

In the Privy Council

ON APPEAL
FROM THE COURT OF APPEAL
OF NEW ZEALAND

BETWEEN
THE COMMISSIONER OF INLAND REVENUE
Appellant
AND
EUROPA OIL (N.Z.) LIMITED
Respondent

Record of Proceedings
VOLUME 6

MACKRELL & CO.,
Isigo Place,
31 Bedford Street,
Strand,
London W.C.2.

Agents for:
CROWN LAW OFFICE,
Wellington,
New Zealand.

Solicitors for Appellant

MACFARLANES,
Downgate Hill House,
London E.C.A.

Agents for:
MORISON, TAYLOR & CO.,
Wellington,
New Zealand.

Solicitors for Respondent

VOLUME 6

IN THE PRIVY COUNCIL
ON APPEAL FROM THE
COURT OF APPEAL OF NEW ZEALAND

BETWEEN THE COMMISSIONER OF
INLAND REVENUE

Appellant

AND EUROPA OIL (N.Z.) LIMITED

Respondent

RECORD OF PROCEEDINGS

VOLUME 6

| | PAGE |
|--|------|
| Reasons for Judgment of McGregor J. | 6001 |
| Formal Judgment of Supreme Court | 6046 |
| Notice of Motion on Appeal from Judgment of McGregor J. | 6047 |
| Reasons for Judgment of North P. | 6048 |
| Reasons for Judgment of Turner J. | 6078 |
| Reasons for Judgment of McCarthy J. | 6109 |
| Formal Judgments of Court of Appeal: | |
| Allowing Appeal | 6122 |
| As to Costs | 6123 |
| Order Granting Final Leave to Appeal to Her Majesty in Council | 6124 |
| Certificate of Registrar of Court of Appeal of New Zealand | 6125 |

JUDGMENT OF MCGREGOR J.

These are two cases stated pursuant to s. 32 of the Land and Income Tax Act 1954 as a result of objections lodged by Europa Oil (N.Z.) Limited (to which company I will hereinafter refer as "Europa") and Associated Motorists Petrol Limited, to assessments of income tax made by the Commissioner in respect of the years ending 31 March 1959 to 1965 inclusive.

EUROPA OIL (N.Z.) LIMITED:

- 10 Europa is a company incorporated in New Zealand, and carrying on business in the marketing of petroleum products. Another company, Associated Motorists Petrol Ltd. (to which I shall refer as "A.M.P.") also incorporated in New Zealand, is a wholly owned subsidiary of Europa. On 1 June 1956 A.M.P. in conjunction with the Gulf Oil Corporation of the United States procured to be incorporated in the Bahama Islands a company known as the Pan-Eastern Refining Company Limited (hereinafter referred to as "Pan-Eastern") with a capital of £100,000. Of this capital sum one-half was subscribed by A.M.P. and one-half by Propet Company Limited, a wholly owned subsidiary of the Gulf Oil Corporation.

- 20 The narrative in regard to Europa's purchases of gasoline and other petroleum products for marketing in New Zealand for the purposes of the present case commences in 1936. In that year Europa's subsidiary entered into a contract with California Texas Oil Company Limited (generally known as "Caltex") for the purchase of Europa's requirements. This contract was for a term of 14 years to 1951, and was then renewed for a further 5 years, to expire on 31 December 1956. Under this contract Caltex agreed to supply motor gasoline at the lower of the lowest current market quotations for the nominated quality or specifications as published in the National Petroleum News, U.S., Gulf of Mexico quotations or Californian quotations for export, whichever was the lowest. This contract did, however, contain at least one concession in favour of the purchaser in the form of a freight concession. A refund was agreed on freight paid by the purchaser equivalent to the difference between freight actually paid and the current freight rate from Dutch East Indies to New Zealand, Dutch East Indies being treated as "the staging point".

- 30 (I will throughout use the spelling "gasoline", as appears in the contracts, which seems to be the U.S. custom, whereas "gasolene" is more common in British countries.)

- 40 In 1955 it became necessary for Europa to renew its Caltex contract, or arrange an alternative source of supply. Europa's trade is predominantly in gasoline. In refining crude oil a typical yield is 25 percent gasoline, 10.8 percent kerosene, 17.8 percent diesel oil, and 40

percent fuel oil. Those products total 93.6 percent, the remaining 6.4 percent representing waste in refining. Europa possessed practically no market for the lower grade refining products. The 1955 negotiations for a new Caltex contract seem to have commenced with a suggestion that a price formula should be negotiated, giving recognition to Europa receiving a refining profit on the products of refining uplifted by Europa under the Caltex contract.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 I must at this juncture endeavour to explain what is understood in oil circles by the term “posted prices”. Platt’s Oilgram provides a service whereby it gathers and publishes daily what the publishers believe to be accurate news of sales and prices in the oil industry, both in regard to crude oil and refined products. These published or posted prices generally provide a yardstick of market values and a basis for costs in bulk contracts. Platt’s Oilgram originally published North American sales, but was later extended to include Caribbean sales, and it would seem in the early 1950s included sales in the East of Suez area. The posted price system for products fitted into the general international set-up with its supply and competitive patterns.

20 The negotiations between Caltex and Europa broke down in June 1955, and Mr Todd, Chairman of Europa, then commenced negotiations with Gulf Oil Corporation (to which company and some of its subsidiaries I will refer as “Gulf”) to some of the officers of which company he had had earlier introductions. Gulf possessed huge supplies of crude oil in the Middle East. Earlier in 1945 Europa had discussed with Gulf the possibilities of establishing a refinery in New Zealand, and later Europa had had refinery projects prepared by other consultants, but for various sound reasons the projects had been allowed to lapse.

30 In February 1955 there were discussions between officers of Gulf and Mr Todd in regard to proposals that the two companies should engage in refinery operations outside New Zealand, East of Suez. Gulf had a large market for what are known as the heavy-end products of refining, fuel oil and the like, but East of Suez it had no market for the light ends, gasoline and the like. On the other hand Europa had a substantial market for gasoline, but little market for fuel oil. The interests of the two companies were for this reason substantially complementary.

40 Discussions with Gulf continued into 1956. On 3 April 1956 three contracts, which contain the substance of the agreements reached, were entered into. First, a petroleum products sales contract was entered into between Gulf-Iran Company—a subsidiary of the Gulf Oil Corporation—and Europa. Among the provisions of this contract are the following:

- (1) A contract period of 10 years from 1 January 1957 to 31 December 1966, subject to certain rights of renewal.
- (2) Quantity: All of Europa’s requirements of gasoline and certain of its requirements of gas oil.
- (3) Provisions as to quality.
- (4) Delivery F.O.B. tanker to be provided by Europa.

- (5) Price: "The price to be paid by Europa for the gasoline or gasolines certified as shipped shall be, regardless of where loaded, the lower of (a) the lowest quotation applicable for each quality of gasoline supplied hereunder as published in Platt's Oilgram under the heading of 'Caribbean and Far East Refined Products Prices' for cargo lots f.o.b. Caribbean ports, and, (b) the lowest quotation (as and when published by Platt's Oilgram) for cargo lots f.o.b. Persian Gulf Ports for the date on which loading commenced."
- 10 (6) Terms of payment: By a letter of amendment dated 11 April 1957 to clause 6.01 of the contract payment was to be made by Europa upon presentation of documents in Wellington 120 days from date of lifting.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

The second contract is a contract of affreightment; the parties being Gulf Oil Corporation and Europa. It recites the sale contract between Gulf Iran and Europa, and Gulf agrees to transport in bulk by tanker owned, operated, chartered, or otherwise controlled by it, Europa's gasoline and gas oil requirements in New Zealand. The freight rates payable are what are known as "AFRA rates", Average Freight Rate Assessment from Abadan to New Zealand, AFRA being the relevant rate at date of loading as determined by a panel of shipbrokers known as the London Tanker Brokers' Panel. This contract, however, contains an elaborate provision for what is known as the Alternate Freight Rate, Europa ultimately, it seems, obtaining the benefit of the lower of the two rates under the following provision:

30 "For each voyage performed hereunder, the freight charges to Europa shall be computed as if the freight rate were the ALTERNATE FREIGHT RATE for the voyage from Abadan to North Island or to South Island as the case may be, and the difference between such freight charges and the freight charges billed to EUROPA, based on the rates specified in Paragraph IV (a) above, shall be entered in a suspense account. If, upon the termination of this Contract, the balance in such account indicates that the freight charges to EUROPA were less than such charges would have been had the freight rates been the ALTERNATE FREIGHT RATES, no further payment by EUROPA to GULF'S designated collection agent will be due. If, however, upon the termination of this Contract, the balance in such account indicates than the freight charges to EUROPA were more than such charges would have been had the freight rates been the ALTERNATE FREIGHT RATES, GULF'S designated collection agent shall pay to EUROPA a sum equal to such difference."

40 The third contract entered into on 3 April 1956 is entitled "Contract for Organization of Pan-Eastern Refining Company Limited", a Bahama Corporation, and is entered into between Gulf Oil Corporation and Europa. As the recitals in this contract seem to me to be of importance, I quote them in full:

“WHEREAS, contemporaneously herewith GULF IRAN COMPANY and EUROPA have entered into a Petroleum Products Sales Contract and GULF and EUROPA have entered into a Contract of Affreightment;

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 WHEREAS, GULF and EUROPA have mutually agreed to procure the incorporation in and under the laws of the Bahama Islands of PAN-EASTERN REFINING COMPANY, LIMITED, a company to be registered under the Companies Act (Revised Edition 1929, Chapter 83), and hereinafter referred to as “PAN-EASTERN”, in which EUROPA shall beneficially be interested as to a moiety of the shares therein, either directly or through its subsidiaries and in which GULF or its nominee shall beneficially be interested as to a moiety of the shares therein;

WHEREAS, GULF and EUROPA have further agreed that GULF shall enter into a contract with PAN-EASTERN, within a reasonable time after its incorporation, for a supply of crude oil and the processing thereof and disposal of the products therefrom which contract is hereinafter referred to as the “Processing Contract”;

20 WHEREAS, the benefits to be secured and enjoyed by EUROPA by reason of its beneficial interest in the company so to be incorporated and the execution and carrying out by GULF and PAN-EASTERN of the Processing Contract is a major inducement to EUROPA to enter into the Petroleum Products Sales Contract and the Contract of Affreightment; and WHEREAS, the parties hereto accordingly are desirous of securing such benefits to EUROPA and for that purpose have agreed to enter into this present Contract;”

30 This agreement provides for the incorporation of Pan Eastern Refining Co. Ltd. with a capital of £100,000 to be subscribed by the two parties in equal shares. It provides that Gulf shall enter into the processing contract with Pan-Eastern set out in the Third Schedule.

40 The processing contract in conformity with the other contracts is for a term of 10 years. Gulf for a processing fee payable by Pan-Eastern of \$0.475 per net barrel of crude oil to be supplied by Gulf, agrees to process the crude oil at refineries provided or caused to be provided by Gulf. The agreement further provides a price for the crude oil and the purchase and sale of petroleum products at certain prices, but the price to be paid by Gulf for kerosene distillate and residuals re-sold by Pan-Eastern was to be subject to such adjustment upwards or downwards as should ensure that the net earnings of Pan-Eastern should be determined in accordance with a formula set out in the agreement. It seems clear from the evidence, and particularly from subsequent adjustments to which I shall refer later, that the intention of the parties was that Pan-Eastern’s profit should be protected, and should be not less than 2.5 cents per gallon on gasoline produced from the crude oil and supplied to Europa. In effect the intention of the parties seems to be clear, that Gulf should guarantee to Pan-Eastern a profit on this basis, and it was anticipated that the formula set out in the processing contract would produce this result.

As I have said, the sales contract between Gulf Iran and Europa fixed the purchase price for gasoline supplied in accordance with the posted price at date of loading. Such price was not subject to any discount in the ordinary way.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 The general scheme and the relationship between the various companies Gulf, Pan-Eastern and Europa, is summarised in a letter from Gulf's solicitor in the Bahamas to the Controller of Exchange at Nassau, under date 5 March 1956. It sets out the nature of Pan-Eastern's operations, namely, the purchase from Gulf of crude oil at posted prices, the resale to Gulf of motor gasoline derived from refining at posted prices, the sale of other products to Gulf's subsidiary the Propet Company, a Bahamas company, at posted prices, and it estimates that on this basis the net result should be to produce for Pan-Eastern a profit of approximately the sterling equivalent of 50 cents U.S. per barrel on all crude oil processed. The profits derived by Pan-Eastern would be declared as dividends, half of which would go to A.M.P., the Europa subsidiary, and the other half to Propet, the Gulf subsidiary. It also refers to the sales contract between Gulf Iran and Europa in respect of Europa's gasoline requirements.

20 Although it was not anticipated that Propet would show any substantial profits from the sale of the heavy ends, it is clear that the proposed arrangements were most advantageous both to Europa and to Gulf. It was essential to Gulf with its substantial market for the heavy ends, and lack of market for gasoline, that it should procure a market East of Suez for gasoline to absorb this product of its refining process. This would enable it to derive substantial profit from its crude oil supply, and to refine the crude oil to provide the heavy ends for its existing customers.

30 The New Zealand gasoline market in 1955-56 was in the hands (apart from Europa) of international oil companies, through their various subsidiaries. Gulf at this time had no outlet in New Zealand, except that it had some pooling arrangement with the Shell Group. Some time, it would appear, before 1950, Gulf developed substantial crude oil production in Kuwait, and acquired a 7 percent participation in the Iranian consortium. It lacked market outlets of its own in the Eastern hemisphere, but it had prior to 1955 concluded an arrangement with the Shell Group by pooling with Shell the costs and benefits on Kuwait crude oil from the well to the ultimate consumer for those quantities which Shell took under contract with Gulf. This gave Gulf access to eastern hemisphere markets, for which it accepted a realisation per barrel which allowed for a certain margin for Shell, thus giving Shell crude oil at well below posted prices.

40 By the arrangement with Europa, Gulf obtained a market outlet in New Zealand without making an investment of its own. Owing to the nature of the Gulf-Shell contract, and it would appear owing to Gulf's relationship with other international oil companies operating through subsidiaries in New Zealand, Gulf was not in a position to sell gasoline at a discount which would disturb the market in New Zealand,

and which in particular would have affected Gulf's relationship with Shell. To obtain the Europa outlet for gasoline, Gulf could not give to Europa any direct discount on posted prices, and any concession to obtain the Europa outlet had to be provided by Gulf by some indirect means. The posted prices represented the market level of Middle East oils.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 While there is no evidence of discounts on posted prices about the years 1955 to 1956, it seems that there were various indirect methods of inducement to obtain sales to purchasers. As I have mentioned, the earlier Caltex contract with Europa gave Europa indirect benefits. In the 1955 negotiations between Europa and Caltex there were discussions in regard to indirect benefits, although these negotiations broke down as Caltex was not prepared to make the concessions desired by Europa. Direct discounts from 1955 on do seem to have been granted by various international oil companies to bulk purchasers comprising in the main military authorities, or government controlled purchasers. Indirect benefits seem to have been granted by way of freight concessions, provisions of finance, and in other ways, and from 1959 on it is clear that numerous contracts, including long-term contracts, were
20 entered into at substantial discounts on posted prices.

The methods adopted by the various contracting parties in regard to the operation of the 1956 contracts and subsequent events are of assistance in endeavouring to determine the real arrangements between the parties and the objects which they were endeavouring to obtain. Under the contracts the method originally envisaged consisted of five steps. The first step was the sale of crude at posted prices from Gulf to Pan-Eastern. The second step was the return of the crude from Pan-Eastern to Gulf for refining at the stipulated fee. The third step was the return of the products of refining to Pan-Eastern. The fourth step
30 was the return to Propet and Gulf of the heavy products resold to Gulf and Propet. The fifth step was the resale of the gasoline from Gulf subsidiary, Gulf Iran, to Europa, and payment by Europa to Gulf Iran. In practice, however, the parties adopted a simplified method of operation. Gulf arranged with a refiner for the refining of crude oil, and after refining sold to Europa the gasoline at posted prices, gas oil at posted prices less 5 cents a barrel, and charged freight at lower AFRA or alternate freight rate. In other words, the products sold to Europa passed directly from Gulf to Europa, and payment was made to Gulf by Europa. Gulf paid as a credit to Pan-Eastern the profits of the refining venture, which profits Pan-Eastern shared equally between
40 Gulf's subsidiary, the Propet company, and Europa's nominee A.M.P., it being intended that the latter should receive equivalent to 2.5 cents per gallon of gasoline uplifted by Europa.

The complicated formula set out in the contracts was intended to provide Pan-Eastern with profit expressed as a gain per gallon of motor gasoline imported by Europa. Owing to fluctuations in the posted prices of crude oil compared with posted prices of products, the formula did not for long operate as anticipated. The contract commenced on 1 January 1956, and the profit arrived at by the

formula seems at the outset to have been in accordance with anticipations. In 1957–58 the profit seems to have been in the vicinity of 2.7 cents per gallon. Thereafter it declined. On 31 January 1958 Mr Bryan Todd, Managing Director of Europa, took up the matter with Mr Paton, the Vice-President of Gulf Oil Corporation. In a letter of this date Mr Todd reminds Mr Paton that the purpose of the formula was to produce a “clampening or unclubbing” effect to protect Pan-Eastern’s returns against sharp fluctuations which might be caused by market movements in the prices of crude and products. In practice the result had not been as anticipated, and Mr Todd pointed out that it appeared that the return to Pan-Eastern could be sharply affected by price movements in crude and gasoline without taking into account other elements which went to make up the integrated results of the industry as a whole. During the first quarter of 1957 crude prices continued unchanged, and all products improved, resulting in a market increase in overall refining margins. The rise in gasoline prices was reflected in an improvement to 2.7315 cents per gallon in the formula result. During the second quarter of 1957, however, owing to variations in prices, the effect of the formula was to reduce Pan-Eastern’s return to 2.09 cents per gallon on Europa’s gasolines, and at the time of writing the letter calculations showed Pan-Eastern’s return reduced to 1.965 cents per U.S. gallon. Mr Todd pointed out that it seemed apparent at a time when the industry was enjoying an improved price for crude oil, and when overall refining margins had not deteriorated, the formula which resulted in a substantial reduction in Pan-Eastern’s return was a somewhat unrealistic one, and he suggested that the matter seemed to need some revision.

Mr Paton replied later suggesting that the existing price formulation should be allowed to continue until the end of the third quarter of the 1958 year, when the matter could be reconsidered if Pan-Eastern’s earnings continued “below the anticipated average”. He further suggested that should it prove that Pan-Eastern’s earnings did not live up to expectations, a new formula could be devised which would give “the desired clubbing effect” against sharp fluctuations in prices of either gasoline or crude oil.

It appears from the correspondence that as at 30 June 1958 the formula return to Pan-Eastern had fallen to as low as 1.71 cents per U.S. gallon, and a graph prepared by Mr Todd indicates the fluctuations. Again in January 1959 a letter from Gulf to Europa expressed the view that a slight revision was necessary to make Pan-Eastern’s earnings more realistic. A telegram from Gulf confirmed the fact that the original offer to Pan-Eastern was intended to be a flat 2.5 cents per gallon. Correspondence then took place with suggestions in regard to a new formula which might produce the original anticipated profit to Pan-Eastern. In August 1959 Mr Todd suggested that a composite formula plan should continue, but that in each year in which Pan-Eastern’s profits were below $2\frac{1}{2}$ cents Gulf should pay by way of “a crude discount” to Pan-Eastern the difference between processing contract formula and $2\frac{1}{2}$ cents, such discounts to apply from

start of contract. The parties agreed thereafter annually for variations to the contract formula to secure the intended profit to Pan-Eastern. (Correspondence B 14.)

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 The variations contained in the correspondence were dated back to the commencement of the contract, and it is clear that from 1958 to 1965 Europa's share of the Pan-Eastern profit corresponded, with only very slight variations, to the 2.5 cents per gallon on the gasoline purchased by Europa. In my view Professor Leeman's evidence as to the nature of the amendments is a fair summary. Pan-Eastern was made
10 into a repository for a shared discount to Europa, a minimum $2\frac{1}{2}$ cents per gallon on gasoline purchases by Europa for the duration of the agreement. In effect, while the parties avoided any expression of discount, the effect was a benefit to Europa through Pan-Eastern and A.M.P. of what was equivalent to a discount on the price of Europa's gasoline purchases.

20 The Pan-Eastern arrangement in my view cannot be regarded as a conventional refining arrangement. Pan-Eastern provided an intermediate organisation for the somewhat unusual co-operative arrangements between Gulf and Europa. Gulf provided the crude oil, made its
20 own arrangements for refining through a subsidiary in the Middle East; after refining it retained the heavy products for its own marketing through subsidiaries, and it delivered the gasoline and gas oil required by Europa. It further made arrangements for the necessary shipment in tankers. It gave Europa extended terms of credit for payment for Europa's gasoline. The whole of the accounting was done by the Gulf Oil Corporation. It paid the refining charges to the company which
30 processed the crude oil, it paid to Pan-Eastern in the Bahamas the agreed share of profit on refining in accordance with the contracts as varied by the subsequent agreements to which I have referred. Pan-Eastern was then in a position to divide its profits equally between Propet and A.M.P. Pan-Eastern in effect had no organisation and its only participation was in the receipt of profits. As I have said, the subscribed capital of Pan-Eastern was £100,000. Pan-Eastern's balance sheets and trading accounts are illuminating. The following table indicates the position:

| Year | F.O.B. Value of Gasoline Shipments | 50 percent Pan-Eastern Profit Adjusted as per Note \$U.S. | Percent |
|--------------|------------------------------------|---|---------|
| | \$ | | |
| 1956-7 | 5,333,713 U.S. | 1,383,284 | 25.93 |
| 1958 | 4,196,989 | 1,168,789 | 27.85 |
| 1959 | 4,479,349 | 1,234,886 | 27.56 |
| 1960 | 3,656,945 | 1,036,071 | 28.33 |
| 1961 | 5,035,424 | 1,475,687 | 29.31 |
| 1962 | 4,333,525 | 1,324,226 | 30.56 |
| 1963 | 4,484,419 | 1,375,855 | 30.68 |
| | 31,520,364 | 8,998,798 | 28.55 |

40

In Pan-Eastern's balance sheet for 1963 the accumulated amounts receivable from Propet Company and Gulf Iran Company amounted to \$11,965,380, and the retained earnings after payment of dividends amounting to \$2,239,000 were \$12,040,510.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

For the same year the sale of refined products to Europa amounted to \$12,960,178. Purchases of crude amounted to \$9,318,499. After payment of processing fees, the surplus amounted to \$2,751,710.

10 In this year in regard to purchases of crude, there is what is described in the Pan-Eastern balance sheet as "volume discounts relating to 1963 purchases" \$1,596,709. As I understand the position this is the adjustment arranged under the variation agreements in the correspondence to which I have referred. Pan-Eastern had no separate office in the Bahamas, but the small organisation there was conducted in the office of its solicitors. In 1 year its total overhead was as low as \$85. There is a consistent pattern of only nominal overhead expenses. The expression "volume discount" in the 1963 accounts is, in my view, significant as showing the real nature of the profit distributed through Pan-Eastern and A.M.P. and finally accruing to Europa's funds. In regard to another aspect of the matter I will comment later in regard
20 to this expression "volume discount".

Mr Mahon had made a number of submissions relevant to facts, from which he asks I should draw inferences. With some of these facts as emerging from the evidence I am in agreement. Some I do not consider are fair deductions from the evidence, and some I do not think assist me in drawing inferences favourable to the objector.

I agree with the first submission, that Europa was and is an independent New Zealand marketer of petroleum products, with its own particular problems concerning supply contracts, and I agree that Europa had a necessity for a long-term contract from a global
30 source. It might well have been that if the contracts were limited to a specified refinery force majeure might have frustrated the contract. I also agree that in 1954 to 1956, with the approach of the expiry date of the Caltex contract, it was a necessity for Europa to obtain a new contract with some supplier on the most advantageous terms available. In the 1955 period there is no definite evidence of discounts being granted off posted prices of products East of Suez. There were, it seems to me, on the evidence, discounts granted in the Caribbean on spot sales and in distress sales. In my view, from the expert evidence I have heard, firms seeking new outlets or endeavouring to hold existing out-
40 lets did at times grant indirect concessions by freight arrangements, by advantageous market arrangements of an indirect nature, or by provision of advantageous finance facilities. In fact, as far back as 1936 in the Caltex arrangement there was, as I have mentioned, a substantial freight concession to Europa, and it does seem that there was in this contract also a slight discount to Europa on gasoline supplied. As I have mentioned on several occasions, Gulf had particular reasons for endeavouring to obtain Europa's trade in gasoline, particularly as gasoline was generally in surplus supply when the 1956 agreement was con-

cluded. Gulf had unlimited lifting rights in Kuwait crude, and had to have a substantial market, and I would think an increasing market, for gasoline to enable it to refine sufficient crude to produce the heavy fuel oil and the middle distillates which it could readily sell. Gulf had also shortly before acquired a 7 percent interest in the Abadan refinery. If a substantial purchaser for gasoline could be obtained, Gulf would have increased profitability from its output of crude oil and fuel oil. I agree that in 1955–57 as far as the Persian Gulf area was concerned market prices were generally equivalent to posted prices when these commenced to be recorded.

10

I agree that the Caltex negotiations in 1954–55 did not come to fruition, mainly for the reason that Caltex was not prepared to continue the basic point allowance for freight, and the quality differential of .125 cents per gallon benefit derived by Europa under the earlier contract. In these negotiations Mr Todd was adamant in endeavouring to obtain concessions of some nature, either by a discount on posted prices, or probably what would have been more easily obtained, concessions of another nature, but producing the same result by indirect means. But these negotiations indicate no more than a refusal on the part of Caltex, and persistent endeavours on the part of Mr Todd. The plain result is that when it became likely that the negotiations would prove abortive, Mr Todd concentrated on another source of supply, and on another source which by various means might provide a likelihood of higher profitability to Europa. I think both parties in the Gulf-Europa negotiations in 1955 and 1956 recognised that direct discount on products would cause embarrassment, particularly in regard to the New Zealand trade, to the supplier, and might well also if such discounts became public, be a source of embarrassment in New Zealand to the marketer in New Zealand.

20

I do not think the Caltex-Sleigh negotiations or arrangements in regard to Australian marketing are of assistance although it is clear that Caltex would make no concessions off posted prices.

30

I agree that the early 1955 negotiations with Gulf were on a refinery basis. It is clear that Europa recognised that refining in New Zealand or elsewhere would be likely to be a profitable venture, but with the limited market for heavy oils in New Zealand there were obvious disadvantages at that time in setting up a refinery in New Zealand. Gulf's proposal for supply from a refinery in the East of Suez area was distinctly advantageous to Gulf. From Europa's point of view the location of the refinery was immaterial, provided Europa could obtain by some arrangement a share of a refiner's profit. This was indirectly finally effected by the 1956 agreements. The evidence does show that international oil companies conveniently spread their activities among subsidiary companies, and the practice has been to keep the subsidiary activities in water-tight compartments for various reasons, not necessarily for taxation purposes. Questions of exchange of currencies might well enter into the matter.

40

The nature of the Pan-Eastern set-up is, in my opinion, entirely

different from that of a recognised refining joint venture. While the contracts involved normal posted prices for crude and products, and involved payment of a normal processing fee of 47.5 cents, leaving an ordinary refiner's margin, Europa anticipated in the terms of the 1956 contracts a half share in this normal refiner's margin usually regarded as equivalent to \$1 U.S. per barrel of crude. By the subsequent variations it was assured of, and received, a half interest in this refining profit margin. I have already adverted to the intentions of the parties as set out in the letter of 5 March 1956 to the Exchange Control authorities, whereby the end result of all the transactions was described as to produce for Pan-Eastern a profit of approximately the sterling equivalent of 50 cents U.S. per barrel on all crude oil purchased. While this is an ordinary refiner's margin, it seems to me of prime importance that A.M.P. were to provide an insignificant amount of capital, Pan-Eastern was a passive acceptor of the profits, and the whole of the business arrangements were conducted by Gulf.

10

20

I mentioned earlier that in 1 year the total expenses of Pan-Eastern amounted to \$85, and a further perusal of the accounts seems to show that the highest overhead in any year amounted only to the insignificant sum of \$1,974. Pan-Eastern also derived substantial earnings from interest received on bank deposits, which seem to have been handled by the Propet company. In addition, under the contract of affreightment substantial discounts were received.

30

40

I accept that it was impossible for Gulf to offer a discount on a straight-out supply contract, for various reasons. There is little evidence of any custom of granting discounts on posted prices East of Suez on long-term contracts prior to 1956. Discounts would be likely to upset the general price structure in the international oil industry East of Suez. There is a general antipathy to price cutting, and in so far as New Zealand is concerned there would have been likely repercussions in regard to the Gulf-Shell agreement, and on the return to Gulf on the crude oil sold to Shell. It seems further that the Gulf-Shell agreement provided for penalties if Shell could substantiate that by any action of Gulf it had lost market in any of the relevant areas, and Shell had a contractual right in such events to reduce its crude oil off-take from Gulf. I agree that the 1958-59 and subsequent negotiations for variation of profit, which in effect resulted in a guaranteed profit to Pan-Eastern, not based on the original contract formula, but preserved the 2.5 cents per gallon gasoline profit, were conducted on an "arms length" commercial basis. In my opinion, however, Europa was in much the stronger position, Gulf was anxious to increase its production of crude oil to maintain or increase its fuel oil sales. By 1959 there was the prospect of the establishment in New Zealand of a refinery in which Europa and international companies would acquire joint interests. Europa would continue to require for its share in the trade of the New Zealand oil refinery substantial quantities of feed stock or naphtha, which, if procured from Gulf, would retain a substantial advantage to Gulf. It would seem that about July-August 1959 Gulf had become aware of approaches made to Europa by other com-

panies to secure the feed stock contract for the proposed New Zealand refinery. While Europa's suggestions of crude discount were at this stage rejected by Gulf, the variations of the 1956 agreements provided an equivalent result.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 The next step in negotiations commences about 1962. From 1956 on it had been in the minds of the parties that a refinery might be established in New Zealand. Prior to 1962 Europa acquired an interest along with a number of international oil companies in a New Zealand refinery to be constructed at Whangarei, and on the completion of the refinery Europa had become entitled to utilise a part of the refining capacity of the Whangarei refinery. As a result, Europa desired to purchase feed stocks for the purpose of utilising its New Zealand refining capacity. Further negotiations then took place between Gulf and Europa in regard to a feed stock supply contract, and between Gulf and Pan-Eastern in regard to a processing contract. Such contracts were finally entered into on 27 December 1962. I need say little in regard to the 1962 contracts, as they were replaced by another series of contracts on 10 March 1964, before the Whangarei refinery commenced operations, or in accordance with the expression used in the oil industry "came on stream". These contracts bear a resemblance to the 1956 series of contracts with the Gulf organisation, although there are some differences. The 1964 agreements comprise first a supply agreement between Gulf and Europa for crude oil and other refinery feed stocks, and some other petroleum products if required. This agreement, which is ex. B in the case stated, is adequately and correctly explained in the evidence of Mr Newton, a British consultant on economic problems relating to the petroleum industry, and a world authority, at page 31, et seq., of his evidence in chief. Under the supply agreement Europa purchases crude oil at posted prices, and naphtha at the posted price of Kuwait crude oil plus an additional charge in respect of excess of naphtha gravity over the gravity of Kuwait crude oil.

20

30

A further agreement between Gulf and Pan-Eastern (ex. B5) arranged for Gulf to supply to Pan-Eastern crude oil sufficient to meet the requirements of crude oil feed stocks, and finished products required by Europa under the Gulf-Europa supply agreement. Gulf then processed for Pan-Eastern a part of the crude oil and purchased back from Pan-Eastern the resultant feed stocks and products, and the unrefined crude oil equivalent to the quantity supplied to Europa by Gulf. The prices to Pan-Eastern under this contract in respect of crude oil were posted price less 15 percent, and for naphtha a per barrel charge irrespective of gravity, covering the cost of related crude oil and processing. Pan-Eastern sold the naphtha to Gulf at the same price as Gulf had arranged to sell to Europa. I need not refer to the prices of other products.

40

A further contract for transportation of feed stock to be supplied to Europa was entered into between Propet (a Gulf subsidiary) and Europa. At the time these contracts were entered into it seems that

substantial discounts on Middle East crude oils were available, and had become customary in a number of transactions. The Europa supply arrangements provide for posted prices on crude oil without any discount, but in effect by means of the Pan-Eastern arrangements there was an indirect discount to the Europa group. This is clear from the subsequent correspondence exs. B1 to B4 in the case stated. By letter of 16 March 1965 Gulf, with effect from 1 April 1964, granted a reduction in the price of Kuwait and Iranian crude oil sold to Europa under the supply contract of 10 March 1964, and revised
10 invoices giving effect to the reductions covered cargoes sold to Europa during the period between 1 April 1964 and March 1965. A similar reduction was made in the price of naphtha sold under the supply contract. Again, on 30 June 1966 reductions were made in the price of Kuwait and Iranian light crude oils with effect from 2 May 1966. Contemporaneously with the letter of March 1965 Gulf advised Pan-Eastern of the reduction in price to Europa, and pointed out that under the terms of the Pan-Eastern - Gulf processing contract a corresponding reduction would apply in the prices paid by Gulf to Pan-Eastern Refining Company.

20 It seems clear, as analysed by Mr Newton, that under the 1964 series of contracts a discount or concession was provided by means of the Pan-Eastern arrangement, although at the outset Europa paid Gulf full posted prices. When direct discounts were granted to Europa in the 1965 and 1966 correspondence, the profit of Pan-Eastern was reduced by the full extent of these direct discounts. With this reduction in discounts the profit of Pan-Eastern to be shared equally between Gulf and Europa was at a reduced level. Nevertheless, from 1964 onwards Pan-Eastern, which neither handled nor refined the crude oil, nor handled the feed stock supply to Europa for its New Zealand refinery operations, received profits in effect gratuitously, and half of
30 such profits still passed down the chain through A.M.P. for the benefit of Europa. The only inference that can be drawn is that through this channel Europa received a reduction on the posted prices of its supplies, in addition to the direct discount granted in the 1965-66 correspondence. The arrangements, in effect, and in the method of operation, continued the arrangements under the 1956 contracts, whereby a profit or a concession passed directly to Pan-Eastern, and a half share thereof passed indirectly to Europa.

40 I now turn to another branch of Europa's operations. In 1961 it became evident that after the commencement of operations by the New Zealand refinery it would be convenient for Europa to obtain its supplies of gas oil, lighting kerosene, and fuel oil in New Zealand. On 18 December 1961 it entered into an agreement with British Petroleum Company's subsidiary B.P. New Zealand Ltd., to supply these products, the B.P. Company having adequate storage facilities in New Zealand. The prices to be paid to B.P. were based on Abadan posted prices ruling at the date of supply.

About this time a fully-owned subsidiary of Europa, called Pacific Trading & Transport Co. Ltd. (hereinafter referred to as P.T.T.) was

incorporated in the United Kingdom. On 12 April 1962 British Petroleum Trading Ltd. (U.K.) agreed with P.T.T. that in consideration of the latter company having procured a contract for supply between Europa and B.P. (New Zealand) Ltd., B.P. Trading Ltd. would pay P.T.T. a 10 percent commission on each delivery of gas oil, lighting kerosene, and fuel oil purchased by Europa under the supply agreement. This agreement with P.T.T. also provided for, in certain events, freight concessions. Payment of the commission was to be made in sterling to P.T.T. in England at quarterly intervals.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 It is somewhat difficult to understand the purpose of payment of this commission to a subsidiary in England. I do not think that Europa had any intention of tax saving by payment of the B.P. commission to P.T.T., as the latter company would clearly be liable either in the United Kingdom or in New Zealand for income tax on its profits. It was certainly receiving such profits without being actively engaged in the matter. Mr Todd in his evidence stated that the B.P. Trading Company, London, was agreeable that its New Zealand subsidiary should enter into the supply contract, but it was not agreeable that any discount should be granted in New Zealand for the supply of the products into New Zealand. It was agreeable to pay commission to a subsidiary of Europa in England, and the P.T.T. Company was incorporated for this purpose. Be that as it may, the agreement falls into the general pattern of commissions or concessions being received by Europa outside New Zealand through subsidiaries, and is another indication of an indirect concession or discount on products purchased by Europa in New Zealand. I understand, however, that at some stage the New Zealand inland revenue authorities arranged with the British revenue authorities that P.T.T. company would be regarded for taxation purposes as a company resident in New Zealand, and taxation on profits would be levied in New Zealand and not in the United Kingdom.

30 On 30 March 1965 the Commissioner furnished to the objector an amended tax assessment in respect of the objector's income in the year ending 31 March 1960, such assessment disallowing proportion of the cost price of gasoline debited in the objector's accounts. As I understand the position this deduction on cost is equivalent to the share of Pan-Eastern profit in this year received by Europa's subsidiary A.M.P. Similar amended assessments were made in regard to subsequent years. The Commissioner disallowed the proportion of cost price in reliance on the provisions of ss. 108 and 111 of the Land and Income Tax Act 1954 (hereinafter referred to as "the Act").

