No. 20 of 1970

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

Case for the Appellant

Case for the Respondent

VOLUME 7

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Appellant

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IN THE JUDICIAL COMMITTEE OF 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

CASE FOR THE APPELLANT

Record

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1. This is an appeal from a Judgment of the Court of Appeal of New Zealand (North P., Turner J. and McCarthy J.) dated the 21st day of November 1969 following an appeal by the Respondent from the Judgment of the Supreme Court (McGregor J.) in favour of the Appellant in respect of a case stated by the Appellant under Section 32 of the Land and Income Tax Act 1954 (hereinafter referred to as "the Act"). 6122 6046

2. The questions in issue are:

(i) Whether certain amounts claimed as costs of purchases and totalling £3,062,962 for the income years ending 31st March 1960 to 31st March 1965 inclusive

are deductions to be made for the purpose of calculating the assessable income of the Respondent by virtue of Section 111 of the Act as being expenditure exclusively incurred in the production of the assessable income for any income year and not otherwise disallowed by the Act.

(ii) Whether the various contracts and arrangements between Gulf Oil Corporation (hereinafter called "Gulf") or its subsidiaries and the Respondent or its subsidiaries in relation to the supply of petroleum goods by Gulf to the Respondent constitute an arrangement having the purpose or effect of altering the incidence of income tax or of relieving the Respondent from its liability to pay income tax under Section 108 of the Act.

(iii) Whether the doctrines of promissory estoppel or exhaustion of a discretion precluded the Appellant from making any of the amended assessments.

3. At all material times sections 110 and 111 of the Act were as follows:

"110. 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. (1) In calculating the assessable income of any person deriving assessable income from one source only, any expendi-

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

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

And section 108 provided:

"108. 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."

4. The facts of the case may be briefly summarised as follows:

(1) At all material times the Respondent carried on the business of marketing petroleum products in New Zealand and obtained the bulk of its supplies of petroleum products and, later feedstocks, from Gulf.

(2) On the 3rd April 1956, the Respondent

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entered into the first of three groups of contracts either with Gulf or one of its subsidiaries. At the time of the negotiations Gulf having a ready market for products of refining other than gasoline sought an outlet for gasoline. The principal contracts of the first group were:

(a) A "Petroleum Products Sales 3001
Contract" for the supply of gasoline and such gas oil as the Respondent might require. The period of the contract was ten years from 1 January 1957 to 31 December 1966 subject to certain rights of renewal. Delivery was to be by cargo lots f.o.b. tankers provided by the Respondent at ports designated by Gulf. The price to be paid for gasoline under the contract for each cargo lot was the lower of two quotations as published in Platt's Oilgram at the date loading commenced. Platt's Oilgram was a publication which gathered and published news of sales and prices in the oil industry; and the prices at which suppliers made known their willingness to sell f.o.b. in bulk lots had become known as "posted prices".

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(b) A "Contract of Affreightment" whereby Gulf agreed at the cost of the Respondent to transport to New Zealand by tanker the products referred to in sub-paragraph (a) above. 3021

(c) A "Contract for Organisation of Pan-Eastern Refining Company, Limited, a Bahama Corporation" setting out in the Third Schedule thereto a "Processing Contract". One recital to the Organisation Contract stated that contemporaneously therewith the contracts referred to in sub-paragraphs (a) and (b) above had been entered into. It also recited that the benefits to be secured and enjoyed by the Respondent by reason of its beneficial interest in the company to be incorporated and the execution and carrying out by Gulf and Pan-Eastern Refining Company Limited (hereinafter called "Pan-Eastern") of the processing contract was a major inducement to the Respondent to enter into the petroleum products sales contract and the contract of affreightment referred to in sub-paragraphs (a) and (b) above. The Organisation Contract provided for the incorporation of Pan-Eastern with a capital of 3049 3057 3049 3050 3050

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£100,000 to be subscribed by the two parties to the agreement in equal shares. In fact the Respondent did not itself take up the shares in Pan-Eastern; but caused its wholly-owned subsidiary Associated Motorists Petrol Company Limited (hereinafter referred to as "A.M.P.") to do so. It also provided that Gulf should 3052
10 enter into the Processing Contract with Pan-Eastern.

The Processing Contract provided 3058 for the purchase by Pan-Eastern at posted prices of sufficient crude oil to produce the gasoline required under the Petroleum Products Sales Contract referred to in sub-paragraph (a) above. This crude oil was to be processed for Pan- 3059
20 Eastern for a fee at unspecified refineries provided by Gulf to produce deemed yields of products which were to be purchased back by Gulf at posted prices. It was also 3061 provided that Gulf would pay Pan-Eastern for products other than gasoline a price sufficient to ensure net earnings for Pan-Eastern in terms of a formula. In fact the processing
30 referred to in the processing contract was a notional and not an

actual activity. Gulf invoiced Pan-Eastern with sufficient crude oil, at posted prices, to meet the gasoline supplies of the Respondent. Notionally, the crude oil was processed at unspecified refineries provided by Gulf and Gulf or its nominee purchased back the refined products from Pan-Eastern. In fact the only actual activity (apart from bookkeeping) was the sale of gasoline by a Gulf subsidiary to the Respondent. At the prices current when the Contract was entered into in 1956 the Respondent's share of Pan Eastern's profit (through its holding of shares in Pan-Eastern) was 2.5 cents per gallon of gasoline purchased by the Respondent.

