 1955 are prepared on the basis of historic cost and that the adoption of current cost accounting is a departure from general accounting principles which the New Zealand Society of Accountants requires to be disclosed in published accounts'.

There can be no doubt that traditionally inflation has been disregarded in calculating profits in New Zealand for the purposes of the income tax legislation, not only by the Commissioner but also by the Taxation Review Authority and the Courts. Walker's is but one of countless cases in which it has been assumed that historical cost (or 'nominalism') is the only appropriate approach. It is impossible to suppose that in the 1973 Amendment Act Parliament intended to introduce a radical departure from this approach without signifying in any way that the point was even in mind. The same applies to the Property Speculation Tax Act of the same year.

In Secretan v. Hart 1969 3 All E.R. 1196 Buckley J. held that within the meaning of the capital gains tax legislation in the United Kingdom 'the amount or value of the consideration, in money or money's worth, given by him ... for the acquisition of the asset' was the actual consideration given in terms of money, not that sum adjusted to reflect any subsequent change in the value of money. The statute there contained a formula somewhat similar to that of the New Zealand Property Speculation Tax Act 1973, for s.5(2) of the latter referred to 'the value of the consideration'. The Land and Income Tax Amendment Act 1973 did not use a similar formula, but it seems implausible to suggest that the New Zealand Parliament would have meant

historical cost accounting to be obligatory under the Speculation Tax Act, yet current cost accounting to be permissible or obligatory under the Act passed in the same year with which this case is concerned.

Even if, as Mr Molloy submits, Secretan v. Hart is strictly distinguishable because of the wording of the Act then under consideration, the complications of allowing for inflation are so formidable that I agree with Roper J. that one of Buckley J.'s reasons (at p.1199) is still in point:

> If the intention has been that the effects of inflation were to be taken into account in determining whether or not a capital gain had been made, and the amount of such a gain, there would clearly have been in the Act some explicit statement to that effect and some machinery provided for ascertaining the effect of inflation on the relevant considerations. There is nothing anywhere in the Act of that kind.

The important cases in the House of Lords, such as Miliangos v. George Frank (Textiles) Ltd 1976 A.C. 443, concerned with the variations in exchange rates on debts and awards of damages, do not appear to me to have any bearing on the present question.

For these reasons, which are illuminatingly expanded by my brother Richardson in his judgment, I am afraid that the fourth contention cannot be sustained.

The Source of the Profit

The final contention for the appellants may have been put more narrowly in this Court than in the Supreme Court. Here it was that even if the inflationary component is part of the 'profit' it is still not caught because its source is not the sale. The synopsis of the argument continued:

> This is still a contention on "profit", but, this time, on the source of the profit rather than on its calculation. The point is that, even if the mere paper difference between the cost, and the proceeds of sale, is the basis of the "profit or gain" with which paragraph (d) is concerned, the inflationary element still must be excluded: because the paragraph taxes only that profit or gain which is derived from" the sale. To the extent of that inflationary component, the "profit or gain" will not have been derived "from" the sale.

At most it will have been "realised on" the sale.

Mr Molloy developed this contention much more briefly than the others and I shall deal with it with corresponding brevity. The argument involves a refined distinction between a profit realised on a sale and a profit derived from a sale. I do not think that the Court would be justified in introducing that refinement in interpreting paragraph (d). Until there has been a sale there is at best a potential profit; if a sale occurs and does realise a profit, the profit may naturally be said to be derived from the sale. And I agree with Mr Jenkin that, if inflation has to be disregarded for the reasons already given regarding the fourth contention, the Commissioner was entitled in this case to treat all the profits as derived from the sales.

For these reasons I would dismiss the appeal and uphold Roper J,'s answers to the specific issues formulated in the Supreme Court. The Court being unanimous, that will be the result. For costs in this Court the appellants are to pay the respondent $750 with disbursements including the reasonable travelling and accommodation expenses of second counsel to be fixed by the Registrar.

"R B Cooke J."

Solicitors:

Scott Bradley & Unwin, Timaru, for Appellant

Crown Solicitor, Timaru, for Respondent.

No 11

JUDGMENT OF RICHARDSON J

<u>The Scope of Section 88AA(1)(d)</u>

The first of the five issues arising on this appeal is whether the development, subdivision and sale of individual lots of the land owned by the appellants at Timaru comes within the ambit of para (d) of s 88AA(1) of the Land and Income Tax Act 1954. The rival contentions are these. The appellants submit

that the work involved did not amount to the carrying on or carrying out of an "undertaking or scheme" within (d). Their argument is that that provision applies only to what may fairly be characterised in general terms as income earning activity and that the subdivisional development and sale of the resulting lots by the appellants was merely a conversion into cash of parts of a capital asset. The Commissioner contends that that activity falls directly within (d) which, it is said, defines in its terms (and by reference to the exempting provisions of s 88AA) the type of undertaking or scheme taxable under its provisions in such a way as to exclude any possible implication that it merely strikes at what might otherwise be regarded as capital gains.

Paragraph (d) requires the existence of an undertaking or scheme. There is an element of vagueness and elasticity inherent in both words and in the composite expression. In Commissioner of Inland Revenue v Walker [1963] NZLR 339, 357 Gresson P adopted the observation of Dixon CJ in Australian Consolidated Press Ltd v Australian Newsprint Mills Holdings Ltd (1960) 105 CLR 473, 479 that scheme connotes a plan or purpose which is coherent and has some unity of conception. Similarly an undertaking is a project or enterprise organised and directed to an end result. It is clear from the scheme of the paragraph that the width of the composite expression "undertaking or scheme" is not to be affected by considerations of: (i) whether the particular undertaking or scheme was one which was carried on as distinct from carried out - and it has been said that those alternatives appear to cover, on the one hand, the habitual pursuit of a course of conduct, and, on the other, the carrying into execution of a plan or venture which does not involve repetition or system (Premier Automatic Ticket Issuers Ltd v Federal Commissioner of Taxation (1933) 50 CLR 268, 298); (ii) whether it was done by the taxpayer or by someone on behalf of the taxpayer; and (iii) whether it was carried out or carried on on the land itself or in relation to the land.

However, it is not necessary at this point to explore further the concept underlying the ordinary English words "undertaking or scheme" for Mr Molloy accepted, rightly in my view, that the development and subdivision activity in this case, which has been described in some detail in the judgment of Cooke J, constituted a scheme in general terms. The appellants also accepted that, if their activities constituted an "undertaking or scheme" within

s 88AA(1)(d) (as distinct from an undertaking or scheme within the ordinary meaning of that expression), then: (i) the development or subdivision work involved was more than "work of a minor nature"; (ii) it was carried out by them or on their behalf and on or in relation to their land; (iii) the undertaking or scheme was commenced within ten years of the date of their acquisition of the land; and (iv) none of the exception provisions in the later subsections of s 88AA applied in the circumstances of the case.

In order to answer the rival contentions as to the scope of paragraph (d) it is necessary to consider the scheme and language of the provision in its statutory context. Section 88AA was enacted by s 9 of the Land and Income Tax Amendment Act 1973. Subsection (5) of s 9 directed that the new section should apply with respect to any profit or gain derived from any sale or disposition made on or after 10 August 1973. Subsection (3) amended s 88(1) of the principal Act by adding a new paragraph (cc). Section 88 was the general provision listing the categories of items deemed to be included in assessable income. The new paragraph simply added to that list: "All profits or gains derived from the sale or other disposition of any land within the meaning of section 88AA of this Act, being profits or gains to which that section applies." At the same time para (c) was amended by excluding real property from the scope of the first and second limbs (which were concerned respectively with profits of a taxpayer whose business comprised dealing in such property and with profits derived from the sale or other disposition of property acquired for the purpose of sale or other disposition). The third limb of (c) was left intact. It applied to "all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit:". So it applied to any undertaking or scheme affecting real property, as do (d) and (e) of s 88AA(1). Profits and gains in land transactions may also constitute business profits or gains under s 88(1)(a). Notwithstanding that overlap between the old paras (a) and (c) and the new para (cc) of s 88(1), it is clear that the new section 88AA is a special provision in relation to the taxation of land transactions which is designed to extend and does extend the tax net to gather in gains previously excluded from (a) or (c).

Before turning to a more detailed analysis of (d) itself it is worth noting the impact of the companion paragraphs of s 88AA(1). The section does not tax all gains derived on the

sale of land. Each paragraph adopts the same formula of bringing within the statutory term "assessable income" profits or gains derived from the sale or disposition of land, but only where the defined features are present. Paragraph (a) is an expansion in relation to dispositions of land of the second limb of the old para (c). It attaches to such profits or gains if the land was acquired for either the purpose or intention of resale or other disposition, whether or not such a purpose or intention was dominant. In such a case, even if involving a single isolated transaction, the gain is taxable. Paragraph (b) applies where the land was acquired by a land dealer (or a non-dealer associated with a land dealer). The gain on resale is taxable where either the land was acquired for the purpose of the land dealing business or it was sold within ten years. So in the latter case the sale of a private asset or capital asset gives rise to a taxable profit. Paragraph (c) is directed to cases where the land was acquired by a builder (or a person associated with him) where improvements (not of a minor nature), and whether by way of building on the land or otherwise, were carried out. The profit derived on sale or other disposition of the improved land is taxable if either the land was acquired for the purpose of that building business or it was sold within ten years after the completion of the improvements. As under (b) the sale of what was initially a non-trading asset gives rise to a taxable profit if the identified activity - the carrying out of improvements - was completed within ten years before the land was sold. In those situations what would otherwise patently constitute capital gains, are rendered liable to income tax.