40 (Sections 110 and 111 of the Act must be read together. They are as follows:

"110. No deductions unless expressly provided—Except as expressly provided in this 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.

"111. Expenditure or loss exclusively incurred in production of assessable income—(1) In calculating the assessable income of any

person deriving assessable income from one source only, any expenditure or loss exclusively incurred in the production of the assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived for that year.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

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

10

In regard to s. 111 the learned Solicitor-General makes the following submissions:

“(1) That the appropriate test of deductibility in this case is whether the expenditure in question was exclusively incurred in producing assessable income of Europa.

“(2) That the test of deductibility of expenditure under s. 111 is narrower than the test applied in the United Kingdom and Australia.

20

“(3) That while the Commissioner may not challenge the wisdom of an expenditure he may question its purpose (and the two are distinct).

“(4) Expenditure may be apportionable where it is incurred for two or more purposes, a deduction being allowed in respect of that part which is exclusively incurred in the production of assessable income of the taxpayer.

30

“(5) Applying the law to the facts, that the expenditure by Europa on petroleum supplies obtained from Gulf and B.P. was incurred for two purposes: (i) for the purpose of procuring supplies for Europa and thereby producing assessable income of Europa; and (ii) for the purpose of producing a return to Europa through Pan-Eastern and P.T.T. respectively and such part of the expenditure is not deductible.”

The Solicitor-General makes the further submissions on the facts:

40

“When we come to the crux of the matter the basic submission of Europa is that the Commissioner’s assessment is wrong because (Europa claims) the Pan-Eastern set up is a conventional refining venture which produced a refining profit. It is our submission on the facts that the objector has failed to establish that claim because when the whole of the evidence is considered the proper inference to be drawn is that the profit of Pan-Eastern which came to Europa was a price concession or discount for which the Pan-Eastern set up was merely the machinery.

“I propose to consider the evidence under the following two more detailed submissions on the facts.

“1. That the primary object of the overall arrangements between Gulf and Europa was to obtain products and later feedstocks at an attractive price (a discounted price), the Pan-Eastern set up being a means to that end adopted in 1956 by Gulf and Europa

which had the purpose and effect of avoiding upsetting the pattern of posted prices and providing non-assessable income for Europa.

“2. That the properties (sic) which may be pointed to as suggesting a refining venture are entirely outweighed by evidence showing that the arrangement is not a refining or commercial venture, and that the Pan-Eastern arrangements in the guise of a refining venture simply provide for a guaranteed return to Europa, directly related to Europa’s own purchases, and unrelated to a conventional refiner’s margin or any commercial dealing.”

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 Mr Mahon on the other hand submits on the facts that Europa could not purchase gasoline from Gulf at other than the posted price, that the whole matter is one of contract, and that the profits derived by Pan-Eastern cannot be deducted from the market price paid by Europa to Gulf for gasoline, that the fact that some part of the payment comes back to Europa indirectly cannot render it a deduction from the purchase price, and that the payments by Europa were contractual, and not voluntary payments, and that in the negotiations the method and quantum of payment was stipulated by Gulf, and Europa had no option in the matter.

20 While I do not entirely disagree with Mr Mahon’s submissions on the facts, from what I have already said it seems to me that the Solicitor-General’s submissions are substantiated by the evidence, and more particularly by the records of what took place from time to time between the parties.

In my opinion in all the contractual dealings on the part of Europa in obtaining gasoline supplies it is clear that it contracted for a concession on posted prices based on the volume of its purchases. In the 1936 arrangements with Caltex, putting aside the small qualitative concession, there was a freight concession throughout. This freight
30 concession was directly related to the quantity of gasoline purchased. In the 1954–55 negotiations with Caltex Mr. Todd was endeavouring to obtain what can broadly be described as a volume discount on purchases, and also a volume discount on freights. To these proposals Caltex would not agree, and it was then he commenced negotiations with Gulf. I accept that Gulf, for the reasons I have already given, was not prepared to agree to a direct discount to a New Zealand purchaser on posted prices. Gulf was anxious to secure the Europa contract. The parties then explored ways and means of giving an indirect concession. No doubt the scheme of incorporating Pan-Eastern
40 in the Bahamas originated with Gulf. No doubt consideration of the refiner’s profit was a basic factor in the provisions of the 1956 series of contracts. I do not think these contracts can be considered individually. They are all allied and form parts of one complete and related arrangement between the two companies and their respective subsidiaries, all under the control of the two principal contracting parties. The recitals in the various contracts show clearly that they are interlinked. The whole basis of the arrangements was that Europa should obtain what might be described as a refund through Pan-

Eastern and A.M.P. of 2.5 cents per gallon on its cost price in New Zealand of gasoline. This is amply confirmed by the correspondence contained in ex. B14 from 1959 onwards, and this was the result attained. The elaborate provisions in regard to the sale of crude, the refining of the crude, and the resale of the heavy products to Gulf, and of the gasoline and gas oil to Europa was, as has been said, a notional arrangement. In fact, it might be described as a fictional arrangement, and the practical method of carrying the contractual provisions into effect was simpler and more direct, but attains the same desired intention. The complete series of contracts and the series of events must be regarded as one whole. It would be quite lacking in reality to regard any of these individually.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

The 1962 and 1964 contracts establish a similar pattern. The indirect concession or concessions to Europa based on the volume of feed stocks it purchased, and which were derived from Gulf supplies of crude. Again a concession, although in this case a direct concession or discount to another overseas subsidiary, P.T.T., formed an essential part of the B.P.-Europa arrangement.

I must accept from the whole series of transactions, and from the records which are before the Court, that on the whole of the evidence, and in this connection I accept substantially the evidence both of Mr Newton and Professor Leeman, the profit of Pan-Eastern which ultimately came to Europa was a price concession directly related to the cost of Europa's purchases of gasoline, and the intermediate companies were merely machinery.

I am satisfied that Gulf did not enter into or intend to enter into any joint refinery venture with Europa or through the instrumentality of Pan-Eastern. Both parties recognised that a refinery through its operations enjoys a profit as a middle man between the supplier of crude oil and the purchaser of the refined products, that this profit was conventionally a substantial one, although it might be affected by the refiner's squeeze, that is, in the event of an increase in cost of crude oil and a decrease in the market prices of the refined products. In my view the parties recognised that participation in what was equivalent to the refiner's profit, even although Europa would not or could not engage itself in refining operations, would be a means of providing Europa with a concession on its cost price of gasoline. Likewise, Gulf was prepared to grant such concession to obtain a market for gasoline of which it was likely to have a surplus, and to obtain a greater volume of production and sale of crude oil. The arrangement was profitable to both companies. I am satisfied that the whole basis of the arrangement was a return guaranteed to Europa by Gulf of 2.5 cents or thereabouts per gallon on gasoline purchased by Europa. This seems to me also to be implicit in Mr Todd's memorandum ex. P., supplied to the Commissioner in March 1963, when he mentions that in the petroleum industry it is well established that much refining is done on a fee basis, and refers to the operations and the earning capacity of the New Zealand Refining Company expected from the New Zealand Refining Company which had not then commenced its operations. In his evidence

he also confirmed that he anticipated a gross refiner's margin through Pan-Eastern of U.S.\$1 per barrel of crude, and a margin to be earned by Pan-Eastern of approximately 52.5 cents per barrel of crude, and that such figures were a realistic expression of the profitability, based upon the current price of crude oil, current cost of processing, and the current values of the respective market yields. He later stated that in a 50-50 participation in result Europa felt that it was proper that there should be some protection against erosion of profit, and the formula provisions were put forward to offer some sort of stability in the overall earnings to be shared. Pan-Eastern, if it had acted as the refiner, would have expected a gross profit of the difference between cost of crude and sale profits, less the refining cost, but in the practical arrangements ultimately made Pan-Eastern did not operate as a refiner. The refining was done by a subsidiary of Gulf, but Pan-Eastern was guaranteed by Gulf the normal refiner's profits. Gulf provided the crude, supplied the refinery, took all profits, kept the records, arranged all accounting, and any functions conducted by Pan-Eastern in the Bahamas were minimal only.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10

20

30

40

The evidence of Mr Smith sets out the position realistically. He stated that Pan-Eastern never at any stage held stocks of oil. Under the processing contract crude oil was delivered to the refinery at the sole risk of Gulf, the crude was processed at the sole risk of Gulf. All products were taken by Gulf at the refinery, Gulf-Iran the gasoline, and Propet the heavier oils. There was no indication in Pan-Eastern records that at any time Pan-Eastern owned any tangible assets. Pan-Eastern did not incur any normal commercial liabilities other than to Gulf, that is, other than for expenses in the Bahamas. When Pan-Eastern required moneys to make dividend payments, the moneys were made available to Pan-Eastern by the Propet Company. The operations in the Bahamas seem to have been limited to the keeping of the statutory records of the company, and the directors' and shareholders' meetings, which were held in the Bahamas, and all necessary accounting records were prepared and kept by Gulf. The whole Pan-Eastern set-up seems to me to have been artificially designed, mainly, it would seem, to provide machinery to produce a result agreed to by Gulf and Europa, resulting in a concession to Europa, based on its purchases from Gulf. It may be, and this may have been for the benefit of both organisations, that Pan-Eastern was also of assistance as a medium of currency exchange, but in my view this does not alter the real position between Europa and Gulf, and the former's purchases.

I therefore find as facts that Pan-Eastern cannot be regarded as a conventional refining venture, as suggested by the objector; that the primary object of the arrangements was to enable Europa to obtain products and later feed stocks at a concession price which would avoid the repercussions or embarrassments of departing from the pattern of posted prices; that the arrangement, while of a commercial nature, was not a refining venture, and the arrangements merely provided for a guaranteed return to Europa directly related to Europa's own purchases, although the estimated anticipated profits or anticipated return was

based on what might have been expected from an alternative joint refining venture. But there was never such a joint refining venture, and Europa was relieved from making the necessary substantial investment in such a venture.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 Accepting this view, Mr Mahon's submission that the whole payments received by Europa through the Pan-Eastern - A.M.P. chain were contractual, and not voluntary payments, seem to me to be beside the point. Also accepting, as Mr Mahon submits, that Europa could buy only at posted prices, this rendered it necessary that to attract Europa's trade Gulf had to and did devise a means to sell at posted prices, but to grant concessions for the ultimate benefit of Europa in the indirect manner adopted.

I must now, in the light of these findings of fact, consider the application of s. 111 to the situation.

In considering Mr White's submissions I must bear in mind certain general principles which are applicable in general in revenue matters. The burden of proof lies with the objector. This applies to questions of fact and, but perhaps to a lesser extent, the inferences of fact to be drawn from the primary facts and the overt acts of the parties.

20 The mere form by which a transaction is carried through is not conclusive as to its nature, either against the Commissioner or the taxpayer; where such form does not truly express the real position, the matter must be looked at as a whole, and the nature, purpose, and substance of it must be regarded: (*Commissioners of Inland Revenue v. Wright* (1927) 1 K. B. 333). The Court must look at the whole nature and substance of the transaction and not be bound by the mere use of words: (*Secretary of State in Council of India v. Scoble* (1903) A.C. 299, 302). The legal effect of the contract as it stands must be ascertained and not what might be the legal effect if the words of the contract must be disregarded and the substance of the matter be considered: (*Duke of Westminster v. I. R. Commissioner* (1934) 19 T.C. 490 at p. 509 per Lord Romer).

A taxpayer is entitled to order his affairs so as to attract the least amount of tax. I quote the classic statement of Lord Atkin in the *Duke of Westminster Case* at p. 511:

40 "It was not, I think, denied, at any rate it is incontrovertible, that the deeds were brought into existence as a device by which the respondent might avoid some of the burden of surtax. I do not use the word 'device' in any sinister sense: for it has to be recognised that the subject, whether poor and humble or wealthy and noble, has the legal right so to dispose of his capital and income as to attract upon himself the least amount of tax. The only function of a court of law is to determine the legal result of his dispositions so far as they affect tax."

The principle is even more graphically stated by Lord Clyde in *Ayrshire Pullman Motor Services v. Commissioner of Inland Revenue* 14 T.C. 754 at p. 763:

"No man in this country is under the smallest obligation, moral or

other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow—and quite rightly—to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue."

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 Once the real nature of the transaction is ascertained, the results for taxation flow only from what is in fact done, and not from the intention of the parties: (*O'Kane & Co. v. Inland Revenue Commissioners* (1922) 12 T.C. 303, 347, per Lord Buckmaster).

In regard to Mr White's two primary submissions, in my opinion they are incontrovertible. The Act is clear. Except as expressly provided, no deduction shall be made in respect of any expenditure. The deduction provided is for expenditure exclusively incurred in the production of the assessable income.

20 In *Ward & Co. v. Commissioner of Taxes* (1923) A.C. 145 where the taxpayer, a brewery company, sought to deduct money spent in advertising to defeat a prohibition poll, their Lordships had to consider the real question whether the expenditure was within the true meaning of s. 86 (1) of the Act of 1916 (now s. 111 of the Act) exclusively incurred in the production of assessable income. In delivering the opinion of the Board, Viscount Cave L.C. at p. 149 says:

30 "The expenditure in question was not necessary for the production of profit, nor was it in fact incurred for that purpose. It was a voluntary expense incurred with a view to influencing public opinion against taking a step which would have depreciated and partly destroyed the profit-bearing thing. The expense may have been wisely undertaken, and may properly find a place, either in the balance sheet or in the profit-and-loss account of the appellants; but this is not enough to take it out of the prohibition in s. 86, sub-s 1 (a) of the Act. For that purpose it must have been incurred for the direct purpose of producing profits."

40 Again in *Aspro Limited v. The Commissioner of Taxes* (1932) A.C. 683 the judgment of their Lordships in the Privy Council upheld the decision of the Magistrate, and the majority of the Court of Appeal who refused to hold it proved that the payment of £10,000 out of profits to the two directors who were also the sole shareholders in the company was an expenditure exclusively incurred in the production of the assessable income.

There in the Court of Appeal Herdman J. (1930) N.Z.L.R. 935 at p. 946) recognised a general principle acted upon in allowing deductions in *Usher & Wiltshire Brewery Ltd. v. Bruce* ((1915) A.C. 433) that deductions are allowed on the grounds that the expenses were incurred not as a matter of charity, but as a matter of commercial expediency, and were obviously a sound commercial outlay. This principle is relied on by Mr Mahon in the present argument.

In this case the Brewery Company were owners or lessors of a

number of licensed premises which they had acquired solely in the course of and for the purpose of their business as brewers, and as a necessary incident to the more profitable carrying on of their said business. The premises were let to tenants, who were tied to purchasing their beers from the company. The company claimed that in the computation of their profits for assessment, expenses, including repairs to the tied houses, fire and life insurance premiums, rates and taxes, and legal and other costs should be allowed. It was held that all the expenses claimed were deductible as being money wholly and exclusively laid out or expended for the purpose of the trade of the brewery. The basic reason for the decision is set out by Lord Sumner at p. 437. There Lord Sumner says:

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10

20

“It is said that such expenditure is not wholly and exclusively expended. Insofar as any questions of law arise here—and it is not clear that there are any—I think that the decision in *Smith v. The Lion Brewery* (1911) A.C. 150 disposes of them. Where the whole and exclusive purpose of the expenditure is the purposes of the expender’s trade, and the object which the expenditure serves is the same, the mere fact that to some extent the expenditure enures to a third party’s benefit, say that of the publican, or that the brewer incidentally obtains some advantage, say in his character of landlord, cannot in law defeat the effect of finding as to the whole and exclusive purpose.”

30

40

It seems to me that this authority is distinguishable on the facts from the present case. There it would seem that the whole and exclusive purpose of the expenditure was for the purposes of the company’s ordinary trading operations. Incidentally a benefit was derived by the publican lessees. Here the cost of the objector’s purchase of gasoline was an expenditure incurred in its ordinary marketing business in New Zealand, but the question at issue is whether the whole amount paid to the Gulf organisation was paid exclusively for the ordinary New Zealand trade of the objector. No discount was given on the amount charged by the Gulf Company, but a benefit by way of a discount or concession directly related to Europa’s purchases was by virtue of the allied contracts obtained by Europa’s subsidiary A.M.P. The position can be regarded in another way. By subscribing to the capital of Pan-Eastern, Europa through its wholly owned subsidiary A.M.P. acquired a right to a half share in the profits of Pan-Eastern. Pan-Eastern acquired such profits directly by payments to it by Gulf, payments agreed between Gulf and Europa, as a refund or discount on the amount paid by Europa to Gulf-Iran for the gasoline Europa purchased. The rights acquired by Europa and the profits accruing to A.M.P. flowed from the combined effect of the 1956 series of contracts. By virtue of these contracts and the purchases and payments thereunder made by Europa to Gulf, Europa through A.M.P. obtained the power to enjoy the sums paid by way of a concession by Gulf to Pan-Eastern. In my view here there were two purposes attached to the expenditure, first, the ordinary trading gain to Europa, but equally important, the profit by way of concession to its wholly owned subsidiary. The purpose of

the whole series of contracts entered into in 1956 was a dual purpose. It cannot in my opinion be said that the purpose of the expenditure was exclusively for the purpose of the expender's ordinary trade.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 The second purpose, the profit to be obtained by A.M.P., is not by any means minimal or insignificant. In fact, during the years of operation it amounted to 25 percent or more of the amount paid by Europa for gasoline supplied to it. The same considerations seem to me to apply to the 1962 and 1964 series of contracts, and also to the contract between B.P. and P.T.T., again directly allied to Europa's contract with B.P.'s New Zealand subsidiary.

20 In the third place the Solicitor-General submits that while the Commissioner may not challenge the wisdom of an expenditure, he may question its purpose, and that these two matters are distinct. In other words, the Commissioner is not entitled to ask whether the taxpayer should have incurred the expenditure, but he may ask why did the taxpayer incur the expenditure. This is implicit in the judgments of the High Court of Australia in *Ron Pibon Tin No Liability and Tong Kah Compound No Liability v. The Federal Commissioner of Taxation* ((1948-49) 78 C.L.R. 47). There, before the outbreak of the war, the taxpayer carried on in Siam and Malaya tin mining operations from which it derived a substantial income. During the occupation by the Japanese it derived no income from mining, but it maintained its administrative structure in Australia. It incurred expenditure, such as directors' fees and expenses of management in the central administration of its affairs, and in making allowances to the widows and families of managers who were prisoners of the Japanese, but whose widows and families were living in Australia. It was held that only a small part of the total expenditure was referable to the gain of assessable income from investments, and the Commissioner allowed as a deduction only 30 a small percentage from the gross income. The only deductions allowable were losses and outgoings to the extent to which they were necessarily incurred in carrying on a business for the purpose of gaining or producing such income. In the judgment of the Court at p. 60 it is said:

40 "It is important not to confuse the question how much of the actual expenditure of the taxpayer is attributable to the gaining of assessable income with the question how much would a prudent investor have expended in gaining the assessable income. The actual expenditure in gaining the assessable income if and when ascertained must be accepted. The problem is to ascertain it by an apportionment. It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent."

The same matter was considered in the *Aspro Case* (1930) N.Z.L.R. 935 in the New Zealand Court of Appeal, by Justice Herdman, where he said at p. 946:

"Strong as are the inquisitorial powers vested in the taxing authorities, they, of course, cannot dictate to a taxpayer as to how

he shall carry on his business. As was said by Ferguson J., in *Toohey's Ltd. v. Commissioner of Taxes*, 'It is nothing to the point that if he had been more capable, more experienced or more prudent, he might have cut down his expenses. The question is what he did in fact spend on his business. If he chooses to employ a hundred men where twenty would have been ample, that is his own affair. Of course it may still be a matter for inquiry whether these men were really employed in the business, or were merely put on the pay-roll as a device to swell the apparent expenses of the business; but that is another matter.' *Johnson Bros. and Co. v. Commissioner of Inland Revenue* is a case which has an important bearing upon the present one, because in it the Commissioners conducted an investigation into the relations which existed between a father and his sons in carrying on a business, and because it was held that the Inland Revenue Commissioners were entitled to say what amount of the share of profits paid to the sons should be allowed to be deducted as their remuneration for time and labour expended by them in the business."

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10

20

The authority of *Johnson Bros. v. Commissioner of Inland Revenue* (1919) 2 K. B. 717 referred to by Mr Justice Herdman is also accepted in the judgment of the Privy Council in the same case.

The only other authority to which a need refer on this aspect is *Shipbuilders v. Commissioner of Inland Revenue* (1968) N.Z.L.R. 885. There in his judgment in the Court of Appeal Turner J. says that "in deciding whether an expenditure is incurred exclusively in the production of the assessable income it is usual to examine the purpose for which such expenditure was made". And in my own judgment in the same case at p. 912 I place emphasis on the dominant purpose of the appellant in making certain payments.

30

Mr Mahon has referred to *Cecil Bros. Pty. Ltd. v. Federal Commissioner of Taxes* 1962-64 111 C.L.R. 430. I propose to refer to this authority at a later stage, but on this aspect it seems to me that the case was decided on the same principles as the *Ron Pibon Tin* authority. In his judgment at first instance Owen J. says this:

40

"The fact that the taxpayer paid more for its purchases than it would have paid had it dealt direct with the manufacturers or wholesalers in order that Breckler Pty. Ltd. might make a profit out of the transaction does not in my opinion prevent the amount which it in fact paid for the purposes of s. 51 (1) from being regarded as an outgoing incurred in gaining its assessable income. It seems to me that the contention really is that the taxpayer paid more for its goods than it should have. But 'it is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent'."

The next submission of the Solicitor-General is that expenditure may be apportionable where it is incurred for two or more purposes, deduction being allowed in respect of that part which is exclusively incurred in the production of assessable income. There is ample authority in support of this proposition. Previously under the 1900 Land and

Income Tax Assessment Act the requirement was that the expenditure must be wholly and exclusively for the purposes of the business, and it would appear that expenditure was not apportionable (see *Commissioner of Taxes v. Ballinger & Co.* (1903) 23 N.Z.L.R. 188). But the word "wholly" is omitted from the corresponding provisions of the 1923 and 1954 Acts, and it is no longer necessary that the whole of the expenditure should be incurred in the production of the assessable income. Such part of it as is exclusively incurred for that purpose appears to be now the authorised deduction. In *Public Trustee v. Commissioner of Taxes* (1938) N.Z.L.R. 436 at p. 456, where interest was claimed as a deduction on money borrowed and employed in the production of both assessable and non-assessable income, Sir Michael Myers C.J. answered the question at issue that as a matter of law part of the interest is deductible, that is, the portion of interest payable on money borrowed and employed in the production of assessable income, and that the quantum of such a deduction is a matter of fact and is for the Commissioner to decide. The judgment of Mr Justice Callan at p. 458 is to the same effect.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

Other examples of apportionment between expenditure exclusively used for the production of income, and expenditure not so used, are the *Ron Pibon Case*, to which I have referred, the *Aspro Case*, where there was an apportionment, and *Omihi Lime Co. Ltd. v. Commissioner of Inland Revenue* (1964) N.Z.L.R. 731. There Wilson J. decided that costs of the unsuccessful claim for damages in regard to the portions of the claim relating exclusively to income were deductible as portion of the loss on the income claimed, but that the costs relating to issues that were common to both capital and income were not deductible.

The last submission of the Solicitor-General is in effect a submission on the facts. He says that applying the law to the facts the expenditure by Europa on petroleum supplies obtained from Gulf and B.P. was incurred for two purposes, (1) for the purpose of securing supplies for Europa and thereby producing assessable income of Europa, and (2) for the purpose of producing a return to Europa through Pan-Eastern and P.T.T. respectively, and such part of the expenditure is not deductible. Again the issue is largely dependent on the purpose of the expenditure, such purpose to be deduced from the happenings which have taken place. I think the same consideration which Lord Pearce adopted in delivering the opinion of the Privy Council in *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia* ((1966) A.C. 224, 264) indicates the correct approach. He said:

"The solution to the problem is not to be found by any rigid test or description. It is to be derived from many aspects, the whole set of circumstances, some of which may point in one direction, some in the other. One consideration may point so clearly that it dominates over vaguer indications in the contrary direction. It is a common-sense appreciation of all the guiding features which must provide the ultimate answer."

In the *Regent Oil Ltd. v. Inland Revenue Commissioners* (1966)

A.C. 295 Lord Reid refers to the further source of difficulty, which has been a tendency in some cases to treat some one criterion as paramount, and to press it to its logical conclusion, without proper regard to other factors in the case. He adopts with approval a statement of Lord Clyde:

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 “So it is not surprising that no one test or principle or rule of thumb is paramount. The question is wholly a question of law for the Court, but it is a question which must be answered in the light of all the circumstances which it is reasonable to take into account, and the weight which must be given to a particular circumstance, and in a particular case, must depend rather on common sense than on strict application of any single legal principle.”

20 Here, as I have already said, while the parties in negotiating the 1956 contract were at arm's length, the common purpose was to provide Europa with a concession other than one in the form of an ordinary trade discount, and other than one which would have repercussions in the normal trading of either party, Gulf or Europa. With this object in mind Gulf was not prepared to grant Europa an ordinary trade discount on its purchases of gasoline. It insisted on the supply contract being based on posted prices. On the other hand, Gulf recognised that Europa's custom was highly profitable to Gulf if it could secure a long-term contract with Europa. Another method had to be found to provide a substantial concession or discount for the benefit of Europa. This was accomplished through the Pan-Eastern-A.M.P. arrangements, and the processing and freight contracts. The substantial discount on posted prices ultimately came to Europa by the indirect route. The profits derived by Pan-Eastern were not derived from any commercial activity or effort on the part of Pan-Eastern. In so far as Pan-Eastern and A.M.P. were concerned, payment was in effect
30 gratuitous. But the inducement to Europa to agree to pay posted prices consisted of three benefits. First, an assured supply of gasoline over a long-term period, second such supply at posted prices, and third the benefit of the returns through the Pan-Eastern-A.M.P. link of the concession, directly related to the quantity of gasoline purchased by Europa. The payment at posted prices, in my opinion, was in consideration of the dual benefit, the supply at posted prices and the indirect discount. If the discount had been granted direct to Europa, the net price paid would have been an expenditure exclusively incurred for its normal trading operations, and would have been deductible in
40 full. The price paid correlated with the Pan-Eastern concessions cannot, in my opinion, be regarded as exclusively incurred in Europa's ordinary trading operations. It was incurred for the dual purpose, and in my opinion the Commissioner was entitled to apportion the expenditure between the two purposes. This he has done by deducting from the expenditure a sum equivalent to the amount of A.M.P.'s share of the concession received through Pan-Eastern. As I have indicated earlier, the whole series of contracts entered into in 1956 cannot be looked at individually, but are correlated, and are all constituent parts of one complete bargain. The same considerations apply

to the 1962 and 1964 series of contracts, and the contract entered into between Europa and the B.P. organisation in 1961. In the last instance it is even more clear that the payment which B.P. agreed to pay to P.T.T. was a commission or discount to Europa on the cost of its purchases.

In the Supreme
Court No. 5
Judgment of
McGregor J.
8 May 1969
—continued

In my opinion the present case is the converse of the *B.P. case* (supra). There one of the courses adopted by B.P. to reorganise marketing and distribution in a section of the trade was to join with three other oil companies in order to secure sites where their products might in common be sold to the public. In pursuance of this plan B.P. promised to pay a sum of money, in the agreement called “develop allowance” as part of the consideration for the undertaking by the service station proprietor to deal exclusively in the brands of motor spirit approved by B.P. for a fixed number of years. The gallonage factor was a matter for consideration in deciding what sum should be regarded as the maximum amount which might in the particular case be laid out, but it was not the determining factor. It was decided in the Privy Council on the balance of all the relevant considerations the scales inclined in favour of the expenditure being of a revenue and not a capital nature. The matter was dealt with under the slightly different terms of the Australian statutes, and seems to have been decided on balance, some of the factors being that taking a broad view of the general operation it was made to meet a continuous demand in the trade, and considering many aspects dealing with payments made to customers to secure their custom, the nature of the benefits sought and obtained by B.P. pointed to the expenditure being revenue, rather than capital, and that in considering the manner in which the advantage was to be used, the benefit was to be used in the continuous and recurrent struggle to get orders and sell petrol, and the agreements were the basis of the orders, and made the orders inevitable and merged in and became part of the ordinary process of selling. It seems to me that this might be applicable if I were dealing with the question whether the concessions granted by Gulf were a revenue expenditure, but it does not seem to me to be applicable to the question whether the whole of the purchase cost in New Zealand to Europa was exclusively a revenue expenditure in its New Zealand trading, irrespective of consideration of the other benefits Europa was in fact obtaining in making payments on the basis of posted prices.

In regard to the *Cecil Bros. Pty. Ltd.* decision (supra) I also think it is distinguishable from the matter which I am at present considering. There the main question at issue was whether the dealings between the taxpayer and the company from whom it was purchasing supplies were sham transactions. It was held that they were genuine transactions, and in no way fictitious or unreal. It was further held that s. 260 of the Australian Act, equivalent to our s. 108, could not apply to defeat or reduce any deduction otherwise properly allowable under s. 51, our s. 111. There the Commissioner argued that by virtue of s. 51 the full outgoing should not be regarded as an outgoing necessarily incurred in gaining or producing the taxpayer’s assessable income.

Owen J. at first instance rejected this submission, and with this rejection Menzies J. agreed in his judgment on appeal. There the benefit of the whole price actually paid for goods pursuant to contracts with an outside company went to the outside company, and it was held that the validity of the agreements remained unaffected. It was an outside arrangement pursuant to contracts, the validity of which remained unaffected. Legal efficacy had to be granted to the agreements. Here, however, I am concerned not with one agreement with an independent party, but related agreements between vendor and purchaser which provide, not independently, but dependent on each other, the concession to the purchaser. Again in *The Timaru Herald Co. Ltd. v. Commissioner of Taxes* (1938) N.Z.L.R. 978 it was held (see Myers C. J. at pp. 997 and 998) that the two businesses with which the court was concerned were independent businesses, and the appellant had no control over the business and operation of the company to which payments were made. It followed that the payments made to the independent company were regarded as expenditure exclusively incurred in the production of the assessable income. The agreement was a bona fide one, whereby by virtue of the payments the appellant was enabled to earn or ensure larger profits for itself, and on that account the payments were part of its business outlay or expenditure. I do not think the like considerations apply here.

I therefore reject the submission that the whole of the purchase price of Europa was expended exclusively in the production of its assessable income, and I also consider that the Commissioner was entitled to apportion the company's expenditure fairly in part attributable to the production of assessable income in New Zealand, and in part attributable to the second purpose, the concession to be obtained through Pan-Eastern and A.M.P.

Mr Mahon has raised a subsidiary question relating to estoppel, which I should deal with at this juncture. He submits that the decision of the Commissioner notified to the objector in a letter dated 27 June 1963 was the exercise of a statutory discretion conferred by ss. 22 and 111 of the Act, and may not be reversed by the Commissioner. This submission can operate only in respect of the years up to and including 31 March 1964.

The text of the letter of 27 June 1963 is as follows:

“Bryan Todd Esq.,
110-116 Courtenay Place,
Wellington C.3.
Dear Mr Todd,

You will recall that in March last we discussed the effect on New Zealand taxation of a number of contracts between Europa Oil (N.Z.) Ltd., Gulf Oil Corporation and Pan-Eastern Refining Co. Ltd. I advised then that I would refer the agreements to the Solicitor General for consideration of their validity under New Zealand legislation.

I have now received his advice, with which I am in agreement, and propose to take no action to disturb the present position.

The further question of my obligation to disclose the information to the American revenue authorities under the double tax agreement with the U.S.A. will be considered when the investigation is complete.

I am arranging for Mr Tyler to return to you the copies of contracts which you made available to him.

Yours faithfully,

(F. R. MACKEN)

Commissioner of Inland Revenue”

10

Mr Todd answered as follows:

“CONFIDENTIAL

3rd July 1963.

F. R. Macken Esq.,
Commissioner of Inland Revenue,
Inland Revenue Department,
P.O. Box 2198,
Wellington.

Dear Mr Macken,

20

I acknowledge receipt of your letter of the 27th June. I am very pleased to have your confirmation that the Solicitor General and yourself are satisfied as to the contracts and that the income generated from the contracts with the Pan-Eastern Refining Company Limited does not directly or indirectly constitute assessable income in New Zealand as had been suggested.

30

Regarding the disclosure to the American revenue authorities, I have no doubt that there is no reason on the part of the Gulf Oil Corporation why the American authorities should not be formally advised by you. However, as I indicated to you we are concerned lest any of the international oil companies should consider that dealings with Europa Oil (N.Z.) Ltd. would be of a less confidential nature than with other companies who are domiciled overseas. I therefore appreciate the time interval which will allow me to advise the Gulf Oil Corporation of the discussions which have taken place with you here in connection with the contracts.

Yours sincerely,

BRYAN TODD”

40

Mr Mahon concedes that an assessment may be amended if there has been non-disclosure by the taxpayer of information which he is under a duty to communicate, but submits that during the investigation, prior to the letter of 27 June 1963, the question at issue was not a reconsideration of a return, but an inquiry on behalf of the Commissioner with the purpose of obtaining information whether he should review the earlier assessments.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

Mr Mahon further submits that the decision notified in the letter of 27 June 1963 was acted upon by Europa to its detriment, and the Commissioner is now precluded from contending that the decision can be reversed. The detriment to Europa is said to be that it subsequently used funds, which are now said to be taxable, for distribution to its shareholder that its shareholders paid dividend tax thereon, and that Europa entered into the 1964 contract, which in its terms is in many respects similar to the 1956 contracts, relying on the Commissioner's decision. Europa itself has since 1963 been able to earn money to pay tax assessed, but detriment is suffered in that Europa and A.M.P. have been deprived of funds derived from earnings with which to meet the assessments.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

The investigation by Mr Tyler, the inspector of the department, into the tax affairs of Europa began early in February 1963, and he had various interviews with Mr Smith, the treasurer of Europa Oil, and also a director of that company and secretary of A.M.P. The first interview between Mr Smith and Mr Tyler seems to have been on 13 February 1963, and Mr Tyler then ascertained the registration in the Bahamas of Pan-Eastern Refining Company, in which the shareholding was owned half by Europa's subsidiary and half by Gulf Oil, and it appears that he obtained some information that the profits of Pan-Eastern Refining from 1958 to 1962 approximated £625,000. A further interview with Mr Todd and Dr Lau, a taxation consultant of Europa, took place on 21 February. Mr Tyler then obtained information indicating that the accumulated profits of Europa's half share in Pan-Eastern since 1 January 1957 had amounted to £2,405,000. It seems clear both from notes made by Mr Tyler and also from notes made by Mr Smith, that Mr Todd emphasised that Gulf sold crude to Pan-Eastern at posted prices, and bought back refined products at posted prices, and that the parties were at arm's length; that transactions were made on the basis of the international market, and the Refining Company paid a standard refining fee of 47.5 cents a barrel, and there was no hidden benefit received by it. It would seem that just prior to the interview with Mr Todd, there had been another interview with Mr Smith, and the 1956 series of contracts, including the supply contract, the processing contract, and the freight contract, had been perused by Mr Tyler in the Europa office, but Mr Tyler had not been authorised to make copies. Right from the outset it is clear that Mr Tyler emphasised that he required information for the purpose of deciding whether in regard to Europa's purchases from Gulf it was receiving by some means a discount from Gulf.

There was a further interview with Mr Todd, at which Mr Smith was present, on 21 March, and there does not seem to be any dispute that Mr Todd maintained that no discounts were available in the international oil trade.

On 20 March Mr Todd forwarded to the Commissioner information which he considered necessary to meet Mr Tyler's inquiries. This contains some general information in regard to the oil industry and the refining business, and Europa's marketing operations in New Zealand.