(d) A "Memorandum of Agreement Relative to New Zealand Refinery" under which Gulf and Respondent agreed that in the event of a petroleum refinery being established in New Zealand during the period of the Petroleum Products Sales Contract, the latter contract would be modified to exclude in certain circumstances gasoline there refined and taken by the Respondent. If, for these reasons, the Respondent purchased less than 25% 3017

of its requirements under the Petroleum Products Sales Contract (Gulf having the option of supplying the other requirements of the Respondent if it met the best offer available to the Respondent) either party could cancel that contract on three months notice. 3010 3019

(3) The formula in the 1956 Processing Contract did not produce the intended profit of Pan-Eastern because of unexpected changes in crude and product prices and, following negotiations, the Processing Contract was varied on 24 August 1959. 3199 3245 The variation was retrospective to the commencement of the contract and guaranteed a minimum return to the Respondent of 2.5 cents per gallon of gasoline purchased from Gulf. 3072 3235

(4) Prior to 1962 the Respondent acquired an interest along with a number of international oil companies in a New Zealand refinery to be constructed at Whangarei. Consequently it was necessary for the Respondent to purchase feed stocks for the purpose of utilising its New Zealand refining capacity and the Respondent entered into negotiations with possible suppliers to obtain feedstocks at a favourable price. 5333 5336

As a result the second and third groups of contracts were entered into in 1962 and 1964 respectively.

The 1962 Contracts executed on 27 December 1962 had a number of significant features but they were in fact superseded, before they came into operation, by the third group of contracts entered into on 10 March 1964. The principal contracts of this group were: 5001 5083

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(a) A "Feed Stock Supply Contract" for the supply of crude oil and other refinery feed stocks and some other petroleum products if required, at or related to posted prices. 3112

(b) A "Contract of Affreightment", whereby a Gulf subsidiary agreed at the cost of the Respondent to transport to New Zealand by tanker the feed stocks and products referred to in sub-paragraph (a). 3149

10 (c) A "Processing Contract" between Gulf and Pan-Eastern which provided for Gulf to supply to Pan-Eastern crude oil sufficient to provide the crude oil and other feed stocks and finished products required under the Feed Stock Supply Contract. The Processing Contract provided that having processed crude oil to produce naphtha and other feed stocks and products for Pan-Eastern, Gulf would then purchase back the 20 resultant feed stocks and products and the crude oil purchased by Pan-Eastern and not refined. The Respondent obtained through its shareholding in Pan Eastern an amount equal to the difference between the prices paid by it under the Feedstock Supply Contract and the lower prices for the equivalent goods paid by Pan Eastern under the Processing Contract. The difference in the case of crude was 15% of the posted 30 price. 3134 3138

(5) Both contracts in sub-paragraphs (a) and (c) above were varied by letters dated 3130-313

Record

16 March 1965 by which as from 1 April 1964 price reductions in crude oil, naphtha and gas oil were granted to Europa. As a result, the prices to be paid to Pan-Eastern by Gulf for those goods were correspondingly reduced. 3147

(6) On the 18th December, 1961, an agreement was made whereunder BP (New Zealand) Limited agreed to supply the Respondent with supplies of gas oil, lighting kerosene and fuel oil in New Zealand at or related to posted prices plus freight. 3104

On the 12th April, 1962, BP Trading Limited (U.K.) agreed with Pacific Trading and Transport Company Limited (hereinafter referred to as "PTT"), a wholly owned subsidiary of the Respondent, that in consideration of PTT having procured a contract for supply between the Respondent and BP (New Zealand) Limited, BP Trading Limited would pay to PTT a ten per cent commission on each delivery of the products under the supply agreement. This agreement with PTT also provided for, in certain events, freight concessions. Payment of the commission was to be made in sterling to PTT in England at quarterly intervals. Following investigations regarding these contracts PTT was treated as resident in New Zealand and the payments to PTT were taxed in New Zealand. 3109

Record

(7) In 1963 the Inland Revenue Department began an investigation into the oil industry in New Zealand. The inquiry was directed particularly to the prices at which petroleum products were being invoiced to all oil companies operating in New Zealand and to ascertain whether profits returned in New Zealand were understated. In the course of inquiries copies of the contracts executed in 1956 between the Respondent and Gulf were produced by the Respondent and examined by the Appellant. On the information then provided the Appellant decided not to take any action. The Appellant informed the Respondent in writing on the 27th June, 1963, that there was no intention to "disturb the present position". 2/139/17 5185 3291

(8) Inquiries continued and in March, 1964, a Report addressed to the Appellant by an investigating Inspector recommended that the income being returned for taxation by the oil companies, including the Respondent, should be challenged. More data of a general nature became available both in New Zealand and overseas. Important information throwing light on the Respondent's negotiations and arrangements with Gulf was gradually collected. As a result the Respondent's position was 5182 2/149/9 2/151/31

Record

reconsidered by the Appellant and amended assessments were issued in 1965. These amended assesments are the subject of this litigation.

5. The present case, and a case between A.M.P. and the Appellant, came on for hearing on the 17th February, 1969. The hearing lasted for 17 days and judgment was given by McGregor J. on the 8th May, 1969.

6. In the opinion of the learned Judge the Pan-Eastern arrangement could not be regarded as a conventional refining arrangement as the Respondent claimed. He found that Pan-Eastern was a passive acceptor of the profits, and the whole of the business arrangements were conducted by Gulf. The Pan-Eastern set up provided machinery to produce a result agreed to by Gulf and the Respondent, resulting in a profit or a concession passing directly to Pan-Eastern and a half share thereof passing indirectly to the Respondent. 6008/16 6011/15 6013/35

The 1964 agreements continued the discount or concession arrangements provided under the contracts of 1956.

The agreement between the Respondent and BP and the formation of PTT also fell into the pattern of indirect concessions or discounts on products purchased by the Respondent. 6014/22

The learned Judge found as facts that Pan-Eastern could not be regarded as a conventional refining venture, but that the primary object of the arrangements was to 6018/41

enable the Respondent 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 the Respondent directly related to the Respondent'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.

The learned Judge held that the whole amount claimed by the Respondent to have been expended on petroleum products was not exclusively incurred in the production of its assessable income. The expenditure under the 1956 contracts had two purposes, first, the ordinary trading gain of the Respondent; second, the profit by way of concession which accrued to A.M.P. from Pan-Eastern. The same considerations applied to the 1962 and 1964 series of contracts and to the BP-PTT contracts. Accordingly, since the Commissioner could, in the view of the learned Judge, apportion expenditure between different purposes, that portion of expenditure which equalled the concessions obtained through Pan-Eastern and the commissions paid to PTT should be disallowed as a deduction under Sections 110 and

6021/46

6022/7

6025/40

111 of the Act.