To sum up at this point: the context in which paras (d) and (e) appear in subs (1) lends no support for the argument that in enacting those paragraphs the legislation did not intend to reach gains of a capital nature.

I turn now to (d). The paragraph expressly defines and limits the type of undertaking or scheme to which it applies. It is one "involving the development or division into lots of that land". While it is not clear whether the words "into lots" qualify division only or whether they qualify both alternatives "development or division", it is both necessary and sufficient that the plan or project should involve development or division of the land. This is subject to the qualification that the development or division work involved not be "of a minor nature". Whether the work is of a minor nature must, it seems, depend on an overall assessment of such matters as the time,

effort and expense involved, measured both in absolute terms and relative to the nature and value of the land on which the work is done. More importantly for present purposes, division as an alternative to development and the limitation of the exception to work of a minor nature suggest that not a great deal is required by way of activity to constitute a plan or programme of action an undertaking or scheme under the paragraph. That is the first ingredient. And the addition of the phrase "whether or not an adventure in the nature of trade or business" was obviously intended to exclude any argument that to come within the tax net the development or subdivisional activity must also exhibit features which give the transaction the character of a business deal (see McClelland v Federal Commissioner of Taxation (1970) 120 CLR 487; 2 ATR 21).

The second ingredient is that the development or division work must be carried out or carried on by or on behalf of the taxpayer and on or in relation to the land. The third is that the undertaking or scheme must be commenced within ten years of the date on which the land was acquired by the taxpayer. Thus the legislation in (d) is using the combination of participation in a defined activity and a ten year limitation as the touchstone of taxability; just as it does under (b) and (c). It follows that a dealer who sells land within ten years or a builder who makes improvements to the land (other than improvements of a minor nature), and then sells the land within ten years of completing the improvements, or a landowner who subdivides or develops the land within ten years of acquisition, cannot successfully invoke the original non-business or non-revenue character of the land.

Paragraph (d) may also be contrasted with (e). They are both concerned with the profits of undertakings and schemes. Paragraph (e) parallels (d) in describing the type of undertaking or scheme in terms of development or subdivisional work and in rejecting any need for the involvement to constitute an adventure in the nature of trade or business. But (e) does not apply to profits or gains rendered taxable under any of the earlier paragraphs, including para (d). The additional requirement under (e) which replaces the time limitation under (d) is that the development or division work must involve significant expenditure on works, services or amenities customarily undertaken or provided in major projects involving the development of land for industrial, commercial or residential purposes. In that situation, too, the legislation has taken

some pains to describe and quantify the activity, participation in which involves liability for tax. In doing so it eschews any consideration of the notoriously difficult problems in drawing a dividing line between business or income earning activity and the realisation of capital investments or private assets. The scheme of the exception provisions of subs (3) and (4) of s 88AA supports the prima facie reading of (d) which I have been discussing. The important feature of those provisions for present purposes is that within stated limits they protect the profits derived by a householder or farmer on subdivision. In each case the subsection assumes that, but for the exception, para (d) (or para (e)) could apply. Subsection (3) excepts profits from the sale or disposition of land which "is a lot resulting from the division into 2 or more lots of a larger area of land (being an area which before any division by the taxpayer did not exceed 4,500 square metres) which was occupied by that taxpayer primarily and principally as residential land for himself and any member of his family living with him." Under subs (4) the same formula is employed in relation to subdivision into two or more lots of land occupied or used by the taxpayer primarily and principally for the purposes of a farming or agricultural business carried on by the taxpayer. The exception applies only where the Commissioner is satisfied: (i) that the land sold is capable of being worked as an economic unit as a farming or agricultural business; and (ii) that the land was disposed of primarily and principally for the purposes of the use of that land in any farming or agricultural business.

It seems, then, that the framers of subs (3) and (4) assumed that subdivision of land occupied by the taxpayer for residential purposes (a private asset) or farmland (a capital asset) into more than one lot within ten years after acquisition of the land could give rise to a profit that would otherwise be taxable under para (d).

It remains to mention two propositions that were at the forefront of Mr Molloy's submissions on this first issue. It is true, as Mr Molloy emphasises, that, except where there is a statutory provision which renders his gains taxable income, a landowner may develop and realise his land without making a profit which attracts an income character: even if he goes about the realisation in an enterprising way so as to secure the best price. There is ample judicial authority to support that proposition (see, for example, McClelland in the Privy Council and Walker in this Court).

But that does not entitle any court to make a prejudgment as to the intention of the Legislature in enacting s 88AA(1)(d). Our interpretation of the paragraph must turn on the scheme and language of the statutory provision giving the words their ordinary meaning in their context. Mr Molloy urged us to adopt what he described as a purposive construction, which in his submission would confine the profits reached by the paragraph (which he emphasised was concerned with the determination of assessable income in an income tax statute) to profits or gains traditionally regarded as of an income nature unless in its terms the paragraph was clearly shown to have a wider scope. No doubt he had in mind the injunction contained in s 5(j) of the Acts Interpretation Act 1924 to accord to legislation such fair, large and liberal construction as will best ensure the attainment of the object of the legislation according to its true intent, meaning and spirit. It may equally be said that in a general way, in imposing a new regime for the taxing of gains on certain land transactions, Parliament has in s 88AA demonstrated an intent to extend the tax net and include some gains previously regarded as capital in nature. However, I do not find the reconciliation of general objectives and the quest for the assumptions underlying the new section helpful in determining the precise scope of para (d). The objectives of the provision in that regard and their attainment in the circumstances are not sufficiently clearly discernible at the limits of its operation. Accordingly I have preferred to follow the approach indicated in the classic statement of Rowlatt J in The Cape Brandy Syndicate v The Commissioners of Inland Revenue (1920) 12 TC 358, 366:

> "Now of course it is said and urged by Sir William Finlay that in a taxing Act clear words are necessary to tax the subject. But it is often endeavoured to give to that maxim a wide and fanciful construction. It does not mean that words are to be unduly restricted against the Crown or that there is to be any discrimination against the Crown in such Acts. It means this, I think; it means that in taxation you have to look simply at what is clearly said. There is no room for any intendment; there is no equity about a tax: there is no presumption as to a tax; you read nothing in; you imply nothing, but you look fairly at what is said and at what is said clearly and that is the tax."

In the Court of Appeal of New Zealand

No 11

Judgment of Richardson J

- continued

Looking fairly at para (d) in its statutory context I consider, for the reasons I have given, that the Legislature has set out the criteria to be applied in determining whether subdivisional and development activities affecting land commenced within ten years after the date of its acquisition are taxable, and that it would be inconsistent with the scheme and language of the provision to read in a further requirement that the profits or gains must be income in character. In short, the legislation has identified the gains which are deemed to be assessable income in terms which avoid the necessity for any discussion of how much planning and organising activity is required in such a case to constitute a commitment of assets to income earning activity and so to determine what gains would, but for its provisions, constitute capital or income respectively.

This brings me to Mr Molloy's further argument. It is that the concern of the paragraph is with the profits or gains from an undertaking or scheme (that terminology being in common with that of the third limb of s 88(1)(c). And so, it is said, as is well established under the third limb of (c), para (d) applies only where there is a scheme producing assessable income, not a gain of a capital nature.

There are significant differences in this respect between the third limb of s 88(1)(c) and para (d) of s 88AA(1). First, para (d) omits the requirement contained in the third limb of the old para (c) that the undertaking or scheme be one which was "entered into or devised for the purpose of making a profit". It was that feature of (c) which led the majority in Walker to conclude that the third limb had no application to undertakings or schemes designed to realise capital assets to best advantage. At p 361 North J said:

> "No doubt the third limb is wider in its application than the second, but in giving a meaning to the word 'purpose' in both clauses it is as well to bear in mind that we are dealing with a taxing statute aimed at requiring persons to pay tax on income as distinct from what may loosely be described as gains derived from a capital source. ...
>
> So here the Legislature has introduced the idea of 'purpose' as the factor which determines whether the profits or gains are taxable as income or whether, on the other hand, they are to be regarded merely as in the nature of capital gains."

See, too, Turner J at p 367.

As well as omitting the requirement that the undertaking or scheme should have a profit making purpose, the Legislature in para (d) has taken the further step of expressly negating any need for the undertaking or scheme to constitute an adventure in the nature of trade or business. It is difficult to escape the conclusion that it took this precaution because the Judicial Committee in McClelland had said that the profit on an undertaking or scheme, under the Australian counterpart of the third limb of para (c), was income according to ordinary usages and concepts only if what the appellant did was an adventure in the nature of trade.

Finally, in para (d) and unlike the old para (c), the Legislature describes what is involved in an undertaking or scheme within the paragraph. For these reasons I consider that the limitations imposed on the application of the third limb of the old para (c) have been excluded in the enactment of para (d) of s 88AA(1).