He asserts that Pan-Eastern operates on a conventional refiner's market, that is, the difference between the cost of crude oil and the sales value of the products, less the cost of processing, and refers to the formula contained in the 1956 supply contract as being included for the purpose of cushioning the possible effect of substantial price fluctuations.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

In my opinion it is clear that the directors of Europe possessed a considerable amount of relevant information which was not disclosed to Mr Tyler or to the Commissioner prior to the latter's letter of 27 June 1963. In the first place, when Mr Tyler's February-March discussions with Mr Smith and Mr Todd were taking place, no information was given in regard to the 1962 series of contracts, which had very shortly before been completed with the Gulf group. These were certainly of importance. Furthermore, no mention was made of the B.P. contracts with Europa and Pacific Trading Company, entered into in 1962. No mention seems to have been made until after April 1963 in regard to the 1936 Caltex contracts, and details in regard to these contracts do not seem to have been obtained by the Commissioner until after his letter. The Europa and P.T.T. contracts with B.P. were finally produced to the Commissioner on 15 December 1964, and later, on 11 May 1965 the Caltex 1936 contracts and the Gulf 1964 contracts, were supplied to the Commissioner. From the 1963 interviews, in my opinion, it would be accepted by the Commissioner that the profit obtained by Pan-Eastern was derived on the basis of the formula contained in the 1956 contract, but there was in existence, commencing from January 1958, the amended variations contained in the correspondence between Europa and Gulf Oil Corporation, comprised in ex. B14 of the case stated. As I have said earlier, this resulted in a virtually guaranteed profit to Pan-Eastern of 2.5 cents per gallon on Europa's supply of gasoline. This correspondence seems to have been obtained by the Commissioner as late as 14 June 1966 in reply to a letter from the Commissioner to Europa asking confirmation that the copies of contracts he had received included all contracts or other documents relating to this matter to which the Todd Group of companies and/or the Gulf Group of Companies and/or Pan-Eastern Refining Company Ltd. and/or any associate company were parties.

On some matters of detail in regard to what transpired in the 1963 interviews there is some discrepancy between the evidence of Mr Smith and that of Mr Tyler. I think this is perfectly understandable, as Mr Tyler was on an exploratory expedition, and Mr Smith himself had only the general picture of the set-up, and was not conversant with the purposes of the arrangements or what had transpired in the negotiations for the contracts. I think, however, Mr Tyler's summary dated 20 March 1963, ex. 22, for the Commissioner, contains an adequate summary of the conversations as he understood them, and of the information he had received.

There is one matter of importance. It seems beyond dispute that in March 1963 Mr Smith showed some document to Mr Tyler in the nature of a Pan-Eastern balance sheet for the year ending 31 December 1961. Mr Smith has stated that attached to the accounts for the year

ended 31 March 1961 were auditors' statements by Price Waterhouse & Co., the Pittsburg branch of which firm were the auditors of Pan-Eastern. While I agree that Mr Tyler was able to peruse some document purporting to be a balance sheet of Pan-Eastern as at 31 December 1961, I am certain he did not receive the audited balance sheet ex.AA, nor the statement of income attached thereto. Mr Tyler at the outset of his investigations informed both Mr Smith and Mr Todd that he suspected some discount arrangements, and the term "volume discounts" seems to have cropped up in conversations at an early date. The audited copy of the 1961 accounts ex.AA in the statement of income attached shows clearly volume discounts relating to 1960 purchases, and relating to 1961 purchases. This is shown as a volume discount on the crude purchases of Pan-Eastern. Price Waterhouse's note to the financial statements states clearly that voluntary price reductions on crude oil had been granted to the company by Gulf-Iran Company prior to 1961, the effect of such price reductions being recorded in the year subsequent to the year of sale. However, price reductions relating to crude oil purchases in 1961, as well as in 1960, had been reflected in the 1961 accounts. This was the type of information Mr Tyler was seeking. I am certain that if he had been shown a document of this nature he would have seized on it with avidity. It is noteworthy also that neither Pan-Eastern balance sheet of 31 December 1959, nor the balance sheet of 31 December 1960, gives any indication of volume discounts. They merely disclose the annual profit and the accumulated profit. The accounts from 1961 on in the annual statement of income do show the volume discounts. These were not supplied to the Commissioner until March 1967. I am satisfied that while Mr Tyler in March 1963 may have seen the 1961 balance sheet alone, he saw neither the attached statement of income nor the auditor's note thereon. The copy of the 1961 statement of income given to the Commissioner in 1967 also omits the auditor's statement and the note on the balance sheet that the note on the financial statements is an integral part of the statements and should be read in conjunction with it. Although it may well have been unintentional, I am satisfied that the non-disclosure of the matters to which I have referred was of material importance, and the Commissioner was induced by his lack of information to write the letter of 27 June 1963. I take this view apart altogether from the question whether in any event a letter of this nature was an exercise of a discretion, and the Commissioner was then debarred from re-opening the assessment.

40 In one other matter there seems to have been at least a misunderstanding in the discussions between Mr Tyler and Mr Todd. Discussions took place on the question whether there were price discounts available to purchasers of products on long-term contracts on posted prices. Mr Tyler was considering the matter generally, and Mr Todd assured him that posted prices for all petroleum products other than crude correctly reflected the existing market, and it was just not possible to get a discount on a long-term contract, although it was possible to obtain such discounts on spot sales from sellers who temporarily had excess of product which they were finding hard to quit. Mr Todd states that

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

in making this categorical statement he was expressing his view based on the knowledge of the trade in regard to 1956, and was not adverting to the position in 1963, by which time a practice had grown up of granting discounts. Although the parties were primarily considering the 1956 position, I think Mr Tyler's inquiries were intended to cover, and did cover, a wider field, and in this respect the information obtained did not reflect entirely the true position.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 Mr Mahon has emphasised in his submission that the Commissioner's letter of 27 June 1963 constituted an exercise of a statutory discretion conferred on the Commissioner by s. 111 of the Act, and he has referred to two authorities, *Wood Bros. v. Commissioner of Taxes* 11 G.L.R. 484, and *Robinson v. Commissioner of Inland Revenue* (1957) 7 A.N.Z. I.T.R. 161. In the former case Denniston J. was concerned with a question of depreciation allowance under s. 87 of the Land and Income Tax Act Assessment Act 1908 (now s. 113 (1) of the 1954 Act) which provides that where depreciation cannot be made good by repair, the Commissioner may, subject to s. 113 (a) and s. 117 of the Act, allow such deduction as he thinks just. Mr Justice Denniston held that the Commissioner with sufficient particulars to enable him to
20 make such allowances had judicially exercised his discretion, and could not recover income tax alleged to have been short paid in past years. In my view this case is distinguishable in two respects. In the first place the Commissioner when exercising his discretion had sufficient particulars in regard to the allowance claimed, and in effect had full knowledge. In any event, accepting that s. 113 empowers the Commissioner to exercise a discretion, I do not think the position is the same in regard to s. 111. The decision in *Wood Bros. Case* is distinguished by Mr Justice F. B. Adams in *Robinson's Case* where he remarks that even accepting the principle that the Commissioner may
30 in some circumstances be estopped from reviewing an exercise of his discretion, he was not satisfied in the *Robinson Case* that there was any previous exercise of discretion. Secondly, in *Robinson's Case*, and I take the same view here, Mr Justice Adams thought that the Commissioner did not know what the appellant was doing, and was not sufficiently informed to enable him to exercise his discretion, and never in fact directed his mind, or was called upon to direct his mind, to the exercise of the discretion.

40 Section 22 of the Act empowers the Commissioner from time to time and at any time to make all such alterations in or additions to an assessment as he thinks necessary in order to ensure the correctness thereof, notwithstanding that tax already assessed may have been paid. Section 111 is clear that only any expenditure exclusively incurred in the production of the assessable income for any income year may be deducted from the total income derived for that year. I accept Mr Richardson's submission that liability for income tax is imposed by the statute itself, and in his assessing function the Commissioner merely quantifies an existing liability. In *Reckitt & Colman (New Zealand) Limited v. Taxation Board of Review & Anor.* (1966) N.Z.L.R. 1032 at p. 1045,

McCarthy J. considers the general scheme of the legislation. He there says:

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 “I agree with Mr Richardson that the general scheme of the Acts is as follows. Liability for tax is imposed by the charging sections, ss. 77 to 79 of the Land and Income Tax Act 1954. The Commissioner acts in the quantification of the amount due, but it is the Act itself which imposes independently, the obligation to pay. The assessment and objection procedures are merely machinery for quantifying: they do not cast liability. If the taxpayer does not object to the Commissioner’s assessment within the time stated in the assessment (not being less than 14 days), the amount assessed by the Commissioner becomes incontestably fixed, subject to the Commissioner’s express discretionary power to accept a late objection (s. 29 (2)) and to his additional power to grant relief in the case of serious hardship (s. 226). If the Commissioner does not allow an objection received by him, the objector has a period of two months in which to require the objection to be heard by a Board of Review established under the Inland Revenue Department Amendment Act 1960. Again, 20 if he fails to take that step within the period mentioned, the amount stated in the Commissioner’s assessment is at that point of time fixed finally and incontestably. If he does require the objection to be heard by the Board of Review and the Board later rejects it, he then has a right of appeal to the Supreme Court; but he must give a notice of appeal within 30 days (s. 29 Inland Revenue Department Amendment Act 1960). Once the time limit of 30 days has elapsed, his right of appeal is gone, and at that point the assessment, or so much thereof as has been upheld by the Board, becomes unchallengeable. No express power is given the Commissioner to waive this time limit. And so from that point on the taxpayer has no rights. He must pay 30 unless the Commissioner decided to amend his assessment—and thereby create a fresh cycle of rights of objection and appeal—or, in appropriate cases, to grant relief from payment of the full amount.”

To the same effect are the remarks of Turner J. in *Elmiger v. Commissioner of Inland Revenue* (1967) N.Z.L.R. 161 at p. 184, where he refers to s. 77 of the Act.

40 In my opinion, the Commissioner cannot waive in particular cases liability for payment of tax. He is under a duty to assess the tax payable, the Act itself imposing independently the obligation to pay. In my opinion the objector in the instant matter cannot rely on any principle of estoppel for the reasons, first, that the Commissioner here was not exercising any discretion when in 1963 he decided that there would then be no reassessment, and secondly, the Commissioner was deprived of relevant information which was in the hands of the objector. Further, the Commissioner could not bind himself in regard to his future actions. The only bar to an amendment of the assessment is the time limit of 4 years provided by s. 24 of the Act. I do not think that ss. 110 and 111 confer on the Commissioner any discretion.

On this aspect of the case there is a further principle which must be considered. “An estoppel must fail, if its establishment must result

in an illegality, so it cannot be set up if its establishment results in preventing the performance of a statutory duty." *Spencer-Bower & Turner, Estoppel by Misrepresentation* 2nd Edit. pp. 140, 141. The authority for this principle is contained in the judgment of Lord Maugham in *Maritime Electric Co. Ltd. v. General Dairies Ltd.* (1937) A.C. 610 at pp. 619 and 620 as follows:

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 "The Act imposed a duty on the electric company to charge and on the dairy company to pay, at scheduled rates, for *all* electric current supplied by the one and used by the other, during the twenty-nine months in question. The specific question for determination here is, can the duty so cast by statute upon both parties to this action be defeated or avoided by a mere mistake in the computation of accounts? In the view of their Lordships the answer to this question in the case of such a statute as is now under consideration must be in the negative. The sections of the Public Utilities Act which are here in question are sections enacted for the benefit of a section of the public, that is, on grounds of public policy in a general sense. In such a case—and their Lordships do not propose to express any opinion as to statutes which are not within this category—where, as here, the statute imposes a duty of a positive kind, not avoidable by the performance of any formality, for the doing of the very act which the plaintiff seeks to do, it is not open to the defendant to set up an estoppel to prevent it. This conclusion must follow from the circumstance that an estoppel is only a rule of evidence which under certain special circumstances can be invoked by a party to an action; it cannot therefore avail in such a case to release the plaintiff from an obligation to obey such a statute, nor can it enable the defendant to escape from a statutory obligation of such a kind on his part. It is immaterial whether the obligation is onerous or otherwise to the party suing. The duty of each party is to obey the law. To hold, as the Supreme Court has done, that in such a case estoppel is not precluded, since, if it is admitted, the statute is not evaded, appears to their Lordships, with respect, to approach the problem from the wrong direction; the court should first of all determine the nature of the obligation imposed by the statute, and then consider whether the admission of an estoppel would nullify the statutory provision."

20

30

40 In my opinion the Commissioner was here under a duty to assess the objector for tax in accordance with the provisions of the Act, and again it is not a case where he was exercising a statutory discretion. In this respect the case is distinguishable from *Taranaki Power Board v. Puketapu 3A Block Incorporated* (1958) N.Z.L.R. 297. There North J. had to consider s. 82 (o) of the Electric Power Boards Act 1925 which authorises power boards to sell electricity to any local authority or consumers generally within the district in bulk or otherwise on such terms and conditions as it deems fit. Owing to a defect in the meters, the Board had charged the defendant for less supply than had actually been supplied. North J. held that no offence or breach of a statutory prohibition was committed by the board in supplying electricity to

the defendants at the amount charged in the monthly statements, and that there were, therefore, no obligations imposed by the provisions of the Electric Power Boards Act 1925, and the regulations made thereunder, either on the board or on the defendant, which prevented the plea of estoppel being raised. The defendant had been led to believe that the monthly accounts were correct, and in so acting on them the defendant did so to its damage.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 In making the amended assessments the Commissioner has also relied on s. 108 of the Act, that the contracts, agreements, or arrange-
ments made or entered into are absolutely void in so far as directly or indirectly they have or purport to have the purpose or effect of in any way altering the incidence of income tax or relieving Europa from its liability to pay income tax. Mr Richardson points out that there are three ingredients of s. 108, (1) whether there is a contract, agreement or arrangement, (2) whether a purpose or effect of the contract, agreement, or arrangement was to alter the incidence of income tax or relieve the objector from liability to pay tax, and (3) what is the result on the facts of the case? Is a taxable situation disclosed?

20 I have endeavoured carefully to consider the numerous authorities, both in Australia and in New Zealand, in regard to the principles which should be applied in a consideration of the application of s. 108. In considering the Australian authorities it must always be remembered that the Australian section is worded somewhat differently from the New Zealand section, although they are in pari materia. The New Zealand section avoids every contract in so far as directly or indirectly it has, or purports to have, the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax. The Australia section (s. 260) avoids as against the
30 Commissioner every contract so far as it has or purports to have the purpose or effect of in any way directly or indirectly (a) altering the incidence of any income tax, (b) relieving any person from liability to pay any income tax, (c) defeating, evading, or avoiding any duty or liability imposed on any person by the Act, (d) preventing the operation of the Act in any respect.

I do not need to consider the numerous dicta in the various cases. The two authorities which are relevant are *Newton v. Commissioner of Taxation of the Commonwealth of Australia* (1958) A.C. 450, and the judgment of the New Zealand Court of Appeal in *Elmiger & Another v. Commissioner of Inland Revenue* (1967) N.Z.L.R. 161. The effect of the judgment of the Court in the *Newton Case* is conveniently summarised in the judgment of North P. in the *Elmiger Case* at p. 177, and Wild C. J. has conveniently extracted the same principles, but adapted them to the language of the New Zealand provision in *Marx v. Commissioner of Inland Revenue* (26 November 1968, not yet reported). He sets out the following principles which are the same as those summarised in the judgment of North P. in *Elmiger Case*:
40

“1. The section strikes at real transactions and not merely at shams: *Federal Commissioner of Taxation v. Newton* (1957) 96 C.L.R. 578, 646 and 655. (Woodhouse J’s adoption of this view in the

Elmiger Case ((1966) N.Z.L.R. at p. 689) was approved by North P. ((1967) N.Z.L.R. at p. 179.)

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

“2. The word ‘arrangement’ in the section is apt to describe something less than a binding contract. It comprehends ‘not only the initial plan but also all the transactions by which it is carried into effect’. (*Newton v. Commissioner of Taxation* 1958 A.C. 450, 465.)

10 “3. The word ‘purpose’ relates not to the motives of the parties but to the end in view. The word ‘effect’ means the end accomplished. The whole set of words denotes concerted action to the end of altering the incidence of income tax or effecting relief from income tax. *ibid.* 465.)

“4. The purpose and effect is ascertained by examining the overt acts by which the arrangement was implemented. If on that examination it can be predicated that it was so implemented so as to alter the incidence of or bring about relief from tax then it is within the section (*ibid.* 466) even if there were other purposes as well. It is enough if that was one of the purposes. (*ibid.* 467.)

20 “5. If it cannot be predicated that the arrangement was implemented in that way so as to alter the incidence of or bring about relief from tax, but it is capable of explanation by reference to ordinary business or family dealing without necessarily being labelled as a means of altering the incidence of or relief from tax, then it is not caught by the section. (*ibid.* 466.)”

I would add this, that the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only with the means which they employ to do it. It affects every contract or arrangement which has the purpose or effect of in any way altering the incidence of income tax or relieving any person from his liability to pay it: (See North P. *Elmiger Case* pp. 177, 178.) As Turner
30 J. has stated in the *Elmiger Case* at p. 187:

“To bring the arrangement within the section you must be able to predicate the arrangement—by looking at the overt acts by which it was implemented—that it was implemented in that particular way so as to relieve the taxpayer from liability to pay income tax. If this cannot be predicated, but it must be acknowledged that the transactions are capable of explanation by reference to ordinary business or family dealings without necessity of being labelled as a means of relieving the taxpayer from liability for tax, then the arrangement will not come within the section.”

40 In *Mangin v. Commissioner of Inland Revenue* (4 February 1969, as yet unreported) Wilson J. has remarked:

“It is not necessary, as was pointed out by North P. in *Elmiger’s Case* (at p. 178, citing *Newton’s* case at p. 467) that tax avoidance should be the *sole* purpose or effect—the section can still work if that was one of the purposes or effects. Nevertheless, as far as my researches go, it has not been held sufficient to avoid the arrangement unless it was the predominant purpose or effect.”

I do not agree with the criterion that the relief from liability to be

taxed must be the predominant purpose or effect. I prefer not to add adjectival expressions to the words used in the section of the Act. As was said both in the *Newton Case* and adopted by North P. in the *Elmiger Case*, it is immaterial that the avoidance of tax was not the sole purpose or effect of the arrangement. The section can still work if one of the purposes or effects was to avoid liability for tax. The section definitely says "so far as it has the purpose or effect." This seems to import that it need not be the sole purpose.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 This case has some resemblance to *Cecil Bros. Pty. Ltd. v. Commissioner of Taxation of the Commonwealth of Australia* (supra). There the taxpayer purchased some of its stock-in-trade from a family company at prices higher than those which would have been charged to it by its usual suppliers, thereby allowing the family company to make a profit. The Commissioner of Taxation disallowed portion of the company's claim for deduction for stock purchases, and reduced its taxable income by that amount. It was held that the section did not authorise the Commissioner to substitute a different price for that
20 actually paid. It was held upon the facts that there was no contract, agreement, or arrangement by which the taxpayer company was a party falling within s. 260, but *semble* s. 260 could not apply to defeat or reduce any deduction otherwise properly allowable under s. 51 (equivalent to N.Z. s. 111). Menzies J. at p. 442 remarked that the facts again illustrate that s. 260 could not be treated as giving to the Commissioner some power to modify, when its sole function was to destroy.

30 Considering the facts of this case, it seems to me to be in an entirely different category to the numerous cases which have been before the New Zealand courts in regard to family dealings. The question really at issue to be decided on the facts is whether or not the transactions are capable of explanation by reference to ordinary business or commercial dealings, without necessarily being labelled as a means of relieving the taxpayer from liability within the arrangement. In the *Cecil Case* the transaction was capable of explanation by reference to ordinary business dealings. The real question at issue was the extent of the applicability of s. 51 (our s. 111).

40 The scheme of the Bahamas Company was initiated by the Gulf Corporation, and in fact the Gulf Corporation insisted on entering into the contracts through the medium of the Bahamas Company, Pan-Eastern. There is no suggestion that the Pan-Eastern contracts had the effect of altering the incidence of income tax or relieving Gulf from any liability for tax. The series of contracts had the purpose, and also had the effect, of facilitating and obtaining increased profitability to Gulf in its trade in fuel oil. It had the purpose of avoiding repercussions in Gulf's trade with other purchasers of refined products, and in its relations under the Gulf-Shell contracts. It had the purpose and effect of avoiding repercussions or difficulties to Europa in its New Zealand trade, both in regard to competition and in regard to Government regulation of retail petrol prices. Probably included in the purposes were the obtaining of facilities and advantages in matters of overseas

exchange. A further purpose or effect was the return to Europa by indirect means of a discount on its gasoline purchases, a discount which could not be obtained by direct means, owing to the refusal of Gulf, and the similar refusal by other companies, to give direct discounts either on crude or on the refined product. I do not think that the purpose of the arrangement in its initial stages was to avoid tax liability. In fact, it would be contradictory to my conclusions that the Europa share of Pan-Eastern's profits must be deducted from the cost of Europa's supplies in deciding expenditure deductible for tax purposes, if I were to hold that the effect of the contracts, agreements, and subsequent arrangements was to obtain relief. If, on the other hand, it were held that the indirect profit or discount to Europa is not exigible for tax under the provisions of ss. 110 and 111, it may well have to be further considered whether the series of contracts are not void as having the effect of relief from tax liability under s. 108 in the light of the effect of each contract.

10

20

Taking this view, I do not need to consider Mr Mahon's further submissions that s. 108 is not applicable for the reason that the income of the Pan-Eastern Company was not derived in New Zealand, and Pan-Eastern is a non-resident company, and not controlled in New Zealand. I would, however, express the tentative view that it is the income of Europa with which the Commissioner is concerned, and this income is taxable, even if it is derived from overseas sources. I also do not need to consider the further question of the effect of the annihilation of the contracts if s. 108 applies. I think this difficult question should remain to be considered when it is directly in point.

ASSOCIATED MOTORISTS PETROL CO. LTD.

30

In furnishing returns of income to the Commissioner for the income years ending on 31 March 1960 to 1965 inclusive, A.M.P. declared its dividends from Pan-Eastern as non-assessable income, and the Commissioner assessed liability for tax accordingly.

40

On 30 March 1965 the Commissioner made an amended assessment of tax in respect of the income derived by A.M.P. during the year ended 31 March 1960, including therein A.M.P.'s share of the Pan-Eastern income as proprietary income of A.M.P. pursuant to s. 138 of the Act. A.M.P. on 7 April 1965 lodged an objection to this assessment, and later to further assessments on this basis in respect of the years ending 31 March 1961 to 1965 inclusive. I am told that the extra liability of A.M.P. to 31 March 1968, if assessments on the basis of proprietary income are upheld, amounts to almost \$4,000,000.

The main basis of A.M.P.'s objection is that at the material times Pan-Eastern was not a proprietary company within the meaning of s. 138 and s. 2 of the Act. This involves in the main a question of construction of various sections.

The term "proprietary company" is defined by s. 138 (1) (a) as follows:

"The term 'proprietary company', in relation to any income year,

means a company which at the end of that year is under the control of not more than four persons.”

If Pan-Eastern is a proprietary company within this definition A.M.P. is clearly a “shareholder” (s. 138 (1) (b)) and Pan-Eastern is an “ordinary proprietary company”.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

It is convenient at this stage to quote s. 138 (1) (e), (f), (g), (h), and (i), which it will be necessary to consider:

10 “(e) The term ‘*non-assessable income*’ means non-assessable income as defined in section 2 of this Act; and includes non-assessable proprietary income:

“(f) The term ‘*residual taxable income*’, in relation to any proprietary company and any income year, means the amount by which the *taxable income* of the company for that year (including taxable proprietary income) exceeds the total amount of the income tax . . . payable by the company in respect of income derived by it during that year:

20 (Provided that, for the purposes of this paragraph, the social security income tax payable by the company shall be calculated as if social security income tax were payable by the company not only on income of the company which is otherwise chargeable under this Act with social security income tax, but also on the taxable proprietary income derived by the company from any other company during that year:)

Provided also that in the application of this section to any shareholder that is a company the *residual taxable income of the proprietary company* for any income year shall be deemed to be the amount of the taxable income of the proprietary company for that year:

30 “(g) The term ‘*total income*’, in relation to any proprietary company and any income year, means the total amount of the residual taxable income and non-assessable income of the company for that year:

40 “(h) The total income derived in any income year by a proprietary company shall be deemed to be income derived in that year from the company by the shareholders of the company. In the case of an ordinary proprietary company the total income shall be deemed to be derived by the shareholders in the proportions which the numbers of shares held by or on behalf of the shareholders respectively bear to the total number of shares issued by the company. In the case of a proprietary company other than an ordinary proprietary company the total income shall be deemed to be derived by the shareholders in proportions determined in such manner as may be prescribed by regulations made under this Act, or in default of any such regulations or so far as they do not extend, in such proportions as the Commissioner thinks just and reasonable, having regard to the nature and relative importance of the interests of the shareholders in the company:

“(i) The term ‘*proprietary income*’, in relation to any shareholder in any proprietary company and any income year, means the income deemed under this subsection to have been derived by the shareholder from the company in that year in every case where that income (together with any other income deemed under this section to have been derived by that shareholder in that year) is not less than one-fourth of the total income of the company for that year. The proprietary income derived by a shareholder from any proprietary company in any income year shall be deemed to consist of assessable and non-assessable income in the proportions in which the total income of the company for that year consists of residual taxable income and non-assessable income.”

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10

This objection has been fully and ably argued by Mr Pethig for the objector, and Mr Cain for the Commissioner.

20

Mr Pethig submits that Pan-Eastern is not a proprietary company; for a shareholder to derive proprietary income the proprietary company must be one which is liable for tax under the provisions of the New Zealand statute; and in the context s. 138 requires the term “proprietary company” to be limited to exclude companies not within s. 166 of the Act or deriving income in New Zealand.

30

There are numerous cases in which it has been held that statutes passed by a legislative body are *prima facie* presumed to apply only to persons and objects within the jurisdiction of the particular legislature, although general words are used. In *Colquhoun v. Heddon* 25 Q.B.D. 129, the question arose whether a right given under the Income Tax Act to deduct from the assessment premiums paid for life insurance was to be limited to premiums paid to registered English companies, and it was held that the exemption did not extend to life insurances effected with a New York company, although that company was carrying on business in England and had an office in London. In that case Lord Esher makes the following observations on the principles of construction:

40

“Now, supposing the words ‘any insurance company’ stood alone, and there was nothing else in the section to modify the view which one would take of their meaning, would it or would it not be right to say that those words in an English Act of Parliament would include all foreign insurance companies, wheresoever they might be? What is the rule of construction which ought to be applied to such an enactment standing alone? It seems to me that, unless Parliament expressly declares otherwise (in which case, even if it should go beyond its rights, as regards the comity of nations, the Courts of this country must obey the enactment), the proper construction to be put on general words used in an English Act of Parliament is that Parliament was dealing only with such persons or things as are within the general words and also within its proper jurisdiction, and that we ought to assume that Parliament (unless it expressly declares otherwise) when it uses general words is only dealing with

persons or things over which it has properly jurisdiction. It has been argued that that is only so when Parliament is regulating the person or thing which is mentioned in the general words. But it seems to me that our Parliament ought not to deal in any way, either by regulation or otherwise, directly or indirectly, with any foreign person or thing which is outside its jurisdiction, and, unless it does so in express terms so clear that their meaning is beyond doubt, the Courts ought always to construe general words as applying only to persons or things which will answer the description, and which are

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10

also within the jurisdiction of Parliament.” This principle of construction was quoted with approval by Sir Robert Stout C. J. in delivering the judgment of the Court of Appeal in *In re Adams* (1905) 25 N.Z.L.R. 302.

20

By virtue of s. 165 of the Act all income derived by any person who is resident in New Zealand at the time when he derives that income shall be assessable for income tax whether it is derived from New Zealand or from elsewhere. Under s. 166 (2) a company is deemed to be resident in New Zealand if it is (a) incorporated in New Zealand or (b) has its head office in New Zealand. A.M.P. is both incorporated and has its head office in New Zealand. It is therefore assessable for income tax on all income derived by it, whether such income is derived from New Zealand or elsewhere. Pan-Eastern is a company incorporated in the Bahamas and has its head office in the Bahamas. Its income is not derived in New Zealand. It is not a company resident in New Zealand. It is not within the New Zealand jurisdiction.

30

By s. 2 of the Act “company”, unless the context otherwise requires, means any body corporate whether incorporated in New Zealand or elsewhere. But Mr Pethig submits, even so, that a proprietary assessment pre-supposes (s. 138) that the proprietary company is a company resident in New Zealand; that the context necessitates the meaning of company in this section to be so restricted.

In my opinion Pan-Eastern is a proprietary company. It is a company, and it is controlled by not more than four persons. “Person” includes a company. Pan-Eastern is controlled by two persons (Propet and A.M.P.) but this cannot decide the question in issue.

40

Mr Pethig submits that the terms used in s. 138 are appropriate only to New Zealand taxation provisions. In s. 138 (1) (i) “proprietary income” in relation to any shareholder in any proprietary company (here A.M.P.) means the income deemed to have been derived by the shareholder from the company, and is deemed to consist of assessable and non-assessable income in the proportion in which the total income of the company for that year consists of residual taxable income and non-assessable income.

“Assessable income” (s. 2) means income of any kind which is not exempted from income tax otherwise than by way of a special exemption expressly authorised as such by the Act. In other words, the special exemption is one recognised in the Act. The special exemption authorised by the Act cannot apply to Pan-Eastern, as Pan-

Eastern is outside the jurisdiction. Section 88, after enunciating special classes of assessable income, enacts that the assessable income of any person (which includes a company) shall be deemed to include "income derived from any other source whatsoever". Non-assessable income means "(c) Dividends derived from companies and exempt from income tax under s. 86c of the Act". Section 86c (1) exempts from income tax dividends derived from companies other than from companies that are exempt from income tax. Pan-Eastern is not a company that is exempt from New Zealand income tax. Before

10 a company can be exempt from income tax it must be a company that would, but for a special exemption in the Act, be subject to taxation in New Zealand: (*Australian Mutual Provident Society Ltd. v. Commissioner of Inland Revenue* (1961) N.Z.L.R. 497 F.C.; (1962) N.Z.L.R. 449 P.C.). "Taxable income" is defined "(a) in relation to ordinary income tax means the residue of assessable income after deducting the amount of all special exemptions to which the taxpayer is entitled in respect of ordinary income tax". In my view this definition is not apt in regard to a non-resident company. "Ordinary income tax" must have reference to liability for New Zealand tax.

20 "Assessable income" can have reference only to income which is assessable under New Zealand law, that is, the income arrived at after deducting the amount of all special exemptions to which the taxpayer is entitled in respect of ordinary income tax under New Zealand law.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

Subsection (h) might be made applicable to an overseas proprietary company in regard to "total income", but again I am faced with the reference to residual taxable income (income subject, in my opinion, to the exigencies of New Zealand tax law) and "non-assessable income" (non-assessable under "the Act") in subs. (g). Subsection (f) refers to the "taxable income" of the proprietary company and "the income tax" payable by the company. In my opinion these references are

30 applicable only to a New Zealand company.

I agree that s. 139 is not applicable to a proprietary company not resident in New Zealand. Section 139 cannot be applied to a proprietary company not resident in New Zealand in the calculation of the taxable income of such company. It has no taxable income in New Zealand. The Commissioner has no jurisdiction over the proprietary company, although he has jurisdiction in regard to the income derived therefrom by a New Zealand resident.

I am primarily concerned with the income of A.M.P. in its position

40 as a shareholder of Pan-Eastern. The matter for consideration is whether A.M.P. is within the tax net in relation to its share in Pan-Eastern's income. But before one can determine the proprietary income of A.M.P. derived by A.M.P. from Pan-Eastern, one must be able to determine the proportion in which the total income of Pan-Eastern consists of residual taxable income and non-assessable income. Pan-Eastern has no residual taxable income. It is not liable to ordinary income tax as referred to in the definition of taxable income (s. 2) and the provisions in regard to special exemptions (*ibid*) are again

apt only to a New Zealand taxpayer, a person chargeable with New Zealand land tax or income tax.

The same considerations apply to the use of the expressions “non-assessable income” in s. 138 (1) (e) “residual taxable income”, “taxable income of the company”, “the total amount of the income tax” in s. 138 (1) (f), “total income”, “residual taxable income” and “non-assessable income” in s. 138 (1) (g).

10 While these are in a sense machinery sections, they refer to matters which cannot be determined, and which in my opinion the Commissioner lacks jurisdiction to determine in regard to the income and the sub-
 20 division thereof of Pan-Eastern. It seems to me as a corollary that the Commissioner cannot as a result determine the amount of income of A.M.P. which might be exigible in the hands of A.M.P. for proprietary tax. These matters lead me to the conclusion that it was not the intention of the legislature in enacting s. 138 that “company” or “proprietary company” as used therein should include companies other than those resident in New Zealand under the provisions of s. 165 and s. 166, and that the legislature was intending s. 138 to apply only to persons and matters within its jurisdiction, notwithstanding the generality of some
 20 of the expressions used.

If the matter is one of doubt, I consider I should apply the special rules of construction which have been recognised as an aid in interpreting tax legislation. A tax Act is to be construed in favour of the subject, but if the taxpayer comes within the letter of the law he must be taxed, however great the apparent hardship.

30 “It is urged that in a taxing Act clear words are necessary in order to tax the subject. Too wide and fanciful a construction is often sought to be given to that maxim, which 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 those Acts. It simply means that in a taxing Act one has to look merely 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. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.” *Cape Brandy Syndicate v. I.R. Commissioners* (1921) 1 K.B. 64, 71; (1921) 2 K.B. 403, per Rowlatt J.

40 “My Lords, there is a maxim of income tax law which, though it may sometimes be overstressed, yet ought not to be forgotten. It is that the subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax on him. It is necessary that this maxim should on occasion be re-asserted and this is such an occasion.” *Russell (Inspector of Taxes) v. Scott* (1948) 2 All E.R. 1, 5 per Lord Simonds.

“I cannot think that there can be much doubt as to the proper canons of construction of this taxing section. It is not a penal provision; counsel are apt to use the adjective ‘penal’ in describing the harsh consequences of a taxing provision, but if the meaning of the provision is reasonably clear, the Courts have no jurisdiction to miti-

In the Supreme
 Court No. 3
 Judgment of
 McGregor J.
 8 May 1969
 —continued

gate such harshness. On the other hand, if the provision is reasonably capable of two alternative meanings, the Court will prefer the meaning more favourable to the subject. If the provision is so wanting in clarity that no meaning is reasonably clear, the Courts will be unable to regard it as of any effect." *I.R. Commissioners v. Ross and Coulter (Bladnock Distillery case)* (1948) 1 All E.R. 616, 625, per Lord Thankerton.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

10 Mr Pethig has also referred to s. 26 of the Land and Income Tax Amendment Act No. 2 1968, but in view of the provisions of subs. (9) thereof I do not think I am permitted to pray this section in aid in construing the provisions of the principal Act. I am relieved that it now clarifies the future position.

The principle that the provisions of a later Act cannot be taken into account in construing a provision of an earlier Act, except in a limited class of case (obscurity, ambiguity, or capability of more than one interpretation in the earlier Act) is stated by Lord Reid in *Kirkness v. John Hudson & Co. Ltd.* (1955) 2 All E.R. 345 at p. 365 referring to the earlier decision of *Ormond Investment Co. v. Betts* (1928) A.C. 143 and in particular to the speech by Lord Atkinson at p. 164:

20 "This decision of this House appears to me to afford conclusive and binding authority for the proposition that, in construing a provision of an earlier Act, the provisions of a later Act cannot be taken into account except in a limited class of case, and that rule applies although the later Act contains a provision that it is to be read as one with the earlier Act. Of course, that does not apply where the later Act amends the earlier Act or purports to declare its meaning: in such cases the later Act operates directly by its own force. But, where the provisions of the later Act could only operate indirectly as an aid to the construction of words in the earlier Act, those provisions can only be used for that purpose if certain conditions apply

30 to the earlier Act when it is considered by itself."

Although I think there is the necessary obscurity in regard to s. 138 of the principal Act, and it may be capable of more than one interpretation, I am directed by subs. 9 of s. 26 of the 1968 Amendment Act in construing the principal Act to disregard the earlier subsections of s. 26. I have therefore put it aside.

40 There is another difficulty. In making the amended assessments for income tax of Europa for the same years with which I am at present concerned, in regard to A.M.P. assessments, the Commissioner has disallowed as a deduction the amount of Europa's expenditure for gasoline, equivalent to the discount payable to Pan-Eastern on Europa's gasoline purchases. This has been disallowed as not being expenditure exclusively incurred in the production of Europa's assessable income (s. 111). I have upheld these assessments. If A.M.P. is not assessable to proprietary income tax on its share of Pan-Eastern profits, the discount received by Europa through Pan-Eastern chain has reduced its expenditure on gasoline purchased. This discount from expenditure equals the whole of the A.M.P. income. I have held this to be the

position. If, on the other hand, A.M.P. is liable for proprietary tax, Europa's alternate return by way of discount on its expenditure is reduced by the amount of the proprietary tax payable by A.M.P. In my opinion the Commissioner cannot have two bites at this luscious cherry.

In the Supreme
Court No. 3
Judgment of
McGregor J.
8 May 1969
—continued

The same position applies if the proportion of Europa's expenditure must be disallowed under the provisions of s. 108 of the Act. Then, in my view, s. 141 would apply. A.M.P. and Europa consist substantially of the same shareholders, or are under the control of the same persons.

10 The Commissioner may treat the companies as though they were a single company, and assess them jointly. The Commissioner, it seems to me, has already in effect done this; by his reduction in allowable expenditure of Europa by an amount equivalent to the profits obtained through Pan-Eastern and A.M.P.