On the issues of estoppel and exhaustion of a discretion, the learned Judge concluded (i) that the Commissioner was not exercising a discretion when deciding in 1963 that he would not reassess the Respondent; (ii) that there was no question of estoppel operating so as to bar a future assessment, because the Commissioner was not furnished with all the relevant information; (iii) that the Commissioner had no power in any case to bind himself from making a reassessment; and (iv) where there was a statutory duty imposed, as there was on the Appellant to assess tax, estoppel could not be raised as a ground for preventing the performance of the duty. 6032/32 6031/33 6033/36 6034/38

The learned Judge held that Section 108 of the Act did not apply on the ground that it would be contradictory to his conclusions that the Respondent's share of Pan-Eastern's profits must be deducted from the cost of the Respondent's supplies in deciding the expenditure deductible for tax purposes, if he were to hold that the effect of the contracts was to obtain relief from tax liability. 6038/5

7. The Respondent appealed against the Judgment of McGregor J. and the hearing of the appeal commenced on the 25th August, 1969, and lasted for eleven days. On the 21st November, 1969, the Respondent's appeal was unanimously

 Record

allowed by the Court of Appeal.

8. North P. thought it emerged very clearly 6052/47
from the evidence that there was no prospect
at all of Gulf agreeing to give the Respondent
a discount against posted prices. He was
disposed to think that McGregor J. was not right
in concluding that from the beginning the
intention of the parties was that the Respon-
dent should obtain, through Pan-Eastern, 6055/11
precisely 2.5 cents per gallon of gasoline
imported by the Respondent into New Zealand.
The Pan-Eastern arrangement gave the Respon- 6062/47
dent a share in the refining sector of Gulf's
overseas earnings. The Solicitor-General's
argument that this was, in effect, a concession
or discount broke down, in the view of the
learned President, because Pan-Eastern's profit 6063/4
could have almost wholly disappeared leaving
the Respondent still to pay the posted prices.

As regards the 1964 contracts, it was 6064/23
not proved that direct discounts could then
be obtained in New Zealand. The case for 6064/32
the Appellant on the question of discounts
stood or fell on the effect of the arrangements
entered into between Gulf and Europa in 1956.
In 1956, in the view of the learned President,
they simply gave the Respondent a share in the
refining sector of Gulf's overseas earnings.
The share of the Respondent in Pan-Eastern's
profits was not, therefore, a discount.

Record

Moreover, the prices for petroleum products paid by the Respondent were in 1956 and 1964 market prices in New Zealand, the share in the refining profit being merely a collateral benefit. Accordingly, the whole of the moneys paid should be allowed as a deduction. The fact that the Respondent received a benefit by reason of its shareholding in Pan Eastern was, in his opinion, irrelevant. 6069/14

As regards Section 108 of the Act, the learned Judge held that the purpose and effect of the arrangement between Gulf and the Respondent was not the avoidance of tax in New Zealand. He doubted whether section 108 could have application where it was sought to increase the Respondent's taxable income by denying it a deduction from assessable income. He could not see how it could be demonstrated that income would have accrued to the Respondent if the contract with Pan-Eastern had been annihilated. 6072/12 6072/25

As to the arrangements with BP and PTT, there was no evidence in the view of the learned President, that the Respondent could have secured its supplies in New Zealand at a lower price than it paid. The benefit received 6076/41

Record

by PTT was a collateral benefit taxable in its own right, independent of the price paid for the goods supplied. The full price, therefore, was deductible. 6077/5

The learned President did not find it necessary to consider the question of estoppel but adverted to difficulties in the way of the Respondent. 6077/13

9. Turner J. accepted that the purpose of any payment could be examined by the Commissioner. But the learned Judge considered that if what was paid was a contractual price and a market price, then the whole amount was deductible whatever collateral purposes were served. There was no evidence of discounts being directly obtainable in 1956 or 1964. 6087/47 6088/21 6089/4

In the view of the learned Judge the correct test under Section 111 of the Act was whether the transactions could be explained by ordinary commercial dealing. He concluded that the costs claimed were explicable by reference to ordinary commercial dealing and, therefore, were to be allowed as deductions. 6090/1

The learned Judge accepted that all the agreements and arrangements in 1956 were made inter-dependent upon each other. And he considered that it was immaterial whether the refinery set up by the parties was "conventional", "notional" or "fictional". He accepted that, in a sense, a discount was allowed by Gulf to Pan-Eastern and allowed, moreover, by arrange- 6092/39 6100/17 6095/7

Record

ment with the Respondent. But he was 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 Gulf to the Respondent.

The learned Judge did not think that the provisions of Section 108 of the Act applied in the present case. First, if the Pan-Eastern arrangements were avoided under Section 108, the Respondent would not thereby derive any assessable income. Secondly, it could not be said that the arrangements were implemented in that particular way so as to alter the incidence of income tax or to relieve the taxpayer from liability to pay income tax. The arrangements, in the view of the learned Judge, could be explained by the ordinary course of commercial dealing.

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6101/40
6102/8
6090/8

Turner J. rejected the Appellant's submissions as to the application of s.111 to the BP-PTT arrangements for the same reasons as had influenced him in rejecting them in the Pan-Eastern transactions.

6105/7

The learned Judge did not consider it to be necessary for him to discuss the point of estoppel. But he did add that, if it had been necessary for him to consider the submissions on estoppel, he would have disallowed them in the same way as McGregor J. did.

6106/3

Record

10. McCarthy J. was not satisfied that the descriptions used by the parties, on the one hand "discount" and on the other "genuine refining venture", were accurate. In the case of the supply arrangements with Gulf the interlocking contracts, though perhaps artificial and to a degree unreal, were designedly constructed, in the view of the learned Judge, to provide an added inducement to enter into the bargain, the inducement being the sharing by the Respondent ultimately in the profits which were expected to arise from the refining of the products purchased by the Respondent. It was not established that at any time direct discounts were available to the Respondent. Turning to the PTT arrangement McCarthy J. said he found difficulty in accepting that the commission from BP which was paid to an independent company PTT, could be described as a discount between vendor and purchaser especially when the taxpayer was unable to arrange direct discounts to itself.