The Scheme in Relation to "that land"

Mr Molloy's second argument was that the expression "that land", when used in para (d), means the particular land sold in the income year in question and that the paragraph has no application unless there has been a development or division of that land. It followed, so the argument went, that the paragraph could not attach to the profits arising on the sale of a lot unless that lot had been developed or the land sold had been divided into lots. On this interpretation a subdivider could avoid the impact of (d), in relation to lots not the subject of physical development work, (and the same argument must apply equally to (e)) by the simple expedient of confining sales in each year to non-adjoining lots. A surprising result. It happens that this argument would not benefit the appellants in this income year for each of the lots sold from DP 27647 adjoined another lot sold in the income year in question and Lot 9 on DP 24271 had some fill. But Mr Molloy asks the Court to express a view on the point because of its relevance in other tax years.

In my view an undertaking or scheme may fairly be said to involve the development or division into lots of the land sold in an income year, whether the undertaking or scheme is confined to that land or extends to a larger parcel or parcels of land of which the land sold is part only. Subdivisional schemes frequently run over two or more income years and

subs (7) recognises that the land sold in a particular year may be part only of the land to which the scheme applies. Against that background I consider that the broader view of (d) in this respect, which also avoids what could only be regarded as an absurd result, is to be preferred to an unreasoning confining of the development or subdivision to the land sold in the particular year.

The Calculability of Profits

The third issue arising on the appeal is whether it is possible to ascertain what, if any, profits were derived by the appellants under para (d). Mr Molloy's primary submission was that the profits or gains of which para (d) speaks is a net item but that there is no machinery provided for the allocation of acquisition, holding and development costs so as to arrive at the total cost of each lot sold in a particular year for deduction from the sum realised on sale of the particular lot in order to determine, with mathematical certainty, the existence and amount of any profit. He said that the legislation had been left in a half-finished state in that respect and its deficiencies could be cured only by further legislation, not by interpretation. Alternatively, it was submitted that the Commissioner's assessments, which were based on an assumed average cost per lot of all the sections sold and remaining to be sold, did not rest on any rational basis and should be set aside.

The charge for tax is imposed by the Act itself. The Commissioner acts in the quantification of the amount due, but it is the Act itself which imposes, independently, the obligation to pay (Reckitt & Colman v Taxation Board of Review [1966] NZLR 1032 per McCarthy J at p 1045). Section 77(2) states that, subject to the provisions of the Act, income tax shall be payable by every person on all income derived by him during the year for which the tax is payable. Section 78(1) goes on to provide that 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. Taxable income is the residue of assessable income after deducting the amount of all special exemptions to which the taxpayer is entitled (s 2). Assessable income is then defined in s 2, unless the context otherwise requires, as income of any kind which is not exempted from income tax otherwise than by way of a special exemption expressly authorised as such by the Act.

It is not clear from that definition whether it is pointing to gross income or net income after deductions and allowances are taken into account. This ambivalence is also present in s 88(1), the primary provision listing the various categories of assessable income, and in the general deduction provisions. Perhaps the best example is the treatment of business income. Under s 88(1)(a) assessable income includes "All profits or gains derived from any business". A profit or gain is a net figure. It is the surplus over cost. On its face it involves ascertaining what, in the circumstances of the taxpayer, should properly be regarded as the profits or gains derived from his business or other income earning activity. However, s 110 enacts that, except as expressly provided in the Act, no deduction shall be made in respect of any expenditure or loss of any kind for the purpose of calculating the assessable income of any taxpayer; the general deduction provision (s 111) expressly provides for the deductibility of expenditures and losses necessarily incurred in the carrying on of a business for the purpose of gaining or producing the assessable income for any income year; and there is no support in the language and scheme of the various specific deduction and allowance provisions, eg ss 112 and 113, for the view that they have no application in the calculation of business profits, or, for that matter, in the calculation of the other categories of assessable income defined in terms of profits or gains from the specified income earning activities.

A further feature of the statutory scheme is the provision for apportionment of expenditures and losses and the allowing of a deduction of that part of the expenditures or losses attributable to the assessable income (eg s 110A, s 111, s 112(1)(e), (g), (i) and (j)). The relevance of this is that apportionment contemplates allocation of costs in a manner which necessarily involves the exercise of judgment and some degree of estimation. It is not determinable with absolute mathematic precision. And the provisions for the valuation of trading stock (s 98 - s 102) proceed on the same premise.

Finally, taxable income has to be determined annually. It cannot be left until the eventual cessation of the particular business or other income earning activity. The allocation of profits of continuing activities to particular income years inevitably involves the exercise of judgment in the apportionment of costs and the fixing of values.

In the Court of Appeal of New Zealand

No 11

Judgment of Richardson J

- continued

It can thus be seen that the determination of "profits or gains" of an income earning activity in arriving at the assessable income from a particular source for a particular income year is firmly anchored in the legislation. It was common ground, too, that it is embodied in the practice of the commercial community and has been taken for granted in the cases decided in the New Zealand courts under the Act and its predecessors.

Mr Molloy's next argument was that, if the calculation of profits or gains derived from a business was subject to the statutory deductibility regime, that was not the case with profits or gains derived from land transactions under s 88AA, at least under para (d) of subs (1). He repeated his first argument that until the profits had been ascertained there was nothing on which the other provisions of the Act could operate and went on to argue that in the absence of any machinery for cost allocation there was no means for quantifying the acquisition, holding and development costs of particular lots in subdivisional developments. Counsel for the Commissioner agreed that the profits or gains derived from the sale of land under s 88AA had to be calculated without reference to the statutory provisions for arriving at assessable income which I have been discussing. Because of that concession, and in the absence of any argument on the point, I shall not explore the alternative view that in such a case all assets engaged are held on revenue account with the deduction provisions applying in the ordinary way to the outlays all of which are on revenue account and that until a sale occurs the land involved stands in the books at cost for tax purposes, thus matching the outlays on the acquisition, holding and development of the land in the revenue account as at the particular balance date.

In any event, and considering the issue on the basis on which it was approached by the parties, I cannot see any substance in the contention that the profits or gains are incapable of ascertainment. The various paragraphs of s 88AA all proceed on the premise that a taxable profit may arise where the specific requirements of the particular paragraph are satisfied. Difficulty or complexity of calculation is insufficient to overcome the requirement inherent in the charging provisions of ss 77 and 78 that any such profits or gains must be assessed. Speaking in 1912 Lord Mackenzie gave a robust answer to a similar argument which had been addressed to the Court of Session (Macpherson & Co v Moore (1912) 6 TC 107, 115):

"If the Act of Parliament says the amount of profits is to be ascertained, ascertained they must be whether that can be done in a satisfactory method or not."

The administration provisions of the New Zealand legislation recognise that the assessment of income may call for the exercise of judgment by the Commissioner. In the present case, although the point is not referred to specifically in the case stated, it appears likely that the Commissioner made the assessments objected to by the appellants under s 19 (either alone or in conjunction with s 17 and/or s 22). Under that section where default is made in furnishing a return, or the Commissioner is not satisfied with the return made by any person, the Commissioner may make an assessment of the amount on which in his judgment tax ought to be levied and of the amount of that tax, and the person so assessed is liable to pay the assessed tax save in so far as he establishes on objection that the assessment is excessive or that he is not chargeable with tax.

In exercising his judgment the Commissioner is not operating in a vacuum. It is well settled that generally accepted accounting principles and ordinary commercial practices are to be applied in the computation of income for tax purposes so far as the statutory language permits. In Union Bank of Australia v Commissioner of Taxes [1920] NZLR 649, where s 21 of the Finance Act 1916 governing the taxation of excess profits fastened on total income, the Full Court, consisting of Chapman, Sim, Stringer and Herdman JJ, held that the income referred to in the section was net income and that the basis on which it was to be ascertained was that stated by Atkin J in Stott v Hoddinott (1916) 7 TC 85, 91 in connection with profits, namely that they were to be ascertained according to ordinary commercial principles except so far as those principles were modified or altered by the express words of the statute. The Court went on to consider the possible application of the deduction provisions under the Land and Income Tax Act and concluded that it was not reasonable to suppose that the Legislature intended that they should apply. It followed that the income was to be ascertained according to ordinary commercial principles and it was accepted that according to those principles the losses incurred by the bank in realising securities, which were part of its reserve fund, and were immediately available to meet any demands upon it, were properly deductible in arriving at the income of the bank for excess profits duty purposes.

In the Court of Appeal of New Zealand

No 11

Judgment of Richardson J

- continued

The reasons underlying this recognition of commercial principles in the income tax field were comprehensively stated by Dixon J in Commissioner of Taxes (South Australia) v Executor Trustee and Agency Co. of South Australia Ltd (1938) 63 CLR 108, 152 and 154:

> "Income, profits and gains are conceptions of the world of affairs and particularly of business. They are conceptions which cover an almost infinite variety of activities. It may be said that every recurrent accrual of advantages capable of expression in terms of money is susceptible of inclusion under these conceptions. No single formula could be devised which would effectually reduce to the just expression of a net money sum the annual result of every kind of pursuit or activity by which the members of a community seek livelihood of wealth. But in nearly every department of enterprise and employment the course of affairs and the practice of business have developed methods of estimating or computing in terms of money the result over an interval of time produced by the operations of business, by the work of the individual, or by the use of capital. The practice of these methods of computation and the general recognition of the principles upon which they proceed are responsible in a great measure for the conceptions of income, profit and gain and, therefore, may be said to enter into the determination or definition of the subject which the legislature has undertaken to tax. The courts have always regarded the ascertainment of income as governed by the principles recognized or followed in business and commerce, unless the legislature has itself made some specific provision affecting a particular matter or question. ....
>
> In the present case we are concerned with rival methods of accounting directed to the same purpose, namely, the purpose of ascertaining the true income. Unless in the statute itself some definite direction is discoverable, I think the admissibility of the method which in fact has been pursued must depend upon its actual appropriateness. In other words, the inquiry should be whether in the circumstances of the case it is calculated to give a substantially correct reflex of the taxpayer's true income."