If A.M.P. is liable for proprietary tax it seems to me the same fund is being taxed twice, as income of A.M.P. received through its shareholding in Pan-Eastern, and as additional income of Europa through the disallowance of portion of the expenditure incurred in the purchase of gasoline for its trading operations, such disallowance being equated with the profit return through Pan-Eastern and A.M.P. as equivalent to a discount on the posted cost price of such gasoline.

20

In my opinion the Commissioner had an election. There was a choice between two alternatives. In deciding to disallow portion of Europa's expenditure either under s. 111 or s. 108 he necessarily excluded the taxation of the same sum in the hands of A.M.P. Furthermore, A.M.P. distributed these funds to its shareholder, Europa, by way of dividend. The Commissioner pursued one of two courses open to him (*Spencer Bower & Turner on Estoppel* 2nd Edit. 312, 313). The Commissioner has in the first place founded, and still founds his case on Europa's liability. It seems to me in fairness to the associated companies he must make his choice.

30

I therefore answer the question posed in the Europa case stated, para. 23, in the negative, and the question posed in the A.M.P. case stated in the affirmative. No argument has been addressed to me in relation to the quantum of the assessments, the calculations therein or the figures on which the assessments are based. Therefore I have not discussed these matters, and any issues of such nature, if necessary, are reserved.

The hearing of the case has occupied 17 days. I am greatly indebted to all counsel engaged. A great number of subsidiary questions of fact have been discussed. I have considered all the submissions, but I have considered it preferable not to encumber my judgment with too many matters of detail which might result in somewhat clouding the broader considerations. I am prepared to hear counsel on the question of costs.

40

No. 4

In the Supreme
Court

No. 4

Formal
Judgment of
Supreme Court
8 May 1969**FORMAL JUDGMENT OF SUPREME COURT**

Thursday the 8th day of May 1969

BEFORE THE HONOURABLE MR JUSTICE MCGREGOR

UPON READING the case stated by the above-named respondent herein dated the 11th day of July 1968 AND UPON HEARING Mr P. T. Mahon and Mr R. F. Pethig of counsel for the above-named objector and the evidence adduced on behalf of the above-named objector and Mr J. C. White Q.C., Mr I. L. M. Richardson, and
 10 Mr G. Cain of counsel on behalf of the above-named respondent and the evidence adduced on behalf of the above-named respondent, THIS COURT HEREBY ORDERS that the questions for determination by this Court, namely, whether the respondent acted incorrectly in making the assessments in respect of income for the years ended 31 March 1959, 1961, and 1963, referred to in paragraph 7 of the said case stated and for the years ended 31 March 1960, 1962, and 1964, referred to in paragraph 15 of the said case stated and for the year ended 31 March 1965 referred to in paragraph 18 of the said case stated, be answered in the negative; AND THIS COURT HEREBY
 20 FURTHER ORDERS that the question of how such assessments should be amended be reserved and that the question of costs be reserved.

By the Court

T. J. SHARKEY,
Deputy Registrar.

[L.S.]

No. 5
NOTICE OF MOTION ON APPEAL TO THE COURT OF
APPEAL

In the Court
of Appeal
No. 5
Notice of
Motion on
Appeal to
Court of
Appeal

IN THE COURT OF APPEAL OF NEW ZEALAND
No. C.A. 35/69

between

EUROPA OIL (N.Z.) LIMITED of Wellington

Appellant

and

10 THE COMMISSIONER OF INLAND REVENUE

Respondent

TAKE NOTICE that counsel for the above-named appellant WILL
MOVE this Honourable Court on Monday, the 4th day of August
1969, or so soon thereafter as counsel may be heard ON APPEAL
from the whole of the judgment of the Supreme Court of New
Zealand delivered by the Honourable Mr Justice McGregor on the
8th day of May 1969 on a case stated by the above-named respondent
pursuant to section 32 of the Land and Income Tax Act 1954 wherein
the above-named appellant was objector and the above-named res-
pondent was respondent UPON THE GROUNDS that the said
20 judgment was erroneous in fact and in law.

Dated at Wellington this 16th day of July 1969.

HERBERT TAYLOR,
Solicitor for the above-named appellant.

TO: The Registrar of the Court of Appeal
AND TO: The Registrar of the Supreme Court, Wellington
AND TO: The above-named respondent.

No. 6

JUDGMENT OF NORTH P.

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

An appeal from the judgment of McGregor J. on a case stated pursuant to s. 32 of the Land and Income Tax Act 1954 as a result of objections lodged by Europa Oil (N.Z.) Limited, to assessments of income tax in respect of the years ending 31 March 1959 to 31 March 1965 inclusive.

The case is an important one for two reasons. In the first place, according to the figures supplied by counsel, the additional income tax which Europa will be called upon to pay, if the judgment in the Court below stands, is in excess of \$4 million. In the second place these assessments for additional tax rest on rather unusual grounds. The Commissioner first contends that in determining the amount he was required to allow Europa under the provisions of s. 111 as expenditure exclusively incurred in the production of its assessable income in the years in question, he was entitled to deduct Europa's share of the profits earned by two overseas companies (namely, Pan-Eastern Refining Company Limited—incorporated in the Bahama Islands—and Pacific Trading and Transport Company Limited—incorporated in England) in each of which it was beneficially interested, either directly or through a wholly owned subsidiary as a shareholder. Alternatively the Commissioner contends that the arrangement made by Europa with the Gulf Oil Corporation of America, which led to the formation of Pan-Eastern, was void under s. 108 in that it directly or indirectly had the purpose or effect of altering the incidence of income tax or relieving Europa from its liability to pay income tax.

In the Court below, McGregor J., having first rejected a submission by Europa that the Commissioner was precluded by law from reopening certain of the assessments he had made, reached the conclusion that the Commissioner was entitled to deduct the profits earned by Europa both from Pan-Eastern and Pacific Trading and Transport Company Limited in determining the amount he would allow as expenditure exclusively incurred in the production of the assessable income of Europa in the years in question. In these circumstances the learned Judge did not find it necessary to reach a final conclusion as to the effect of s. 108 although he did discuss this further ground in some detail. Accordingly he held that the Commissioner had acted correctly in making the amended assessments in respect of the income derived by Europa in each of the years in question, but he reserved for further consideration the quantum of the assessments, the calculations made therein, and the figures on which the assessments were based. This appeal is from that judgment.

In this Court, counsel for both parties considered that it was necessary to review once again all the relevant facts leading to the conclusion reached by the learned Judge in the Court below. In his judgment McGregor J. has been at great pains to record the course of the negotiations which led to the formation of the two overseas

companies and I did not understand Mr Mahon for Europa to contend that apart from two matters to which I will refer later any serious error was made by the Judge in this respect. But, of course, he strongly contended that the inferences the learned Judge had drawn from the facts were not justified. In result I am relieved of the necessity of dealing with a number of matters referred to by the learned Judge in the Court below. Nevertheless it is, I think, necessary for me to discuss the facts in some detail, even at the risk of some repetition, for a good deal does turn on the emphasis he placed on the facts which I think had a bearing on the inferences he drew therefrom. This I will attempt to do under several headings.

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

A. BACKGROUND

In the main what I have to say under this heading comes from the evidence of Mr Newton, an experienced English consultant on economic problems relating to the petroleum industry, and Professor Leeman, Professor of Economics at the University of Missouri, both of whom were called by the Commissioner. As I understand the matter, since the First World War practically all prolific oil fields have been discovered in areas remote from urban civilisation and consequently the task of developing these oil fields could be successfully undertaken only by large companies possessing considerable resources which justified them undertaking the risks attendant on such enterprises. In result the oil industry was largely in the hands of seven or eight companies, American, British, and French, which became possessed of a virtual monopoly on a world wide basis. This, Mr Newton pointed out, occurred once it became necessary for supplies of oil products to go long distances by sea which meant that oil products were shipped by tankers and had to be stored in bulk tanks. This situation, Mr Newton said, applied particularly to all points East of Suez and in his view went a long way towards explaining the state of exclusivity which a very small number of the oil companies, all of them internationally backed and diversified, had attained. One consequence, he said, was that competition when it obtained inevitably took on what economists call an “oligopolistic” character, namely, the operations of a limited number of marketers obtaining their share by way of investment and development rather than by price competition. Accordingly market shares, once acquired, tended to be respected by other operators with the result the major international oil networks developed and applied the concept of world market prices which provided a framework for the supply to their affiliates and for the price behaviour of the latter. Thus it came about that what is known in oil circles as “posted prices” were used to fix market prices. For some years these have been taken from Platt’s Oilgram which supplied to the industry daily reports of what was believed to be accurate news of sales and prices in the oil industry both in regard to crude oil and refined products. Mr Newton agreed that these listed prices, so far as they concerned Persian Gulf supplies, reflected market prices for products until after the 1956–57 Suez crisis. In his opinion, however, market conditions began to change

10

20

30

40

after the first Suez crisis when the oil companies attempted to reduce posted prices for crude oil in line with market conditions as they developed. After a second reduction of posted prices for crude oil in 1960 the producer countries however became alarmed at seeing their revenue eroded and put a veto on any further reduction. Consequently from that time onwards, posted prices ceased to be effective market prices for crude oil and consequently actual market prices in “arms-length” transactions were from 1960 onwards generally expressed in discounts on posted prices. He said, however, that before 1960 the largest “armslength” buyers had sometimes enjoyed special terms. Professor Leeman agreed that before 1960 relatively few outright price discounts on petroleum products were obtainable.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10

20

30

If I correctly understood the evidence there are four broad sectors of profitmaking in the oil industry. The first is the production of crude oil which has a market value at the well-head after taking into account the cost of production. The second phase is the refining of the crude oil which is, of course, a matter of distillation and the ultimate manufacture of a variety of petroleum products. There is a term well known in the industry named the “refiner’s margin”. This, I understand, to be a trade term in the oil industry which is known and accepted world wide as meaning the difference between the price paid for crude oil per barrel and the price received for the refined products. In other words it represents refining costs plus refining profits. Apparently the refiner’s margin is not a static figure but East of Suez, at all events, in 1956 it was generally accepted as amounting to \$1 per barrel of crude oil from which there was required to be deducted a refining fee of some 47.5 cents leaving in round figures 50 cents profit. As will appear later, it is claimed by Europa that, under an arrangement made with Gulf Oil Corporation—a large American oil concern operating throughout the world—what its subsidiary acquired was a half share in this refiner’s margin in respect of the crude oil required to produce the quantity of gasoline imported by Europa. The third sector of profitmaking in the case of corporations such as Gulf occurs at the stage of transportation for Gulf owns a tanker fleet and consequently when it sells either crude oil or products to purchasers in other parts of the world it makes a profit by way of freight charges. The last sector of profitmaking is in the marketing of petroleum products.

40

These large international oil corporations are spoken of as “wholly integrated corporations” which operate right through all four sectors. Now in New Zealand in 1956 there was no natural supply of oil and no refinery and consequently all petroleum products such as gasoline and different types of oil were imported from overseas and were brought to New Zealand by tankers from the area of production, wherever that might be. The marketing in New Zealand of petroleum products in 1956, and I understand even now, with the exception of Europa, is carried out by a group of New Zealand subsidiaries of the international companies. Europa, on the other hand, did not have an international company behind it and if it was to compete successfully

with the New Zealand subsidiaries of the international companies, it was necessary for it to negotiate a long-term supply contract with some overseas corporation.

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

B. THE INCORPORATION OF EUROPA AND THE
ARRANGEMENTS MADE FROM TIME TO TIME FOR
LONG-TERM SUPPLY CONTRACTS

10 In October 1931, Europa was incorporated in New Zealand under the name, Associated Motorists Petrol Company Limited, but later the name was changed to Europa Oil (N.Z.) Limited. In order to avoid confusion, it will be convenient throughout my judgment to refer to this company by its new title because in March 1954 Europa formed a subsidiary company under its own original title, Associated Motorists Petrol Company Limited, all the shares in which were owned by, or on behalf of, Europa.

20 During the years 1932 to 1936 Europa obtained its supplies of gasoline from Russian interests. This source of supply ended in 1936 whereupon Europa in December 1936 entered into a long-term contract for the supply of gasoline and other products with an international American company known as California-Texas Oil Company (generally known as Caltex). This contract was to run for a period of 14 years but later was extended to 1956. The price which Europa agreed to pay Caltex was the lowest current price quoted from time to time in the *International Petroleum News*. The contract contained a special provision for a freight adjustment to enable Europa to compete on equal terms with other overseas corporations which supplied petroleum products to their New Zealand subsidiaries from a nearer source of supply. During the first period of the contract Mr Bryan Todd, who was in charge of the operations of Europa, persuaded Caltex to give Europa the benefit of a higher grade of gasoline which had come on the market, at the original price. These two benefits were continued when the period of the contract was extended to 1956. According to Mr Todd when he visited Sydney in 1954 he discovered that Caltex allowed Ampol—a large Australian oil distributor—a special discount on posted prices. Armed with this information Mr Todd went to New York with the object of persuading Caltex to give Europa the same kind of concession. Caltex, however, would not agree, claiming that conditions in New Zealand were different because here the industry was controlled by the provisions of the Motor Spirits Distribution Act 1953. Indeed, according to Mr Todd, Caltex were quite emphatic that on the expiration of the current contract it would no longer allow Europa the two price benefits it had earlier agreed to and in result Europa was faced with the prospect of a substantial increase in the landed cost of gasoline. Later when Caltex learned that Mr Todd was negotiating with another overseas corporation—which he refused to name—Caltex changed its attitude. In the end, Caltex, according to Mr Todd, offered him an interest in an overseas refining operation which he was prepared to accept, but unfortunately the parties fell down when it came to settling the precise terms of the proposed arrangement. The course of the

30

40

negotiations between Caltex and Europa are contained in a number of letters and telegrams produced at the hearing which, in my opinion, confirm generally what Mr Todd had to say on this matter. So this brought to an end the negotiations between Europa and Caltex for a new long-term supply contract.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

C. NEGOTIATIONS BETWEEN EUROPA AND GULF WHICH LED TO THE FORMATION OF PAN-EASTERN AND ITS EXECUTION OF THE 1956 SET OF CONTRACTS

10 In 1942 Mr Bryan Todd succeeded his brother, Mr Desmond Todd, as Chairman of Directors of Europa. The evidence, in my opinion, makes it quite clear that Mr Bryan Todd very shortly afterwards became actively interested in advancing the interests of Europa which, in his view, operated at the disadvantage of being the only New Zealand company marketing gasoline in this country whereas the overseas oil interests which had established subsidiary companies in New Zealand gained as well large profits from their refining operations. In 1945 Mr Todd was given the opportunity of meeting the chairman of the Gulf Oil Corporation of America and he discussed with him the possibility of that company establishing an oil refinery
20 in New Zealand in which he hoped to obtain an interest. The chairman of Gulf told him that while they were not at that time in a position to supply products to the New Zealand market, they had in prospect vast reserves of crude oil in the Middle East and in Venezuela and with this prospect in mind they were interested in Mr Todd's proposal for the establishment of an oil refinery in New Zealand. In result no less than three refinery projects were prepared by Gulf and studied by Mr Todd. Mr Todd as well engaged a firm in California named Bechtel-McCone to prepare for him preliminary details of a scheme for the establishment of a petroleum refinery at Wellington. However, for
30 economic reasons, none of these schemes came to fruition. Mr Todd, however, remained of opinion that sooner or later it would be in the interests of Europa to establish an oil refinery in New Zealand. Accordingly in September 1954, he commissioned a Mr C. S. Snodgrass, an oil refinery consulting engineer, practising in Washington D.C., to prepare a further refining project report. But, once again, the prospective economic results of such an enterprise were not encouraging. I have thought it right to refer to these efforts by Mr Todd in the direction of establishing a refinery in New Zealand because, in my opinion, they are relevant when at a later stage I come to consider the arrange-
40 ment ultimately entered into by Europa with Gulf.

Early in 1955 Mr Todd, on behalf of Europa, commenced serious negotiations with the senior officers of Gulf for the purpose of making an arrangement with that company to take the place of the supply contract with Caltex shortly coming to an end. I have examined the evidence of Mr Todd regarding these negotiations and the voluminous file of correspondence which passed between the two companies during this period. I think it emerges very clearly indeed that there was no

prospect at all of Gulf agreeing to give Europa a discount against posted prices. I need not discuss this evidence in any detail because at the relevant time, as I have earlier said, the two experts called by the Commissioner agreed that generally speaking at all events discounts would not be regarded favourably by any of the international oil corporations, each of which had a tacit understanding, one with the other, to maintain the supply of gasoline and other oil products at posted prices. Moreover, the learned Judge in the Court below has so held saying: “I accept that it was impossible for Gulf to offer a discount on a straight
 10 out supply contract for various reasons.” This being the position, it is plain that the negotiations between Gulf and Mr Todd proceeded on different lines, namely, that Mr Todd applied himself to the task of persuading Gulf to give his company a share in what I have earlier described as the refiner’s margin. In approaching Gulf in this way, Mr Todd was dealing with a company which was possessed of large sources of crude oil, yet was restricted in its refining operations by the fact that while it had in the northern hemisphere an adequate market for diesel and fuel oil, it lacked a market for gasoline which constituted 25 percent of the yield from the refining of crude oil. If I may say so,
 20 McGregor J., in my opinion, put the position accurately when he said:

In the Court of
 Appeal
 No. 6
 Judgment of
 North P
 21 November
 1969
 —continued

“In February 1955 there were discussions between officers of Gulf and Mr Todd in regard to proposals that the two companies should engage in refinery operations outside New Zealand East of Suez. Gulf had a large market for what are known as the heavy-end products of refining, fuel oil and the like, but East of Suez it had no market for the light ends, gasoline and the like. On the other hand, Europa had a substantial market for gasoline, but little market for fuel oil. The interests of the two companies were for this reason substantially complementary. . . . I agree that the early 1955 negotiations with
 30 Gulf were on a refinery basis. It is clear that Europa recognised that refining in New Zealand or elsewhere would be likely to be a profitable venture, but with the limited market for heavy oils in New Zealand there were obvious disadvantages at that time in setting up a refinery in New Zealand. Gulf’s proposal for supply from a refinery in the East of Suez area was distinctly advantageous to Gulf. From Europa’s point of view the location of the refinery was immaterial, provided Europa could obtain by some arrangement a share of a refinery’s profit.”

40 Early in 1956 Gulf and Europa reached an agreement for a long-term contract, the terms of which are contained in a set of documents all bearing the date 3 April 1956 and consisted (inter alia) of:

- (i) A petroleum products sales contract under which Gulf-Iran (a subsidiary of Gulf) undertook to supply Europa for a period of ten years with all its gasoline and some gas oil requirements in New Zealand. In the case of gasoline the f.o.b. price was the lowest Platt’s quotation f.o.b. at Caribbean or Persian Gulf regardless of loading port;
- (ii) A freight contract under which Gulf was responsible for the

delivery of the petroleum products supplied by it to New Zealand ports;

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

(iii) A collateral agreement between Gulf-Iran and Europa which provided that in the event of a petroleum refinery being established in New Zealand during the period of the petroleum products sales contract, the terms and conditions of that contract were to be modified to exclude therefrom:

- 10 1. The quantity of Europa's requirements of motor gasoline purchased by Europa which is refined from crude oil produced by a company either under the control of members of the Todd family or a company in which they have an interest provided however that if it should so happen that the company was operated by other marketers of petroleum products in New Zealand as well, then the quantity of Europa's motor gasoline requirements to be excluded from the petroleum products sales contract was to be adjusted accordingly in proportion to the total motor gasoline refined from such crude oil.
- 20 2. The quantity of motor gasoline which the New Zealand Government may require Europa to purchase from locally refined crude;
3. The quantity of motor gasoline for which Europa is disadvantaged by tariffs, customs duty or otherwise for not taking and for which Gulf-Iran shall refuse to make an allowance equal to such tariff, customs duty, or other disadvantage;
- 30 4. If in any year during the continuance of the petroleum products sales contract Europa purchased less than 25 per cent of its total requirements of motor gasoline under the petroleum products sales contract, then either party had a right on notice to terminate that contract.

40 (iv) An agreement making provision for the establishment in the Bahama Islands of a company to be known as Pan-Eastern Refining Company Limited. This company was to have a capital of £100,000 divided into 100,000 £1 shares of which 50,000 were to be subscribed for by three persons on behalf of Gulf. The remaining 50,000 shares were to be subscribed for by three persons on behalf of Europa. Provision was made in this contract whereby immediately upon the incorporation of Pan-Eastern, Gulf undertook to enter into a processing contract with Pan-Eastern in the form set out in the Third Schedule attached to the agreement. Upon the incorporation of Pan-Eastern this processing contract was duly executed by Gulf and Pan-Eastern. Under its terms Gulf undertook to supply Pan-Eastern with sufficient crude oil at posted prices to meet the gasoline supplies to Europa but the crude oil was not to be processed by Pan-Eastern but by Gulf. In broad terms the arrangement was intended to give Pan-Eastern a

profit which was to be calculated on the basis of a specified formula. Pan-Eastern was to pay Gulf 47.5 cents per barrel of crude oil as a refining fee, which meant that Pan-Eastern would retain approximately 50 cents per barrel of crude oil being the net refiner's profit on the quantity of crude oil required to supply Europa's requirements of gasoline. This profit was to be divided equally between Gulf and Europa. There seems no doubt, and I understood Mr Mahon to concede, that on the then current prices the benefit to Europa was likely to amount to 2.5 cents per gallon of gasoline imported by Europa into New Zealand, but I am disposed to agree with Mr Mahon that McGregor J. was not right in concluding as he did that from the beginning the intention of the parties was that Europa should obtain this precise benefit for as I read the contract the profit which Pan-Eastern would earn was likely to fluctuate with any movement in posted prices and this is exactly what happened.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10

D. 1959 AMENDMENT TO THE PROCESSING CONTRACT

In January 1958, Mr Todd wrote to Mr Paton, the Vice-President of Gulf pointing out to him that the purpose of the formula was to produce a "dampening" or "snubbing" effect to protect Pan-Eastern returns against sharp fluctuations which might be caused by market movements in the prices of crude and products, but, in his view, matters had not worked out as he had expected with the result that Pan-Eastern's profit had seriously declined. Mr Paton replied stating that his company considered that the existing price formula should be allowed to continue until the end of the third quarter of that year "when we can take another look at it if Pan-Eastern's earnings continue below the anticipated average". However by July 1958, there had been a further decline in the formula return and consequently Mr Todd once again urged that there should be a reconsideration of the formula.

On 17 February 1959, Gulf sent a telegram to Mr Todd in which Gulf proposed that "our original offer flat $2\frac{1}{2}$ cents per gallon earning to Pan-Eastern would simplify all contracts", and invited Mr Todd's concurrence. Mr Todd immediately replied stating "unable to agree to suggestion of flat earning". In the end, Gulf decided not to revise the formula but to grant Pan-Eastern a voluntary crude discount to be applied retroactively through 1958 and thereafter year by year in order to sustain the desired earnings of Pan-Eastern. As I understand this proposal it meant that Gulf in effect guaranteed Europa a minimum return of 2.5 cents, but, on the other hand, Europa was entitled to the benefit of the existing formula if it should so happen that world prices rose. At this point in the negotiations, I think Mr Mahon has shown that McGregor J. was in error in stating as he did that it was Mr Todd who suggested that the formula plan should continue but that in each year in which Pan-Eastern's profits fell below the 2.5 cents return to Europa, Gulf should pay a crude discount to Pan-Eastern to make

up the difference between the formula and the 2.5 cents. The correspondence, in my opinion, shows that it was Gulf which made the proposal, not Mr Todd. However this may be, it is clear that Gulf did undertake to sustain the profits of Pan-Eastern to ensure a minimum return to Europa of 2.5 cents per gallon on the gasoline imported by Europa from Gulf.

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

10 It should perhaps be mentioned as well that during this period a proposal was made by Mr Todd for the setting up of a naphtha reformer in New Zealand and this proposal was studied by Gulf, the idea being that partially refined crude oil should be finally refined in New Zealand but nothing came of this proposal because by this time the New Zealand Government was definitely interested in the setting up of an oil refinery in New Zealand. There is some slight evidence in the correspondence at this time that Gulf, in agreeing to assure Europa of a minimum return of 2.5 cents, was influenced by the fact that a New Zealand refining company was in prospect which meant that Europa would be free to modify Gulf's supply contract and, in certain circumstances, make a new arrangement with another overseas company.

20 E. AGREEMENT FOR SUPPLY OF GAS OIL, LIGHTING
KEROSENE MADE BETWEEN B.P. (N.Z.) LIMITED AND
EUROPA

30 At the end of 1961 Europa entered into negotiations with B.P. Trading Limited, the parent company of the New Zealand subsidiary for the supply of the above-mentioned petroleum products but the parent company would not agree to its New Zealand subsidiary allowing Europa a discount on posted prices, presumably because it might have adversely affected the New Zealand market but, on the other hand, it expressed itself as willing to allow a 10 percent commission to a company to be formed in England by Europa to be known as Pacific Trading and Transport Company Limited. In result Europa agreed to purchase these petroleum products from B.P.'s New Zealand subsidiary at posted prices and the parent company from then on paid to Pacific Trading and Transport Company Limited (a wholly owned subsidiary of Europa) a commission of 10 percent on the price paid in New Zealand by Europa to the New Zealand subsidiary. Mr Todd agreed that this commission was in the nature of a discount.

F. 1962 AGREEMENTS BETWEEN EUROPA AND GULF

40 In 1962 when the New Zealand Government had approved the building of a New Zealand refinery, new contracts were entered into between Europa and Gulf under which Gulf was to supply Europa with its requirements of feedstocks to enable the latter company to participate in the New Zealand refinery but these agreements, though executed, were never acted on.

G. TAX DEPARTMENT'S INVESTIGATION

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

In February 1963 the New Zealand Inland Revenue Department commenced an investigation into the affairs of Europa with particular reference to the contracts made by Europa with Gulf. A Mr Tyler was the investigating officer, and these investigations continued until June 1963. In due course Mr Tyler's report was examined by the then Commissioner of Inland Revenue, Mr Macken. An internal memorandum by Mr Macken was an exhibit in the case and included this passage:

10 “(b) *Supply agreement with Gulf Oil*—Looking at page 4 of the Inspector's report it seems to me abundantly clear that the aim of the contracts is to divert to a Bahama company in which Gulf and Europa are interested profits derived in the United States. Provided the sale of gasoline to Europa which is the final step is at posted prices and comparable with the base adopted by other companies I do not see how we could invoke Section 108 or any other Section to impute a New Zealand origin to any of these profits.”

On 27 June 1963 Mr Macken wrote to Mr Todd as follows:

“Dear Mr Todd,

20 “You will recall that in March last we discussed the effect on New Zealand taxation of a number of contracts between Europa Oil (N.Z.) Ltd., Gulf Oil Corporation and Pan-Eastern Refining Co. Ltd. I advised then that I would refer the agreements to the Solicitor-General for consideration of their validity under New Zealand legislation.

“I have now received his advice, with which I am in agreement, and propose to take no action to disturb the present position.

30 “The further question of my obligation to disclose the information to the American revenue authorities under the double tax agreement with the U.S.A. will be considered when the investigation is complete.

“I am arranging for Mr Tyler to return to you the copies of contracts which you made available to him.

“Yours faithfully,

F. R. MACKEN.”

Later Mr Macken retired and the new Commissioner took a different view when as the result of further investigations into the affairs of Europa amended assessments were made resulting in the present proceedings.

40 H. 1964 CONTRACTS BETWEEN EUROPA AND GULF

These agreements recorded a new arrangement entered into by these two companies consequent upon the establishment of a refinery in New Zealand. The reason given by Mr Todd for the substitution for the 1962 contracts was that he thought it prudent to keep the new contracts more closely in line with the 1956 contracts which had been

examined by the Commissioner and accepted by him. It requires to be noticed that these new agreements were entered into before the 1956 agreements terminated in accordance with the collateral agreement to which I have earlier referred. I do not think that it is necessary for me to record in any detail the terms of these new agreements; substantially they proceeded on the same lines as the 1956 agreements. Their purpose was to continue to allow Pan-Eastern a profit on the feedstocks now being supplied by Gulf to Europa. Details of these agreements are recorded in the judgment under appeal and in the evidence of Mr Newton, one of the two experts called by the Commissioner.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

I. SUMMARY OF THE EVIDENCE OF THE TWO EXPERTS CALLED BY THE COMMISSIONER

I have already dealt with the very valuable outline of the oil industry given by Mr Newton, but it is, I think, important to have regard to what the experts had to say regarding the 1956–59 contracts and the 1964 contracts. Apparently without objection both these gentlemen were allowed to express their own opinions on the nature and effect of these agreements. Mr Newton said that it was not unusual for a marketer to endeavour to obtain a stake in the refinery phase (backward integration) but he said it would be somewhat far-fetched in oil industry terms to do so if that marketer in fact needed limited quantities of one product only, viz gasoline. Mr Newton was at great pains to explain in what respects, in his opinion, the processing contract entered into by Gulf with Europa in 1956 and again in 1964 differed from a conventional joint refining project, and then went on to say that in his opinion the set of contracts entered into by Gulf with Europa was “nothing but a subterfuge to cover up a discount by Gulf to Europa”. In expressing this opinion he appears to have been influenced by the fact that the supply contract was made with Gulf and not with Pan-Eastern, and that Pan-Eastern incurred no expenditure nor ran any financial risk. In cross-examination he was asked what he meant by the term “subterfuge”; he replied “I mean ‘camouflage’ for a discount.” He was cross-examined closely regarding the reasons which had caused Europa to prefer to have its supply contract with Gulf rather than with Pan-Eastern. It was put to him that Gulf had the necessary supplies of crude oil and if by any chance Pan-Eastern had folded up, Europa would be left without a long-term contract, the continuance of which was essential to its business. In the end Mr Newton appears to have recognised that there was something in this point for he suggested that that difficulty could have been overcome by a guarantee from Gulf assuring Europa a regular supply of gasoline.

Professor Leeman, likewise, expressed the opinion that the 1956 agreements could not properly be regarded as a refining venture and he set out what he regarded as the essential qualities of such a venture. He said “I think that Pan-Eastern (before amendments by letter) can best be described not as a refining enterprise but as a somewhat peculiar trading venture. It is essentially a venture in trade because it seeks the

profits of trade (through the purchase of crude and the sale of products) and it may take some risks of trade. It does not manufacture nor take the risks of manufacture." He described the contract as a "processing deal" which did not have the properties of a refinery. He, too, expressed the opinion that the Pan-Eastern trading business was a substitute for a discount.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

I hope the material I have referred to gives an adequate background to the questions I am now called upon to consider.

10 In this Court both counsel divided their arguments under several headings and I think it will be convenient to maintain the order in which the arguments of counsel were presented.

1. THE CONTRACTS BETWEEN GULF AND EUROPA IN
RELATION TO SECTIONS 110 AND 111 OF THE LAND
AND INCOME TAX ACT 1954

Mr Mahon, for Europa, having reviewed the facts in detail over a number of days, submitted that Europa by virtue of the Pan-Eastern contracts obtained participation in the refining sector of an oil company's overseas earnings and all the attempts to attribute any other character to Pan-Eastern's profits must fail. The Solicitor-General, on the other hand, submitted that the proper inference to be drawn from the evidence was that the return which came to Europa from Pan-Eastern was a price concession or discount on supplies by Gulf to Europa and provided by Gulf for which the Pan-Eastern set-up was merely a machinery. In developing this submission he contended that the primary object of the overall arrangements between Gulf and Europa was to obtain gasoline and other products and later feedstocks at reduced prices, the Pan-Eastern part of the arrangement being the means to that end and having as its purpose and effect the provision of non-assessable income for Europa. He justified this last submission by further contending that the Pan-Eastern part of the arrangement was not a commercial refining venture but in the guise of a refining venture simply provided for a guaranteed return to Europa directly related to Europa's own purchases from Gulf and unrelated to a conventional refiner's margin or any independent commercial dealing. He accordingly submitted that the Commissioner, by virtue of ss. 110 and 111 was entitled to deduct from the expenditure incurred by Europa in the purchase of gasoline not merely the dividends declared by Pan-Eastern, but one-half share of Pan-Eastern's income before distribution. In the alternative, the Solicitor-General submitted that in any event the accepted test of deductibility of an expenditure under s. 111 was that the expenditure must have been "exclusively incurred in the production of the assessable income for any income year" and accordingly in his submission the proper inference from the facts was that the expenditure by Europa on oil supplies from Gulf was incurred for two purposes:

- (a) For the purpose of producing assessable income for Europa;
- (b) For the purpose of producing income for Associated Motorists

Petrol Company Limited which, when returned to Europa, would be non-assessable income of Europa.

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

Before proceeding any further there are two matters that require to be referred to. Counsel for the Crown expressly disclaimed any intention of contending that the processing contract between Gulf and Pan-Eastern was a sham. He conceded it was a real transaction and required to be considered in this way. Even so there are several passages in the judgment in the Court below which, in my view, indicate that McGregor J. regarded himself as entitled to view the matter in a more general way for he said: “The mere form by which a transaction is carried through is not conclusive as to its nature either against the Commissioner or the taxpayer; where such form does not truly express the real position the matter must be looked at as a whole and the nature, purpose and substance of it must be regarded”, citing in support *Commissioners of Inland Revenue v. Wright* (1927) 1 K.B. 333, and *Secretary of State in Council for India v. Scoble* (1903) A.C. 299. I am disposed to think, too, with great respect to McGregor J., that more than once he allowed himself to be unduly influenced by the views expressed by Mr Newton that the processing contract was merely “camouflage” for a discount. It is important then, in my opinion, to be quite clear as to the route which this Court is required to follow. It is of course beyond doubt that in all cases such as this the Court, if asked to do so, must consider whether or not the documents really mask the true transaction. “If they do merely mask the transaction, the Court must have regard to the true position in substance and in fact and for this purpose tear away the mask or cloak that has been put upon the real transaction”: see *In re George Inglefield Limited* (1933) Ch. 1, per Lord Hanworth M.R. at page 17. But a sham is not suggested here. The golden rule then which must be applied was clearly laid down by Lord Herschell in *Helby v. Matthews* (1895) A.C. 471, 475:

“My lords, it is said that the substance of the transaction evidenced by the agreement must be looked at, and not its mere words. I quite agree. But the substance must, of course, be ascertained by a consideration of the whole of the agreement.”

In this connection I can do no better than refer to the judgment of Lord Greene M.R. in *Commissioner of Inland Revenue v. Wesleyan and General Assurance Society* (1946) 30 T.C. 11, where he said (p. 16):

“There have been cases in the past where what has been called the substance of the transaction has been thought to enable the Court to construe a document in such a way as to attract tax. The particular doctrine of substance as distinct from form was, I hope, finally exploded by the decision of the House of Lords in the case of *Duke of Westminster v. Commissioners of Inland Revenue*, 19 T.C. 490. The argument of the Crown in the present case, when really understood, appears to me to be an attempt to resurrect it. The doctrine means no more than that the language that the parties use is not necessarily to be adopted as conclusive proof of what the legal

relationship is. That is indeed a common principle of construction. To take one example, where parties enter into a contract, though they describe it as a licence, but the contract according to its true interpretation creates the relationship of landlord and tenant, the parties can call it a licence as much as they like but it will be a lease. There are other cases in the books in which the parties have described a particular document as a lease when the relationship created by it is that of licensor and licensee. In those cases it is not a lease but a licence. Similarly here, if the parties have entered into a contract, the legal result of which on its true construction is to create an annuity, the parties could not avoid the legal consequences by referring to the payments as loans.”

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10

20

In the next place, in order to avoid confusion and to simplify the issues I am called upon to consider, I have referred throughout to Gulf and Europa. This for the reason that counsel are in agreement that it makes no practical difference that in point of fact both these companies from time to time made use of subsidiaries. Thus in the case of Europa, its shares in Pan-Eastern were subscribed for by its wholly owned subsidiary, Associated Motorists Petrol Company Limited. Again at a later stage the feedstocks supply contract entered into on 10 March 1964 was made with Europa Refining Company Limited, likewise a company under the control of Europa. Similarly, in the case of Gulf the first petroleum sales contract entered into on 3 April 1956 was made between Gulf-Iran and Europa. Again when Pan-Eastern was incorporated, Gulf was represented by a subsidiary company known as Propet Limited. Then in the case of the feedstocks supply contract, to which I have just referred, this contract was made by Gulf Exploration Limited.