6109/43

6111/18

6112/21

6115/5

6116/34

The learned Judge accepted that, where two or more purposes of expenditure are established, the Commissioner may apportion. In his view, however, there was only one purpose in the present case. The additional advantages for Pan-Eastern and PTT were simply a by-product of the expenditure by the Respondent and not its purpose.

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6120/31

The learned Judge held that Section 108 of the Act did not assist the Appellant. He said that if he was correct in his conclusion that it was not established that Europa could have claimed a discount in New Zealand then it was 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.

11(i) The Appellant respectfully submits that each of the groups of contracts entered into by the Respondent with Gulf and its subsidiaries in 1956 and 1964 and with BP Trading Ltd and its subsidiary in 1961 should be construed as an interlocking whole designed to produce in each case a composite result. This construction is amply supported, it is submitted, by the terms of the contracts themselves and by the way in which those terms were put into practice. This is exemplified by, inter alia, the express words in the recitals of the 1956 agreement for the incorporation of Pan-Eastern; and by the interaction between the discounts granted under the 1964 processing contract to Pan-Eastern and the direct discounts granted to the Respondent after March 1965. When direct discounts were introduced, the discounts to Pan-Eastern correspondingly decreased.

In the Court of Appeal the learned Judges appeared to isolate the supply contracts and, because the Respondent had contracted to pay posted prices, allowed the whole of the amounts expended as deductions. It is respectfully submitted that this approach is too narrow and ignores the commercial reality of the arrangements.

(ii) The Appellant respectfully submits that McGregor J. was correct in regarding the purpose of the arrangements with Pan-Eastern and PTT to be to obtain a form of concession in respect of the expenditure of the Respondent while conforming outwardly with the system of posted prices. That was the composite result.

(iii) North P. regarded Pan-Eastern as a repository to receive a share of the refiner's profit. Turner J. agreed that Pan-Eastern was in a sense allowed a discount by arrangement with the Respondent. McCarthy J. accepted that Pan-Eastern's share of profits under a contract, which could be described as perhaps artificial and to a degree unreal, was an inducement to the Respondent to enter into the interlocking supply contract. However, all three learned Judges declined to take the further step of characterising the arrangements as a grant of a concession in respect of the posted prices paid by the Respondent, which would show a duality of purpose in the payments made by the Respondent for its supplies.

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6111/18

(iv) It is respectfully submitted that it is incorrect to stop short of the conclusion reached by McGregor J. and to regard Pan-Eastern's profits solely as a share of refining profits. Pan-Eastern's profits were refining profits only in a notional sense, and even then were calculated in an artificial and, in 1964, wholly uncommercial way. In reality they were designed to provide, and did provide, a concession to be passed through an indirect route to the Respondent in consideration of its purchases from Gulf at posted prices. In the case of the BP contracts, the true position emerges clearly. As McCarthy J. pointed out, the Respondent's Chairman admitted that the payments to PTT were discounts in reality under another name. 6116/25

(v) The Appellant submits that it is immaterial how the "concession" is described; it is the nature of the arrangements, not their description, which is material. It is not part of the Appellant's case under section 111 that the corporate personality of Pan-Eastern or PTT should be disregarded.

(vi) It is submitted that the concessions granted to Pan-Eastern and PTT were not casual benefits which might or might not have accrued to either company while the Respondent would in any case always pay posted prices. While it is true that under the 1956 arrangements, as originally made it was theoretically possible

that no profit might have accrued to Pan-Eastern while posted prices would still have been payable, nevertheless that was not the intended result of the formula and under the 1959 variation, which was retrospective to the start of the 1956 contracts, the concession, though it might fluctuate, could not fall below a guaranteed minimum.

Accordingly, it is submitted that the expenditure of the Respondent on purchases of petroleum supplies was incurred on the understanding and with the intention that a concession on the posted prices paid would be made. Therefore, the amount to be regarded as exclusively incurred in the production of the assessable income of the Respondent is the full amount claimed to have been expended on the purchase of petroleum supplies less the amount of the concessions accruing to the Respondent through Pan-Eastern and PTT.

(vii) The Appellant respectfully submits that for the provisions in Section 108 of the Act to operate there must be found, first, arrangements made or entered into which, directly or indirectly, had or purported to have the purpose or effect of altering the incidence of income tax or relieving any person from his liability to pay income tax; secondly, a state of affairs such that if so much of the arrangements as

gave effect to that purpose or effect are avoided the taxpayer would have derived assessable income.

On the provisions of Section 108 of the Act the Appellant submits that:

(a) "Liability" and "incidence" are not confined to existing liability and incidence but include prospective liability and incidence.

(b) It is not determinative who receives income under the arrangements or where the income is derived under the arrangements.

(c) "Purpose" and "effect" are alternatives; the provisions in Section 108 may apply both where the purpose exists but has not yet been effected and where the end has been achieved.

(d) It is immaterial that the arrangements are entered into overseas or are related to foreign operations if the income affected would otherwise be assessable income of a New Zealand taxpayer.

(e) Section 108 applies where the arrangement itself gives rise to the income sought to be taxed.

(f) Section 108 applies where, under the arrangements, the income sought to be taxed never passes through the hands of the taxpayer as his income.

(g) The words "altering the incidence of income tax" or relieving any person from his liability to pay income tax in Section 108 are to be interpreted in the same way as the words "avoiding any duty or liability imposed on any person by this Act" in Section 260 of the Australian

Income Tax & Social Services Contribution Assessment Act.

(viii) It is submitted that the provisions of Section 108 apply to the arrangements effected by the Respondent in the 1956 and 1964 agreements in that they had the purpose or effect of altering the incidence of income tax or relieving the Respondent from its liability to pay income tax.