Dixon J's reference to the development of methods of estimating in money terms the income derived over a period is reflected in the observation of Fullagar J in Australasian Jam Co. Pty Ltd v Federal Commissioner of Taxation (1953) 88 CLR 23, 30; 5 AITR 566, 571 that: "It is common knowledge that in many matters of accounting an honest and careful estimation is the most that can be expected or achieved." A further illustration of the same point, which also serves to emphasise the proper scope for judgment and estimation in commercial accounting, is Sun Insurance Office v Clark [1912] AC 443. That case was concerned with the question of whether, and if so what, allowance should be made for unexpired risks on policies outstanding at the end of the year in calculating the profits of a fire insurance company for income tax purposes. The insurance company's practice of carrying forward to the succeeding year a certain percentage of its premium receipts as an allowance to meet outstanding losses on unexpired risks, was upheld. That necessarily involved recourse to some form of estimation. As Lord Atkinson emphasised at pp 461-2:

> "Having regard, therefore, to the fact that companies carrying on this kind of business are, under the decision of your Lordships' House, clearly entitled to object to their receipts being treated as per se their profits and gains without the proper deduction having been made of the cost of earning those receipts, it is obvious that the amount of the taxable profits and gains can only be ascertained by some system of averages or estimation, or by some other practical rule of thumb based upon experience and the facts of different cases."

Referring to the same matter Earl Loreburn LC said at p 454:

> "There is no rule of law as to the proper way of making an estimate. There is no way of estimating which is right or wrong in itself. It is a question of fact and figures whether the way of making the estimate in any case is the best way for that case. ....
>
> I am equally anxious that your Lordships should not be supposed to have laid down that the method applied by the Commissioners in the present case has any universal application. ....
>
> A rule of thumb may be very desirable, but cannot be substituted for the only

In the Court of Appeal of New Zealand

No 11

Judgment of Richardson J

- continued

rule of law that I know of, namely, that the true gains are to be ascertained as nearly as it can be done."

I turn again to consider the calculation of profits under s 88AA. There are two situations where the legislation makes express provision for the treatment of particular items in the calculation of profits. In one of those cases commercial accounting would not provide an acceptable answer. In the other a valuation unrelated to cost is required. The first provision is s 102 which is an anti-avoidance provision directed to circumstances where trading stock is disposed of for an inadequate consideration. The definition of trading stock for the purposes of the section includes land within the meaning of s 88AA, any profit or gain from the sale or other disposal of which would be a profit or gain to which s 88AA applies. Where trading stock is sold or otherwise disposed of without consideration in money or money's worth, or for consideration which is less than the market price or true value as at the date of sale or other disposal, the trading stock, for the purposes of the Act, is deemed to have been sold at and to have realised the market price thereof at the date of sale or other disposition and, where there is no market price, is deemed to have been sold and to have realised such price as the Commissioner determines. The deemed realisation price is then taken into account in calculating the assessable income of the person selling or otherwise disposing of the trading stock (subs (1)).

The second provision is concerned with the calculation of profits or gains under para (e) of s 88AA(1). That is the only paragraph where a value as distinct from the allocation of cost is required for the purpose of calculating the profit or gain involved. This is because under (e) the profits are taxable only to the extent that they are derived from the carrying on or carrying out of an undertaking or scheme. In order to make that calculation it is necessary to have as the base figure the value of the land at the commencement of the undertaking or scheme - just as the transfer of assets between trading and private account requires an assessment of their value at the time they were committed to or withdrawn from the income earning activity as the case may be (Sharkey v Wernher [1956] AC 58; Bernard Elsey Pty Ltd v Federal Commissioner of Taxation (1969) 121 CLR 119; 1 ATR 403; and 5 NZTBR Case 49). It is against that background that subs (5) provides that for the purposes of paragraph (e) the Commissioner may ascertain the value of any land at the date of commencement of any undertaking or scheme referred to in that paragraph in such manner as he thinks fit.

It cannot be assumed that the Legislature, which saw fit to provide expressly for those two special situations in that way, overlooked that allocations of actual costs would be necessary in the calculation of the profits of subdivisional development under (d) and (e). Of their nature such allocations require the exercise of judgment and are not a simple matter of arithmetical calculation. I think it is implicit in thelegislation that, in conformity with well settled principles of income tax law, cost allocations should be made in accordance with recognised commercial accounting practices.

I turn to consider Mr Molloy's alternative submission. The onus of proof rests on the taxpayer (Land and Income Tax Act 1954 s 32 (10); Inland Revenue Department Amendment Act 1960 s 20). Where the assessment is made pursuant to s 19 he is liable to pay the tax, "save in so far as he establishes on objection that the assessment is excessive". The effect of that onus is to require the taxpayer to establish not only that the assessment is wrong but also by how much it is wrong (Commissioner of Taxes v McCoard [1952] NZLR 263). That burden also applies equally to an amended assessment under s 22 as it does to the original assessment (Babington v Commissioner of Inland Revenue [1957] NZLR 861).

In rare cases a threshhold question may arise In making an assessment the Commissioner is required to exercise judgment in determining the assessable income of the taxpayer. He is not entitled to act arbitrarily in disregard of the law or facts as known to him. If the assessment is not made on an intelligible basis, it cannot stand. That matter was given some consideration in the judgments in Walker and Gresson P at p 357 expressed the firm view that the method which the Commissioner had adopted in that case was "too theoretical to be valid."

In the present case the Commissioner arrived at the profit on the sale of the individual lots by deducting from the net proceeds of sale in each case the amount of $2300. That sum was the estimated average cost per lot of all the sections in the subdivision including in the global figure the acquisition cost of the whole block and the actual and projected holding costs (rates, interest etc)) and development expenses.

At first blush, to allocate an average land cost per lot sold may appear to be an unrealistic, if not arbitrary, method of arriving at the profits derived from the sale of a particular lot. Where an entirety is purchased

and developed over a period of years and part only is sold there is an obvious difficulty in determining what costs should be attributed to what has been sold. The approach adopted in a number of cases in various jurisdictions has been to allocate a proportion of the acquisition costs of the land to each lot on the basis of a retrospective valuation of the land, lot by lot, and to make a like allocation of holding and development costs to each of the lots sold during the particular income year. No doubt this reflects a concern that the land involved may not be sufficiently uniform to justify the adoption of an average acquisition cost per lot or per square metre and an assumption that the holding and development costs of the scheme as it proceeds are not likely to confer an equal benefit on each lot in the subdivision.

It may also be said, however, that there is an element of artificiality in retrospectively fixing acquisition values on the basis of a plan of subdivision which was neither contemplated nor, perhaps, possible at the time of purchase and that, at least in some circumstances, an average cost approach may reflect a fair balance of unders and overs. By way of illustration, land more readily subdivisible may bear a higher proportion of the acquisition price and a lower proportion and, in some cases, perhaps no part of particular holding and development expenses whereas land not subdivisible without substantial development work may bear a lower proportion of the acquisition price and a higher proportion and, in some cases, perhaps all of particular holding and development expenses. As Lord Macnaghten observed in an earlier English decision on the allowance of a deduction for unexpired risks in calculating profits of a fire insurance company (General Accident, Fire, and Life Assurance Corporation Ltd v McGowan [1908] AC 207, 212: "It is impossible to obtain anything approaching complete accuracy by any conceivable method." And the adoption of an average method of calculating costs per lot may in some circumstances be a fair as well as convenient method of cost allocation.

For these reasons I would not be prepared to rule that the attributing of costs to individual lots on an average cost per lot basis is necessarily to be regarded as an arbitrary and impermissible method of cost allocation for the purpose of arriving at profits under para (d). The suitability of an average cost approach in this area is just as much dependent on the circumstances of particular cases as it is in other areas of profit calculation. And the widespread use in tax accounting in New Zealand of average costs and standard costing, particularly in determining methods and

rates of depreciation of fixed assets and in the allocation of costs to trading stock and work in progress reflects the realities of commercial life in this respect.

I do not find it helpful to discuss the evidence in the present case in any detail. In my view the material in the case is too sparse to allow of a finding that, in making his assessments adopting the average cost method, the Commissioner was not acting rationally and fairly on the information he had in his possession. There are three features of the case that weigh heavily with me in reaching this conclusion. The first is that, in response to the Commissioner's request for advice as to the respective cost prices of the sections sold during the income year in question, the appellants' chartered accountants replied:

> "In order to arrive at a cost per section at the commencement of the subdivision we took the initial cost of the land, added the projected cost of the total development, interest on loans, legal fees, rates and other expenses of holding the land, then divided the total thus obtained by the number of sections. This gave a figure of $2,300 which it is realised is an average figure and does not take into account variations in area, but it has been on this basis that capital profit adjustments have been made in the land account to date.
>
> As there are some sections in the block still to be sold the final cost is not yet known but with approximately 80% of the subdivision now disposed of it appears that our calculated cost figure is reasonably correct."

