

*Judgment of the Lords of the Judicial Committee of the Privy Council on the Appeal of The Kauri Timber Company, Limited, v. The Commissioner of Taxes, from the Court of Appeal of New Zealand (Privy Council Appeal No. 7 of 1913); delivered the 10th July 1913.*

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PRESENT AT THE HEARING :

THE LORD CHANCELLOR.

LORD SHAW.

LORD DE VILLIERS.

LORD MOULTON.

SIR SAMUEL GRIFFITH.

[DELIVERED BY LORD SHAW.]

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The present Appeal is from an Order made by the Court of Appeal of New Zealand under "The Declaratory Judgments Act, 1908," of that Colony. An originating summons under that statute laid before the Court the following question:—"In what cases (if at all) and to what extent (if at all) is a Company which in manner set forth in the statement of facts hereto annexed carries on (*inter alia*) the business of cutting, milling, and selling the standard timber owned by the Plaintiff Company entitled in its assessment for Income Tax to deduct from the gross proceeds of its business the value of the standing timber so cut by it?" It was admitted that the true question was whether, in striking the annual

profits of its business for the purpose of taxation, the Company was to deduct a proportion of the original capital oncost of acquiring the timber rights with the necessary possession of land to enable these to be exercised.

The Company was incorporated in Victoria in the year 1888, and it has since that year carried on its business in New Zealand. Among the objects set out in its memorandum were "to purchase and acquire lands of any tenure, any kauri and other timber, in the Colony of New Zealand." Another object was "to purchase and acquire on any terms the Company may think fit the rights of any persons under any contracts made or to be made by them for any such purchase as aforesaid." The third object under the memorandum was "to carry on the business of sawmill proprietors and timber merchants." The other objects were very wide, including a power to do everything "conducive to the attainment of any of the above objects or any objects similar thereto." It is apparent from this description that, so far as the Company was concerned, it is a mistake to treat it as if its objects were merely the carrying on of a timber merchant's business.

Immediately upon incorporation, namely, in 1888, the Company purchased a large number of bush properties comprising freehold and leasehold lands, upon which great quantities of natural timber were growing. In the statement of facts appended to the Originating Summons the Appellants put this acquisition as "either by purchase outright of the land itself, with the standing bush upon it, or by purchasing the timber with the right to cut and remove the same at any time within a stated period."

The Board was informed in the course of the discussion that at least a considerable portion of the property was acquired under leases for a period of 99 years. This is the first salient fact in the case. The second is that there is no obligation upon the Company immediately to cut down and remove the timber, or indeed to do so at any specific date, their rights with regard to the timber being co-extensive in time with the currency of their leases. The case is thus removed, in fact, from any analogy with decisions quoted at their Lordships' Bar, in which a sale of standing timber was coupled with the duty of its instant removal from the ground. And before approaching the construction of the New Zealand Acts it is expedient, in view of the argument presented, to state the manner in which such rights are viewed under the Common Law.

It appears to the Board that the present case involves no refinement of distinction; for the transaction under which these timber rights were acquired was not one under which a mere possession of goods by a contract of sale was given to the Appellant Company, but was one under which they obtained an interest in, and possession of, land. So long as the timber, at the option of the Company, remained upon the soil, it derived its sustenance and nutriment from it. The additional growths became *ipso jure* the property of the Company. All rights of possession necessary for working the business of cutting, or even for preserving uninjured the standing and growing stock of timber were ceded under the leases. All this, together with the business facilities for removal and sale, was granted to the Company, which became thereby invested with the possession of, and an interest in, the land. This was so,

undoubtedly, in a practical, and, indeed, very ample sense, and, in the opinion of the Board, it was so also in the eye of the law.

So far for the view of the Common Law. From the point of view of accounting and finance, the matter appears equally clear. There can be no question that the cost of acquisition of this possession of, and interest in, land, and of the timber rights thereon, was just as plainly a capital oncost as if the land, with the timber upon it, had been bought outright. And just as plainly it was not a proper accounting debit item as against revenue.

These general considerations would seem to settle the case. But there have been many litigated cases on these topics and frequent stages of legislative effort in the incidence and adjustment of taxation upon property so situated.

With regard to the decided cases, the general principle as to the impropriety of treating a quota of invested capital, or of the corpus of the subject acquired, as a proper item of debit from annual profits received, can no longer be considered to be in doubt.

As to coal, the decision of the House of Lords in *The Coltness Iron Company v. Black* (6 A.C. 315) set out the principles with clearness and in detail. The case had reference to the taxation of a mine, and it was settled that the tenant was not entitled in computing the profits for Income Tax to deduct any sum as representing the amount of capital expended in making bores and sinking pits, even although that expenditure was necessitated by the exhaustion of the capital in the year's working. The case was accordingly much stronger than a mere attempt to debit a proportion of original capital, because the expenditure was of the

nature of replacement or an equivalent for depreciation. Yet it was held that that equivalent was a capital equivalent and could not enter as a debit against annual profits. The leading judgment of Lord Penzance has been frequently referred to. And these expressions put the matter in brief compass:—

“The words ‘profits received therefrom’ are here introduced to define the annual value of the thing which is to be taxed, which is the ‘mine,’ and it could not, I think, be intended that, for the purpose of calculating the ‘annual value’ of a ‘mine,’ the original cost of the ‘mine’ itself, or any part of it, should be first deducted. On the contrary, the words ‘profits received therefrom’ in this connection mean, I think, the entire profit derived from the ‘mine,’ deducting the cost of working it, but not deducting the cost of making it.”