30

40

I turn now to consider whether Europa has established that the true nature of the arrangement made between Gulf and Europa in 1956, which resulted in the formation of Pan-Eastern, gave Europa a share in the refining sector of an oil company's overseas earnings or whether, on the other hand, the contrary submission made by the Solicitor-General is to be preferred, namely, that the proper inference to be drawn from the set of documents executed in 1956 read in the light of the surrounding circumstances gave Europa a price concession or a discount on supplies of gasoline by Gulf to Europa, the total amount of which the Commissioner was entitled to deduct in determining what sum Europa was entitled to claim as an expenditure incurred in New Zealand in earning its assessable income. In my opinion, Europa established beyond doubt that for a number of years it had been engaged in negotiations with Gulf for the establishment of a refining project in New Zealand but as I have recorded, the several attempts made in this direction all failed owing to the economic difficulties largely centred round the fact that there was no adequate market in New Zealand for what is known as the “heavy ends” of the refining process. It is important, too, in my opinion, not to lose sight of the fact that Europa, in its negotiations with Gulf, found itself in a particularly favourable position because Gulf, while it had in the

northern hemisphere markets for the heavy ends, it did not have an adequate market for gasoline which constituted the largest percentage of the petroleum products distilled by the process of refining. Consequently Gulf, which had ample supplies of crude oil, was unable to operate its refineries to their full capacity unless it could secure a market for gasoline. This circumstance may explain why Gulf was prepared to give Europa "a stake in the refinery phase", to adopt Mr Newton's expression, although Europa needed only limited quantities of one product, viz, gasoline. Furthermore, it is established and was so found by McGregor J., that Gulf could not with propriety have entered into a contract to supply Europa with gasoline at a discount on posted prices which it is accepted represented the world market prices in 1956.

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

When I view the contracts in the light of these surrounding circumstances, I feel compelled to reject the contention of the Commissioner that the arrangement made between Gulf and Europa was merely a device to give Europa a discount on the posted prices which it had agreed to pay under its supply contract with Gulf. I have, of course, paid close attention to the evidence given by Mr Newton and Professor Leeman but, in my opinion, with great respect to these gentlemen, their approach was wrong. They appear to have been of opinion that the Commissioner's case was made out once they were able to show that the processing contract made between Gulf and Pan-Eastern did not have the characteristics of an ordinary joint refining project, but, in my opinion, it is a long step to take from there to conclude as they did that therefore the processing contract had as its object and purpose the giving to Europa of a discount on posted prices. It is no doubt quite true that in preparing the formula contained in the processing contract, Gulf would want to know what the result would be in money terms. But, in my opinion, it emerges very clearly indeed that Mr Todd was not prepared to agree to a fixed return from Pan-Eastern. The share that Europa would receive was certainly not static and could go up or down with variations in the price of crude oil. I agree that the Solicitor-General has demonstrated that on world prices at the time the likely return to Europa would be 2.5 cents on the quantity of gasoline it imported into New Zealand. But, in my opinion, altogether too much attention has been paid by the Commissioner and his advisers to this circumstance. It was of the essence of the arrangement between Gulf and Europa that its return would depend upon the quantity of crude oil required to produce the gasoline imported by Europa. It was inevitable then that it would always be possible for an economist to calculate the benefit to Europa in terms of so many cents on the price it was required to pay Gulf under its supply contract. I do not question the submission made by the Solicitor-General that Pan-Eastern should be regarded as "a repository" to receive the 50 cents refiner's profit but I fail to see what difference that makes. As I read the contract, Europa was given a half share in the refining sector of Gulf's overseas earnings (calculated by reference to the quantity of gasoline it imported) and I see no justification for

the submission made by the Solicitor-General that this was merely an indirect way of giving Europa a price concession or discount from the posted prices it was required to pay under its contract which was to run for a period of 10 years. The argument for the Commissioner, in my opinion, breaks down at this point for if it had so happened that changes in the world price of crude oil had resulted in Pan-Eastern's profits almost wholly disappearing, Europa would still have been obliged to pay Gulf the price laid down in its supply contract. This was a danger which Mr Todd in 1956 was prepared to run. He wanted a share, whatever it might be, in the refiner's margin; this, in my opinion, he secured.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

A good deal was made by the Solicitor-General of the rather involved way in which the arrangement was described in the set of contracts entered into between Gulf and Europa in 1956, but in my opinion some such arrangement required to be made, once the parties agreed that Europa would only receive a limited share in the refiner's margin calculated by reference to the quantity of gasoline it from time to time imported into New Zealand. The Commissioner has conceded that the arrangement cannot be regarded as a sham cloaking an agreement for a discount and this being so, in my opinion, it must be accepted that Pan-Eastern was a company incorporated by Gulf and Europa solely for the purpose of giving Europa a share in the overseas earnings of Gulf in the operation of its refineries.

In the course of argument Mr Mahon commented on the use of the term "a price concession" as distinct from "a discount", which latter term Mr Mahon pointed out was the way the Commissioner looked at the matter in his letter of 9 May 1965. I do not, however, think anything turns on the change of language. I notice that the meaning of the word "discount" was discussed by Lord Devlin in delivering the advice of the Privy Council in *Chow Toong Hong v. Choong Fah Rubber Manufactory* (1961) 3 All E.R. 1163, 1167, where he said, "Discount is a deduction from the price fixed once and for all at the time of payment". Plainly, in my opinion, Europa was obliged to pay Gulf, under the supply contract, the agreed price for the gasoline imported into New Zealand. Whether it later gained a benefit from Pan-Eastern depended wholly on the results of Pan-Eastern's operations when the time arrived for the preparation of its annual accounts.

But the Solicitor-General argued that in any event the position changed when in 1959 Gulf agreed to amend the contract so as to assure Europa of a minimum return of 2.5 cents. I have explained the circumstances in which this amendment was agreed to and, in my opinion, it can make no difference. The correspondence shows that Mr Todd rejected Gulf's proposal that a fixed return to Pan-Eastern should be substituted for the formula. In the end, a compromise was reached under which the formula still operated but Pan-Eastern was assured of a minimum return of 50 cents of which Europa would receive one-half. For these reasons, I am of opinion, with great respect to the contrary view which found favour with McGregor J., that the profits

received by Europa as a shareholder in Pan-Eastern under the 1956-59 contract cannot be regarded as a discount on the price paid by Europa to Gulf, for the gasoline it imported into New Zealand from that company.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—*continued*

I must now go on and consider whether a different view should be taken in regard to the 1964 contracts. It will be recalled that during the operation of the 1956 contracts, a refinery had been established in New Zealand. In result Europa, which had acquired a share in the refinery, no longer needed—except for a short period—the same quantity of gasoline, but it did require a regular supply of feedstocks to enable it to participate in the New Zealand refinery. This contract which was executed on 20 March 1964 was to operate for a period ending on 31 December 1973. The same procedure was adopted in this set of contracts, namely, that Gulf entered into a processing contract with Pan-Eastern with the result that Pan-Eastern continued to enjoy a share in the refiner's margin. It is true, as the Solicitor-General pointed out, that by 1964 there was evidence that the international companies on occasions in other parts of the world at all events were prepared to allow a discount on posted prices and this was recognised by Gulf for it allowed Pan-Eastern a discount of 15 percent on posted prices. I do not consider, however, that there was sufficient evidence to show that discounts on posted prices, even after 1960, were obtainable in New Zealand. Moreover, at the time the 1962 and 1964 contracts were negotiated, the 1956 contract was still in force and had some years to run. The collateral contract to which I have referred certainly gave Europa room for negotiations with Gulf but in my opinion it would be wrong to describe Europa as a free agent in a position to make an "armslength" new contract with Gulf. No doubt Europa could have offered to give up its interest in Pan-Eastern in return for a discount on posted prices, but having secured the benefit it had obtained from the formation of Pan-Eastern, why should it attempt to do so? In my opinion the case for the Commissioner on the question of discounts stands or falls on the effect of the arrangement entered into between Gulf and Europa in 1956. The reasons I have given, when discussing the earlier contracts, in my opinion, are of equal force in the case of the 1964 contracts, namely, their effect was to give Europa a share in the refining sector of Gulf's overseas earnings. This being the view I take it is unnecessary for me to consider the implications of the doctrine laid down in *Salomon v. Salomon & Co.* (1897) A.C. 22.

But the view I have so far expressed is not the end of the matter for Europa must still meet the submission made on behalf of the Commissioner that when regard is had to the language of s. 111, Europa has not satisfied the onus which lay upon it of showing that the whole of the expenditure incurred by Europa for the purchase of gasoline was exclusively incurred in the production of its assessable income in the years in question. Section 111 (1) reads thus:

"In calculating the assessable income of any person deriving assessable income from one source only, any expenditure or loss exclusively incurred in the production of the assessable income for

any income year may, except as otherwise provided in this Act, be deducted from the total income derived for that year.”

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

The Solicitor-General argued that the sum of the evidence shows that the expenditure on supplies of gasoline was incurred in part for the purpose of producing a return to Europa through Pan-Eastern and, therefore, a reduction required to be made in the amount claimed by Europa as a deduction under s. 111. In making this submission, the Solicitor-General placed great reliance on two New Zealand cases which went on appeal to the Privy Council. These are: *Ward and Co.* v. *Commissioner of Taxes* (1923) A.C. 145, and *Aspro Limited v. Commissioner of Taxes* (1932) A.C. 683. In the first of these cases, Ward and Co. claimed as a deduction £2,123 expended by it in the tax year in advertising and the like for the purpose of defeating a special licensing poll to determine whether the prohibition of the sale of all alcoholic liquors met the wishes of the citizens of this country. Their Lordships accepted the view expressed by the Court of Appeal of New Zealand that it was impossible to hold that the expenditure was incurred exclusively or at all in the production of the assessable income of the company for the year in question for the reason that it was not incurred in the production of income but for the purpose of preventing the extinction of the business from which the income was derived. The only relevancy of this case is that it provides an example that the Commissioner is entitled under ss. 110 and 111 to examine any deduction claimed by a taxpayer and to determine whether the available evidence shows that the expenditure was exclusively incurred in the production of the assessable income of the taxpayer. This I would think is self-evident from the terms in which the section is expressed. More to the point is the second case which concerned a Melbourne company which had established a subsidiary company in New Zealand. The parent company in Australia and the New Zealand subsidiary had been established by two brothers who lived in Melbourne and only paid occasional trips to New Zealand. These two persons held all the shares in the New Zealand company and were the sole directors. Under the Articles of Association the fees of the directors in each year required to be fixed by resolution of the company in general meeting which meant in fact that the two director-shareholders themselves determined each year what sums should be allowed to them by way of directors' fees. In the year in question the profits of the New Zealand company were rather more than £15,000 and the general meeting resolved that each director should receive a fee of £5,000 thus spreading the profits in more or less equal proportions between the two directors and the company. The Commissioner disallowed the full amount of £10,000 claimed as a deduction in respect of directors' fees allowing the company a deduction of only £2,000. The Commissioner's assessment was challenged before a Magistrate who held that the state of the evidence was not such as to compel him to the conclusion that the £10,000 had been exclusively incurred in the production of the company's assessable income. In considering the ratio of this case it is important to bear

in mind that the appeal to the Court of Appeal and ultimately to the Privy Council was on a point of law only. Their Lordships expressed the opinion that if the only evidence before the Magistrate had been the company's resolution fixing the directors' fees and vouchers for payment of the amount so fixed, it would be difficult to see how the Magistrate could reasonably have refused to hold that the assessment was excessive but as their Lordships pointed out the Magistrate had before him other evidence as well which showed that there was complete identity of the persons interested as shareholders in fixing the amount of the fees to be paid to the directors and of the persons to whom the fees were to be paid. In these circumstances, their Lordships were of opinion that there was sufficient evidence before the Magistrate to justify his conclusion as a question of fact that the £10,000 had not been exclusively incurred in the production of the assessable income. The importance of this case of course is that their Lordships did recognise that the Commissioner was not obliged to accept at face value the resolution of the company in general meeting fixing each director's fee at £5,000.

10

To similar effect is the English case of *Johnson Brothers and Company v. The Inland Revenue Commissioners* (1919) 2 K.B. 717, to which their Lordships referred. That case concerned the relationship between a father and his two sons who worked in the business but the father did not make them partners. But nevertheless he entered into a contract under which each son was to receive 25 percent of the profits. Rowlatt J. held that the Commissioner was entitled to refuse to allow the total sums paid to the sons "as money wholly and exclusively laid out or expended for the purposes of the trade or business". I conclude that the Court in this case, too, recognised that the Commissioner was entitled to go behind a contract and determine what sums should be allowed by way of deduction as an expenditure incurred in the earning of assessable income.

30

The Solicitor-General also referred us to a decision of the High Court of Australia in *Ronpibon Tin No Liability v. Federal Commissioner of Taxation*, *Tongkah Compound No Liability v. Federal Commissioner of Taxation* (1949) 78 C.L.R. 47. The position in that case was unusual because the taxpaying company was engaged in mining operations in Siam which were interrupted upon the outbreak of war with Japan. The High Court upheld the contention of the Commissioner that only a small part of the total expenditure claimed as a deduction by the company was referable to the gaining of assessable income, expressing the opinion that the Judge who heard the appeal should decide as a matter of fact what part or proportion of the expenditure was fairly or appropriately attributable to gaining the assessable income.

40

Mr Mahon, for Europa, on the other hand, placed great reliance on the view expressed by the High Court of Australia in *Cecil Brothers Pty. Limited v. The Federal Commissioner of Taxation* (1962) 111 C.L.R. 430. That case concerned the relationship between the taxpayer, Cecil Brothers Pty. Limited and a company named Breckler Pty.

Limited, in which the shareholders were either shareholders in or near relatives of the shareholders in Cecil Brothers Pty. Limited. In the year in question, the Commissioner disallowed the sum of £19,777 of its deductions and increased its taxable income by that amount. His justification was that Cecil Brothers had purchased trading stock from the Breckler Company at a higher price than the same goods were obtainable directly from the manufacturer or wholesaler. The appeal from the Commissioner's assessment was heard at first instance by Owen J., who said (p. 434):

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10 “It was contended that, of the total payments of £230,000 made
by the taxpayer to Breckler Pty. Ltd., the amount of £19,777 should
now be regarded as an outgoing incurred in gaining or producing
the taxpayer's assessable income. That amount was paid, so it was
argued, not as part of the purchase price of goods supplied but to
provide Breckler Pty. Ltd. with income. I do not agree with this
submission. The fact that the taxpayer paid more for its purchases
than it would have paid had it dealt with the manufacturers or
wholesalers in order that Breckler Pty. Ltd. might make a profit
out of the transactions does not, in my opinion, prevent the amount
20 which it in fact paid from being regarded, for the purposes of
s. 51 (1), as an outgoing incurred in gaining its assessable income.
It seems to me that the contention really is that the taxpayer paid
more for its goods than it should have. But “it is not for the Court
or the commissioner to say how much a taxpayer ought to spend
in obtaining his income, but only how much he has spent.” (*Ronpibon
Tin N.L. and Tongkah Compound N.L. v. Federal Commissioner
of Taxation* and the cases therein cited).

The learned Judge then went on to consider a submission that the
dealings between the taxpayer and the Breckler Company were sham
30 transactions and he said (p. 434):

“The short answer is that they were genuine transactions for the
sale and purchase of goods and in no way fictitious or unreal.”

Finally, Owen J. accepted the third submission made on behalf of
the Commissioner that the purchasing arrangement between the tax-
payer company and Breckler Company was rendered void under s. 260
of the Australian Act which has as its purpose the setting aside of tax
avoidance arrangements. For immediate purposes I need not consider
this further ground and I will return to this case when I come to
consider the submission made by the Solicitor-General that the arrange-
40 ment made by Gulf with Europa for the setting up of Pan-Eastern
is caught by the provisions of s. 108 of the New Zealand Act. On
appeal to the High Court, all five judges made short work of the conten-
tion of the Commissioner that he was entitled to deduct the £19,777
from the sum paid by the taxpaying company for the goods supplied
by the Breckler Company. The principal judgment was delivered by
Menzies J. who said (p. 439-440):

“The appellant company is a retailer of boots and shoes, so that
what it pays for its stock is an outgoing which s. 51 makes an allow-

able deduction. Normally, in the sort of business carried on by the taxpayer company, the retailer buys at the best price available, but the taxpayer here chose not to do so. It preferred to buy some of its stock from Breckler Pty. Ltd. interposed between it and its usual suppliers at prices higher than those that would have been charged to it by those suppliers. The shareholders in Breckler Pty. Ltd. were the children, grandchildren and other relatives of the shareholders in the taxpayer company and what happened was that Breckler Pty. Ltd. made profits by buying the taxpayer company's requirements as ordered at the prices the taxpayer would itself have had to pay the suppliers and reselling what it bought to the taxpayer company at higher prices."

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

In the main Menzies J. paid attention to the argument of the Commissioner that the arrangement between the two companies was rendered void under s. 260, but he said (p. 441):

"The Commissioner did argue unsuccessfully before Owen J. that, independently of s. 260, the amount of £19,777 should not be regarded as an outgoing necessarily incurred in gaining or producing the taxpayer's assessable income. His Honour rejected this submission, relying upon *Ronpibon Tin N.L. and Tongkah Compound N.L. v. Federal Commissioner of Taxation*. With this I agree."

Dixon C.J. said (p. 438):

"The facts of the case are sufficiently set out in the judgment of Menzies J. which I have had the advantage of reading and I shall not repeat them. Upon those facts, once it was held that the payment of the amount received by Breckler Pty. Ltd. from the taxpayer company was paid for boots and shoes as stock in trade, there could, I think, be no ground for excluding any part of it from the allowable deductions from assessable income."

In reliance on the judgments delivered by the High Court of Australia in this case, Mr Mahon submitted that at all events in the case of trading stock expenditure the only inquiry is whether the money was in fact paid for trading stock. In his submission, once this was established any implication of purpose or motive was irrelevant and trading stock expenditure was not apportionable on any ground. If *Cecil Brothers'* case was rightly decided then that is an end to this part of the case. But I must confess that I do find some difficulty in accepting this submission in the broad way it was made. If the Commissioner was entitled to examine whether the sum fixed for directors' fees in the *Aspro* case should be allowed in full as an item of expenditure, it is difficult to perceive the basis for a distinction being drawn between the quantum of directors' fees and the price paid for trading stock, but it may be that the decision of Owen J., and later of the High Court, rested on practical considerations for there may be serious objections to the Commissioner being entitled to examine the price paid by a company for trading stock in order to determine whether the same goods could not have been purchased elsewhere at a lower price, particularly so when regard is had to the fact that the Commissioner no doubt as well assessed the Breckler Company with tax on its earnings.

10 However, I propose to look at the matter in the way the Solicitor-General invited this Court to do, namely, that while neither the Court nor the Commissioner may challenge the wisdom of an expenditure, it may question its purpose, but even so, in my opinion, before the Commissioner was entitled under s. 111 to disallow part of the expenditure in fact incurred by Europa for the supply of gasoline, there must at least be some evidence that Europa was not obliged to pay the full amount it in fact paid to Gulf for its gasoline, and that it voluntarily paid a greater price than it needed to have paid for its supply of gasoline. Now Europa had entered into a contract with Gulf, which was to run for 10 years, to purchase its supplies of gasoline at current posted prices. In 1956 the evidence is all the one way, namely, that it was impossible for Europa to have secured a discount against current posted prices, and McGregor J. so held. Therefore, I must start with the premise that it paid no more for its supplies of gasoline than the current market price. The fact that Europa received a collateral benefit by reason of its shareholding in Pan-Eastern, in my opinion, is irrelevant. In my opinion, what happened was that by adroit negotiations conducted by Mr Todd, Europa won a share in a refiner's profit which otherwise would have gone exclusively to Gulf. The revenue authorities in New Zealand were deprived of nothing. Europa had bound itself to pay current posted prices and, in my opinion, once that is made clear the amounts so paid, supported as no doubt they were by vouchers, were deductible as items of expenditure. It had no option in the matter. It had bound itself to pay the current posted prices whether or not Pan-Eastern for some reason or another ceased to earn profits. I see no reason why the new arrangement made in 1964 should be treated any differently for it is closely linked with the earlier agreement and in any case there is insufficient evidence to show that the contract price for feedstocks was other than the market price in New Zealand. In reaching this conclusion, I have not overlooked the fact that the New Zealand section imposes a narrower test than that applied in the United Kingdom and Australia, but for present purposes the fact that the New Zealand section requires that the expenditure should be "exclusively" incurred in the production of the assessable income of the taxpayer can make no difference when the Court is concerned with the purchase of trading stock which undoubtedly was exclusively required for the purpose of the taxpaying company's business.

40 2. CONTRACTS BETWEEN GULF AND EUROPA WHICH LED TO THE FORMATION OF PAN-EASTERN ARE RENDERED VOID UNDER SECTION 108 OF THE LAND AND INCOME TAX ACT

This section reads:

"Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence

of income tax, or relieving any person from his liability to pay income tax.”

In the Court of
Appeal

No. 6

Judgment of
North P
21 November
1969

—continued

In the last year or two this Court has been called upon to consider the meaning and effect of s. 108. It did so in *Elmiger v. Commissioner of Inland Revenue* (1967), N.Z.L.R. 161, and again quite recently in *Marx and Carlson v. Commissioner of Inland Revenue*. In respect of the latter case leave has been granted to the taxpayers to appeal to the Privy Council. If it should so happen that their Lordships take a different view from that which commended itself to the majority
10 of the members of this Court, then it would appear likely that the Commissioner's contention that s. 108 can be invoked by him in the present proceedings must fail. But for present purposes I must proceed on the basis that the interpretation placed on s. 108 by the majority of the members of this Court is correct. Mr Mahon, as he was bound to do, recognised that he was obliged to argue his case on that basis. But he desired to record a submission that these two cases were wrongly decided so that he would be free to take this line in the event of this case too going on to the Privy Council. Mr Mahon made three sub-
20 missions: (i) Section 108 only applies to cases where the income sought to be taxed is or will be derived in New Zealand; (ii) Section 108 can only have even prima facie application where on the facts, if it had not been for the arrangement, the moneys in question would have come into the hands of the taxpayer as taxable income; (iii) in any event s. 108 does not apply to this case for two main reasons: (a) these transactions can be explained by reference to ordinary commercial dealing, (b) even if the section is prima facie applicable, it has no effect because the annihilation of all possible contractual steps exposes no state of facts upon which any additional income can be assessed against the appellant. In reply, Mr Richardson, second
30 counsel for the Commissioner, submitted that s. 108 did apply to the two arrangements made between Europa and Gulf in 1956 and 1964 and in result the effect of the section was to destroy: (a) the petroleum products sales contract, (b) the incorporation Pan-Eastern, (c) the feedstocks supply contract and related agreements. I have of course, studied all that he had to say and I hope he will not think it is discourteous of me if I do not answer in detail the submissions he made for, in my opinion, his argument fails *in limine* because I am satisfied that the arrangement made between Gulf and Europa is capable of explanation by reference to ordinary commercial dealings. *Newton v. Commissioner of Taxation of the Commonwealth of Australia* (1958) A.C. 450; *Mobil Oil (Australia) Limited v. Commissioner of Taxation of the Commonwealth of Australia* (1966) A.C. 275. In a large measure, in my opinion, the contention of the Commissioner is disposed of by the findings of fact in the Court below. McGregor J. said:

“The scheme of the Bahamas company was initiated by the Gulf Corporation, and in fact the Gulf Corporation insisted on entering into the contracts through the medium of the Bahamas company, Pan-Eastern. There is no suggestion that the Pan-Eastern contracts had the effect of altering the incidence of income tax or relieving

10 Gulf from any liability for tax. The series of contracts had the purpose, and also had the effect, of facilitating and obtaining increased profitability to Gulf in its trade in fuel oil. It had the purpose of avoiding repercussions in Gulf's trade with other purchasers of refined products, and in its relations under the Gulf-Shell contracts. It had the purpose and effect of avoiding repercussions or difficulties to Europa in its New Zealand trade, both in regard to competition and in regard to Government regulation of retail petrol prices. . . . I do not think that the purpose of the arrangement in its initial stages was to avoid tax liability. In fact, it would be contradictory to my conclusions that the Europa share of Pan-Eastern's profits must be deducted from the cost of Europa's supplies in deciding expenditure deductible for tax purposes, if I were to hold that the effect of the contracts, agreements and subsequent arrangements was to obtain relief."

The approach which the courts should make in considering the application of the Australian tax avoidance section was explained in *Newton's* case by Lord Denning who delivered the judgment of the Board. He said (p. 465-66) :

20 "The answer to the problem seems to their Lordships to lie in the opening words of the section. They show that the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only with the means which they employ to do it. It affects every 'contract, agreement or arrangement' (which their Lordships will henceforward refer to compendiously as 'arrangement'), which has the purpose or effect of avoiding tax. In applying the section you must, by the very words of it, look at the arrangement *itself* and see which is *its* effect—which *it* does—irrespective of the motives of the persons who made it. Williams J.

30 put it well when he said: 'The purpose of a contract, agreement or arrangement must be what *it* is intended to effect and that intention must be ascertained from its terms. Those terms may be oral or written or may have to be inferred from the circumstances but, when they have been ascertained, their purpose must be what they effect.' In order to bring the arrangement within the section you must be able to predicate—by looking at the overt acts by which it was implemented—that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference

40 to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section."

Once Europa established, as I think it did, that it could not obtain a discount on posted prices in their petroleum products sales contract, then in my opinion there is no room for the application of s. 108. The arrangement made between Gulf and Europa which was dictated by Gulf in my opinion was intended to give Europa a share in the refining sector of Gulf's overseas earnings. It is true that Gulf selected as the

place where Pan-Eastern would be incorporated, the Bahama Islands where no income tax is payable. I can quite understand that the fact that Europa escaped the payment of any income tax on the very substantial profits it derived from its share in Pan-Eastern must have excited the suspicions of the Commissioner but, in my opinion, that circumstance is quite irrelevant. It cannot possibly be contended by the Commissioner that Gulf should have incorporated Pan-Eastern in New Zealand. There was no commercial reason at all why it should take this course and even if there were tax advantages from the point of view of Gulf, in incorporating Pan-Eastern in the Bahama Islands rather than in U.S.A., the fact remains that before s. 108 can be applied, the purpose or effect of the arrangement made between Gulf and Europa must have been the avoidance of tax in New Zealand by Europa and, in my opinion, such a contention receives no support from an examination of the voluminous documents which we have been called upon to consider on this appeal. Even, however, if I should be wrong in this conclusion I am still of opinion that there are insuperable difficulties in the way of the Commissioner invoking s. 108 in the present case. One of these difficulties was referred to by the High Court of Australia in the *Cecil Brothers Pty Ltd.* case to which I have earlier referred. What the Commissioner seeks to do is to increase Europa's taxable income by denying to it an outgoing from assessable income to which, in my opinion, it was entitled. This being so I share the doubt expressed by Dixon C. J. that in such circumstances s. 108 can have any application at all. Then again s. 108 has no more effect than to destroy the arrangement with Gulf and it is still necessary for the Commissioner to demonstrate that the annihilation of the arrangement resulted in taxable income reaching Europa and I cannot see how the Commissioner can overcome this further difficulty. This being the view I take it follows that, in my opinion, the arrangement made by Gulf cannot be attacked under s. 108. In concluding my observations on this branch of the case I should add that it was not questioned by Mr Mahon that the Commissioner was entitled to collect a dividend tax from the shareholders in Europa on the dividends declared by Pan-Eastern. It may be as well that he can invoke the provisions of s. 138 if he is able to show that Pan-Eastern is a proprietary company within the meaning of that section but this question falls to be determined in a second case stated between the *Commissioner of Inland Revenue v. Associated Motorists Petrol Company Limited* which was heard immediately following the present case and will be the subject of a separate judgment by the members of this court.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

3. THE CONTRACT MADE BETWEEN THE B.P. (N.Z.) LIMITED AND EUROPA

It will be recalled that at the end of 1961 Europa entered into negotiations with B.P. Trading Company Limited of England, the parent of the New Zealand subsidiary for the supply of gas oil and lighting kerosene. The English parent company would not agree to

its New Zealand subsidiary allowing Europa a discount on posted prices but it expressed itself as willing to allow a 10 percent commission to a company to be formed in England by Europa under the name Pacific Trading and Transport Company Limited. It is not suggested by the Commissioner that this arrangement is caught by s. 108 but he does contend, perhaps with more force, that viewing the matter as a whole it is plain that Europa did secure a 10 percent discount on the posted prices of these products and therefore he was justified in disallowing the full amount claimed by Europa as a deduction under s. 111.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10 The question which I am now called upon to consider is whether the contention of the Commissioner is sound. Viewed superficially at all events there is much to be said for the contention of the Commissioner for, as Mr Todd frankly conceded, the arrangement he made with the parent company in effect did give Europa a discount on posted prices but there do seem to me to be difficulties in the way of the adoption of the Commissioner's contention. To begin with it is common ground that the Pacific Trading and Transport Company Limited, although an English company, by arrangement with the
20 British Revenue authorities, is to be regarded for taxation purposes as a company resident in New Zealand and consequently taxation on its profits are levied in New Zealand and not in the United Kingdom. This being so, the problem I am confronted with is this. Here we have two New Zealand companies, one the subsidiary of the other, the trading company purchases goods from a vendor at the market price operating in New Zealand, the other receives a commission from an overseas company of 10 percent on the total purchase price of the goods supplied by its New Zealand subsidiary to the trading company. In
30 these circumstances, is the Commissioner entitled to levy income tax on the profits earned by the company receiving the commission and then refuse to allow the trading company a deduction for the price in fact paid by it for the goods it purchased from the vendor? Mr Mahon submitted that this savours of double taxation. I do not think that this is so, but it certainly causes me to take a second look at the Commissioner's contention that he is entitled to decline to allow the full price of the goods required by the trading company exclusively for the purposes of its business operations for the two companies are separate entities and in accordance with the doctrine laid down in *Salomon v. Salomon & Co.* (1897) A.C. 22, this circumstances cannot lightly be
40 disregarded.

The Solicitor-General, in developing this part of his argument, referred us to a recent judgment of the Court of Appeal in England, *Littlewoods Mail Order Stores Ltd. v. McGregor (Inspector of Taxes)*, which since the hearing is reported in (1969) 3 A11 E.R. 855. In order to appreciate the exact point which the Court of Appeal was required to consider in that case it is necessary to refer to an earlier case, *Inland Revenue Commissioners v. Land Securities Investment Trust Ltd.*, which at first instance came before Cross J. and is reported in (1968) 1 A11 E.R. 955. In that case the taxpayer company held long leases

and sub-leases of varying durations from landlords who were a charity. The landlords sold to the taxpayer company the reversion on the leases and subleases in consideration of rentcharges payable in each case for 10 years amounting in the aggregate to £96,000 per annum and the taxpayer company assumed liability for the headrents where the reversions so acquired were leasehold reversions. The annual payments thus undertaken by the taxpayer company involved a considerable increase over the total rents formerly paid by it in respect of the long leases and subleases. The question which Cross J. was called upon to determine was whether the rentcharges aggregating £96,000 were deductible for income tax purposes. He held that the right to receive the rents for the remainder of the periods of the leases or subleases which the companies acquired by purchasing the reversions was a capital asset and, therefore, the rentcharges prima facie represented, in part, payment for a capital asset and he remitted the case to the Commissioners for further consideration. The taxpayer company then appealed to the Court of Appeal which unanimously reversed the judgment of Cross J.: see (1968) 3 A11 E.R. 33. The case was then taken to the House of Lords who unanimously allowed the appeal and restored the judgment of Cross J. holding that although capital assets may be purchased by income payments, yet on ordinary principles of commercial accounting, these rentcharges were not to be debited against the incomings of the taxpayer company's trade as a property investment company for purposes of computing its liability to profits tax since the legal result of the purchase was that it purchased reversions which were capital assets in its hands.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10

20

30

40

Returning now to *Littlewoods'* case, which came before the Court of Appeal a week after the judgment of the House of Lords in the *Land Securities Investment Trust Ltd.* case was delivered, the only point left to the taxpayer on a very similar state of facts was that the taxpaying company had interposed a subsidiary company, named Fork Manufacturing Company Ltd., which acquired the freehold and then leased back to the former freeholders the premises under a lease for 22 years and 10 days at a rent of £6 a year, and the taxpayers became sublessees of the former freeholders under a lease for 22 years at a rent of £42,450. The effect was that the taxpayers gave up a lease for 88 years at a rent of £23,444 and took instead a lease from the former freeholders for 22 years at a rent of £42,450, but in addition they would have the entire freehold possession at the end of 22 years through their subsidiary. The revenue commissioners determined that they would not allow as a deduction for income tax purposes the new rent of £42,450 but only £23,444 being the amount of the original rent. *Littlewoods'* case was thus on all fours with the *Land Securities Investment Trust Ltd.* case, save for the one factor that the Fork Manufacturing Company Ltd. had been interposed. In view of the judgment in the House of Lords, the only argument left to counsel for the taxpayer was the contention that the Fork Manufacturing Company Ltd. was to be regarded as a separate and independent entity just as if its shares were owned by someone else and unconnected with Littlewoods. This contention was

decisively rejected by all three members of the Court of Appeal and the judgment of the House of Lords in the *Land Securities Investment Trust Ltd.* case was applied. Lord Denning M.R., in his forthright way, disposed of this argument by saying (p. 860) :

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10 “I decline to treat the Fork Manufacturing Co. Ltd. as a separate and independent entity. The doctrine laid down in *Salomon v. Salomon & Co.* (1897 A.C. 22) has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the Courts cannot see. But that is not true. The Courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind.”

20 But this approach was unacceptable to the other two members of the Court, Sachs and Karminski L.JJ., who approached the matter on rather different lines. Sachs L.J. said: “This transaction thus inspected provides the clearest possible example of the acquisition by a taxpayer of capital assets by payment of instalments over 22 years”. Then, having referred to the House of Lords’ judgment in the *Land Securities Investment Trust Ltd.* case, he proceeded to deal with the argument of counsel for the taxpayer that the interposition of the Fork subsidiary made all the difference. He said (p. 861–62) :

30 “For the Crown it was urged that it made none. It is an issue to be approached with some caution; for at one stage it seemed as if the Crown might be on the verge of seeking to erode the principle that for tax purposes every company, whether it be a subsidiary or not, has its own separate legal entity. All the more did it appear that that erosion might be sought when one observed that even today there can be no question of any statutory grouping of the Fork company with the taxpayers for tax purposes, for the simple reason that the two companies do not carry on the same trade. There was certainly no such groupings in the days with which the instant assessments are concerned. Any attempt, however, thus to erode that important principle was firmly disclaimed by counsel for the Crown, who without qualification agreed that the Fork company and the taxpayers were separate entities for the purposes of tax legislation; moreover nothing in this judgment of mine is intended to have any such erosive effect. The essence of the Crown’s submissions in the instant case was that, as in the *Land Securities* case, one has to examine the true nature of the transaction and then arrive at a conclusion as to how, on the principles of proper commercial accounting, one should allocate the two segments of the overall annual payments of £42,450 One has here simply to look at the true nature and purpose of the expenditure each year of the £42,450. In so doing, despite the contrary submissions of counsel for the taxpayers, it seems to me that the *Land Securities* case permits the court to dichotomise that expenditure. On that footing £19,006 was clearly expended for the purpose of acquiring a capital asset which happened to have been put into the ownership of the Fork

40

company. It is thus in truth expenditure of a capital nature to secure the advantage of an enduring benefit. It was also an expenditure that was not made wholly and exclusively for the trade purposes of the taxpayers during the relevant years under consideration by the commissioners (see s. 137 (a) of the Income Tax Act 1952). In those circumstances it seems clear to me that this appeal must be allowed."

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

Karminski L. J., in a short concurring judgment, said (p. 862–86) :

10 "Counsel for the taxpayers in what I hope I may be allowed to describe as a rearguard action conducted with enormous skill and equal good humour, had to rely on the confusion created by the subsidiary company in order to distinguish this case from the decision of the House of Lords in *Inland Revenue Comrs. v. Land Securities Investment Trust Ltd.*; and his contention, as I understood it, was rightly that the Fork Manufacturing Co., Ltd., and the taxpayers are two separate entities in law. There is no doubt as to the correctness of that submission, based as it is on the rule in *Salomon v. Salomon & Co., Ltd.* of many years standing. But it is necessary here, as I think, to look at what I believe to be the realities of this situation. The taxpayers are, as we have heard, a large and important trading company. The Fork company is shown by its balance sheet, which we have seen, to be not only a separate entity, but one which is a creation of, or at any rate, completely dependent on the taxpayers. . . . It is necessary I think to ask myself, after that examination of the details, who really benefited from getting hold of the freehold. To that in my view there can be only one answer, i.e., the taxpayers, and not the Fork company. If that view is right, then the distinction which has been sought to be drawn by counsel for the taxpayers between the facts of the present case and those in the *Land Securities Investment Trust, Ltd.* case does not really exist."

20

30

It will, I think, be at once apparent that *Littlewood's* case is an entirely different class of case from the present one. The question in issue in that case was whether the full rent of £42,450 should be allowed as a deduction in Littlewoods' accounts. It was held that a deduction of the full amount of the new rent should not be allowed for it was plain that as a result of the series of conveyancing steps undertaken by the taxpayer it acquired a capital asset even although the title to the capital asset was in the name of its subsidiary, the Fork Company.