Thus, the Commissioner adopted the appellants' method of calculating costs attributable to the lots sold in the knowledge (i) that following completion and sale of 80% of the subdivision the projected total cost figure had been proved reasonably correct; and (ii) that, although the $2300 was an average figure, the partners had made their capital profit adjustments relying on that method of calculation. Their acceptance of that method is also reflected in the partnership accounts furnished to the Commissioner pursuant to s 10 of the Act and reg 10 of the Land and Income Tax Regulations 1946 and, although a taxpayer is not in general bound by the form of his accounts, they do constitute a prima facie recognition of the appropriateness of that accounting method for the commercial accounting purposes of the partnership.

The second is that it was expressly agreed by the appellants in the agreed statement of facts that the average land cost method is a reasonable and proper accounting approach to the calculation of profits for general commercial purposes. The third is that the appellants have not sought to argue that the profit figure arrived at by the Commissioner is excessive.

Against that background and in the absence of any evidence to show that the average cost allocation produced an unreasonable or unfair result in the circumstances of this case, I consider that the Commissioner was entitled to make the assessments on that basis.

The Impact of Inflation in the Calculation of Profits

The fourth contention for the appellants is that in computing the profits derived from the sale of land under para (d) it is necessary to adjust the sums involved to eliminate the inflationary element in the nominal difference between the sums expended and the sums realised on sale. In broad terms the submission was that the calculation of profits involves the comparison of like with like; that because of the reduction in the purchasing power of money over a period of inflation it is not appropriate to set-off the nominal amount of dollars expended in one year against the nominal amount of dollars realised in a later year; and that to treat what may broadly be described as the inflationary increase in the value of sums expended between the incurring of the expenditures and the realisation of the proceeds of sale is to impose a tax on wealth.

The dollar is the conventional base for financial measurement in New Zealand. One of its properties is its purchasing power as a store of value. It is this feature which leads to problems affecting its reliability for use in conventional accounting methods. So long as prices remain stable it is possible to add or subtract a number or series of monetary costs and prices and values incurred or received at different points in time and thereby arrive at a total which has a sensible meaning. However, when price levels change a dollar spent does not measure the same value as a dollar subsequently received. The increasing recognition of the deficiencies of historical cost accounting as the method of measuring results of commercial activity in a realistic way where costs and prices and values are changing has given rise to examination and discussion of the appropriateness

for financial reporting purposes of various concepts of profit and capital maintenance. This is reflected in the reports published following official inquiries into inflation accounting in this country and elsewhere in recent years (eg in the United Kingdom, the Report of the Inflation Accounting Committee (1975) (Cmnd 6225); in Australia, the Report of the Committee of Inquiry into Inflation and Taxation (1975); and, in New Zealand, the Report of the Committee of Inquiry into Inflation Accounting ([1976] A to J H of R H.4)), and in the pronouncements of accounting bodies.

Nevertheless, it is quite clear, and it was common ground on the argument of the appeal, that in this country accounts for financial reporting purposes have traditionally been prepared according to historical cost conventions and tax accounting has followed that practice subject to modifications required under the income tax legislation. In this respect it is, perhaps, of some relevance that in March 1973, only a matter of months before the enactment of the new s 88AA, the Special Committee to Review the Companies Act, chaired by The Hon Mr Justice Macarthur, recognised in para 256 of its Final Report ([1973] A to J, H of R, H 7) that the historical cost basis of accounting was the basis on which company accounts were prepared in New Zealand and, by way of explanation of the purpose of accounts, cited with approval a passage from the Recommendations of Accounting Principles of the Institute of Chartered Accountants in England and Wales (1952), the relevant extract from which reads:

> "Similarly, a profit and loss account is an historical record. It shows as the profit or loss the difference between the revenue for the period covered by the account and the expenditure chargeable in that period, including charges for the amortisation of capital expenditure. Revenue and expenditure are brought into the account at their recorded monetary amounts."

Against that background I am satisfied that it cannot reasonably be argued that in enacting the new s 88AA in 1973 the Legislature intended that the profits brought to charge for income tax purposes should be calculated on other than the historical cost basis that had for so long been adopted in the calculation of profits and gains of business and other income earning activities under the income tax legislation.

Moreover, if it had been intended that the effects of inflation should or could be

taken into account in the determination of taxable income it would have been necessary to provide appropriate machinery for that purpose. The appellants' argument breaks down on any analysis of the provisions that would have to be enacted in the interests of fairness and certainty in the administration of the legislation. Three examples will illustrate the point I am seeking to make. To begin with the measurement of changes in the value of the dollar is itself a matter for debate. A price index is a numerical expression of changes in the value of money between two points of time. But it is an indicator of such changes only in relation to the commodities and/or services included in the particular index. Prices do not move in unison. The usefulness of a particular index as a measure of change depends on the appropriateness of the group of items included in the regimen and on the weighting giving to each regimen item.

Movements in the Consumers Price Index could scarcely be regarded as the universal measuring rod for the determination of the effect of inflation on commercial and casual profits. That index is based on the fluctuating prices of a weighting of certain goods and services assumed to be consumed and used by the average New Zealander. It is not directly concerned with the investment or expenditure of commercial profits. There are other indices which the Government Statistician prepares or is in the process of developing to measure changes in other price levels. Thus the General Price Index contains price indices for outputs (sales) and inputs (purchases) for 21 market oriented productive areas of the New Zealand economy and four non-market areas; and there are numerous indices in respect of particular classes of assets that have been developed or are being developed.

The appropriateness of a particular index as a measure of the inflationary element in profits derived from land transactions may depend on the particular activity engaged in and the assumptions made as to the use by the taxpayer of the net proceeds of sale. In the absence of a statutory rule it would be difficult to determine the impact of inlation on the particular taxpayer or on the particular transaction or on the general body of taxpayers.

The second point for consideration is that there are gains as well as losses to be made as a result of the continuing reduction in the purchasing power of money. Borrowers benefit from being able to repay their indebtedness in depreciated currency so long as they invest the borrowed money in assets that do not likewise diminish in value. At the same time they

are able, both for financial reporting purposes and for income tax purposes, to deduct the interest paid on the indebtedness even though the interest rate may reflect, at least to some extent, the expectations of the parties to the loan of the impact of inflation over the term of the loan.

It is not surprising then that the treatment of monetary liabilities and monetary assets has been the subject of much debate in the development of current cost accounting concepts. More to the point for present purposes it is difficult to argue that, while the adverse effects of inflation should be taken into account in the computation of profits for tax purposes, the benefits should be disregarded. Comprehensive adjustments to reflect whatever was decided in policy terms in that respect would surely require legislation.

The third consideration is that there are various features of the legislation which assume that constant dollar figures will be employed in the calculations. The charge for tax is in respect of income derived at any time during the particular income year. It assumes the use of nominal dollars even though particular items may be separated in time by almost 12 months. That same assumption is reflected in the provisions for payment and refund of taxes whatever time lapse is involved. Then there are the provisions of the legislation governing the calculation of income where the particular item of revenue or deduction affects more than one income year. Examples are the provisions governing the use of standard values for certain classes of trading stock, provisions for the spreading and recapture of revenue items, and provisions for retrospective adjustments to assessable income in various situations. Provisions of these kinds all assume the use of nominal dollars and the disregarding of any changes in the value of the dollar over time.

For the reasons which I have given I would reject the fourth contention advanced for the appellants.

The Source of the Profit

The final contention advanced for the appellants was that, to the extent that the profit arose from the effects of inflation on land values over the period during which the particular lot sold was held by the appellants, its source was inflation and it did not constitute a profit "derived from sale" of the land. It was submitted that the inflationary ingredient in the ultimate sale so arising was arising or accruing over that period: the sale was merely the occasion on which and not the

In the Court of Appeal of New Zealand

No 11

Judgment of Richardson J

- continued

source from which it was derived.

Apart from raising considerations similar to those which have led me to reject the appellants' fourth submission, this contention turns on the distinction which the appellants seek to draw between a profit realised on a sale and a profit derived from a sale. It is a fine distinction and the justification for attaching such significance to it is not discernible in the scheme of the new s 88AA. That section is directed to realised profits on land transactions. What was up to the point of sale a potential gain may fairly be said to have been derived from the sale; that is in the absence of statutory provision for the exclusion of the inflationary element in the calculation of the taxable profits.

I would dismiss the appeal.

"I L M Richardson J"

No 12

No 12

JUDGMENT OF McMULLIN J

Judgment of McMullin J

This case raises a number of questions as to the construction of s 88AA(1)(d) of the Land and Income Tax Act 1954 which was enacted by s 9(1) of the Land and Income Tax Amendment Act 1973 and made applicable with respect to any profit or gain derived from the sale or other disposition of land made on or after 10 August 1973. The amendment, on which respondend bases his assessment of income tax against appellants, effected important changes to the law on the taxation of profits or gains from the sale of land. Appellants claim that the circumstances of this case do not come within it.