12. The Appellant humbly submits that the decision of the Court of Appeal was wrong and should be reversed and that this Appeal ought to be allowed with costs here and below for the following among other

R E A S O N S

(1) Because, with respect to expenditure by the Respondent under the Gulf-Europa arrangements, the proper inference to be drawn from the evidence is that the return to the Respondent from Pan-Eastern was in the nature of a price concession or a discount.

(2) Because, with respect to expenditure by the Respondent under the BP-Europa arrangements, the proper inference to be drawn from the evidence is that the return to the Respondent through PTT was in the nature of a price concession or a discount.

(3) Because the appropriate test of deductibility under Section 111 of the Act in the present case is whether the expenditure in question was exclusively incurred for the purpose of

producing assessable income of the Respondent and such expenditure is apportionable where it is incurred for two or more purposes, a deduction being allowed only in respect of that part which is exclusively incurred for the purpose of producing assessable income of the Respondent.

(4) Because the expenditure by the Respondent on petroleum supplies obtained from Gulf and BP was incurred for two purposes:

(i) for the purpose of procuring supplies for the Respondent and thereby producing assessable income of the Respondent; and

(ii) for the purpose of producing a return to the Respondent through Pan-Eastern and PTT respectively and such part of the expenditure is not deductible.

(5) Because the learned Judges of the Court of Appeal erred in construing each set of agreements too narrowly.

(6) Because the benefit accruing to the Respondent from the profits of Pan Eastern and the commission paid to PTT was not a casual or collateral benefit but a

direct and intended result of the payments by the Respondent to Gulf and BP respectively.

(7) Because Section 108 of the Act applies to the supply arrangements between the Respondent and Gulf under the 1956 agreements and the 1964 agreements and, in particular, (i) there was in each case an arrangement which was entered into, (ii) the arrangement had or purported to have a purpose or an effect of altering the incidence of income tax or relieving the Respondent from its liability to pay income tax, and (iii) upon the facts remaining, after stripping aside so much of the arrangement as gave effect to that purpose or effect, the Respondent derived the additional assessable income on which it was in that respect assessed.

(8) Because the claim that the Appellant lacked power to make certain of the amended assessments to which the objections relate is inconsistent with the scheme of the Inland Revenue Acts.

(9) Because as to the question, whether the Appellant by the letter of 27th June,1963, exhausted his discretion, the Appellant's

actions were not within the class of acts which may constitute the final exercise of a discretionary power or the Appellant was not sufficiently informed as to the material facts to enable him to exercise any discretion in that respect.

(10) Because as to promissory estoppel, the requirements of estoppel are not satisfied on the facts and in particular: (i) the necessary legal relationship for the raising of promissory estoppel did not exist between the Appellant and the Respondent, (ii) the Respondent had withheld material information from the Appellant and had given him information material to his determination which was incorrect, (iii) the Respondent has not altered its position to its detriment, and (iv) the Appellant has given the Respondent a reasonable period for re-adjustment before enforcing the Respondent's liability for income tax for the years in question.

(11) Because of the reasons given by McGregor J. in the Supreme Court with respect to Section 111 of the Act, estoppel and exhaustion of a discretion.

J.C. White
I.M.Richardson

IN THE JUDICIAL COMMITTEE OF THE
PRIVY COUNCIL

ON APPEAL

FROM THE COURT OF APPEAL NEW ZEALAND

BETWEEN

THE COMMISSIONER OF INLAND REVENUE

Appellant

- and -

EUROPA OIL (N.Z.) LIMITED

Respondent

CASE FOR THE APPELLANT

MACKRELL & CO.,
31 Bedford Street,
Strand,
LONDON W.C.2.

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

CASE FOR RESPONDENT PURSUANT TO RULE 60

THE CIRCUMSTANCES OUT OF WHICH THE APPEAL ARISES

RECORD

1. This appeal is from a judgment of the Court of Appeal of New Zealand given at Wellington on the 21st day of November 1969 in which the Court of Appeal allowed an appeal by Europa Oil (N.Z.) Limited (hereinafter referred to as "Europa") against a judgment of the Supreme Court of New Zealand given in favour of the New Zealand Commissioner of Inland Revenue (hereinafter referred to as "the Commissioner") confirming certain assessments of income tax made against Europa by the Commissioner in respect of the years ended 31st March 1959 to 1965 inclusive.

2. In the Supreme Court, Europa had objected to the said assessments by way of case stated pursuant to Section 32 of the Land and Income Tax Act 1954. The said assessments related in part to the profits earned

in each of the said years by Pan Eastern Refining Company Limited (hereinafter referred to as "Pan Eastern") a company duly incorporated and registered in the Bahama Islands and in part to the profits earned in some of the said years by Pacific Trading and Transport Company Limited (hereinafter referred to as "Pacific Trading") a wholly owned subsidiary of Europa duly incorporated and registered in the United Kingdom. The tax involved in the Pacific Trading aspect of the appeal is a minor proportion of the total amount in issue and the circumstances relating to Pacific Trading are described in a later part of this Case. The share capital of Pan Eastern was and is owned equally by Associated Motorists Petrol Company Limited (hereinafter referred to as "A.M.P.") which is incorporated in New Zealand and is a wholly owned subsidiary of Europa and by Propet Company Limited a wholly owned subsidiary of the Gulf Oil Corporation of America (hereinafter referred to as "Gulf").

1/2/27 to 1/3/27

3. The earnings of Pan Eastern were and are shared equally by the two equal shareholders A.M.P. and Propet, and the dividends paid to A.M.P. come into its hands as foreign dividend income and thence into the hands of Europa as dividend income derived from A.M.P. The dividends from A.M.P. representing its share of Pan Eastern earnings constitute non-

assessable income in the hands of Europa but when passed on to Europa's ultimate shareholders in the form of dividends from Europa they have borne from 1958 (being the year when dividend tax was first introduced into New Zealand) dividend tax at the rate of 7 shillings in the £ or 35 cents in the dollar. New Zealand currency became dollar currency in 1967. Pacific Trading paid New Zealand income tax on all its income and on distribution by way of dividend, such dividends came into the hands of Europa as non-assessable income. On distribution to Europa's ultimate shareholders those shareholders paid dividend tax as in the case of the dividends resulting from Pan Eastern earnings.