40

Nothing like that happened here. There is nothing in the facts, so far as I can see, to justify the inference that Europa could have secured in New Zealand its supply of gas oil, kerosene, and the like at a lower price than it in fact paid. If it had emerged that Europa had agreed voluntarily to pay a higher price in New Zealand in order to obtain the 10 percent commission in England, the position might well be different. So the question I am called upon to determine is simply whether the trading company, Europa, was entitled to deduct

as an item of expenditure the price of goods which it purchased from the New Zealand subsidiary of B.P. (U.K.) at market prices. Viewing the matter in this way, in my opinion, the correct conclusion is that the 10 percent commission which B.P. (U.K.) were prepared to allow the Pacific Trading Company, was a collateral benefit which, while it attracts income tax in its own right, is independent of the agreed price for the goods supplied. In my opinion then, *Littlewood's* case does not assist the Commissioner in the present case who must be content with the income tax he receives on the commissions earned by Pacific Trading Company and must allow Europa a deduction for the full price it paid for the goods it purchased from the New Zealand subsidiary company.

In the Court of
Appeal
No. 6
Judgment of
North P
21 November
1969
—continued

10

20

In view of the conclusion I have reached, it is not necessary for me to go on and consider the question whether there is any substance in Mr Mahon's submission that the then Commissioner's letter to Europa of 27 June 1963 stands in the way of the revenue authorities making the new assessments in respect of the period ending 31 March 1964. In the circumstances I find it unnecessary to say any more than this. In my opinion there are very real difficulties in the way of the appellant relying on this letter. To begin with I think that this letter was written before the investigation made by Mr Tyler was concluded and on incomplete information. Furthermore, in so far as Mr Mahon's argument rested on the doctrine of estoppel, the difficulty in his way is that the Commissioner, in making the new assessments, did so in exercise of the statutory duty which rested on him under the Land and Income Tax Act 1954.

30

For these reasons I am of opinion that the appeal should be allowed and the questions asked in the case stated should be answered "yes" the Commissioner did act incorrectly in making the assessments in question.

The members of the Court being unanimously of that opinion the appeal is allowed accordingly. The question of costs in the Court below and in this Court are reserved.

JUDGMENT OF TURNER J.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

I do not find it necessary to restate the primary facts in detail. They have been comprehensively set out in the judgment of McGregor J. in the Court below, and his account of them was not, except in a very few respects, the subject of any criticism by either side in this Court. I hope that I shall be careful, in accepting generally McGregor J.'s account of the primary facts, not to include an unqualified acceptance of any aspect of them which was made the subject of contest before us, without remembering the submissions, not very many in number, which
10 Counsel made before us in this respect.

It will be convenient to refer to appellant company as "appellant" or "Europa" and to respondent Commissioner as "the Commissioner". Other companies associated with appellant will be found referred to as "Pan-Eastern", "Associated Motorists", "Europa Refining", and "P.T.T.". The oil companies from whom these obtained supplies will be found referred to as "Gulf", "Gulfex", "Gulfiran", "Propet", "Caltex", and "B.P.".

Two principal arguments were presented on behalf of the Commissioner to McGregor J., and repeated to us on appeal. In the first
20 place it was submitted that the Commissioner had power to disallow in part the amount claimed by appellant under section 111 as a deduction from assessable income for total purchases of oil. The second submission was that the transactions proved in evidence were such as to amount to an arrangement which was void pursuant to section 108, as one made for the purpose of relief against liability to pay income tax. McGregor J. accepted the first of these submissions, and found it unnecessary finally to decide upon the second. The success of either submission without the other was enough to justify the Commissioner in reassessing appellant. This appeal is brought by the taxpayer from
30 McGregor J.'s decision, and appellant contests his conclusion that the deduction claimed under section 111 may be disallowed in part. The Commissioner relies on McGregor J.'s judgment as to partial disallowance under section 111, and in the alternative, as he is fully entitled to do, repeats before us the further submission made to, and reserved by, McGregor J. as to the availability of section 108.

I will deal first with the arguments as to the Commissioner's powers under section 111, and will then come to the applicability of section 108. This is the order in which McGregor J. dealt with these matters in the Court below. Section 111 (1) at the material times provided
40 as follows:

"In calculating the assessable income of any person deriving assessable income from one source only, any expenditure or loss exclusively incurred in the production of the assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived for that year."

Under this subsection the Commissioner's argument was twofold. In

the first place it was said that the gross amount claimed as a deduction for the purchase price of oil was shown by the evidence to have been subject to a discount the amount of which the Commissioner was entitled to subtract from the deduction claimed; in the second place it was said in the alternative that the total expenditure claimed was not “exclusively incurred in the production of the assessable income”, in that it was paid out for two purposes—viz (a) as the purchase price of the oil bought and (b) for the purpose of creating a reserve fund abroad in the hands of a company in which Europa or its shareholders held one half of the shares. With regard to this second argument it was contended that in so far as payments were made for this latter purpose the expenditure claimed as a deduction was not *exclusively* incurred in the production of the income.

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10

I find it convenient to deal first with the second of the submissions made to the Commissioner under section 111—viz, that the expenditure claimed as a deduction was not *exclusively* incurred in the production of the assessable income. In answer to this contention from the Commissioner it was submitted by Mr Mahon that the total of the moneys claimed by way of deduction for purchase price of oil was in fact actually paid out in respect of real purchases of oil by appellant as claimed, and that in these circumstances the decision of the High Court of Australia in *Cecil Brothers Proprietary Limited v. Commissioner of Taxation* 1964 111 C.L.R. 430, was a powerful authority for the proposition that the Commissioner had no power to go behind the payments.

20

Several New Zealand and three or four English authorities were cited by the Solicitor-General to support his contention that the expenditure incurred by the taxpayer in this case was examinable by the Commissioner, and apportionable by him between the different purposes served by it. I will first examine the New Zealand authorities cited. These were *Ward & Co. Ltd v. Commissioner of Taxes* 1923 A.C. 145 and *Aspro Ltd v. Commissioner of Taxes* 1932 A.C. 683—both decisions of the Judicial Committee—and a dictum of my own in *Commissioner of Inland Revenue v. Shipbuilders Ltd.* 1968 N.Z.L.R. 885 at page 904. I do not find this last dictum of much use in the present case, though the learned Solicitor-General appeared to rely upon it, and indeed it was cited and followed by McGregor J. in his judgment. But it seems to me only to have recorded the rather obvious thought that when the whole of a deduction is challenged, which has been claimed as expenditure incurred in the production of the assessable income, it may be useful to inquire what was the purpose for which the expenditure was incurred. But the *Shipbuilders* case was not an apportionment case. It was one in which an item of expenditure was challenged, as made wholly for a purpose outside the provisions of the section. I do not find the *dictum* of any help in the present case, where the point is a different one. Here it is a matter almost of agreement that the payments were *prima facie* within the statute. They were payments for oil. But it is said that they had an ultimate collateral result, and were made with the intention, that the transactions of which

30

40

they were part would ultimately build up, in the Bahamas, a fund in the hands of Pan-Eastern, a company in which Europa or its shareholders held half of the shares. And it is this duality of purpose which is the foundation of the Commissioner's contention.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

10 *Ward & Co. Ltd. v. Commissioner of Taxes (supra)*, the next of the cases cited by the Solicitor-General, was a case in which the Commissioner disallowed expenditure claimed under section 111, on the ground that it was not incurred in the production of the assessable income. The amount claimed had there, as in the present case, been
20 actually expended, but it had been expended in the course of promoting a political campaign of commercial advantage to the taxpayer. The Judicial Committee upheld the Commissioner's disallowance of the claim for a deduction, saying at page 150 that it was necessary under the New Zealand statute for the taxpayer to show that "it must have been incurred for the direct purpose of producing profits". But *Ward & Co. Ltd. v. Commissioner of Taxes* was not a case where a payment was questioned as having two collateral purposes, the Commissioner seeking to apportion it between the two; it was a case where a payment made for one purpose was wholly disallowed because that purpose
20 was not the purpose specified in section 111. It resembled the *Shipbuilders* case in this regard, and I find the decision of little or no assistance in the case before us.

30 *Aspro Limited v. Commissioner of Taxes* 1932 A.C. 683 is a little nearer the mark. It was a case where the Commissioner, questioning a payment actually made, was held justified in disallowing *a part of it*, leaving the deduction claimed allowed in part only. But again the facts were different from those of the present case. The payment claimed as a deduction was directors' fees. The directors were also the sole shareholders in the company. Seeking, no doubt, a tax advantage from the procedure, they had arranged that the Company should pay them in the year under review the sum of £10,000 for directors' fees. The payment was challenged by the Commissioner as an unreasonably large deduction. His reassessment was confirmed by the Judicial Committee, who held that the learned Magistrate (who originally decided the matter) was entitled on the evidence to decline to hold it proved that the whole of the £10,000 paid out had been expended exclusively in the production of the assessable income.

40 This was indeed a case where the Commissioner apportioned a payment, declining to accept the taxpayer's contention that the expenditure had been *exclusively* incurred in the production of the income. It may be said perhaps that there is this distinction between the *Aspro* case and the one presently under discussion—that in *Aspro* the expenditure challenged was not a payment made in discharge of a legal liability incurred in the production of the income, such as in a payment for goods supplied at contract rates. The company was under no legal obligation to pay its directors £10,000, or any sum. It was competent for the company in general meeting to vote a director's fee, but it was under no contractual liability to do so. It was not within the province

of the Commissioner to dictate to the company how much it should vote; but it remained a question of fact to be considered by him how far any amount which (being under no obligation to vote anything) it did vote was voted as remuneration reasonably attributable to the services rendered by the directors, and how far it could be regarded as voted for other reasons or purposes. After careful reflection, I have come to doubt whether this distinction on the facts gives rise to any difference in principle.

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10 In the English case of *Copeman v. William Flood & Sons Ltd.* 1941
1 K. B. 202, Lawrence J. held, on the words of the English provision,
that the Commissioners were entitled to decide whether moneys paid
as directors' fees were in fact wholly and exclusively laid out or
expended for the purposes of the company's trade, and, if not, to
find how much of the sums paid was so laid out or expended. This
decision appears to be parallel to that in the *Aspro* case.

20 *Johnson Bros, & Co. v. Commissioners of Inland Revenue* 1919 2
K.B. 717, was a case at first instance, and the judgment was an oral
one; but it was a judgment of Rowlatt J., than whom there have been
few greater authorities in this field. It was a case on excess profits
duty. Before the year 1910 the owner of the appellants' business had
in his employment his three sons, to each of whom he paid a salary
of £150. In 1910 an agreement was entered into by the father with
his sons whereby each of the latter was to receive thereafter 25 percent
of the net profits; but the sons were not taken into partnership, and
they continued to hold subordinate positions in the business. From
1912 the profits increased, and large sums were paid to the sons. In
30 assessing the profits of the business for excess profits duty, the Com-
missioners disallowed as a deduction the difference between the sums
paid to the sons in the last pre-war year and those paid to them in
each of the 3 years 1914–16. On appeal to the Special Commissioners
£250 of the amount paid to each son was held to be the full amount
which was "wholly and exclusively laid out or expended for the
purposes of the trade or business", the balance being disallowed as a
deduction. The effect of this was to increase the amount of the profits
assessable for excess profits duty. It was held by Rowlatt J. on appeal
40 that the Special Commissioners had jurisdiction to increase the assess-
ment, and that they were entitled to decide what amount of the share
of the profits paid to the sons should be considered a fair allowance for
the time and labour expended by them in the business. It may be that
Rowlatt J. held in this case that every contract of employment between
an employer and his servants is examinable by the Commissioners
with the result that they may allow the employer as a deduction for
income tax purposes only such a sum as they may decide is reasonable
for the time and labour expended by the employee in the business. If
this is what Rowlatt J. must be taken as deciding then this decision
must stand in flat opposition to that of the High Court of Australia in
the *Cecil Brothers'* case, unless some distinction can be made (which
I for myself doubt) between contracts of employment and contracts

for the supply of goods. But it is possible to regard Rowlatt J.'s decision as standing on rather narrower ground, and it may be thought that he treated the facts as establishing that the income which came to the sons from the business in that case was not in the nature of a salary or wage at all, and could not support a claim for a deduction for wages paid out. He found it established that the sons were working as the servants of their father, not as wage earners, but for no wages, it having been agreed that they should receive in lieu of a wage—but not as partners—a share of the profits of the business year by year. He said at page 721:

10

“By this arrangement the father put the sons in a position which was not that of wage-earners at all; he gave them a share of the profits because they were working in the business. In assessing the profits of the business in these circumstances some allowance must be made for the time and labour expended by the sons who receive nothing expressly for these, the share of the profits being a sufficient inducement to them to do the work.”

20

The question for the Commissioners to decide, in assessing excess profits duty—and this was the question actually before the Court—was the amount of the profits “arising from the trade or business” of the taxpayer. Rowlatt J. held that the profits assessable for duty, on the actual facts of the agreement between the parties, were the whole profits of the trade or business of the taxpayer before any deduction proceeding from that division of them for which the agreement provided. In these circumstances, applying the provisions of the Income Tax Acts to the ascertainment of the question, what were the true profits of the business, he thought that the Commissioners must determine a reasonable remuneration allowable to the sons before the division of profits as remuneration “wholly and exclusively laid out or expended for the purposes of the trade” for which the firm should be entitled to a deduction in being assessed for tax. If this was the narrower ground upon which the decision truly stood, then it is hardly in point in the present case, but may be regarded as a special decision on a particular set of facts; and in such case I must turn to a more modern English decision to which I have not yet referred—that of the Court of Appeal in *Littlewoods Mail Order Stores Limited v. Commissioners of Inland Revenue*, reported, since this appeal was argued, in 1969 1 W.L.R. 1241.

30

40

In this case the taxpayer was lessee of a city property under a lease from a friendly society. The lease was for 99 years at an annual rental of £23,444. At the material time only 11 years of the term had expired, and the lessee was therefore entitled to remain in possession for another 88 years at an annual rental of £23,444. But the property had greatly appreciated in rental value during the 11 years over which the lease had been current. It was accepted by the Court that at the time material to the action the property could have been leased for £60,000 per year. The society wished to dispose of an asset so unprofitably let. The lessee was prepared to buy the reversion. Negotiations

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

were commenced and ultimately the society sold its reversion to a subsidiary company wholly owned by the lessee, by a series of contracts which it was hoped would result in the revenue authorities furnishing some substantial aid to the transaction. The relevant transactions were (1) the surrender of the existing lease, (2) a conveyance of the freehold to the X company, a wholly owned subsidiary of the lessee, (3) a lease from the X company to the society for 22 years at a nominal rental, (4) a sublease from the society to the original lessee for the same period of 22 years less a few days, at a rental of £42,450 —something like twice the original rental, but still, it should be noted, very substantially less than the rack rental. The result of the transactions, was (1) that in 22 years the X company would have the freehold, the only consideration paid to the society being the increased rental paid by the lessee taxpayer, (2) that the society would have sold its unprofitable asset for a price which it considered acceptable realised over 22 years, (3) that the moneys paid in discharge of the covenant to pay rent in the new lease, which it must be remembered were fixed at a rate well below the rack rental, would be claimable by the lessee company as a deduction for income tax purposes. The Special Commissioners disallowed the deduction as claimed, being of opinion that a deduction was allowable only in respect of the amount of the rent payable under the original lease. It was held by the Court of Appeal that the payments of rent at the increased rental were not expenditure wholly and exclusively for the purposes of the trade of the lessee. The Court found as a fact that the payments were made partly for the purpose of paying the purchase price of the freehold on behalf of the subsidiary company. The result of the appeal was, to quote the judgment of Sachs L. J., to permit the Court to look at the true nature and purpose of the expenditure each year of the £42,450 and to dichotomise the expenditure in question, apportioning it according to the principles of proper commercial accounting between expenditure as rent and expenditure on the purchase of the freehold. And this, notwithstanding the fact that the freehold had been acquired in this case, not by the taxpayer company itself, but by its subsidiary the X company, an independent legal entity.

In citing this case as an authority of considerable persuasive force I do not rely on the judgment of the Master of the Rolls, in so far as he reached his conclusion, the same as that to which the other members of the Court came, by the process of regarding the X company as the *alter ego* of the taxpayer company. This argument was not put forward by counsel for the Commissioners, and the judgments of Sachs and Karminski L.JJ. plainly accept the validity of the taxpayer's contention that the two companies—the taxpayer company and the X company—were separate entities, but held that this notwithstanding the purpose for which the payments were made could, to use the language of Sachs L.J., be “dichotomised”. But I shall have occasion to refer to this difference between the reasons of the members of the Court of Appeal at a later stage in this judgment.

Against this group of decisions there are the judgments of the High

Court of Australia in *Cecil Bros. Proprietary Limited v. Federal Commissioner of Taxation* 1964 111 C.L.R. 430, which Mr Mahon cited as establishing that at least in the Commonwealth jurisdiction an expenditure incurred for goods supplied, paid out in pursuance of a legal liability according to the tenor of a binding contract to supply, is not examinable or apportionable by the Commissioner. *Cecil Bros. Proprietary Limited* was a retailer of shoes. It had been incorporated in 1955 to take over the existing business of a partnership consisting of six persons. Another company, Breckler Proprietary Limited had been incorporated earlier in 1951; its shareholders were at all material times either shareholders or near relatives of shareholders in Cecil Brothers Proprietary Limited. I will refer to the two companies as "Cecil Bros." and "Breckler". Breckler purchased stock from manufacturers and suppliers, which it resold to Cecil Bros. at a profit. It would have been possible for Cecil Bros. to have made the same purchases direct and at the same prices as Breckler had paid, without the interposition of that company. In the year of income Breckler made a profit amounting to £19,777, which was the difference between what Cecil Bros. paid Breckler for stock and what Breckler had itself paid for that stock. Owen J., before whom the matter came at first instance, found that if Cecil Bros. had done all its buying direct from manufacturers and wholesalers its total purchases for the year would have been less by £19,777 than the figure actually paid by it, and its profits would have been correspondingly increased. The Commissioner added back this profit of £19,777 to that which Cecil Bros. had returned as its income, and reassessed the taxpayer accordingly, relying in this regard on submissions, made in the alternative, upon sections 51 and 260 of the Commonwealth Act.

In the Court of Appeal
No. 6
Judgment of Turner J.
21 November 1969
—continued

Section 51, subsections (1) and (2), at the material time provided:

"(1) All losses and outgoings to the extent to which they are incurred in gaining or producing the assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing such income, shall be allowable deductions except to the extent to which they are losses or outgoings of capital, or of a capital, private or domestic nature, or are incurred in relation to the gaining or production of exempt income.

"(2) Expenditure incurred or deemed to have been incurred in the purchase of stock used by the taxpayer as trading stock shall be deemed not to be an outgoing of capital or of a capital nature."

The Commissioner's contentions were (1) that the amount which Cecil Bros. had deducted, as total purchase price of stock should be reduced by £19,777, since to this extent the total paid out for purchases had not been incurred in producing the assessable income; (2) that the transactions were "shams" and should be set aside accordingly; and (3) that the transactions offended against section 260 (corresponding to section 108 of the New Zealand Act).

Owen J., at first instance, rejected the contention of the Commis-

sioner that he could make the adjustment. At page 434 he said:

10 “It was contended that, of the total payments of £230,000 made by the taxpayer to Breckler Pty. Ltd., the amount of £19,777 should not be regarded as an outgoing incurred in gaining or producing the taxpayer’s assessable income. That amount was paid, so it was argued, not as part of the purchase price of goods supplied but to provide Breckler Pty. Ltd. with income. I do not agree with this submission. The fact that the taxpayer paid more for its purchases than it would have paid had it dealt direct with the manufacturers or wholesalers in order that Breckler Pty. Ltd. might make a profit out of the transactions does not, in my opinion, prevent the amount which it in fact paid from being regarded, for the purposes of s. 51 (1), as an outgoing incurred in gaining its assessable income. It seems to me that the contention really is that the taxpayer paid more for its goods than it should have. But it is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent. (*Ronpibon Tin N.L. and Tongkah Compound N.L. v. Federal Commissioner of Taxation* and the cases therein cited).”

20 Having thus dismissed the Commissioner’s contention based upon section 51 (1), and likewise his second contention (that the transactions were “shams”), Owen J. upheld the third of the Commissioner’s submissions in which section 260 was invoked, and held the transactions to be arrangements for the purpose of avoiding tax.

30 From this decision the taxpayer appealed. The appeal succeeded, the High Court concluding that once it was held that the amount had been actually paid out for boots and shoes as stock-in-trade, pursuant to a genuine contractual liability to pay, section 260 could have no application to the set of facts proved. The principal judgment was written by Menzies J. As to the argument based upon section 51, he accepted in one sentence at page 441 the view expressed by Owen J. Kitto J. and Taylor J. delivered concurring judgments. In the short judgment of Dixon C.J., the other member of the Court, the same view was taken, the learned Chief Justice saying at page 438:

“Upon those facts, once it was held that the payment of the amount received by Breckler Pty. Ltd. from the taxpayer company was paid for boots and shoes as stock in trade, there could, I think, be no ground for excluding any part of it from the allowable deductions from assessable income.”

40 It is clear from page 437 of the report that section 51 was argued on behalf of the Commissioner, and that the Court in the result rejected the argument, holding that the interposition of the subsidiary company, and its profit from the transactions, did not give ground for apportioning the deduction so as to disallow that part thereof which ultimately produced the subsidiary’s profit. On its face at least this decision may appear an authority for the proposition that a purchase of supplies by a trading company is not examinable by the Commissioner on the ground that more has been paid out than has

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

been necessary to purchase the goods, even though the purpose, and the result, of the transaction has been to produce a fund in the hands of a company related in shareholding to the taxpayer.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

If the decision of the High Court of Australia in *Cecil Brothers Proprietary Limited v. Commissioner of Taxation* is sound in principle, and if it goes as far as I have suggested, it must stand as a very considerable authority supporting appellant's contentions in the appeal now under consideration. But I find it hard to accept the conclusion that *in no case* where goods are purchased at a price in excess of
10 market rates, with the proved purpose and result of producing a fund in the hands of a related company, can the Commissioner re-examine the transaction and disallow a part of the deduction claimed thereon under section 111. Surely the Act means what it says, when it uses (in this country) the words "any expenditure . . . *exclusively incurred* in the production of the assessable income"? And if expenditure is claimed as a deduction, surely it must be a question of fact whether it was *exclusively* incurred in the production of the assessable income? And if so, who but the Commissioner may decide that question in the first instance?

20 It may be suggested that *Littlewoods Mail Order Stores Limited v. Commissioner of Inland Revenue (supra)* and *Cecil Brothers Proprietary Limited v. Federal Commissioner of Taxation (supra)* are not so flatly contradictory of each other in principle as at first appears, and that the facts of the two cases offer grounds for distinguishing between them; but I have grave doubts as to whether any such reconciliation is possible. It might be suggested, however, that there is a distinction to be made between moneys paid as the price of goods and payments by way of rent. This is a distinction between the facts in the two cases, but without any difference in principle which I can perceive or
30 define. Or again it could perhaps be suggested that whereas in *Littlewoods* case the company into whose hands the freehold came was a wholly owned subsidiary of the taxpayer, whereas in *Cecil Bros.* case the shareholders of the company were distinct, though all the shares of both companies were held by members of the same families. I suppose it would be possible to argue that this last point could furnish a distinction between the cases; but I do not perceive in the judgments in *Cecil Bros.* case that anything was ever made of the point, and for myself I do not think that any true difference between the cases can be based upon it.

40 If *Cecil Bros.* case is compared with *Littlewoods*, I think that modern conceptions of taxation law are more logically illustrated in the latter decision than the former. Let us test the two cases by carrying the decision in each case to an extreme. Let *Cecil Bros.* case be taken as holding that an expenditure for goods actually supplied, at a rate payable according to its tenor under a contract legally binding on the taxpayer, cannot in any circumstances be examinable by the Commissioner under section 111 (it should be especially noted that section 108 is for the moment placed on one side). It must follow in principle, if an extreme case be proposed, that I may, in order to benefit my

children, purchase certain of my manufacturing supplies from a company in which the shares are held in their name or on their behalf at (say) six times their market price, building up in the children's company's hands a substantial fund, and at the same time may claim that the sums so paid out are a legitimate deduction from my own taxable income, on which I would otherwise pay at maximum rates. I am somewhat reluctant to believe that if the facts in *Cecil Bros.* case had been so extreme that case would have been decided in the same way; and yet I do not see why it should have been differently decided if the *dicta* in the case are correct statements of principle. On the other hand, if *Littlewoods'* case is correctly decided the result must be that the Commissioner may examine every contract for the payment of rent or the supply of goods and that it is for him to decide in the first place (though of course there may be an appeal) whether the taxpayer has paid more than the market rate, and, if so, to inquire with what purpose he did so. This seems a far-reaching proposition indeed; yet, of the two extreme consequences which I have posed I prefer this on the whole to the other—more, perhaps, because it seems to me more in keeping with the modern development of income tax law all over the world. After some hesitation I have formed the opinion that the decision in *Littlewoods Mail Order Stores Ltd. v. Commissioner of Inland Revenue* is preferable to that in *Cecil Bros. Proprietary Limited v. Federal Commissioner of Taxation* if the two are, as I think they are, finally irreconcilable. I have come to the view that the Commissioner may examine any transaction pursuant to which a payment is made, which is set up as a deduction, and may decide in a proper case that such a payment, when examined in the light of the particular transaction, was not one made exclusively in the production of the assessable income.

30 But if the Commissioner is entitled to examine the payments made for purchases in the present case, can he establish satisfactorily that more was paid than would have had to be paid on the open market? Where a deduction is claimed, and the taxpayer can establish (as was established in the case before us) that the moneys paid out were paid out in the production of the assessable income, the Commissioner may, while conceding this, question whether the payments were *exclusively* so incurred. It seems to me that while the onus of proving that they were must finally rest upon the taxpayer, yet the evidentiary burden which lies upon him may be discharged at an early stage in the inquiry if he is able to demonstrate—as in the case before us—that the moneys were paid out in discharge of a contractual liability binding upon the taxpayer. Where this is shown there can be no doubt *ex hypothesi* but that the taxpayer was bound to pay; and bound to pay every penny of what was paid. The only question is as to the purposes which actuated him in incurring the liability to make the payment. And when this stage is reached, if it then appears that in paying the amount which the taxpayer was in law bound to pay, he paid no more than he would have had to pay on the available market for the supplies, even if he had never entered into the contract at all, then it cannot

matter what other purposes of the taxpayer were collaterally served by the payment. Nothing more has in such a case been paid, over and above what would have had to be paid for the goods had the collateral purposes never entered the mind of the taxpayer. Now I think that this is where matters were left by the evidence in the case before us. Undoubtedly, as regards the 1956 contracts, McGregor J. so specifically found. At page 6005 he said:

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10 “By the arrangement with Europa, Gulf obtained a market outlet in New Zealand without making an investment of its own. Owing to the nature of the Gulf-Shell contract, and it would appear owing to Gulf’s relationship with other international oil companies operating through subsidiaries in New Zealand, Gulf was not in a position to sell gasoline at a discount which would disturb the market in New Zealand, and which in particular would have affected Gulf’s relationship with Shell. To obtain the Europa outlet for gasoline, Gulf could not give to Europa any direct discount on posted prices, and any concession to obtain the Europa outlet had to be provided by Gulf by some indirect means. The posted prices represented the market level of Middle East oils.”

20 and immediately continues with the observation that

“There is no evidence of discounts on posted prices about the years 1955 and 1956 . . .”

Again on page 6011 the learned Judge says of the 1956 position:

“I accept that it was impossible for Gulf to offer a discount on a straight-out supply contract, for various reasons.”

And he gives the reasons for this statement, which I need not recite in detail here.

30 As regards the 1959 contracts I hold without hesitation that these made no difference; all that happened in 1959 was that being entitled to continue with the 1956 contracts, Europa managed to stabilise, at 2.5 cents per gallon, the profit to be derived by its associated company Pan-Eastern from the notional refinement of its gasoline. McGregor J. found at pages 6011–12 that the 1959 negotiations, conducted at arm’s length, did no more than I have said, and without any increase in the prices prescribed in the 1956 contracts.

40 It was contended by the Solicitor-General, however, that at least by 1962 conditions had changed, and that it had then become possible, by one means or another, for purchasers of oil to obtain at least “concessions” of various kinds from the supply companies, which, if not precisely equivalent to discounts on posted prices, yet could be put to ends equally advantageous. He submitted that it was in this situation that the 1962–64 contracts between Gulf and Europa were negotiated, and also those between B.P. and P.T.T. which resulted in the latter accumulating a substantial fund for “commission” in England. He contended accordingly for the Commissioner that the evidence demonstrated that Europa had in the contracts of 1962 and 1964 purchased its supplies of oil at a dearer price than was necessary, having regard to then current market conditions.

I do not find it necessary to examine in any detail the evidence for or against these submissions. Such examination of it as I have made has by no means convinced me that it would have been possible, in 1962 or in 1964, for Europa to buy supplies on the world market at better prices than were contracted for by the contracts of those years, judging the matter as one of substance, and weighing various considerations one against another. But even if I had been brought to such a conclusion, I do not think that the power of the Commissioner to apportion expenditure for goods supplied can be exercised simply because it is shown, without more, that one price was actually paid for goods and that a better price was in fact available. No doubt this is a factor which has to be shown; and if the margin between the two prices be sufficient, this fact alone may, in all the circumstances of a particular case, be enough to bring the Commissioner's power of apportionment into play. But the choice between different sources of supply is often made upon a great number of considerations, of which price is only one. In the case before us one of these considerations must be the fact that Europa was not by any means completely free to choose its source of supplies; when negotiating the 1962-64 contracts it was still bound by those of 1956-59.

Whether or not in a given case the Court will support the Commissioner in apportioning expenditure must in any given case depend upon the degree of conviction to which the Court is brought upon his contention that a payment actually made for the supply of goods was in fact made for a dual purpose. It may be relevant in my opinion to recall the observations which fell from the lips of Lord Denning when delivering the judgment of the Judicial Committee (on a different statutory provision) in *Newton v. Commissioner of Taxation* 1958 2 All E.R. 759. In that case the matter for the Court to consider was whether the evidence demonstrated that a contract had had the purpose of avoiding liability for tax. In this case we are also considering whether the evidence showed that the taxpayer had a certain purpose (not in entering into a transaction, but in making a payment). Lord Denning pointed out that if the section which he was considering were sufficiently widely construed all the motives and purposes of the taxpayer would come under scrutiny, and at page 763 he recalled the rhetorical question of counsel for the taxpayer, who had invited the Court to say, if a wide interpretation of the statute were favoured, where the section should stop. Lord Denning solved the problem, on the words of the section before him, in these words:

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

I have come to the conclusion that the same kind of test is appropriate in the application of the section now before us. If the Commissioner questions the purpose with which a payment has been made, once it is shown that that payment was in fact actually made, and made moreover in pursuance of a binding contract for the supply of goods actually purchased, then I think that he must go so far as to demonstrate that (to use the words of Lord Denning with some degree of paraphrase) “the expenditures are not capable of explanation by reference to ordinary business dealing”, and that if this cannot be pre-

10 dicated of them, then the submission of dual purpose must fail. In the case before us I cannot think that the evidence can bring the Court to the degree of conviction which is necessary, and I am of opinion that having regard to the contractual obligations still current under the 1956–59 contracts, and to the multitude of commercial considerations which might fairly influence Europa in the selection of a supplier, and in the negotiations of terms of supply, it is impossible to predicate, of the 1962–64 contracts between Europa and Gulf, that the prices contended for are not satisfactorily capable of explanation by reference to ordinary commercial dealing.

20 This seems to me necessarily to follow when it is remembered that when proposals for the 1962 contracts were being discussed Europa was already bound by the contracts of 1956 and 1959, whose currency ran till 1966, from which it could be released only by the agreement of Pan-Eastern and the Gulf group. Europa was not a free agent to negotiate on the world market for supplies of oil, influenced in its choice of a vendor only by considerations of price. It could claim as of right some degree of modification of the existing contracts, by virtue of the clauses in them entitling it to do so upon the coming into operation of the New Zealand refinery; but the modifications which

30 it sought were not all obtainable as of right, and were in general matters for negotiation within the framework of the existing contracts. Of the contracts of 1962 and 1964 it cannot in my opinion possibly be said to be predicatable that they were entered into with a dual purpose, *not being explainable by reference to ordinary commercial dealing*, having regard to the circumstances in which they were negotiated. Indeed the evidence very distinctly brings me to the contrary conclusion. I think that it is shown that, negotiating at arm’s length, Europa drove the best bargain it could within the framework of the 1956 and 1959 contracts, by which it was still bound, and that at least

40 till 1966 it cannot be argued, on the evidence, that the prices which it contracted to pay were contracted for with the duality of purpose which is necessary if the transactions are to be caught by section 111. Till 1966, because the 1956–59 contracts ran till 1966; and we are now *not* in this case called upon to consider what must be the result as regard income earned after 1966.

For the reasons which I have cited above I am therefore of opinion that the first submission of the Solicitor-General under section 111 must fail, even if the decision of the English Court of Appeal in *Littlewoods’* case is (as I have thought) to be preferred in principle

to that of the High Court of Australia in *Cecil Bros. Pty. Ltd. v. Federal Commissioner of Taxation*. If, of course, the latter decision is to be preferred to the former, *cadit quaestio*, and the same result will follow without the examination of the facts which the acceptance of the decision in *Littlewoods'* case renders necessary.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

I must now come to the second submission made by the Solicitor-General on behalf of the Commissioner under section 111—viz, that the payments for oil included a “discount”, the amount of which should be disallowed from the total claimed as a deduction. McGregor J. accepted this contention, basing his judgment in this regard upon the evidence of the experts, and he said:

“I must accept from the whole series of transactions, and from the records which are before the Court, that on the whole of the evidence, and in this connection I accept substantially the evidence both of Mr Newton and Professor Leeman, the profit of Pan-Eastern which ultimately came to Europa was a price concession directly related to the cost of Europa’s purchases of gasoline, and the intermediate companies were merely machinery.”

For myself I think that this argument exhibits a fatal fallacy, and indeed at the end of the argument on appeal before us I understood the Solicitor-General to be rather inclined to rely more upon the other one, which for myself I have just dismissed. It seems to me to be clear that the notion of a “discount” subtractable from gross price, with the result that a “net” price can be arrived at, must necessarily involve a rebate in price allowed between vendor and purchaser, or, if not actually between them, between persons who can be said to stand in their places. But I do not think it can possibly be said in this case that Pan-Eastern, into whose hands the “profit”, “allowance”, or “commission”, on these oil purchases fell, could be said to be standing in the place of Europa, so as to receive anything *on its behalf*. The shareholding in Pan-Eastern, it must be remembered, was held as to half by the American oil companies. The doctrine of *Salomon v. Salomon & Co.* 1897 A.C. 22, must surely prevent this argument from succeeding; and for myself I do not see how the “discount” argument can survive this point, even if it could have been shown, at the next stage, that more was paid in New Zealand for the oil than need have been paid, if in making the contract Europa had more diligently beaten down its suppliers to the best available figure.

But, with regard to this last point, I am of the opinion, as I have already stated, that it cannot be sufficiently satisfactorily concluded on the evidence that even in 1964 Europa Refining could itself have obtained any further discount in New Zealand on the prices which it then contracted to pay, over and above such discounts as it actually received here from its suppliers. The evidence is rather the other way, and I have already referred, earlier in this judgment, to the considerations which must result in the failure of the Commissioner’s submissions on this point.