From 1960 on, appellants carried on in partnership in Timaru the business of fruiterers and greengrocers. In 1961 they purchased for $20,024.99 a block of land of approximately 10 acres at Gleniti on the outskirts of the city. They intended to use this as a market garden, a source of supply of vegetables for their greengrocery business and as a place on which to store fruit cases which were excess to their requirements at the shop. As a result of the development of adjoining land for housing purposes and the interest of an oil company in the purchase of some of the front land in the block for use as a service

station, appellants, in 1963, decided to subdivide the 10 acre block into residential sections and to offer these for sale. That part of the block which was nearest to an existing road was developed first. The balance of the land was subdivided a few years later. This case is concerned only with those sections in the subdivision which were sold in the year ended 31 March 1974 although the result will have tax implications in other years.

As part of the subdivision it was necessary for appellants to construct roading, provide services and do other development work. In the year ended 31 March 1974 ("the fiscal year") appellants sold, at an average price of $5000 each, six sections in a subdivision of the land effected by two subdivisional plans. Respondent assessed appellants for income tax on the "profits or gains" made on the sale of these sections. He did so on the basis that, in planning and carrying out the subdivision, appellants had carried on an "undertaking or scheme" within s 88AA(1)(d). In view of the explanation offered by appellants as to why they sold land within a relatively short time after its acquisition, respondent does not seek to justify his assessment on the ground that the land was originally acquired for the purposes of sale and he has not sought to tax profits on sales made prior to the coming into force of s 88AA(1)(d).

Section 88AA(1) provided:

"(1) For the purposes of paragraph (cc) of subsection (1) of section 88 of this Act, the assessable income of any taxpayer shall be deemed to include -

(d) All profits or gains derived from the sale or other disposition of land where -

(i) An undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land has been carried on or carried out, and the Commissioner is satisfied that that development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to that land; and

(ii) That undertaking or scheme was commenced within 10 years of the date on which that land was acquired by the taxpayer."

Subsections (3) and (4) of s 88AA impose limitations on the application of s 88AA(1)(d) but they have no application to the present case. Section 88AA(1)(d) has since been enacted as s 67(4)(e) of the Income Tax Act 1976 which repealed the Land and Income Tax Act 1954 but the repeal has no bearing on the present case which turns upon that part of the section which is underlined above.

Appellants concede that, if what they have done by way of subdivision of the land amounts to an "undertaking or scheme" within s 88AA(1)(d), the developmental or subdivisional work carried out by them was more than merely of a "minor nature"; that it was carried on or out by them or on their behalf and on or in relation to their land; that the "undertaking or scheme" was commenced within 10 years of the date of their acquisition of the land; and that none of the exemptions contained in the section apply to them.

In the High Court Roper J decided the case against appellants and upheld respondent's assessment. There, the case was dealt with on five questions which the Court was asked to answer. In this Court appellants have made submissions on the same five questions.

Submissions on Appeal

The first question, which Roper J answered in the affirmative, was whether, in planning, committing themselves to, and having carried out, the subdivision into lots, together with developmental work effected on the subdivision, appellants carried on or carried out, or caused to be carried on or carried out, an "undertaking or scheme", within s 88AA(1)(d), which was capable of giving rise to a taxable profit or gain within that enactment.

Appellants contended that whatever they had done in the way of surveying and developing the subdivision was not an "undertaking or scheme" within s 88AA(1)(d) because that provision applied to income proceeds only whereas the proceeds of the sales of appellants' subdivided sections were no more than a conversion into cash of smaller parts of a total capital asset. They said that the advantageous realisation of a capital asset was not a profit-making scheme and that to come within the ambit of s 88AA(1)(d) the

gain must be in the nature of income; not merely of a capital kind. While Mr Molloy accepted that it may well have been the intention of the authors of s 88AA(1)(d) to enact a capital gains tax he said that any such intention had miscarried because of the language in which it was expressed.

This submission was founded upon the basis of a statement of agreed facts and issues placed before the High Court in which it was said and accepted that when they came to dispose of their land appellants might have done so by the sale of the whole block as one. Instead they chose to sell it in smaller parcels.

Applicants in essence say that s 88AA(1)(d) took its character from other sections in the Land and Income Tax Act 1954 which it was intended to supplement, such as s 88(1)(c), which shows that it was a provision which required persons to pay tax on income as distinct from gains of a capital kind.

Both Mr Molloy and Mr Gresson, who argued this part of the case for respondent, referred us to the history of the legislation and the various decisions of the Court on similar provisions in the Act. It was accepted that there was no legislation of a comparable kind in overseas jurisdictions which directly assisted in the interpretation of the section although an Australian provision containing wording significantly different, was considered by the Privy Council in McClelland v FCT (1971) 1 All ER 969. It is useful to consider the legislative history of those provisions in tax legislation which have taxed gains from the sale of land. Profits or gains from the sale of land were first made taxable by s 85(c) of the Land and Income Tax Act 1916. That provision made taxable "all profits or gains derived from the sale or disposition of land or any interest therein, if the business of the taxpayer comprised dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it at a profit". When the legislation was consolidated and amended in 1923, s 79(1)(c) of the 1923 Act repeated the substance of the 1916 provision. S 79(1)(c) was itself repealed and replaced by s 10 of the Land and Income Tax Amendment Act 1951 which made taxable:

> "All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises dealing in such property,

In the Court of Appeal of New Zealand

No 12

Judgment of McMullin J

- continued

or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit".

Whereas s 79(1)(c) of the 1923 Act had covered only profits or gains from dealing in land or from the sale of land acquired for disposal at a profit, the 1951 amendment expanded the section in three ways. It included profits from the sale of personal property it no longer required that the purpose of the acquisition should be a profit-making one; and it added what has become known as a "third limb" to catch "undertakings or schemes" entered into or devised for the purposes of making a profit. But it is noteworthy that under the 1951 amendment the "scheme or undertaking" had to have a profit-making purpose. When the Land and Income Tax Act 1954 was passed, s 88 (c) retained that structure. The provision was in this form when it was considered by Henry J in Eunson v CIR (1963) NZLR 278, a case which concerned the sale in small lots of part of a larger block of rural land acquired for farming purposes. The question was whether or not the sale of the land by way of subdivision into building lots, when the seller's business did not include dealing in land and the land had not been acquired for sale, produced assessable income because it was the carrying out of an undertaking or scheme entered into, or devised for, the purpose of making a profit. Henry J said:

> "I reject any suggestion that the third limb of s 88(c) so departs from the general scheme of income tax that it imposes what is tantamount to a capital gains tax. It does not sweep away the distinction, long recognised by the Courts, between capital gains and income gains. After all, as has been said by the high authority, 'income tax is a tax on income", per Lord Macnaghten in London County Council v Attorney-General (1901) AC 26, 35. Assessable income is by s 88 deemed to include certain specific items which either define or add to the general meaning of income. Such definition or addition does not limit the natural meaning of income. Nevertheless, the governing concept is something in the nature of income or profits from trading or dealing or the like with a view to profit.

The third limb is, in my view, a specific provision for ensuring that assessable income does include profits in the nature of income earned or derived from the carrying out of schemes and undertakings. If the Legislature meant to tax all profits from the sale of land the three limbs of s 88(c) would be unnecessary and the subsection would proceed no further than the opening words, namely, "All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein'. The third limb catches some residue of methods of earning profits which are neither a business nor the realisation of property bought for the purpose of sale". (280)

In CIR v Walker (1963) NZLR 339 the third limb was again the subject of consideration by the Court of Appeal. Of it North J said:

> "No doubt the third limb is wider in its application than the second, but in giving a meaning to the word 'purpose' in both clauses it is as well to bear in mind that we are dealing with a taxing statute aimed at requiring persons to pay tax on income as distinct from what may loosely be described as gains derived from a capital source." (361)

Beetham v CIR 3 ATR 342 was a further case involving the same provision. There Henry J said:

> "Our system of taxation does not hit at capital gains, only income, albeit that that word is greatly extended in its meaning by statutory provision. Despite the extension of the meaning of income, gains of a capital nature have never been taxable and it would require a clear statutory provision to bring about such a drastic change in the concept of tax on income." (353)

Henry J in Eunson's case thought that the governing concept was "something in the nature of income or profits from trading or dealing or the like with a view to profit" (280). It was "a specific provision for ensuring that assessable income does include profits in the nature of income earned or derived from the carrying out of schemes or undertakings" (280) In Walker's case both North J and Turner J, who were in the majority, placed weight on the purpose, i.e. the purpose of making a profit.

If the present case fell to be decided under the legislation as it was when Eunson, Walker and Beetham were decided, respondent might find himself in some difficulties in justifying an assessment made on the basis of the third limb in that, to yield taxable profits, any undertaking or scheme embarked on by the taxpayer would have to be entered into or devised for the purposes of making a profit.