4. By his said assessments the Commissioner sought to treat in effect a half share of the profits of Pan Eastern, and all the profits of Pacific Trading, as the income of Europa. He supported the said assessments by two alternative contentions:

(a) That in determining the amount he was required to allow Europa under Section 111 of the said Act as expenditure exclusively incurred in the production of its assessable income in the years in question, he was entitled to deduct A.M.P.'s share in the profits of Pan Eastern, and the whole of the profits of Pacific Trading. 1/22/10 to 1/22/29

(b) That the arrangement made between Europa and the Gulf Oil Corpor- 1/22/29 - 1/24/16

ation of America which led to the formation of Pan Eastern was void under Section 108 of the said Act 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.

5. Simultaneously with the assessments made against Europa the Commissioner also assessed A.M.P. with income tax under Section 138 of the said Act in respect of its "proprietary income" contended to have been derived by A.M.P. as a shareholder in Pan Eastern. The provisions of Section 138, briefly stated, authorise the assessment of a company which owns at least a quarter of the shares in another company, with tax on its "proprietary income" being its share of the total income earned by the latter company in the fiscal year. If Pan Eastern had been incorporated in New Zealand, then there would be no doubt that Pan Eastern was a "proprietary company" from which A.M.P. derived "proprietary income" for which it would be liable for income tax as if it had earned the "proprietary income" in the course of its own trading. But because Pan Eastern is neither incorporated in New Zealand nor carrying on business or deriving any income there and is consequently not liable to pay New Zealand tax, both the Supreme Court and Court of Appeal of New Zealand have decided that the "proprietary tax" assessments

against A.M.P. are and were invalid. The Commissioner has appealed to Her Majesty in Council against the judgment of the Court of Appeal.

The dividend tax payable by the shareholders of Europa on that part of their dividends referable to the Pan Eastern earnings was $2,823,187 for the years ended 31st March 1960 to 1965 being 35% of $8,066,250. 5398

The rate of dividend tax (as previously stated) is 7s.0d. in the £. The rate of "proprietary tax" assessed to A.M.P. was 8s. 6d. in the £. The rate of income tax assessed to Europa was 10s. in the £. Taking into account the dividend tax already paid, the total tax charged against the Pan Eastern earnings by the Commissioner was and is 25s. 6d. in the £.

Prior to the hearing of the Europa and A.M.P. objections in the Supreme Court the advisers of Europa asked the Commissioner and the Minister of Finance for relief against this total liability of 25s. 6d. in the £ in the event of the Commissioner succeeding against both Europa and A.M.P., but the Minister declined to place any limit on the total tax which Europa and its shareholders and A.M.P. would be required to pay. His view in this respect is contained in a letter dated 7 July 1965 in which it is stated "that in the event of the courts deciding that both assessments were valid I would support a recom-

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mendation from the Commissioner to authorise the cancellation of such amount of tax as was fitting.".

6. In relation to the assessments against Europa, and its objections thereto, the judgment of the Supreme Court, given by McGregor J. at Wellington on 8th May 1969, was in favour of the Commissioner. McGregor J. held that in determining the amount the Commissioner was required to allow Europa under Section 111 of the said Act as expenditure exclusively incurred in the production of its assessable income in the years in question, the Commissioner was entitled to deduct A.M.P.'s share in the profits of Pan Eastern, and the whole of the profits of Pacific Trading. McGregor J. did not find it necessary to reach any final conclusion as to the Commissioner's alternative argument under Section 108.

McGregor J. 6027/23-29

McGregor J. 6038/17-21

7. The Court of Appeal held against the Commissioner on both grounds and thus allowed Europa's appeal.

8. The facts relevant to this appeal are as follow in the succeeding paragraphs.

9. Europa is, and was, at all material times an independent company wholly owned by New Zealand shareholders, and engaged in the marketing of petroleum products in New Zealand. At all material times the business competitors of Europa in the marketing of petroleum products in New Zealand were six New Zealand subsidiaries of different international oil companies.

McGregor J. 6001/10-11 6005/29-31 6009/26-30

North P. 6050 line 44 - 6051 line 3

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

McGregor J. 6009/26-34
North P. 6050 line 44 - 6051 line 3
McCarthy J. 6114/41-48

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

McGregor J. 6001/23-27 6012/7-20
North P. 6051/15-21

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

McGregor J. 6001/41-42 6002/19-21
North P. 6051 line 15 to 6052 line 5

13. Europa accordingly began negotiating with Gulf with whom it had been in previous contact in 1944 and also in 1954. In 1944 proposals had

McGregor J. 6002/20-37
North P. 6052/17-40

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been considered by Europa and Gulf for the construction of a refinery in New Zealand, and technical projects had been worked out accordingly. The economics of such an operation appeared to be against the proposal which was then allowed to lapse. In 1954 Europa had again taken up with Gulf the proposal of constructing an oil refinery in New Zealand and Europa had obtained an economic project prepared by an independent American refinery consultant but again the economics of the operation appeared on balance to be against the proposal, and the discussions were allowed to lapse for the time being. The principal factor which operated against the establishment of a New Zealand refinery was the unduly high proportion of gasoline consumed on the New Zealand market in relation to the "heavy end" products such as gas oil and fuel oil which would also be produced by the refinery. The "heavy end" products would be far in excess of New Zealand requirements and this would necessitate transportation of the "heavy ends" some thousands of miles to the nearest worth while markets, an operation which was uneconomic.

North P. 6053/14-38

14. The negotiations with Gulf in 1955 were based on the proposal that instead of Europa participating in the refining in New Zealand of the crude oil required to produce total requirements of Europa, a contract was made whereby Europa could participate in the related overseas

McGregor J. 6002/29-38

North P. 6053/14-38

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refining and thereby in the related profits of such overseas refining. This proposal was made by Gulf and accepted in principle by Europa and negotiations then proceeded in 1955 to establish the corporate structure and the contracts by which such intention might be effectuated. Caltex thereupon re-opened negotiations with Europa and submitted proposals which also envisaged participation in the overseas refining operations of Caltex related to Europa's product requirements, but after due consideration their final proposals were declined by Europa and binding contracts were entered into with Gulf on 3rd April 1956.