I do not think that it is permissible, in deciding whether a discount

has been obtained on expenditure, to look at the “global effect”—economic, not legal—of a number of transactions, some being transactions to which the taxpayer was a party, and other transactions to which he was not, and to say of the whole of them broadly that their “overall effect” is that the price which in some of these transactions he pays for goods is subject to a discount, simply because at the end of all the transactions the taxpayer, or someone representing him, is left with a residual fund in hand. The question is not whether the taxpayer or anyone else is left at the end with a fund in hand, but whether, if he is, that fund is in hand by reason of a discount having been granted to the purchaser from the price of the goods which he paid. And if the fund is produced or engendered by some transaction other than the granting of a discount, it is not to be called a discount because, if the purchaser had been allowed a discount, the result would have been the same. A taxpayer is not to be taxed upon transactions into which he might have, but did not, enter.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

10

20

30

40

Now what were the transactions into which the parties entered in (for instance) the 1956 contracts? There was a contract to buy and sell gasoline, entered into between Gulfiran as vendor and Europa as purchaser. Every penny of the deductions claimed under the 1956 contracts was expended in cash in the payment of debits presented by Gulfiran under this contract, in respect of gasoline actually supplied, at the rate specified in the contract. But it is said that there was “in reality” a discount allowed on this price. This, it is said, was brought about by the cumulative effect of the following transactions: (1) A contract between Gulf and Europa to set up a “refining company”—Pan-Eastern—in which each should hold half the shares; (2) The incorporation of Pan-Eastern as arranged; (3) A contract between Pan-Eastern and Gulf whereby Pan-Eastern contracted to buy from Gulf, and Gulf to sell, at posted prices, such crude oil as would furnish Europa with its requirements of gasoline; (4) A contract between Pan-Eastern and Gulfiran by which Pan-Eastern agreed to sell, and Gulfiran to buy, the gasoline so refined, at a price calculated from current market price according to a formula set out in the contract; (5) A contract between Gulfiran and Europa by which Gulfiran agreed to sell and Europa to buy the latter’s whole requirements of gasoline at prices fixed by reference to market rates; (6) A contract of affreightment between Gulfiran and Europa for the carriage of this gasoline to New Zealand. All these six contracts were made interdependent upon each other; and there was another (7) A contract between Pan-Eastern and Propet whereby Propet agreed to buy and Pan-Eastern to sell all the residual products of the refinement of the crude oil bought by Pan-Eastern from Gulf as above, at a price related, not to the market price of these products, but related, through the formula which I have mentioned, to the market price of the gasoline. The effect of this last transaction was to produce a profit in the hands of Pan-Eastern on the sale of the “heavy-ends” exactly equivalent to the profit which had been made on the sale of the gasoline refined from the same crude oil; the result was that the profit in the hands of Pan-Eastern was always exactly

double that made through the application of the formula on the sale of the gasoline. And this double profit, being the profit of a company in which Associated Motorists held half the shares, meant that in the ultimate result, on the declaration of the necessary dividends, Associated Motorists, or its shareholders, must receive a gain exactly equivalent (allowing for the costs of administration) to the whole profit derived from the sale of the gasoline.

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—*continued*

10 There can to my mind be no doubt but that if, instead of being (as it was) a notional refiner only, Pan-Eastern had been established with a much larger capital, still held in equal shares by Europa and Gulf, and had established with these larger resources its own refinery, physically refining the oil which Europa ultimately required and no other oil, and had made from these physical operations the same profit which in fact resulted from the notional ones, it would have been impossible to argue that the profits which it so made were anything but profits legitimately derived by Pan-Eastern from an ordinary commercial transaction, not possibly to be treated as a discount in the hands of someone else. *Salomon v. Salomon & Co.* 1897 A.C. 22, must have stood as a fatal objection to any such contention. But how can it make any
20 difference on this point that the operations of Pan-Eastern were notional and not actual? If I contract to grow and sell to X so many sacks of potatoes of a given quality, and then, without planting a potato or securing any land upon which to grow one, I arrange when the time for supply comes to purchase potatoes of the required quality from some grower who has gone to the necessary trouble, and, purchasing the potatoes, supply them to X on the contract dates, and he, satisfied with the supply, pays the contract price, how can it lie in the mouth of the Commissioner of Taxes to say that I have not as a matter of reality produced the potatoes, or that the effect of my performance
30 of the contract is in any way different, for taxation purposes, from what it would have been if I had acquired the land and grown every potato myself? In the case before us Pan-Eastern was a separately incorporated company, some but not all of the shares in which were held by a subsidiary of Europa (I speak in broad terms, but we were especially informed that nothing turned on this point). This separate company cannot, when the effect of section 111 is being considered, be treated as other than a separate entity, and the profit which it derived cannot, by the invocation of section 111 alone, be deemed to be derived by someone else—e.g., the present appellant. It may be argued of course
40 that the purpose of the payments to Gulfiran was a dual one—but this is an argument which I have already dealt with. It may be argued, on a suitable set of facts, that the transaction is a “sham”, and that on this account what appears on the surface of the transactions as other than a discount is really to be treated as a discount. But no one suggested in the case before us that the transactions which I have mentioned amounted to a “sham”, and this argument need not be considered. It was in my opinion impossible to raise it on the facts; it would have been hopelessly untenable. What we are now considering is simply whether the profit *derived by Pan-Eastern* from the contracts of 1956 can be

called a "discount" *in the hands of Europa*. For myself I do not see, notwithstanding the conclusion to the contrary of the learned trial Judge, that this is possible.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

The same result must in my opinion follow any attempt to construe the effect of the 1959 contracts to be the grant of a discount to Europa. What was done in 1959 can be simply stated. The profit derived by Pan-Eastern from its notional refinement of gasoline and the supply of this commodity to Europa, under the 1956 contracts, would, if the posted price of crude oil and the market price of gasoline had remained constant at the figures prevailing on the contract date, have resulted in a profit of 2.5 cents per gallon on every gallon of gasoline sold by Pan-Eastern to Gulfiran, and of an exactly equivalent aggregate amount on the corresponding sales of "heavy ends" to Propet. This profit, however, could become greater or less by reason of fluctuations in the two variable figures which I have mentioned. If posted prices of crude oil fell, or the market price of gasoline rose, the profit would increase; if posted prices of crude oil rose, or the market price of gasoline fell, profits would decrease. Because of this, the "formula" in the contract was devised. It is not necessary to examine it, but it contains a factor, the effect of which was (1) to produce, as on the prices current on the day of the contract, a profit of exactly 2.5 cents per gallon of gasoline sold and (2) to "cushion" the impact of fluctuations in price so as to make their effect less, and the profit more stable, than would have been the case without this factor. But by 1959 market conditions had changed considerably from those prevailing in 1956. By 1959 Pan-Eastern's operations, in which it was necessary to have the oil refined by someone else for a fee, would at the prices then prevailing, have had some difficulty in showing a profit; and even after the application of the formula its profit was greatly diminished. In these circumstances Europa approached Gulf, asking that some new formula should be devised designed to produce a more constant profit, nearer the rate of 2.5 cents per gallon prevailing at the inception of the operation. There was no need for Gulf to agree. The parties were bound by a 10-year contract, which had run for only 3 years. Gulf could at this stage have stood on this contract. But two considerations were persuasive against so intractable an attitude. One was the desirability of retaining the goodwill, even beyond 1966, of a purchaser of gasoline who was necessary to Gulf's economy, and by whose help an accumulation of gasoline in Gulf's hands could be overcome, which otherwise must stand in the way of further increasing its market for "heavy ends". The other was the threat of the impending establishment of a refinery in New Zealand. The second of these two factors proved crucial. Gulf gave way, and a new formula was negotiated. Several suggestions were made; but in the upshot it was agreed that Pan-Eastern was now to receive 2.5 cents flat rate profit per gallon on the gasoline sold to Gulfiran for resale to Europa, this profit being "doubled" again in the hands of Pan-Eastern by the process which I have already described. And this flat profit was backdated to the beginning of the contract. But this was done as the ultimate result of a lengthy process of bargaining, and bargaining by

the toughest description. To describe the parties merely as at arms' length is greatly to understate the matter. It was a tense struggle for commercial advantage. And it is the accumulation of Pan-Eastern's ultimate profits, derived under an amended contract resulting from this process of negotiation between parties at arms' length, which it is now sought to describe as a "voluntary discount" granted by the suppliers to Europa. It is true that in the correspondence setting up the amended arrangement Europa, as well as Gulf and Pan-Eastern indeed referred to the allowance to be made to the last named as a "voluntary discount".

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10 No doubt in a sense it was—a discount allowed by Gulf to Pan-Eastern on the latter's purchases of crude oil, and allowed, moreover, by arrangement with Europa. But I am unable to take the next step taken by McGregor J., and to conclude that this "voluntary discount" so allowed by Gulf to Pan-Eastern should be deemed to be a discount allowed by Gulfiran to Europa. I find it no more possible to take this step under the 1959 contracts than under those of 1956, and for virtually the same reasons. And if the "voluntary discount" allowed to Pan-Eastern is not to be a discount allowed to Europa then, however much a discount it may be, it does not matter.

20 The 1962 contracts form a different pattern. This set of arrangements was substituted for the 1959 contracts by reason of the establishment in New Zealand of the refinery at Whangarei, in which all the oil retailers, including Europa, had an interest. It became desirable for all the companies to review their supply arrangements, and this was done in the case of Europa as with the others. The old contracts were amended by agreement and after a brief period of overlap in which both the new and the old contracts were collaterally operative, a new set of arrangements became effective between Gulf and its associates and Europa and its subsidiaries the purport of which

30 was as follows: (1) Europa Refining, instead of Europa, became the purchaser of oil—but now not fully refined gasoline, as earlier, but naphtha feed-stock. The change in the identity of the company purchasing does not matter, as the interlocking of the shareholdings makes it irrelevant, as counsel on both sides agreed, whether Europa or Europa Refining was the company supplied. (2) Europa Refining agreed to buy all its requirements of naphtha feed-stocks from Gulfex, a subsidiary of Gulf, and Gulfex agreed to supply the same, at current market prices. (3) Gulf agreed to sell and Pan-Eastern agreed to purchase sufficient crude oil to yield the quantity of naphtha feed-stocks required

40 by Europa Refining at posted prices. (4) Pan-Eastern agreed to sell and Gulfex to buy the naphtha feed-stocks produced by this crude oil at the same price at which the same should later be sold by Gulfex to Europa Refining. (5) Pan-Eastern agreed to sell and Propet to buy the "heavy ends" resultant from the refinement of the crude oil necessary to produce the above quantity of naphtha, at a price sufficient to produce in the aggregate the same amount of profit as had been realised by Pan-Eastern on the sale of the naphtha supplied to Gulfex. (6) There was a contract of affreightment the details of which need not now be set forth, except that it should be noted that the rebate on

freights consequent upon the provision as to “staging points” in this contract was payable not to Europa Refining, but to Pan-Eastern. It may be noticed that the consequence of this would be that the freight rebate which formerly accrued to Europa under the old contracts was now to go into the coffers of Pan-Eastern, with the result that only half of it, and not the whole, would ultimately find its way back to the New Zealand group.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

10 These 1962 contracts were superseded in 1964, before they had actually come into operation, by another set of contracts, identical with those described above except as to one point, a comparatively small one. This was that the rebate allowable under the contract of affreightment was given back to Europa Refining in the 1964 contracts instead of being given to Pan-Eastern, as in those of 1962. The reason for this was simple. Europa had been informed in New Zealand by the Commissioner of Inland Revenue, in a letter which is given some attention hereafter, that the contracts of 1956–59 did not appear to the Commissioner to give any ground for the reassessment of Europa. It became apparent to Europa’s advisers that if any new contracts were now to be entered into they should be made as nearly as possible in terms identical with those of 1956–59, so as to give as little reason as possible for any change of attitude on the part of the Commissioner. As the contract of affreightment of 1962 had altered the ultimate destination of the rebate consequent upon the provision as to “staging points”, it was thought desirable to change back to the position obtaining under the 1956–59 contracts, and to make the affreightment rebate accrue directly to the New Zealand consignee—in this case Europa Refining—as had been previously the case. This was done accordingly.

30 I do not find any reason for differentiating between the contracts of 1956, those of 1959, and those of 1962–64, in deciding whether the Commissioner, having regard to the provisions of section 111 only, could disallow in part the deduction claimed for expenditure on purchases of oil, any more than McGregor J. did in the judgment appealed from. And I am of the same opinion as regards the variations of 1965–66, in which a direct discount was allowed to Europa on the feed-stocks purchased. The result of this last variation was that the prices which Europa paid were less, and the prices received by Pan-Eastern underwent a corresponding reduction. The accountancy effect of all this was simply to increase the profit of Europa in New Zealand, and to decrease that of Pan-Eastern in the Bahamas by exactly twice the amount, it being remembered in this regard that the ultimate dividend of Associated Motorists, which held half the shares in Pan-Eastern, would be decreased by exactly the amount by which Europa’s profit had been increased by the operation. All this followed as a necessary contractual result of the grant of a discount to Europa in New Zealand. The Taxation effect was to make Europa directly liable for income tax upon the amount of the discount given in New Zealand. That discount consequently becomes irrelevant in the present case, for tax had been paid upon it in full, and the taxability of the *balance*

of the income of Pan-Eastern thereafter, which is all we are concerned with in this case, is unaffected by the grant of the discounts.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

10 For the reasons which I have endeavoured to express I have for myself arrived at the conclusion that the facts in this case cannot support the submissions made for the Commissioner under section 111; for, I have endeavoured to explain, it is impossible to describe the profits which ultimately accumulated in the hands of Pan-Eastern as a “discount” which may be subtracted from the price paid for oil by Europa to Gulfiran. On the other hand the price which Europa paid, being in fact paid pursuant to a genuine contractual obligation incurred in the purchase of necessary goods, cannot be apportioned by the Commissioner, unless it can be shown that the price paid was more than was necessary, and that it can be predicated of the transactions that they cannot be explained by ordinary commercial dealing. I have held that there is no evidence that too much was actually paid; and also that the transactions did not lead to the predication necessary for the conclusion submitted by the Commissioner.

20 In deciding, as he did, that the residuary profit in the hands of Pan-Eastern arising from the sale of gasoline to Gulfiran should be subtracted from the price paid by Europa to Gulfiran, as a “discount”, McGregor J. seems to me to have arrived at the wrong answer through having asked himself the wrong question. This is a process familiar to all philosophers, and one eternally exemplified in the realms of science by the stultification which followed upon Michelson and Morley’s famous investigation into the problem of relativity in 1887. The learned Judge asked himself whether Pan-Eastern was a “true refinery”, and whether the “real effect” of the transactions was to produce a benefit “equivalent to a discount” to the purchaser. He introduced these topics by saying at page 6005 that:

30 “By the arrangement with Europa, Gulf obtained a market outlet in New Zealand without making an investment of its own. Owing to the nature of the Gulf-Shell contract, and it would appear owing to Gulf’s relationship with other international oil companies operating through subsidiaries in New Zealand, Gulf was not in a position to sell gasoline at a discount which would disturb the market in New Zealand, and which in particular would have affected Gulf’s relationship with Shell. To obtain the Europa outlet for gasoline, Gulf could not give to Europa any direct discount on posted prices, and any concession to obtain the Europa outlet had to be provided by Gulf by some indirect means. The posted prices
40 represented the market level of Middle East oils.”

With this introductory statement I entirely agree. Having examined the facts of the “refinery arrangement” through which Pan-Eastern derived its profits, McGregor J. then alluded to Professor Leeman’s evidence, and said at page 6008, in a passage which I have already quoted:

“In my view Professor Leeman’s evidence as to the nature of the amendments is a fair summary. Pan-Eastern was made into a repositi-

tory for a shared discount to Europa, a minimum $2\frac{1}{2}$ cents per gallon on gasoline purchases by Europa for the duration of the agreement. In effect, while the parties avoided any expression of discount, *the effect was a benefit to Europa through Pan-Eastern and A.M.P. of what was equivalent to a discount on the price of Europa's gasoline purchases.*"

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

The learned Judge then proceeded to examine the 1964–66 contracts as he had examined the earlier ones. Having done so he said at page 6014 of the agreement with P.T.T.

10 “The agreement falls into the general pattern of commissions or concessions being received by Europa outside New Zealand through subsidiaries, and is another indication of an indirect concession or discount on products purchases by Europa in New Zealand.”
and at page 6016.

20 “In my opinion in all the contractual dealings on the part of Europa in obtaining gasoline supplies it is clear that *it contracted for a concession on posted prices* based on the volume of its purchases. In the 1936 arrangements with Caltex, putting aside the small qualitative concession, there was a freight concession throughout. This freight concession was directly related to the quantity of gasoline purchased. In the 1954–1955 negotiations with Caltex Mr Todd was endeavouring to obtain what can broadly be described as a volume discount on purchases, and also a volume discount on freights. To these proposals Caltex would not agree, and it was then he commenced negotiations with Gulf. I accept that Gulf, for the reasons I have already given, was not prepared to agree to a direct discount to a New Zealand purchaser on posted prices. Gulf was anxious to secure the Europa contract. The parties then explored ways and means of giving an indirect concession. No doubt the
30 scheme of incorporating Pan-Eastern in the Bahamas originated with Gulf. No doubt consideration of the refiner's profit was a basic factor in the provisions of the 1956 series of contracts. I do not think these contracts can be considered individually. They are all allied and form parts of one complete and related arrangement between the two companies and their respective subsidiaries, all under the control of the two principal contracting parties. The recitals in the various contracts show clearly that they are inter-linked. The whole basis of the arrangements was that Europa should obtain *what might be described as a refund* through Pan-Eastern and A.M.P. of 2.5 cents per gallon on its cost price in New Zealand
40 of gasoline. This is amply confirmed by the correspondence contained in Ex. B14 from 1949 onwards, and this was the result attained. The elaborate provisions in regard to the sale of crude, the refining of the crude, and the resale of the heavy products to Gulf, and of the gasoline and gas oil to Europa was, as has been said, *a notional arrangement. In fact, it might be described as a fictional arrangement*, and the practical method of carrying the contractual provisions into effect was simpler and more direct, but attains the same desired intention. The complete series of contracts and the series

of events must be regarded as one whole. It would be quite lacking in reality to regard any of these individually.

“The 1962 and 1964 contracts established a similar pattern. The indirect concession or concessions to Europa based on the volume of feed stocks it purchased, and which were derived from Gulf supplies of crude. Again a concession, although in this case a direct concession or discount to another overseas subsidiary, P.T.T., formed an essential part of the B.P.-Europa arrangement.

10 “I must accept from the whole series of transactions, and from the records which are before the Court, that on the whole of the evidence, and in this connection I accept substantially the evidence both of Mr Newton and Professor Leeman, *the profit of Pan-Eastern which ultimately came to Europa was a price* concession directly related to the cost of Europa’s purchases of gasoline, and the intermediate companies were merely machinery.”

McGregor J. concludes this part of his judgment with a further examination of the “refinery venture” of Pan-Eastern.

20 “In my view” (he said) “the parties recognised that participation in what was equivalent to the refiner’s profit, even although Europa would not or could not engage itself in refining operations, would be a means of providing Europa with a concession on its cost price of gasoline. Likewise, Gulf was prepared to grant such concession to obtain a market for gasoline of which it was likely to have a surplus, and to obtain a greater volume of production and sale of crude oil.”

And he concludes on page 6018:

30 “I therefore find as facts that Pan-Eastern cannot be regarded as a conventional refining venture, as suggested by the objector; that the primary object of the arrangements was to enable Europa to obtain products and later feed stocks at a concession price which would avoid the repercussions or embarrassments of departing from the pattern of posted prices; *that the arrangement, while of a commercial nature, was not a refining venture*, and the arrangements merely provided for a guaranteed return to Europa directly related to Europa’s own purchases, although the estimated anticipated profits or anticipated return was based on what might have been *expected from an alternative joint refining venture. But there was never such a joint refining venture*, and Europa was relieved from making the necessary substantial investment in such a venture.”

40 It is perfectly plain that in these passages McGregor J. was asking himself (1) whether Pan-Eastern could be regarded as a “conventional refining venture”—to which he returned the answer “No”, and whether “the effect” of the transactions was “equivalent” to a “discount” on the price of Europa’s gasoline purchases, as was the view of Professor Leeman (an economist, not a lawyer)—to which he returned the answer “Yes”. I do not accept the view that the “effect”—i.e., the *economic effect*—of these transactions furnishes a touchstone in this matter. Professor Leeman, an economist of repute, is no doubt

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

to be listened to when he gives his opinion on this question. But unfortunately it is not the question which must be asked. The question to be asked here is what was the true *legal* effect of the transactions into which these parties entered? Of course if the transactions had been “shams” other considerations would apply; but it was never contended by anyone that they were “shams”. And of course if section 108 is invoked, the legal transactions into which the parties entered may be avoided—but we have not come to that argument yet. The inquiry at this stage is as to the result of what was done, conceding
 10 that the transactions were not “shams”, and without recourse as yet to section 108. At that stage the only inquiry in my opinion is: what was the legal effect of the transactions into which the parties actually entered—not, as Professor Leeman posed the matter, what was the result in the eyes of an economist, or whether the result was “equivalent” to the result which would have supervened upon other transactions into which the parties, might have entered, but did not.

In the Court of
 Appeal
 No. 6
 Judgment of
 Turner J.
 21 November
 1969
 —continued

Whether or not Pan-Eastern was a “conventional refinery” does not seem to me to matter one jot. I do not hesitate to agree with all the conclusions of the learned trial judge when he accepted Professor
 20 Leeman’s view as to the notional—even fictitious—nature of the refining operations attributed to that corporation. These were matters in the Professor’s province, and I accept his views with becoming respect. But in my opinion the result in this case must be exactly the same whether the oil was actually refined by Pan-Eastern or not, and whether the “refinery” set up by the parties was “conventional”, “notional”, or “fictional”—and it would have been the same if instead or setting up a notional refinery what the parties had done was to
 30 arrange—as they did in one of the 1966 contracts—for a company abroad in which Europa had a shareholding simply to be paid a commission on the oil which Europa purchased. The questions to be asked are still the same—first, did Europa pay, in New Zealand, more than it would have had to pay if its supply had been purchased otherwise than under the questioned contract? Second, if so, can it be predicated of the extra amount paid that it was paid for some purpose other than the production of the assessable income? Third, whether or not the amount paid in New Zealand was more than what would have had to be paid had supplies been obtained otherwise than under the
 40 questioned contract, was there some refund or allowance made to Europa, or someone at its behalf, by way of discount or commission in New Zealand or abroad? The answers to these questions seem to me not to depend at all on whether the refining operations of Pan-Eastern were actual or notional. Having come to the conclusion that the evidence answers all three questions in the negative, I have for myself concluded in the result that the submission made for the Commissioner under section 111 must be disallowed.

The second principal submission made for the Commissioner was based on section 108. This section at the material times provided:

“Every contract, agreement, or arrangement made or entered

into, whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax.”

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10 It was the submission of the Solicitor-General that the contracts of 1956, 1959, 1962, and 1964, whether looked at separately or together, constituted an arrangement or arrangements having the purpose and the effect both of altering the incidence of income tax and of relieving
10 appellant from its liability to pay income tax. If what was done by Europa amounted to an arrangement or arrangements falling within either of these categories, the effect of section 108 is to avoid absolutely that arrangement or arrangements. But this effect of “annihilation”, as it has been called, does no more than enable the Commissioner to assess the taxpayer as if the transactions challenged had never been entered into at all. The Commissioner is not empowered by the section to substitute for the actual challenged transactions other hypothetical transactions into which the parties did not enter, though they might
20 have done so. The result is that while in the cases of some kinds of arrangements the avoidance of the transactions entered into leaves income derived by the taxpayer (for instance) assessable without taking into account in his favour a deduction which the challenged transactions would have set up (*Elmiger v. Commissioner of Inland Revenue* 1967 N.Z.L.R. 161), in other circumstances the avoidance of the challenged transactions, and their consequent “annihilation”, leaves behind a state of affairs upon which it is difficult to make an amended assessment without substituting other hypothetical transactions for those into which the parties actually entered.

30 In the kind of situation which is illustrated by the circumstances of the case now before us it becomes extraordinarily difficult, if the Commissioner’s first proposition is accepted (and the “arrangements” are held void) to decide what the result should be from a taxation point of view. For myself I do not see how it can be contended that the incorporation of Pan-Eastern could be an “arrangement” which could be held void. But once the incorporation and existence of that company is left unchallenged, the picture emerges of a separate duly constituted legal entity carrying on business abroad, entering into trans-
40 actions abroad, with persons other than Europa—for as far as I can remember the case Pan-Eastern never contracted directly with Europa at all. These being the circumstances in which Pan-Eastern derived its profit, I cannot see how the notional “avoidance” of the contracts (to some of which, it must be remembered, Europa was not even a direct party) can result in Europa being deemed to have derived a profit which in fact it never derived, by the effect of section 108; and I agree with the conclusion to which the members of the High Court of Australia came in *Cecil Brothers v. Federal Commissioner of Taxation (supra)*, and am prepared to hold in this case, as they did in that, that section 108 can have no logical application. The facts of the two cases, indeed, as I have already pointed out, have some

remarkable essential similarity. But in the case before us there is the additional detail, in favour of the taxpayer, that the transactions by which the profits were accumulated in the hands of Pan-Eastern were all transactions outside the jurisdiction, between persons not resident or domiciled within it—in fact they never came into it at all. *A fortiori*, it seems to me, the same result which followed in *Cecil Bros.* case should follow here.

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10 Even if I had been of a different opinion, and had been preparing to hold that the effect of notionally annihilating in New Zealand, in favour of the Commissioner, the arrangements between Europa and the other parties, including in these some arrangements made between the other parties only, as a part of the whole, yet I should still have held that there was no evidence in this case, or insufficient evidence, to enable the Court to find that the test proposed by Lord Denning in Newton's case was met. That test as I pointed out in *Elmiger v. Commissioner of Inland Revenue* 1967 N.Z.L.R. 161, at page 187, should in New Zealand undergo some small degree of paraphrase, so as to meet the exact words of the New Zealand section. In this country, in order to bring the arrangement within the section, it must be possible to pre-
20 dicate of the arrangement challenged, by looking at the overt acts by which it was implemented, that it was implemented in that particular way so as to alter the incidence of income tax, or so as to relieve the taxpayer from his liability to pay income tax. I do not think that it is possible so to predicate with sufficient certainty when the challenged transactions are surveyed through the complicated jungle of counter-
30 vailing commercial considerations which surrounds them. No doubt, for instance, Pan-Eastern was set up and incorporated in the Bahamas and not in New Zealand, at least partly so that any income which it might derive should not be liable for tax in New Zealand. But it might equally well be said that the reason for not incorporating it in the United States was so that it should not be liable for tax in that jurisdiction. It must be remembered that the shareholding was held equally between the two groups, and it was at least as logical to set up Pan-Eastern as an American company as it would have been to set it up as a New Zealand one. For these and other reasons I have thought it impossible for the Commissioner successfully to challenge the incorporation of Pan-Eastern under section 108. But once that incorporation is duly established it must be shown that the effect of Pan-Eastern being given a profit was to increase the price which Europa
40 must pay in New Zealand for its oil above the price which it would otherwise have had to pay. If this had been shown there might indeed have been ground for applying *Elmiger v. Commissioner of Inland Revenue* (*supra*) to the facts of this case. But this was not shown. McGregor J. did not find, and I cannot for myself think that the evidence would have justified a finding, that at the stage when any of the contracts which are now challenged was made it was possible for Europa to insist upon a substantially lower price for the supplies which it required than the price which it actually in the event paid. The evidence was all the other way. And once this is recognised, the factual
50 foundation for the Commissioner's submissions under section 108 seems

to me to vanish away. For all these reasons I would disallow the submission made upon this section.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

In all that I have so far said I have been considering the application of the Solicitor-General's submissions, made under section 111 and under section 108, to the transactions by virtue of which Pan-Eastern derived its income. I now turn to those by virtue of which P.T.T. derived its income. P.T.T. was a wholly owned subsidiary of Europa, and was set up especially for the purpose of receiving, in England, "commissions" paid to it in respect of sales of kerosene by B.P. and its subsidiaries to Europa in this country. The President has summarised the facts of these transactions and I need not repeat them in my judgment. It is sufficient to say that these oils were purchased in New Zealand by Europa from B.P. or its subsidiaries at posted prices, but upon the understanding that a commission at stated rates should be paid to P.T.T. in England in respect of all sales so made. It was contended by the Solicitor-General that the amount of such commissions should be subtracted from the deduction allowed to Europa for purchases of oils under section 111, for the same two reasons as had been put forward in respect of the profits derived by Pan-Eastern from transactions in gasoline sold to New Zealand. Having reflected on these submissions, I think that they should be disallowed, for the same reasons as those which influenced me in rejecting them on the Pan-Eastern transactions. As to the first (that the commissions constituted "discount" to Europa), I cannot agree that the commission paid to P.T.T. must be a "discount" properly subtractable from the gross purchase price of the oils bought by Europa, because the discount, if it be a discount, was allowed or paid, not to Europa in reduction of the purchase price, but to a company with a separate identity, and this notwithstanding that the company was a wholly owned subsidiary. I do not read the decision of the English Court of Appeal in *Littlewoods'* case as supporting the Commissioner's submissions that the fact of P.T.T. being a wholly owned subsidiary is significant, and that a discount allowed to it must be regarded as one allowed to Europa. The judgment in that case of Lord Denning M.R., it is true, might by itself be read as a pronouncement tending to erode the long-standing authority of *Salomon v. Salomon & Co.* 1897 A.C. 22. The Master of the Rolls, dealing with the argument that the case before the Court was distinguishable from *Inland Revenue Commissioners v. Land Securities Investment Trust Limited* 1968 1 W.L.R. 1446, on the ground that the income had been derived not, as in the earlier case, by the taxpayer company, but by a different company, albeit a wholly owned subsidiary, appears to have gone so far as to say that a wholly owned subsidiary, at least in the circumstances of the case before him, could not be regarded as a separate and independent entity. He said at page 1253 of the report:

"I cannot accept this argument. I decline to treat the Fork Manufacturing Co. Ltd. as a separate and independent entity. The doctrine laid down in *Salomon v. Salomon & Co.* (1897 A.C. 22) has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which

the courts cannot see. But that is not true. The Courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The Legislature has shown the way with group Accounts and the rest. And the courts should follow suit. I think that we should look at the Fork Manufacturing Co. Ltd. and see it as it really is—the wholly-owned subsidiary of Littlewoods. It is the creation, the puppet, of Littlewoods, in point of fact: and it should be so regarded in point of law. The basic fact here is that Littlewoods, through their wholly-owned subsidiary, have acquired a capital asset—the freehold of Jubilee House: and they have acquired it by paying an extra £19,006 a year. So regarded, the case is indistinguishable from the *Land Securities Case*. Littlewoods are not entitled to deduct this extra £19,006 in computing their profits.”

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

10

20

30

But Lord Denning did not attract the assent of either of the other two members of his Court to these widely expressed propositions. Sachs L.J. and Karminski L.J. agreed with the result which he proposed, but on ground narrower than that by which he had supported it. Karminski L.J. was brought to his conclusion by the argument that though the two companies were indeed separate entities in law, the one which “really benefited” from the transactions was Littlewoods, and not the Fork Company. Having regard to this conclusion of fact, he was able to discard the argument based on identity, and to proceed, without it, to examine the submission of duality of purpose notwithstanding the lack of identity between the two companies. Sachs L.J., pointing out that counsel for the commissioners had expressly declined to submit the argument accepted by the Master of the Rolls, and for himself declaring, at page 1255, as regards the principle in *Salomon’s* case, that “nothing in this judgment of mine is intended to have any . . . erosive effect” simply concluded that when the true nature of the transaction was examined it was proper, on the principles of proper commercial accounting, to attribute a substantial proportion of the payments made to a purpose other than that for which the statute allowed a deduction. Duality of purpose, accordingly, was decisive of the issue.

40

The second of the submissions made for the Commissioner in the present case, regarding the transactions from which P.T.T. derived its “commissions”, as seen in the light of the decision of the Court of Appeal in *Littlewoods’* case, must simply be this: can it properly be said of these transactions that they exhibit a duality of purpose justifying the Commissioner in apportioning the payments made for purchases of kerosene? Had the evidence supported the proposition that Europa could have purchased its oils, at the time when the contracts were entered into, at prices substantially less than those contracted for, but preferred instead to purchase at the higher rate for the purpose of building up a fund in England, then the submission might have succeeded. But I apply to these transactions the same test which I applied to those of Pan-Eastern. There appears to me to be no satisfactory evidence that without setting up an English company to

receive a commission in England Europa could have purchased in New Zealand at a rate substantially less than it actually paid. The evidence is all the other way. B.P. actually refused to allow any price concession in New Zealand. I am sure that it cannot possibly be predicated of these transactions, any more than of those in which Pan-Eastern was concerned, that they are not explainable by reference to ordinary commercial dealing. For exactly the same reasons, therefore, as those which influenced me to reject the submissions made under section 111 for the Commissioner on the Pan-Eastern transactions, I reject the same submissions on the P.T.T. transactions.

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

In the view which I have taken it has not been necessary for me to discuss the point of estoppel which was raised by appellant, and disallowed by McGregor J. in the Court below. This submission was founded upon a letter which the Commissioner wrote to Mr Todd on behalf of appellant, dated 27 June 1963, in the following terms:

27 June 1963

“Bryan Todd Esq.,
110–116 Courtenay Place,
Wellington, C.3.

20 Dear Mr Todd,

You will recall that in March last we discussed the effect on New Zealand taxation of a number of contracts between Europa Oil (N.Z.) Ltd., Gulf Oil Corporation and Pan-Eastern Refining Co. Ltd. I advised then that I would refer the agreements to the Solicitor-General for consideration of their validity under New Zealand legislation.

I have now received his advice, with which I am in agreement, and propose to take no action to disturb the present position.

30 The further question of my obligation to disclose the information to the American Revenue authorities under the double tax agreement with the U.S.A. will be considered when the investigation is complete.

I am arranging for Mr Tyler to return to you the copies of contracts which you made available to him.

Yours faithfully,
F. R. MACKEN,
Commissioner of Inland Revenue.”

40 It was contended by Mr Mahon that this letter amounted to an unequivocal intimation that the Commissioner would not reassess appellant. Mr Mahon submitted (1) that the letter gave rise to a promissory estoppel (2) that it constituted an election by the Commissioner to stand upon the assessments previously made and (3) that it amounted to the exercise of the Commissioner’s discretion (to reassess or not to reassess) under section 22, once and for all, and that, having exercised

this discretion by making a decision not to reassess, the Commissioner could not thereafter revise such decision.

In the Court of
Appeal

No. 6

Judgment of
Turner J.
21 November
1969

—continued

McGregor J. disallowed these submissions. It is not necessary, in the view to which I have come, to consider the matter; but in case the dispute between the parties goes further I think it desirable to add that had it been necessary for me to consider the submissions I would have disallowed them also, in the same way as McGregor J. It seems to me that no question of promissory estoppel can arise in this case, and that Mr Mahon's submission under this head involves some misconception of that doctrine as it has been explained by the Judicial Committee in *Emmanuel Ayodji Ajayi v. Briscoe* 1964 3 All E.R. 556 at page 559. As to election and the exercise of discretion, I am of opinion that the Commissioner cannot be precluded by the application of these doctrines from doing his duty as directed by the statute: see, in this regard, *Maritime Electric Co. Ltd. v. General Dairies Ltd.* 1937 A.C. 610 at pp. 619–20. Moreover, in any case it would seem to me that he who invokes such doctrines will himself be precluded from relying upon them, if his own acts or omissions have resulted in him who is set up as having elected being less than fully informed on the facts upon which an election is submitted. I do not say that the facts in this case demonstrated an improper or deliberate withholding of essential information by appellant; but it is clear to me that the Commissioner, at the time when he is said to have elected, or to have exercised his discretion, must have done so on less than a full disclosure of all the facts which were truly relevant to his decision. I agree with McGregor J. that although this may have not been intended on the part of appellant, the degree of non-disclosure amounted to a factor of material importance, and that the Commissioner was in fact influenced by his lack of information to write the letter referred to. For this reason also, then, I would, had it become necessary to do so, have agreed with McGregor J. in disallowing Mr Mahon's submissions.

I ought to conclude, as I began, with some reference to McGregor J.'s judgment on the facts. In the conclusions to which I have come I have in general accepted the learned trial Judge's findings; but in case this matter should go further I will mention some aspects of the facts upon which I would have felt myself compelled to differ from him, and to correct his version, had the matters which I now mention been relevant to the logic of my judgment. These are as follows:

1. In several passages in his judgment the learned Judge refers to the profit of Pan-Eastern as being 2.5 cents per gallon of gasoline. For instance, on page 6004 he says:

“It seems clear from the evidence, and particularly from subsequent adjustments to which I shall refer later, that the intention of the parties was that Pan Eastern's profit should be protected and should be not less than 2.5 cents per gallon on gasoline produced from the crude oil and supplied to Europa.”

It is clear that this is not a correct statement of the facts, and I am confident that McGregor J. was under no misapprehension as

to the true position. It is only the way in which his summary of the result was expressed which was the subject of criticism by Mr Mahon, and I understood the Solicitor-General to accept this criticism as valid. I conceive it to be abundantly clear on the evidence that the effect, for instance, of the contracts of 1959, was that Pan-Eastern should derive 2.5 cents profit on every gallon of gasoline supplied to Gulfiran for sale to Europa, and that it should be credited simultaneously, in respect of the sale to Propet of the "heavy ends" resulting from the refinement of the gasoline, with an equivalent aggregate sum. The final result was the "doubling" which was referred to constantly in the argument; the profit accumulated by Pan-Eastern in the final result was the sum approximating to 5 cents per gallon on gasoline supplied to Europa, one half of which would ultimately find its way, it was hoped, into the hands of Associated Motorists through a process of distribution of profit.