It is against this legislative background that s 88AA(1)(d) is to be considered. Because liability to tax is a creation of statute, any provision which is said to create it must do so without ambiguity (Russell (Inspector of Taxes) v Scott (1948) AC 422, 433 per Lord Simonds). Nevertheless the primary enquiry must be as to the meaning to be deduced from the words of the applicable provision. In interpreting a taxing statute there are no special canons of construction. The relevant principle was set by Lord Russell of Killowen in Attorney-General v Carlton Bank (1899) 2 QB 158 as follows:

> "I see no reason why special canons of construction should be applied to any Act of Parliament, and I know of no authority for saying that a taxing Act is to be construed differently from any other Act. The duty of the Court is, in my opinion, in all cases the same, whether the Act to be construed relates to taxation or to any other subject, namely to give effect to the intention of the Legislature as that intention is to be gathered from the language employed having regard to the context in connection with which it is employed. The Court must no doubt ascertain the subject matter to which the particular tax is by the statute intended to be applied, but when once that is ascertained, it is not open to the Court to narrow or whittle down the operation of the Act by seeming considerations of hardship or of business convenience or the like. Courts have to give effect to what the Legislature has said". (164)

Now what is immediately significant about s 88AA(1)(d) is that it contains no requirement that the scheme or undertaking must be entered into or devised for the purpose of making a profit. That is the main difference between it and the third limb of s 88(1)(c) discussed in the cases referred to earlier. For my part I do not think that much help is afforded in endeavouring to interpret the new provision by reference to whether or not it was intended to bring about the taxation of

capital gains. I think it likely that gains, normally regarded as capital, which would not otherwise have been taxable, will fall within the provision and, indeed, if such were not intended to be caught, one might well ask what indeed was its purpose. And it is to be remembered that when Henry J in Eunson's case said that a violent departure from the general principles of taxing income ought not to be adopted as a matter of construction unless the words used clearly and unequivocably required such a construction and required their application to the particular facts, he was of course speaking of provisions of the Act as they then stood. If the words of a statutory provision are plain enough then I see no reason why capital gains should not be taxable even though the particular statute does not bear a caption to that effect. Moreover, the activity involved in a subdivision need not be a business activity. Section 88AA(1)(d) makes that clear. It is therefore, a feature of the provision that the profits or gains need not arise from normal business activity nor need the undertaking or scheme have a profit-making purpose. The absence of the first of these characteristics distinguishes the case from McClelland v FCT (supra) in which the absence of reference in the Australian legislation to the operation of a business influenced the majority in the Privy Council to say that such a notion was implicit in the words "undertaking or business".

In enacting s 88AA(1)(d) in the form in which it did, the Legislature has placed some limitations upon the taxability of profits or gains derived from the sale or other disposition of land. Profits or gains are only caught by the provision where the undertaking or scheme:

(a) Involves a development or division into lots that has been carried on or out, and

(b) The work of development or division is not of a minor nature, and

(c) The undertaking or scheme was commenced within 10 years of the date, and

(d) It is outside of the matters mentioned in ss (3) and (4).

The time element is particularly important. It distinguishes the class of case caught by s 88AA(1)(d) from cases of subdivision or development by persons who have held and used their land as farm land for a longer period of time and have found subdivision necessary or worthwhile only because of the impact of the urban sprawl. These factors,

In the Court of Appeal of New Zealand

No 12

Judgment of McMullin J

- continued

namely the time at which the subdivision is carried out and the need for development to be of more than a minor nature, suggests to me that the Legislature was creating a new and separate category of taxable gains or profits, whether they be regarded as capital or not, when it introduced s 88AA(1)(d).

I think that there is no warrant for placing upon the subsection a construction which would limit its application to profits or gains of a traditionally income kind and the activity engaged in by appellants falls squarely within the provision. Accordingly, Roper J was right in answering the first question against appellants.

The second question raised by the appeal was whether any undertaking or scheme involved the development or division into lots of "that" land, where that expression appears in sub-paragrap (i) of paragraph (d) of s 88AA(1).

The submission made on behalf of appellants was that even if the first question be answered in the affirmative there was still no scheme for the purposes of s 88AA(1)(d) be cause it did not affect "that land". At the time that the sales by appellants were made in the fiscal year there were two plans of subdivision in existence. Five of the six sections sold were shown on one plan and the sixth section on the other. Before Roper J the point seems to have been made for appellants that because this sixth section, lot 9 on DP24271, had not been developed and had not been itself the subject of subdivision into lots, it was not "that land". But in this Court Mr Molloy said that because some filling work had in fact been done on lot 9 and each of the other five lots was adjacent to another lot, it was not open to him to take the point on the assessment for the fiscal year. But, he said, it could have significance in other years over which the subdivision sales have extended and on that account he sought an indication as to this Court's attitude on the point. Mr Molloy conceded that the effect of his contention would be that whatever fiscal consequences s 88AA(1)(d) may have had, these could have been avoided if sales in a subdivision were limited in any one year to non-adjacent lots on which no work had been done.

I cannot accept this proposition. It supposes that for s 88AA(1)(d) to operate, the land, from the sale or other disposition of which the profits or gains were derived, must have been all the land which was the subject of the scheme of development. I do not think that such a narrow reading is justified. I think that s 88AA(1)(d) is to be properly read

as requiring that the land which was the subject of the sale must have been the whole of or part of a block upon which developmental or subdivisional work had been done. Lot 9, the lot which stood on its own, was part of the larger block of the subdivision. It is of no moment, in my view, that no developmental work was done upon it. It is sufficient for the purposes of the section if the developmental or surveying work was done on the total subdivisional area of which any lot or lots sold formed part. Therefore Roper J was right in answering the question in the affirmative.

The third question raised the point as to whether, to form the basis of a valid assessment, an assessable profit or gain could be calculated by the method used by the Commissioner, or by any other method; or could be attributed to any particular income year.

Appellants' submission was that there was no calculable profit in the fiscal year upon which respondent was able to assess income tax because s 88AA(1)(d) applied only if the profits or gains could be ascertained with mathematical certainty or some convincing measure of accuracy. Against this, Mr Molloy said, were the difficulties in the apportionment of costs and sale prices brought about by the natural features of the subdivision, section sizes and their proximity to existing roads.

The factual basis against which this submission must be examined is contained in the case and evidence given in the High Court by the surveyor. In a letter dated 25 March 1975 the Commissioner advised the chartered accountants acting for appellants that sales of sections in the subdivision made on or after 10 October 1973 would be subject to the provision of s 88AA. He asked for information as to the number of sections sold in the year ended 31 March 1974, the date of purchase of the land, the respective cost price of the sections, the date upon which each section was sold and the selling price of each. The accountant's replied on 10 June 1975. The relevant portion of their letter is set out in the judgment of Cooke J. Further facts were agreed for the purposes of the case. They were:

> "The Commissioner's assessment is based upon the objector's calculation of an average land cost, plus an average share of actual and estimated subdivision and related costs, being attributed to each section. The objectors agree that this

In the Court of Appeal of New Zealand

No 12

Judgment of McMullin J

- continued

is a reasonable and proper accounting approach to the calculation of 'profits' for general commercial purposes, but contend that neither it, nor any other method, is appropriate as a basis for valid assessment under the Land and Income Tax Act 1954".

At the hearing in the High Court the surveyor who prepared the subdivisional plans gave evidence as to the natural features of the subdivision. He said that several of the sections needed a modest amount of fill and that roading was required to make some lots saleable. Mr Molloy argued that before any profit could be calculated, the actual cost of purchasing, holding and subdividing the land had first to be ascertained and that because this was impossible of ascertainment where the subdivision was not complete, and possible contingencies had not materialised, there was no calculable profit or gain upon which the Commissioner could make an assessment.

The information contained in the letter from the accountants, generalised and meagre though it be, might seem to present a formidable hurdle to appellants' contentions. I think that the flaw in appellants' approach is that it reads into s 88AA(1)(d) something which the section does not express. There is nothing in that provision which requires costings to be made accurately and estimates to be disregarded completely, and it overlooks entirely the point that respondent was largely adopting the approach which had commended itself to appellants' advisers. The fact that ss (5) of s 88AA empowers the Commissioner, in the case of a profit to which ss (1)(e) applies, to ascertain the value of any land at the date of the commencement of any undertaking or scheme "in such manner as he thinks fit" does not preclude him, in cases to which ss (5) has no application, from adopting the approach which appellants' accountants adopted and ordinary business methods would justify.

It may be, as Mr Molloy submitted, that a taxpayer's own financial records are not always binding upon him. In FCT v Thorogood 40 CLR 454 that point was made, but Isaacs ACJ said:

> "The primary material on which an assessment has to be made is necessarily the return furnished by the taxpayer himself; and to test its accuracy the first field of investigation is ordinarily the taxpayer's own information and his books

> and vouchers. No doubt he is free to select his own method of accountancy, but, if by that method there appears to be a greater liability for income tax than his returns disclose, he cannot complain if the Commissioner, in protection of the Public Treasurey and in justice to other taxpayers, holds him to his own accounts unless he satisfactorily proves them erroneous."

Those words are apposite here. The information upon which respondent made the assessment was contained in a letter written by taxpayers accountants, who by then knew that the Commissioner proposed to assess any profits or gains from the subdivision in the year ended 31 March 1974. The generalised evidence of the surveyor did not inject into the case any material which would make the basis adopted unsatisfactory.