15. A company was formed under the name of Pan Eastern Refining Company Limited, and the shares in the company were issued half to Propet Company Limited, and half to A.M.P., as already described in paragraph two hereof. The consent of the United Kingdom Treasury was required for the formation of Pan Eastern and this consent was duly obtained. In support of the application for consent a letter was sent setting out the nature of all the contracts proposed to be entered into.

McGregor J. 6004/26-29

North P. 6054/32-38

McGregor J. 6005/5-19

4120

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

(i) The Petroleum Products Sales Contract made between Gulf Iran (a subsidiary of Gulf) and Europa whereby Gulf Iran contracted to supply Europa for

McGregor J. 6002/39 to 6004/25

North P. 6053/39 to 6055/17

a period of ten years with all of its gasoline and some of its gas oil requirements in New Zealand, the prices for such products to be posted prices.

(ii) A Freight Contract under which Gulf was responsible for the delivery of the petroleum products supplied by Gulf Iran to New Zealand ports.

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

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

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result of these contractual arrangements was that Pan Eastern would earn the conventional refiner's margin on the quantity of crude oil required to supply the equivalent of Europa's requirements of gasoline and this margin was estimated to be approximately 52.5 United States cents for every barrel of crude oil processed, based on the posted prices then prevailing.

17. On the basis of the current prices in 1956 for crude oil and for gasoline and for other products the estimated profit of Pan Eastern of 52.5 cents per barrel of crude oil was equivalent to five cents in respect of every gallon of gasoline imported by Europa under the supply contract, but this figure would fluctuate with any movement in the posted prices of either crude oil or gasoline. North P. 6054/38 to 6055/17

18. The conclusion of these arrangements was to the considerable mutual advantage of Gulf and Europa. Gulf had a secure and substantial market for the "heavy ends" of the refining operation but very little market for the gasoline. Europa was in the converse position. Further, the participation of Europa in this sector of Gulf's overseas refining operations was an effective substitute for the original plan of participation by both companies in refining operations in New Zealand. Both parties still had in contemplation the possibility at some time in the future of establishing a refinery in McGregor J. 6002/31-36

New Zealand, and this is borne out by the further negotiations which took place in 1958 as will be hereinafter described. At a later stage in the operation of the 1956 contracts Gulf agreed with Europa that Pan Eastern should retain as undistributed profits a considerable proportion of its earnings so as to provide Europa with a fund of foreign exchange with which to meet its share of expenditure in the establishment in New Zealand of the proposed refinery. At a later date all the earnings of Pan Eastern including those accumulated from previous years were distributed to A.M.P. and Propet.

19. The first deliveries of gasoline under the Petroleum Products Sales Contract entered into on 3rd April 1956 were made in 1956 and thereafter all the contracts between the parties were carried out according to their tenor. The accounts of Pan Eastern were kept by the Accounts Division of Gulf in Pittsburgh and these were detailed accounts recording all transactions between Gulf and Pan Eastern and between Propet and Pan Eastern. Copies of all the accounts from the inception of the contracts right through until the year ended 31st December 1965 were produced as Exhibit "X" in the proceedings before the Supreme Court of New Zealand in Wellington, but such accounts in view of their bulk are not printed as part of the Record in this Appeal to Her

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Majesty in Council. However, a copy of the accounts for representative periods is included by way of sample in the said Record. 4185 - 4241

20. During the last quarter of 1956 the profits earned by Pan Eastern expressed in terms of cents per gallon of gasoline purchased by Europa amounted to 5.46 cents which was well above the level of 5 cents which would be produced on the basis of current posted prices as at the beginning of 1956. During the first quarter of 1957 the Pan Eastern profit was still maintained at the level of 5.46 cents but in the second quarter of 1957 it declined to 4.18 cents and in the third quarter it was still 4.18 cents and in the last quarter of 1957 it declined to 3.92 cents and then declined further in the first quarter of 1958 to 3.42 cents. This represented a decline of nearly one third from the estimated earnings of 5 cents per gallon and was due to the progressive decline in posted prices of gasoline East of Suez and the simultaneous rigidity of the Middle East posted price for crude oil. McGregor J. 6006/46

21. The steady erosion of the Pan Eastern profits from 1959 onwards was due primarily to the fact that the Middle East posted price for crude oil, being the price payable by Pan Eastern under the Processing Contract, ceased to be equivalent to market price. This in turn was due to the action of the oil producing countries (acting

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through an organisation known as OPEC) in refusing to acknowledge or accept any reduction in the posted price of crude oil upon the grounds that their royalties and tax income would thereby be reduced. The posted price of crude oil therefore remained static at $1.80 per barrel from 1960 onwards whereas the market price over the same period was always at a figure representing a substantial discount off the posted price.

2/6/26 to 2/7/32

22. In consequence of the decline in profit resulting from the development outlined in paragraph 20 hereof, Pan Eastern began negotiations with Gulf in January 1958 for a revision of the profit formula set out in the Processing Contract between Pan Eastern and Gulf upon the grounds that the existing formula was not producing the current commercial refiner's profit. After lengthy negotiations during which the Pan Eastern profit declined to the said figure of 3.42 cents to the gallon, Gulf finally proposed in August 1959 not to vary the profit formula of the Processing Contract but to meet the position by granting whenever necessary a voluntary discount off the sale price of crude oil sold by Gulf to Pan Eastern of such an amount as would restore the earnings of Pan Eastern to a level of 5 cents per gallon of gasoline. In addition to agreeing to make this annual adjustment for the future (whenever necessary) Gulf also agreed to apply this adjustment retroactively for all years prior to 1959 in which the Pan

McGregor J. 6007 line 3 and line 45

North P. 6055/19 to 6056/19

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Eastern profit for the year had not reached the said level of 5 cents per gallon. The result of this variation in the pricing provisions of the contracts was to guarantee to Pan Eastern a minimum refining profit equivalent to not less than 5 cents per gallon of gasoline sold to Europa.