10

20

30

2. In several places in his judgment McGregor J. refers to the "original offer" of Gulf to allow a profit of 2.5 cents per gallon of gasoline. I accept Mr Mahon's criticism of this finding, and do not think it warranted on the evidence. It appears that in the course of the conversations which preceded the making of the 1956 contracts, there was some mention, among a number of other possibilities, of an allowance of this sum, or something like it; but the matter did not get as far as a definite proposal, much less any offer or acceptance of an offer. When the contracts of 1956 were entered into, the formula by which prices were to be calculated was so devised that if market prices of crude oil and gasoline had remained constant the result would have been to produce 2.5 cents per gallon. But it was known to all that they would not necessarily remain constant, and that the resultant profit could go up or down accordingly. McGregor J.'s reference, then, at page 6007 to "the original offer" of Gulf to Pan-Eastern of 2.5 cents must be taken as going too far.

40

3. I cannot accept McGregor J.'s conclusion at page 6009 that there had been in the original Caltex contracts anything in the nature of a "discount". The freight concession made by the prescription of a "staging point" was no more than an attempt to put Europa, as regards freight charges, in the same position as its competitors, notwithstanding that in effect its oil was brought from further afield. And I am not persuaded that there was anything else in the Caltex contracts of which it could reasonably be submitted that it amounted to a "discount" at all; the price, slightly cheaper than market rate, at which Europa received one grade of gasoline arose simply from the fact that the contract had provided on the one hand that Caltex should meet current improvements in quality of its product, but had not provided for any increase in price. Europa in these circumstances insisted upon being supplied with the improved quality gasoline but still at no more than the price which would have been payable on the old quality. I cannot agree with McGregor J.'s terminology when he refers to the result as a "discount".

None of these passages from the judgment of McGregor J. to which

I have just referred have proved of any great relevance in the view to which I have come on the matter under appeal, but I mention them for the sake of completeness. For the reasons which I have endeavoured to set out, I have come to the conclusion on the whole case, first, that it was not competent for the Commissioner on the facts proved to disallow any part of the deduction claimed under section 111 without the aid of section 108; and, second, that in the circumstances of this particular case section 108 cannot assist him by avoiding the challenged transactions, with the result that reassessment becomes possible as a consequence of such avoidance. I would therefore allow the appeal as proposed by the President.

In the Court of
Appeal
No. 6
Judgment of
Turner J.
21 November
1969
—continued

JUDGMENT OF McCARTHY J.

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

The various questions arising in this appeal have been thoroughly covered in the judgments of my brothers which have just been delivered. Consequently I am able to deal with them in a more general manner and to indicate my conclusions in broader terms. Nor need I recount the facts or explain the different abbreviations which we have used, or distinguish between the Europa and Gulf companies and their subsidiaries. The President has already explained why that is so.

10 The Commissioner having disallowed as an expense incurred in earning the assessable income of the appellant, part of the sums paid by it to overseas suppliers for gasoline and other petroleum products in the tax years under review because he would not accept that the whole of that expenditure was incurred in earning that income, the onus was thrown upon the taxpayer to establish that it was. In such circumstances if it can be shown that the expenditure questioned was in fact made in the purchase of goods for the ordinary processes of business trading, there is, if I might adopt a phrase from Lord Donovan in *I.R.C. v. Korner* 1969 1 All E.R. 679, a legitimate prima facie assumption that the expenditure was for the purposes of the trade alone.

20 Then, in my view, an evidentiary burden passes to the Commissioner to show that that was not so. McGregor J. in the Court below decided, in effect, that the Commissioner had done that, and so he upheld the disallowance of that portion of the expenditure which the Commissioner challenged. The appeal to this Court from that finding is a general appeal giving a rehearing on fact and law. *C.I.R. v. Parson* 1968 N.Z.L.R. 375. There is, however, no challenge to the primary facts found by McGregor J.; it is his deductions from those facts, the conclusions he ultimately arrives at, which are under attack. It is accepted that those deductions or conclusions are freely reviewable by us.

30 In disallowing the amounts in dispute in this case, the Commissioner asserted, as a first ground or reason, that the profits of Pan-Eastern and of Pacific Trading should be seen as discounts, albeit indirect ones, to be deducted from the amounts actually paid to Gulf and B.P. for the gasoline and other petroleum products imported. To understand the appellant's answers, and there are more than one, it is necessary to examine each of the different sets of contracts separately.

I take initially the contracts entered into with Gulf involving the setting up of the Pan-Eastern structure. Appellant's basic answer is that all those contracts so far as they involved Pan-Eastern were genuine refining ventures and that the profits from those ventures should be regarded separately and independently of the contract of supply and certainly not as discounts.

40

Neither of the descriptions used by the parties, on the one hand "discount" and on the other "genuine refining venture" satisfies me by its accuracy. The term "discount", as I understand it, is used in commercial circles to indicate a deduction or abatement from the normal value or price, a reduction in the price charged to the purchaser. That is certainly not what was provided for in the contracts we are

concerned with, for not only were there no deductions from posted prices agreed on between purchaser and vendor, but what was characterised by the Commissioner as discounts, were in truth received by another company altogether. So they were not discounts, and to call them "indirect discounts" indicates merely that they were something like discounts, but not ones. Certainly the epithet does not help to solve the problems of this case. But neither do I think that "the setting up of a genuine refining venture", Mr Mahon's phrase, describes in any more accurate way the real character of the arrangement. It verges on the romantic. What happened, plainly, was that the parties constructed an elaborate device to enable Europa to share in the profits to be made on the refining of the quantity of crude needed for the gasoline and other products required by Europa; but despite all the elaboration, it was never intended that Europa should involve itself in the actual processes of refining.

10

20

30

40

But this case does not turn on nomenclature, nor is it influenced by the labels which the parties have obviously sought to attach to the manoeuvres of Europa and Gulf. I have consequently been unable to attribute as much importance as counsel did to the question whether "discount" or "indirect discount", or a term more frequently used by the Solicitor-General in this Court, "price concession" are appropriate. The answer to that question cannot be conclusive of any of the issues we have to decide. But as so much time was spent in this area during the argument in this Court, I should say something more about it and of the findings of McGregor J. in the Court below concerning it.

In the course of his judgment, McGregor J. records the finding of fact that at the time of the first contracts between Europa and Gulf, the 1956 contracts, Gulf was not in a position to give Europa any direct discount off posted prices, and that if it was to obtain the Europa outlet, a concession had to be provided by some indirect means. He then went on to say, and I think this is very important, that "the posted prices represented the market levels of Middle East oils". These findings of fact seem to me to be abundantly supported by the evidence. I see no adequate evidence anywhere that Europa could have obtained a long-term contract covering all their needed imports and erecting necessary safeguards against interruptions of supply by local wars or other catastrophies, which would give discounts, in the true sense, off posted prices. On the contrary I think that the evidence shows that, at any rate in 1956, such a contract was not to be obtained. Indirect concessions, however, were not completely unknown and in those circumstances it is not surprising that Europa and Gulf, particularly in view of Gulf's surplus of crude and its lack of outlets East of Suez for petrol and other light ends of the refined output, should have turned their minds to the ways in which an indirect concession could be constructed.

But, as I have already said, whilst the benefits which Pan-Eastern received under the various contracts should not be equated to discounts between vendor and purchaser, equally I cannot regard the Pan-Eastern arrangement as being a conventional refining venture

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

as, at least at one stage, the appellant asserted. Nor would McGregor J. so regard it. He pointed to a number of circumstances which led him to reject that description. But there are others as well. For instance, the evidence that Europa was supplied, on occasions, out of Venezuela and not out of the Persian Gulf, presumably under Gulf's exchange agreement with Shell. I do not know how it can be suggested that Pan-Eastern refined that petrol. Again the refined products were not charged out at actual yields, but wholly on a hypothetical deemed yield. Then, too, though there were, no doubt, binding contracts of sale in future between Gulf and Pan-Eastern and back again, there was never physical appropriation of goods to those contracts.

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

McGregor J., having held that there was not a true refining venture, went on to say that Pan-Eastern was artificially designed to provide machinery to produce a "price concession" agreed to by Gulf and Europa. It is here, with great respect, I think McGregor J. commenced to move into doubtful ground. His adoption of the term "price concession", from, I think, Mr Newton, rather presupposed a conclusion and could have misled. I prefer to say that the interlocking contracts, though perhaps artificial and to a degree unreal, were designedly constructed to provide an added inducement to entry into the bargain, the inducement being the sharing by Europa ultimately in the profits which were expected to arise from the refining of the products purchased by Europa. To do that an elaborate system was built on the amount of crude oil required to produce the particular products and on the share which the purchaser of only some of those products, as opposed to them all, might be given. Of necessity this edifice had to operate on gallonage bases, this being necessary from the standpoints of both vendor and purchaser so that an impetus to maximum development would be imparted. It seems that for many years Mr Todd had his eyes on seizing at least some of the profits arising out of refining processes, and that when it became apparent that the establishment of a refinery in New Zealand by his organisation was unlikely to be economic, he turned his attention to securing, by one means or another, some of the profits which his suppliers were obtaining from their refining. He was clearly in a position to put pressure on Gulf and did so with extraordinary adroitness.

In his description of the 1956 contracts Professor Leeman speaks of them as constituting a trading agreement, not a refining one. This is right, but when he goes on to say that the contracts were nothing but a "subterfuge" or a "camouflage" for a discount I think he went too far. No doubt in his economist's eyes they produced the same ultimate result, but that is not the issue with which we are concerned. It must be emphasised that the Commissioner at no time has suggested that the arrangement was a "sham". On the contrary, he concedes that the agreements were intended to create legal rights and obligations and did create them. The accounting processes adopted by the parties ensured that those rights and obligations were respected. So their form and legal effect cannot be disregarded now. In this connection I recall what Diplock L.J. said in *Snook v. London and*

West Riding Investments Ltd. 1967 1 All E.R. 518, 528; 1967 2 Q.B. 786, 802: In the Court of Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

10 “As regards the contention of the plaintiff that the transactions between himself, Auto-Finance, Ltd. and the defendants were a ‘sham’, it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of

20 creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities (see *Yorkshire Railway Wagon Co. v. Maclure* (1882) 21 Ch.D. 309; *Stoneleigh Finance, Ltd. v. Phillips*, 1965 1 All E.R. 513, 1965 Q.B. 537) that for acts or documents to be a ‘sham’ with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a ‘shammer’ affect the rights of a party whom he deceived.”

I have said earlier that I see no adequate evidence that Europa could, in 1956, have obtained a discount rightly so described, off posted prices. The Commissioner, however, maintained that the negotiations with Caltex in 1955 provided an example of the way in which one might have been secured. Certainly the cable to Mr Todd of 26 February 1955 did make an offer which, if implemented, would have resulted in a direct reduction of the price charged out by Gulf, something at least very close to a true discount, though I do not overlook that the offer was, at the same time, based on the concept of sharing refining profits.

30 But these negotiations came to nothing because Caltex formed the view that the proposed allowance would provide an undue proportion of a refiner’s margin. More complex formulae were later suggested, including, at one stage, the incorporation of a company in the Bahamas. Gradually the offer moved away from what fairly could be described as a discount and eventually the discussions broke down and were abandoned. These fruitless steps do not in my view invalidate my earlier conclusion that there is insufficient evidence that Europa in 1956 could have obtained a discount in the true sense as part of the supply contract which they obviously needed. This, as I have already pointed out, was

40 the conclusion at which McGregor J. arrived.

And so I consider that it was not established that Europa obtained, or could have obtained, an advantage properly described as a discount under the 1956 contracts, and I move on to the 1959 variations.

It emerges clearly from correspondence relating to these variations that at the time the 1956 contracts were entered into, it was estimated on then existing prices and costs that the profit to Pan-Eastern would prove to be approximately 5 cents a gallon. The formula designed at that time was intended to provide a snubbing effect, to stop the profit

varying widely on either side of this figure. But it did not work in that way, and after an initial rise the profit allowance received by Pan-Eastern over the years fell gradually and persistently from the contemplated 5 cents. Mr Todd consequently took the matter up with Gulf, and urged that the formula be revised. He wanted a result more in line with the 1956 vision. Gulf agreed. It suggested, early in these negotiations, that Pan-Eastern should receive 5 cents flat, neither more nor less. But Mr Todd would not have that. He made the point that he needed a floor below which the price could not fall, but he still wanted the rises above the floor. Then, the parties entered into further

10 involved discussions and emerged with the scheme which has been described in the judgments of my brothers and which by a process of volume discounts on crude oil written into the accounting between Pan-Eastern and Gulf subsequent to the purchase by Europa of the particular products, ensured that the profit to Pan-Eastern did not fall below 5 cents a gallon. Moreover, it gave this variation a retroactive action back to 1956.

There is some evidence that by this time (1959) direct discounts were being reported in Platts Oilgram and other publications. Even so, it is far from established that Europa could have obtained such a discount on products shipped to New Zealand under such a long-term contract as was essential to it. In any event, the 1956 contracts were still binding on the parties, and although by providing a minimum return the 1959 variations might be said to have brought the benefits closer in result to an indirect discount, nevertheless the arrangement was still constructed on the 1956 contracts to which Europa remained bound and they maintained the original concept of sharing refining profits. This sharing in my view should not be seen as the giving of a discount.

20

By 1962 (the year following the B.P. contract to which I will refer later) it became apparent that a refinery in which all the New Zealand distributors would hold shares and from which they would be entitled to draw proportions of the products, would shortly be established in New Zealand. Europa was therefore concerned to see that it had adequate contracts to cover the feedstocks required for its proportion of the output of the proposed refinery. In view of the imminence of the refinery, there was, naturally enough, competition between the international oil companies to secure these valuable sales to Europa, but Europa continued its association with Gulf (as, I suggest later, it seems clear it was really in the position of having to do so) and entered in

30 40 1962, into agreements covering the envisaged situation. However, these contracts were never put into operation. They were replaced in 1964 by somewhat similar ones. The 1962 and 1964 contracts are described in detail in the judgment of McGregor J. and do not need further description. I agree with him that, basically, they were of a like character to the 1956 series of contracts. They included a supply agreement between Gulf and Europa for crude oil and other refinery stocks; an agreement between Gulf and Pan-Eastern for the supply by Gulf to Pan-Eastern of crude oil sufficient to meet Europa's requirements of crude oil, feed stocks, and finished products; and an agreement for the

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

processing by Gulf for Pan-Eastern of a part of the crude oil and the purchase back by Gulf from Pan-Eastern of the resultant feed stocks and unrefined crude required under the supply contract between Gulf and Europa. The contract also provided for a discount of 15 percent on the crude oil sold by Gulf to Pan-Eastern, but no discounts were given under the supply contract between Gulf and Europa. Finally there was a new contract for transportation between a Gulf subsidiary and Europa, and some other subsidiary agreements.

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

10 The period with which this appeal is concerned terminates with the tax year ending 31 March 1965. The 1964 agreements were dated 10 March 1964, so that they affect the period we are concerned with for just over a year. It is, however, desirable to record that by subsequent variations of those agreements in 1965 and 1966 a series of direct discounts or concessions were granted Europa by Gulf. These, of course, improved the profit position of Europa and affected its tax liability in New Zealand. They also resulted in a corresponding decrease in the return to Pan-Eastern.

20 Like McGregor J. and the President whose judgment I have had the advantage of reading, it seems to me that there is not a great deal of difference between the situations under the 1956 agreements and the 1964 ones, except in one respect and that is that by March 1964 direct discounts were becoming increasingly numerous in some parts of the world, and so it might be said that rather than enter into the agreements which it did in March 1964, Europa could, and should, have obtained from some other supplier discounts on posted prices.

30 In this connection, two particular matters stressed by the Solicitor-General at various stages of his argument deserve special discussion. The first concerns Mr Newton's evidence that having regard to the increasing willingness of overseas oil companies to grant discounts or other price concessions to purchasers, more particularly of crude oil, it was "inconceivable" that by 1964 some price concession could not have been obtained. Certainly, I would think that parties to such large scale buying would expect some form of advantage. That was what Mr Todd thought. He wanted a continuing share in the refining profits as his concession. But it does not follow from the events of those years that something in the nature of a discount or price concession was obtainable in respect of oil sold to a New Zealand purchaser for distribution in this country under terms of a contract which gave the purchaser the long-term protected supply which was necessary in Europa's
40 vulnerable position. I have already touched on these features on several occasions. To me they are at the heart of this situation. Europa was the sole independent petrol distributor in New Zealand. It was essential if it were to survive economically, that it secured long-term contracts, contracts which covered all its requirements in crude oil and the different products, and which would be isolated as far as possible from the crises of war and other foreseeable interruptions. Consequently, it had to deal with a supplier of magnitude and world-wide sources, and that meant dealing with one of the great international companies. But as the

evidence makes it clear, these were united to maintain prices over certain areas, including New Zealand. Gulf admittedly was not engaged in distribution in New Zealand, but it had entered into price maintenance undertakings with, for example, Shell, which obliged it to adhere to the maintenance of the posted price structure East of Suez. The real question in this particular aspect of the case, surely, is not whether Europa was in a position to extort some additional incentive or benefit but whether it could have secured something amounting to a discount or price concession, one which the Commissioner could fairly deduct from the cost of its imports into this country. As I say, I do not think that was established.

In the Court of
Appeal
No. 6
Judgment of
McCarthy J.
21 November
1969
—continued

10

The second is the disproportion between the amount invested by Europa, through Associated Motorists, in Pan-Eastern, and the almost incredible return which resulted from that investment. £(NZ) 50,000 was invested in 1956, and over the 6 years we are concerned with, namely, those ending 31 March 1960–65 inclusive, to say nothing of earlier and later years, that investment, still intact, brought in income which the Commissioner estimates at £(NZ) 2,898,026 or \$5,796,052. This is, of course, staggering to ordinary mortals, and it demonstrates, no doubt, how fortunate are those who can sell to or in markets such as New Zealand. Some obviously think that it also points to the conclusion that profits made by the oil industry generally in these areas are unconscionable, but, if that be so, the treatment of the situation is a matter for Government, not for the courts whose task it is to apply the law as it exists and who cannot be swayed by such considerations.

20

Furthermore, it must be remembered that by 1964 the Europa-Gulf arrangement had been in existence for 8 years. Presumably it had worked satisfactorily. Moreover, Gulf had met Europa's request for variation when in 1959 it was thought that the expected results were not being achieved. In these circumstances it would, I think, be unreasonable to say that Europa was obliged to cast aside, assuming it could, its connection with Gulf in the interests of the New Zealand Inland Revenue, even if it were the fact that some form of discount could have been obtained from some other supplier.

30

At this stage, I would remark on one aspect of the case which I feel received inadequate weight in the argument here and in the Court below. It is the continuing binding effect over the whole period we are concerned with of the 1956 contracts. It will be recalled that McGregor J. found, and I agree, that discounts were not available to Europa in 1956 when the agreements were signed. Amongst those agreements was one providing for negotiation for variation of the supply contract in the event of a petroleum refinery being established in New Zealand and giving each of the parties power to cancel the whole arrangement in the event of certain consequences eventuating from the establishment of such a refinery. But in fact at no time over the whole period were the circumstances such that Europa could unilaterally have cancelled the contracts. The Solicitor-General concedes this. Europa, then, was never completely free to seek more advantageous bargains on the open

40

market. It was in the position of having to negotiate with Gulf, as best it could, and the evidence is certainly against the conclusion that it could have obtained discounts or any other direct concessions from that supplier. Therefore, it seems to me, much of the speculation as to what might conceivably have been obtained from other would-be suppliers was largely beside the point. Europa's conduct must be examined against the background of its continuing contractual obligations. The President has made this point in his judgment just delivered, and I respectfully concur in the importance he places upon it.

In the Court of
Appeal
No. 6
Judgment of
McCarthy J.
21 November
1969
—*continued*

10 For these reasons I think that the benefits under all these contracts should not be viewed as discounts, direct or indirect. There is another reason, too. That is the fact that they were benefits obtained not by Europa directly but by an independent company, albeit one in which Europa's wholly owned subsidiary held 50 percent of the shares. The creation of Pan-Eastern and the receipt by it of the share in the refining profits was a requirement of Gulf, and I think it would be going too far to disregard the independent existence of Pan-Eastern and to hold that Europa's share of what it received was a discount as between
20 Gulf and Europa. The principle of *Salomon v. Salomon and Co.* 1897 A.C. 22, as I shall later show when I come to the B.P. contract, is a serious obstacle to that conclusion.

So far I have been discussing the contracts between Europa and Gulf, but what of the contract entered into between Europa and B.P. in 1961 pursuant to which commissions were paid to Pacific Trading? Mr. Todd under cross-examination accepted that these commissions were in reality discounts under another name, but he maintained nevertheless that he was unable to obtain discounts to Europa on supplies to New Zealand, because, as I have already said, the inter-
30 national oil companies would not allow the price system under which they operated in New Zealand to be upset by such an arrangement. Therefore, he was, in effect, obliged to accept commissions and related freight concessions payable to a subsidiary set up in London directly for that purpose.

There is unquestionably a plain distinction between this contract and those between Europa and Gulf. I do not think it is possible to maintain, nor indeed do I remember it being asserted, that the B.P. arrangement was intended to be a sharing of refining profits. On the contrary, it provided for straight out commissions or, one might say, discounts. But again, we have the fact that Europa had no real option
40 regarding the place and manner of payment of the commission and had to accept payment in England to a subsidiary. Is it possible then in such a situation to disregard the independent existence of that subsidiary and to take a like view of that separate entity as Lord Denning M.R. did in *Littlewoods Mail Order Stores Ltd. v. James McGregor (H.M. Inspector of Taxes)* 1969 1 W.L.R. 1241. Putting it more plainly, should we say now that the doctrine laid down in *Salomon v. Salomon and Co.* is not to be allowed to prevent the Commissioner from claiming that there was in truth a discount received by Europa? In *Littlewoods* case the U.K. tax authorities had refused to allow as

a deduction a very substantial rent which had in fact been paid on a property occupied by the taxpayer. Their ground was that one of the purposes and results of the payment of the rent was the progressive acquisition by a wholly owned subsidiary of the freehold of the land in question. They apportioned the rent, relying on *I.R.C. v. Land Securities Investment Trust Ltd.* 1969 2 All E.R. 430. But for the objector it was argued that that decision was to be distinguished, because there the freehold interest was acquired, ultimately, by the taxpayer itself, whereas in the *Littlewood* situation an independent subsidiary was to get it. Lord Denning refused to accept the distinction. He said:

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

10

20

30

“I cannot accept this argument. I decline to treat the Fork Manufacturing Co. Ltd. as a separate and independent entity. The doctrine laid down in *Salomon v. Salomon & Co.* (1897 A.C. 22) has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the Courts cannot see. But that is not true. The Courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The Legislature has shown the way with Group Accounts and the rest. And the Courts should follow suit. I think that we should look at the Fork Manufacturing Co. Ltd. and see it as it really is—the wholly-owned subsidiary of Littlewoods. It is the creation, the puppet, of Littlewoods, in point of *fact*: and it should be so regarded in point of *law*. The basic fact here is that Littlewoods, through their wholly-owned subsidiary, have acquired a capital asset—the freehold of Jubilee House: and they have acquired it by paying an extra £19,006 a year. So regarded, the case is indistinguishable from the *Land Securities* case. Littlewoods are not entitled to deduct this extra £19,006 in computing their profits.”

40

Lords Justices Sachs and Karminski, on the other hand, plainly were not prepared to allow the *Salomon* principle to be eroded. They found for the tax authorities on the ground that a clear duality of purpose was apparent and that therefore the English provision similar to our s. 111, could be applied in favour of the commissioners. I stress that the case was one which in New Zealand would be a s. 111 case; it was not concerned with the point I am discussing at the moment, namely, whether our Commissioner can assert that what was received by Europa's U.K. subsidiary was a discount in the hands of Europa. These issues may be somewhat related, but they are not the same, and I find difficulty in accepting that a commission paid to an independent company, albeit a completely owned subsidiary, can be described as a discount between a vendor and the purchasing parent company, especially when, as here, the taxpayer was unable to arrange discounts allowed directly to itself, but was compelled by the trading situation to accept payment of commissions to a subsidiary.

Thus I reject the assertion that the term discount, direct or indirect, is fairly descriptive of the particular benefits which Europa obtained under the contracts with Gulf and B.P. But as I said earlier, that is

not conclusive of the matter. The real test is a wider one, whether the expenditure claimed by Europa was exclusively incurred in the production of the assessable income of the company; see s. 111. And so the Solicitor-General progressing from his discount argument to his second ground, goes on to contend that it was not, for whether or not the benefits which I have been discussing can correctly be described as discounts or price concessions, the challenged expenditure was incurred for two reasons:

In the Court of
Appeal
No. 6
Judgment of
McCarthy J.
21 November
1969
—continued

1. For the purpose of producing the assessable income of Europa; and
- 10 2. For the purposes of producing income for Pan-Eastern and through it for Associated Motorists.

A similar submission is made in respect of the supplies from B.P. under the 1961 contract with that organisation.

I accept the Solicitor-General's argument that the proper test whether a particular expenditure is exclusively incurred in the production of the assessable income of the taxpayer is the purpose of the expenditure. That, it seems to me, must always be determined as a question of fact. Not every payment of an overprice could lead to the inference the Solicitor-General contends for in this case. Much, doubtless, will turn
20 upon the degree of overpayment.

This test of purpose underlies, I believe, the decisions, of the Privy Council in *Ward and Co. v. Commissioner of Taxes* 1923 N.Z.L.R. 145, and in *Aspro Ltd. v. Commissioner of Taxes*, 1932 N.Z.L.R. 683. I refer also to the judgments of Herdman J. and Blair J. in the *Aspro* case in this Court (1930 N.Z.L.R. 935). It appears, too, that the same principle is applied to the somewhat like provision in the English legislation, s. 137 (a) of the Income Tax Act 1952. See, for example, in addition to *Johnson Bros. and Co. v. I.R.C.* 1919 2 K.B. 717 (approved so it seems to me by the Privy Council in *Aspro Ltd. v. Commissioner of Taxes*), the *Littlewoods* case to which I have already referred, and the recent judgment of the House of Lords in *I.R.C. v. Korner* (supra), especially the judgment of Lord Donovan at p. 688, which, when referring to a consequential benefit acquired by someone other than the taxpayer, says "but this is immaterial unless such private benefit was the purpose of the expenditure".

Mr Mahon contends to the contrary. He says that whilst the test of purpose is commonly applied to apportion expenditure as between capital and income and also to disallow expenditure which consists of voluntary payments, the case of trading stock expenditure is different,
40 the only inquiry then being whether the money was in fact paid for trading stock. Once that is established, he proceeds, any implication of purpose or motive is irrelevant and the trading stock expenditure is not apportionable on any ground; and as here Europa entered into legitimate contracts to buy and paid under those contracts, that is the end of the matter. I find difficulty in understanding how a distinction can be satisfactorily drawn between expenditure on trading stock and other expenditure legitimately made in the production of the profit. Mr Mahon submits, however, that that is what, in effect,

was held by the High Court of Australia in *Cecil Bros. Pty. Ltd. v. Federal Commissioner of Taxation* 111 C.L.R. 430. That case, he says, properly understood, rejects the purpose test and holds that even though one of the purposes of a contract entered into by a taxpayer for the purchase of goods, is to provide a profit in the hands of another company of linked ownership with the result that the taxpayer pays more for his goods than if he buys direct from a wholesaler, it is not open to the Commissioner to disallow the total price paid because it is “not for the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent”. See also *Ronpibon Tin N. L. v. Federal Commissioner of Taxation* 78 C.L.R. 47 from which these particular words descend.

In the Court of
Appeal
No. 6
Judgment of
McCarthy J.
21 November
1969
—continued

Any opinion of the strong Court which decided the *Cecil Bros.* case calls for careful respect, and if this is the effect of the judgment, as I am inclined to agree it is, and if it be right, then that seems to me to be the answer to all the submissions of the Commissioner in this present case based on s. 111. But I have considerable doubt whether that is the correct way to approach our section, and I prefer to take the route of applying myself to the purpose of the expenditure. This, as I have said, seems to me to underlie the two Privy Council decisions to which I have referred, the *Ward* case and the *Aspro* case. In those cases the Privy Council was specifically dealing with our section. It differs somewhat in its terms from the Australian section, though I confess that I find difficulty in saying that the difference goes to the root of the question I am now discussing. But if, as I prefer, purpose is the test, and if when there are two purposes established the Commissioner may apportion, then the question here is whether such a second purpose has been established in the present case. My view is that it has not; this for the reasons which I have given generally in relation to the matter of discount, especially that it seems to me not sufficiently established that at material times Europa was in a position to secure supplies to New Zealand at lower prices to itself; on the contrary I think it was virtually forced to accept bills at posted prices. The mere fact that it secured for another company in which it holds a substantial interest contemporaneous benefits of a very substantial nature seems to me more an incidental consequence than a direct purpose of its expenditure. I think that the situation in this case may be likened to that in *I.R.C. v. Korner* (*supra*) and, as was said then, I say now, that the benefit to Pan-Eastern was immaterial, unless that was a purpose of the expenditure. Doubtless that benefit was keenly desired and fought for, but as Europa, so it seems to me, had really no option in the matter but was obliged in any event to pay posted prices, the obtaining of the additional advantages for Pan-Eastern was “simply a by-product of this outlay not its purpose”. For these reasons I am not in favour of supporting the Commissioner’s disallowance of these particular sums.

When I come to consider the like arguments of the Solicitor-General in relation to the commissions paid to Pacific Trading pursuant to the

contract between Europa and B.P., I arrive at the same conclusion for the same reasons. It is manifest that B.P. were not prepared to reduce their invoice prices to Europa below posted prices, and the commissions payable to Pacific Trading, an independent company, were in the result again a by-product of the outlay. At this point the argument based on *Littlewood's* case reintroduces itself. It could be said that just as in *Littlewood's* case the Court was able to dichotomise the payments, when plainly one of their purposes was to secure a capital asset in the hands of a subsidiary, so a similar course should be taken

10 here. But there is a sharp difference between the *Littlewood* situation and the present. The important feature of the former case was that the asset being acquired was a capital one, and the acquisition of such an asset, albeit by a subsidiary, justified on correct commercial accountancy procedures certain attitudes being adopted in relation to the accounting of the parent company. Lord Justice Sachs stressed this feature at p. 1,255. In the present case, there was no acquiring of capital assets. I agree that this distinction would not necessarily defeat the Commissioner's argument that nevertheless duality of purpose

20 could be demonstrated and, for myself, I would be inclined to agree that if it were plain that one of the purposes of the payment here was to confer a source of income on a subsidiary, the Commissioner would be entitled to adjust the amounts deducted. But that purpose is not established because—again we come back to what seems to me at all points to be the central feature of this case—the trading situation existing at the relevant times compelled Europa, if it was to obtain any concession at all, to accept concessions conferred outside New Zealand on subsidiaries or related companies. In those circumstances I find it impossible to say that even in relation to the B.P. contract, the Commissioner was entitled to divide the expenditure, the required

30 duality of purpose, as opposed to consequence, not being established.

Alternatively to s. 111, the Commissioner relies on s. 108. So far as that difficult section is concerned, my clear view is that if I am correct in my conclusion that it is insufficiently established that Europa could have secured a discount or other benefit receivable in New Zealand, then it is impossible to say that the contracts between it and Gulf constituted an arrangement having the purpose or effect of altering the incidence of income tax of or of relieving Europa from its liability to pay income tax. Like the members of the High Court in *Cecil Bros. Pty. Ltd. v. Federal Commissioner of Taxation (supra)*, I find difficulty

40 in understanding how s. 108 can have any application when s. 111 does not apply. The section is, of course, concerned with New Zealand income tax, and so if but for the attacked arrangement the income would not exist for that tax to accrue on, it seems impossible to say that the arrangement has the prescribed purpose or effect. No doubt the tax advantages of the schemes were not overlooked, and the choice of Nassau as the domicile of Pan-Eastern was not because of its Bahamian charm, but once it is accepted that the contracts did not result in a loss of New Zealand tax, then whether the siting was in Pittsburg, or Adaban or Nassau seems immaterial.

As an additional defence to s. 108, the appellant relying on what was said by the Privy Council in *Newton and Others v. Commissioner of Taxes* 1958 A.C. 450, claimed that it was impossible to predicate, on an examination of the overt acts by which the agreements were implemented, that they were implemented in their particular ways for the purposes of altering the incidence of or of avoiding tax. Our attention was also directed to the language of the Board in *Mobil Oil Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia* 1966 A.C. 275, 292, and using that language Mr Mahon

10 contended that it was not surprising that Europa entered into these particular contracts; from a commercial point of view the arrangements in their different times were sensible. But that, of course, depends upon one's view of the facts. I agree that if the facts were as I believe them to be, namely, that a discount or other benefit was not obtainable by Europa on importations into this country, then doubtless the arrangements were eminently sensible, but, as I have said, in such circumstances I do not think that any question of alteration of incidence or avoidance of liability really arises.

20 I would consequently hold that s. 108 does not assist the Commissioner.

In these circumstances I find it unnecessary to consider Mr Mahon's submission of election. I am in favour of allowing the appeal with the consequences stated in the judgment of the President.

Solicitors for Appellant:

Morison, Taylor, and Co.
Wellington

Solicitors for Respondent:

Crown Law Office,
Wellington

In the Court of
Appeal

No. 6

Judgment of
McCarthy J.
21 November
1969

—continued

No. 7

In the Court of
AppealFORMAL JUDGMENT OF COURT OF APPEAL ALLOWING
APPEALNo. 7
Formal
Judgment
Allowing
Appeal.
21 November
1969

Friday, the 21st day of November 1969

BEFORE:

THE RT. HON. SIR ALFRED NORTH, PRESIDENT.

THE RT. HON. MR JUSTICE TURNER.

THE RT. HON. MR JUSTICE McCARTHY.

10 UPON READING the Case on Appeal filed herein and UPON
HEARING Mr P. T. Mahon and with him Mr R. F. Pethig of
Counsel for the Appellant and the Solicitor-General, Mr J. C. White
and with him Mr I. L. M. Richardson and Mr G. Cain of Counsel for
the Respondent IT IS ORDERED that the Commissioner acted in-
correctly in making the assessments in question and that this appeal
therefore be allowed AND IT IS FURTHER ORDERED that the
question of costs in the Court below and in this Court be reserved.

By the Court

[L.S.]

G. J. GRACE,
Registrar.

No. 7

In the Court of
Appeal

FORMAL JUDGMENT OF COURT OF APPEAL AS TO COSTS

No. 7

Monday, the 2nd day of February 1970

Formal
Judgment as
to Costs.
2 February
1970

BEFORE:

THE RT. HON. SIR ALFRED NORTH, PRESIDENT.

THE RT. HON. MR JUSTICE TURNER.

10 THIS COURT having by judgment delivered on the 21st day of November 1969 allowed this appeal and reserved the question of costs UPON HEARING Mr R. F. Pethig of Counsel for the Appellant and Mr G. Cain of Counsel for the Respondent on the question of costs IT IS ORDERED by consent that the Respondent do pay to the Appellant the sum of \$7,000 for costs in the Supreme Court and the sum of \$5,000 for costs and \$1,479.92 for disbursements in this Court, making in all the sum of \$13,479.92.

By the Court

[L.S.]

G. J. GRACE,
Registrar.

No. 8

**ORDER GRANTING FINAL LEAVE TO APPEAL TO
HER MAJESTY IN COUNCIL**

Monday, the 2nd day of February 1970

In the Court of
Appeal
No. 8
Order Granting
Final Leave
to Appeal.
2 February
1970

BEFORE:

THE RT. HON. MR JUSTICE NORTH, PRESIDENT.

THE RT. HON. MR JUSTICE TURNER.

THE HON. MR JUSTICE HASLAM.

10 UPON READING the Notice of Motion of the Respondent dated
the 30th day of January 1970 and the Affidavit of Max Bertuch
AND UPON HEARING Mr G Cain of Counsel on behalf of the
Respondent and Mr R. F. Pethig of Counsel on behalf of the Appellant
THIS COURT HEREBY ORDERS that final leave to appeal to Her
Majesty in Council from the judgment of this Honourable Court
delivered on the 21st day of November 1969 be and the same is hereby
granted to the Respondent.

By the Court

[L.S.]

G. J. GRACE,
Registrar.

**CERTIFICATE OF REGISTRAR OF COURT OF APPEAL
AS TO ACCURACY OF RECORD**

I, GERALD JOSEPH GRACE, Registrar of the Court of Appeal of New Zealand DO HEREBY CERTIFY that the foregoing six volumes of printed matter contain true and correct copies of all the proceedings, evidence, judgments, decrees and orders had or made in the above matter, so far as the same have relation to the matters of appeal, and also correct copies of the reasons given by the Judges of the Court of Appeal of New Zealand in delivering judgment therein, such reasons having been given in writing: AND I DO FURTHER
10 CERTIFY that the appellant has taken all the necessary steps for the purpose of procuring the preparation of the record, and the despatch thereof to England, and has done all other acts, matters and things entitling the said appellant to prosecute this Appeal.

AS WITNESS my hand and Seal of the Court of Appeal of New Zealand this 3rd day of February 1970.

[L.S.]

G. J. GRACE,
Registrar.