In the absence of a specific statutory direction profits are to be arrived at on ordinary commercial principles - see 23 Halsbury's Laws of England (4th ed) para 258. It may be difficult to calculate profits from transactions where these arise from the subdivision of land with developmental costs extending beyond a fiscal year and realisation of the sections is postponed over several years. But difficulties of that kind do not preclude altogether the making of an assessment if it has a basis which is real and sensible. A number of cases decided under s 26(a) of the Income Tax Assessment Act 1936-80, a section comparable in this respect to s 88(c) of the Land and Income Tax Act 1954 (NZ), confirm this. In Chapman v FCT (1968) 10 ATR 548 an assessment of tax had been made on the basis that a proportionate part of the expenses of subdivision and sale were allowed against the sale price. Of this basis Menzies J said:

> "Where an entirety is purchased and part only is sold there is always the problem of determining what profit has been made. Sometimes this may prove insuperable. Some cost must be attributed to what has been sold for the purpose of ascertaining the profit upon resale and it could be that no basis can be found for so doing. In this case what was done - perhaps arbitrarily - was to divide the price of the farm by the acreage to determine the initial cost of each acre and so to calculate the cost of the area which has already been sold, and then to allow a proportionate part of the expenses of subdivision and sale."

In the Court of Appeal of New Zealand

No 12

Judgment of McMullin J

- continued

and, he said:

> "No objection was taken to this and in the circumstances I think that the Commissioner and the Board were not in error in calculating the profit in this manner."

I do not overlook the consideration that the profit arising from a transaction will not always be calculable by deducting the price paid for the land and the amount realised upon its sale. That may represent an approach that is altogether too simple. There may be other considerations to take into account - see Elsey v FCT (1969) 1 ATR 389 and McGuiness v FCT (1972) 3 ATR 22. And an assessment may so lack any sensible basis as to be quite insupportable.

Two further points should be mentioned. We were referred to the provisions of the Property Speculation Tax Act 1973 which was passed to make provision for the imposition, assessment, and collection of a tax on profits or gains derived from property speculation. That Act provided formulae for assessing the profit, the value of land at acquisition and at disposition, and allowable expenses. Those formulae have application to that Act only. I do not regard them as being of any assistance in interpreting the more broadly based s 88AA.

The second point is that we were informed that, since the judgment of Roper J was delivered, s 23 of the Income Tax Amendment Act 1980 has inserted into the principal legislation a new provision, to take effect from 1 April 1980. This will enable the Commissioner to "determine the cost price of any land in such manner as he thinks fit". The new section is, no doubt, intended to give the Commissioner wider powers than he has enjoyed in the past, but its insertion, as an aid to this end, does not render invalid assessments made on the basis of a taxpayer's own figures.

I accept that Roper J was entitled to accept on the information in the case that "average" land costs were a "reasonable basis for formulating an assessment" and that they did not amount to an arbitrary assessment.

The fourth question is whether any profits which may be held to have been made were derived "from" sales or whether they were derived from such sources as the rise in property values, and the inflation, which occurred during the period between the acquisition of the block and each of these sales.

Mr Molloy submitted that any profit or gain from the undertaking or scheme of subdivision was in any case incorrectly calculated in that it did not allow for the effects of inflation. Appellants contended that the difference between the historic cost of the land and the proceeds of sale was not profit for the purposes of s 88AA(1)(d) and that there must be an adjustment for inflation to ensure that a comparison is made of "like with like". It was accepted in the agreed statement of facts that the value of the New Zealand dollar was affected considerably because of inflation between the date when the land was purchased in June 1961 and the dates when the sections were sold and the matter is one which in any case is self evident.

In a series of affidavits by economists and accountants which were made part of the case, it was said that there is a great difference between the results produced in the accounts of any business enterprise by historic cost accounting and inflation adjusted accounting, and that the imposition of tax on business profits of the traditional historical basis cuts considerably into their existing resources of businesses. From this, Mr Molloy sought to argue that taxing the profit or gain broadly reached by deducting the cost of acquiring and developing the land from the amount realised by the sale of the sections, respondent was in fact taxing wealth, not income, and income tax, he said, was a tax upon income. As it happens the point taken by Mr Molloy was taken in Secretan v Hart (Inspector of Taxes) (1969) 1 WLR 1599 where it was raised by a litigant in person. Buckley J rejected it. He said:

> "It is a point of view with which, I think, any taxpayer would feel a certain degree of sympathy, for it is very irritating to think that if one buys a piece of property - say, for instance, a plot of land - and holds it for a number of years during which nothing occurs to affect its market value and it is then sold for a price which exceeds the price originally paid for it because of a change in the value of money, one will then be taxed on a gain which in terms of sterling one has made but to which one has not contributed in any way and which has not been brought about by any circumstance other than merely a change in the value of money. But one has to look at the statute and see in what way this tax is charged, in what circumstances liability arises and what the liability is".

There are differences between the statute which Buckley J was considering, the Finance Act 1965 (UK), which taxed capital gains, and s 88AA(1)(d) which taxes profits or gains. What Buckley J said of that section seems nonetheless applicable. If account is to be taken of inflation, and the apparent gains and profits reduced in the present case by some percentage for inflationary increases, then the principle must have a wider application to many other forms of income. If accepted, it could wreck the present tax structure and greatly alter what has been treated as assessable income under successive statutes. I know of no legal principle which allows a debtor to calculate an internal debt by reference to changes in the value of money and there is no indication in the tax legislation that any different approach is to be taken there.

While there may be something to the point that increases in the value of property arising from inflationary trends over a number of years should not be regarded as real profits or gains, the step which Mr Molloy asks this Court to take is one which would need legislative intervention. It is not a matter for judicial lawmaking.

Mr Molloy's last point was that even if the inflationary component were to be properly regarded as part of the profit or gain for the purposes of s 88AA(1)(d) the profits were still not caught because those were not derived from the sale, merely realised on it. This submission was directed to the source of the profit rather than its calculation. The distinction sought to be made is, in my view, no more than a play upon words and without any real difference. I would reject it as did Roper J.

I agree that the appeal should be dismissed.

"D W McMullin J"

Solicitors for Appellants: Scott Bradley & Unwin
Timaru

Solicitor for Respondent: M C Gresson
Crown Solicitor
Timaru

No 13

In the Court of Appeal of New Zealand

No 13

Formal Judgment

FORMAL JUDGMENT OF COURT OF APPEAL

Friday the 13th day of March 1981

Before the Right Honourable Mr Justice Cooke presiding, the Right Honourable Mr Justice Richardson, and the Right Honourable Mr Justice McMullin

THIS APPEAL coming on for hearing on the 9th and 10th days of February 1981 and UPON HEARING Mr A P Molloy of Counsel for the Appellants and Mr P J H Jenkin and Mr T M Gresson of Counsel for the Respondent

THIS COURT HEREBY ORDERS that the appeal brought by the Appellants against the judgment of the Honourable Mr Justice Roper delivered on the 8th day of June 1979 BE AND THE SAME IS HEREBY DISMISSED with costs to the Respondent of $750 and with disbursements including the reasonable travelling and accommodation expenses of second counsel to be fixed by the Registrar.

BY THE COURT

LS

'W D L'Estrange'

REGISTRAR

In the Court of Appeal of New Zealand

No 14

Formal Order Granting Final Leave to Appeal

No 14

FORMAL ORDER GRANTING FINAL LEAVE TO APPEAL TO HER MAJESTY IN COUNCIL

Monday 3 August 1981

Before the Right Honourable Mr Justice Cooke presiding, the Right Honourable Mr Justice Somers, and the Honourable Mr Justice Barker

UPON READING the notice of motion dated 20 July 1981, UPON READING the affidavit of Russell James Charles List in support, and UPON HEARING Mr I M Antunovic of Counsel for the Appellants and Mr R Fardell of Counsel for the Respondent

THIS COURT hereby ORDERS that final leave to appeal to Her Majesty in Council from the judgment of this Honourable Court delivered herein on 13 March 1981 BE AND IS HEREBY GRANTED TO the Appellants.

BY THE COURT

LS 'W D L'Estrange'

REGISTRAR

No 15

In the Court of Appeal of New Zealand

No 15

Certificate of Truth and Correctness of Foregoing Record

CERTIFICATE OF REGISTRAR OF COURT OF APPEAL AS TO TRUTH AND CORRECTNESS OF ITEMS 1-14 AND AS TO STEPS TAKEN BY THE APPELLANTS

CA 112/79

IN THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN PAUL DOUGLAS LOWE, HERBERT MONTY LOWE, and KEITH LOWE

APPELLANTS

A N D COMMISSIONER OF INLAND REVENUE

RESPONDENT

I, WILLIAM DORMER L'ESTRANGE, Registrar of the Court of Appeal of New Zealand CERTIFY that the foregoing 170 pages of printed matter contain true and correct copies of all the proceedings, evidence, judgments, decrees and orders had or made herein so far as the same have related to the matters on appeal, and also correct copies of the reasons given in writing by the Judges of the Court of Appeal of New Zealand in delivering judgment:

AND I CERTIFY FURTHER that the Appellants have taken all necessary steps for the purpose of procuring the preparation of the record, and its despatch to England, and have done all other acts,

matters and things entitling them to prosecute this Appeal.

AS WITNESS my hand and the Seal of the Court of Appeal of New Zealand this 30th day of September 1981.

REGISTRAR

IN THE PRIVY COUNCIL No of 1983

ON APPEAL
FROM THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN

PAUL DOUGLAS LOWE, HERBERT MONTY LOWE, and KEITH LOWE

Appellants

- and -

The COMMISSIONER OF INLAND REVENUE

Respondent

RECORD OF PROCEEDINGS

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