The language of the learned Lord had, of course, specific reference to the expressions used in the English Income Taxing Statutes, but the principle to be applied is clearly a general one to the effect that the consumption of capital cannot be treated in the ascertainment of profits as a revenue debit.

The same principles were enunciated in the various stages of *The Alianza Company, Limited, v. Bell* (1906, A.C. 18). The claim in that case was by a company which carried on a manufacture of nitrates and iodine by working up certain deposits—in particular, a deposit called “caliche,” found upon land owned by them in Chili. It was clearly true that part of the corpus of what was purchased, namely, the deposits themselves, was being worked out and exhausted. But all the Courts held what is plainly expressed in one sentence of the Judgment of Lord Macnaghten, that “this claim is prohibited by the third rule, being a claim in respect of money employed as capital.”

The law—so clearly settled with regard to the working of coal and of nitrates, and settled upon a broad general principle—is in no way different when it comes to be applied to timber-bearing lands. The principle set out above in the present Judgment as to the true reason for holding that such timber rights are of the nature of possession of, and interest in, the land itself, has long been settled. A note by the learned editors in the first volume of Saunders' King's Bench Reports, page 277c, puts the matter thus :—

“The principle of these decisions appears to be this : that wherever at the time of the contract it is contemplated that the purchaser should derive a benefit from the further growth of the thing sold, from further vegetation and from the nutriment afforded by the land, the contract is to be considered as for the interest in land ; but where the process of vegetation is over, or the parties agree that the thing sold shall be immediately withdrawn from the land, the land is to be considered as a mere warehouse of the thing sold and the contract is for goods.”

There may have been certain necessary modifications of the generality of this principle with respect to emblements or the products of industry like ordinary agricultural crops ; but it is unnecessary to analyse these instances or to make any pronouncement upon some of the dicta of Judges in later times. For the present is a broad case of the natural products of the soil in timber—a crop requiring long-continued possession of land until maturity is reached, and the contract with regard to it in the present case raises none of the difficulties springing out of a covenant for immediate severance and realisation. And the judgment of Mr. Justice Brett in *Marshall v. Green* (1. Common Pleas Division. 35) distinguishes this broad case and properly accepts the note to *Duppa v. Mayo* which has just been cited.

It is plain that the Legislature of New Zealand was apprised of the complexities attaching to the imposition and incidence of a taxation in circumstances like the present, and their Lordships see no reason to differ from the analysis of the various Acts of Parliament made in the very careful judgment of Mr. Justice Edwards in the Court of Appeal. It is clear that in the legislative evolution which was occurring there was, as pointed out in the Court below, a determination "to avoid the injustice of double taxation upon the same matter." Another part of that evolution was this: that while, as is seen from the latest statute, that of 1908, the nature of the taxation was to be broadly divided into two parts, namely, a taxation upon land and a taxation upon income, an effort clearly appears, both in the definitions used and in the deductions which are set forth and are now to be mentioned, to make clear to collector and taxpayer alike the position of timber rights and the inadmissibility of deduction from profits of capital expenditure. In the years 1905 to 1907 the Appellants in their Statement of Facts annexed to the Originating Summons explained that they had "paid land tax on such timber " as and being part of the land on which it " was growing." This was done in accordance with the then existing legislation. Then in 1907 and in 1908 (by the statutes of both years) certain changes took place. The provisions of the Act of the later year, which substantially repeat those of the former, are as follows (Section 45 (1)):"No land tax, " whether ordinary or graduated, shall be " assessed or payable in respect of the value " of any minerals, timber or flax; and for " the purpose of any such tax the value of " minerals, timber or flax shall not be taken

“ into account in estimating the value of the “ land.” Timber was thus clearly removed from land taxation. In the opinion of their Lordships the profits derived from the sale or realisation of timber were clearly brought within the scope of taxation upon income. For by Section 79, “ ‘ Income derived from business ’ includes . . . . the profits derived from ” a series of sources which are specified, and in the course of that series there is this :—“(f) From the extraction, “ removal, sale or treatment of minerals, timber “ or flax, whether by the owner of the land “ or by any other person, and whether the said “ income is derived by way of rent, royalties, “ commercial profit or otherwise howsoever.”

It appears to their Lordships that when the New Zealand statute has expressly prohibited timber from being taken into account in estimating the value of land, and therefore from being taxed as part of land, and has, on the other hand, expressly included profit arising from the extraction, removal and sale of timber, howsoever the income has been derived, no further language on the part of the Legislature was required to make it clear that, even though it be granted that all the arguments to the effect that the removal of timber was the destruction or exhaustion of capital were correct, the Legislature has plainly put the income derived from the removal of timber into the profit account for the particular year.

It may in addition be pointed out that by Section 87, in the ascertainment of income it is expressly provided that no deduction shall be made in respect of “ loss of capital ” or of “ capital withdrawn.”

Nor is it necessary to add that this mode of treating timber or mineral for taxation purposes contains nothing novel. For it has long



been the law of the United Kingdom that the exhaustion of capital, however it might be treated on strict actuarial principles or according to certain principles of economics, may for the purposes of taxation be treated as profit. That profit may be temporary, and so when it ceases the capital may be gone and with the going of the capital there will also go the subject and the possibility of the tax. An interesting analysis of this problem is made by Lord Blackburn in the Coltness case.

Their Lordships do not find any ambiguity in the New Zealand Acts on the matter of this Appeal, and they do not entertain doubt that the Court below has come to a correct conclusion.

Their Lordships will accordingly humbly advise His Majesty that the Appeal be refused. The Appellants will pay the costs.

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In the Privy Council.

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THE KAURI TIMBER COMPANY,  
LIMITED,

v.

THE COMMISSIONER OF TAXES.

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DELIVERED BY LORD SHAW.

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