23. Gulf was at all times entitled to stand on the contracts and refuse to vary the processing contract. Even though the profits of Pan Eastern may have dwindled away to nothing, Europa was still bound under the Petroleum Products Sales Contract to buy gasoline at posted price over the whole contract period. But there is evidence to suggest that Gulf decided in 1959 to agree to the contractual variation because it had ascertained in that year that the New Zealand Government had decided that a refinery was to be established in New Zealand on terms involving joint ownership by all the oil companies operating in New Zealand. This meant that at some time in the future Europa would be negotiating on the world market for a long term feedstock supply contract in relation to the New Zealand refinery and the evidence indicates that Gulf was anxious to secure this contract when the time came.

McGregor J. 6011/42 to 6012/4

North P. 6063/4 to line 11

Turner J. 6094/6-44

5332 and 3231

24. In each of the years from 1959 to 1965 inclusive (until the 1964 feedstock contract with Gulf came

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into force) Gulf granted a crude oil discount to Pan Eastern of an amount sufficient to bring the Pan Eastern earnings up to the equivalent of 5 cents per gallon of gasoline supplied to Europa. Without such crude oil discounts the earnings of Pan Eastern would have progressively diminished to the point where by the year ended 31st December 1964 the profit would have been equivalent to 1.9 cents per gallon of gasoline. 5311A

25. In December 1961 Europa entered into negotiations with BP Trading Limited, the United Kingdom parent company of BP New Zealand Limited, for the supply to Europa by BP New Zealand Limited of gas oil and lighting kerosene. BP Trading Limited offered to supply these products at a concession of 10% off posted price, but would not agree to its New Zealand subsidiary selling such products to Europa at any price less than posted price. BP Trading Limited was nevertheless willing to pay or allow a 10% commission in the United Kingdom, to a Europa subsidiary to be formed and registered in the United Kingdom, on the value of sales of gas oil and lighting kerosene to be made in New Zealand by BP New Zealand Limited to Europa. The proposal was accepted and Europa formed and registered in the United Kingdom the subsidiary previously referred to called Pacific Trading and Transport Company Limited which thereafter received the 10% commis-

McGregor J. 6013/39 to 6014/30

North P. 6056/20 - 37

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sion on sales by BP New Zealand Limited to Europa as heretofore described. Pacific Trading paid United Kingdom income tax on all its earnings until it was liquidated as a result of the gas oil and lighting kerosene contract coming to an end. Subsequently the Commissioner took the view that Pacific Trading notwithstanding its United Kingdom registration was liable to New Zealand income tax on its earnings and in due course the United Kingdom revenue authorities accepted this view and refunded the United Kingdom tax to Pacific Trading which thereupon paid to the Commissioner New Zealand income tax on all its earnings from the beginning of its operations.

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

North P. 6056/6-19

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referred to. It now became necessary for Europa to negotiate a contract with Gulf or some other overseas oil company for the supply of crude oil and other feedstocks necessary for Europa's participation in the operations of the proposed New Zealand refinery, subject always to Europa still being committed to Gulf until 1966 under the 1956 Petroleum Products Sales Contract.

27. Gulf expressed its willingness to enter into a future feedstock supply contract within the framework of the existing Pan Eastern structure. The broad basis of the proposed agreement was the same as under the 1956 contracts. The only substantial difference was that instead of Pan Eastern earning the refiner's margin derived from the complete refining of crude oil into gasoline and other products it would earn under the new processing contract the more limited refiner's margin to be derived from the partial refining of crude oil for production of the equivalent quantity of naphtha and middle distillate to be supplied to Europa for processing at the New Zealand refinery.

North P. 6056/38-44

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

5001 McGregor J. 6012/5-16

Turner J. 6095/20 to 6096/7

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In summary, the main provisions of the contracts were:-

(a) Europa Refining Company Limited, a newly constituted subsidiary of Europa, contracted to buy for a period of ten years all its naphtha and crude oil feedstocks from Gulfex, a subsidiary of Gulf, at current market prices.

(b) Gulf agreed to sell and Pan Eastern agreed to buy sufficient crude oil to yield, by the refining process, the feedstocks required by Europa Refining Company Limited under its supply contract with Gulfex.

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

(d) The prices of the naphtha and middle distillate sold by Pan Eastern to Gulfex would be in accord with current market prices prevailing from time to time and such prices received by Pan Eastern, after allowing for the cost of crude oil and the cost of processing by Gulf, would yield a conventional refining profit to Pan Eastern.

(e) Pan Eastern agreed to sell and Propet to buy the surplus "heavy end" production from the aforesaid refining process 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 naphtha and middle distillate to Gulfex.

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

29. In 1963 the Commissioner (at that time Mr F.R. Macken) examined the 1956 contracts previously referred to in order to decide whether he could assess as income of Europa the share of A.M.P. in the profits of Pan Eastern but after due consideration he came to the conclusion that such profits were not assessable under any provision of the Land and Income Tax Act 1954. Mr Macken recorded his view in the following departmental memorandum or minute:

North P. 6057/1-18

"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."

The Commissioner then notified Europa of his decisions by letter

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dated 27th June 1963 addressed to the Managing Director of Europa: McGregor J. 6027/37 to 6028/12

"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. North P. 6057/20-36

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"

30. Following the said notification by the Commissioner it was decided by Europa to ask Gulf to agree to the re-drafting of the 1962 feedstock contracts (which were not yet in operation) so as to make their structure accord with the structure of the 1956 contracts. Gulf agreed with the proposal and on the 20th day of March 1964 another set of feedstock contracts was drawn up North P. 6057/41 - 6058/11 and 6064/4-28

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between Gulf and Pan Eastern and Europa to operate for a period ending on 31st December 1973. The only material difference between the 1962 and 1964 contracts was in the contract of affreightment. Under the 1962 contract of affreightment the benefit of the alternate freight rate was secured to Pan Eastern, whereas by the 1964 contract the said benefit was secured to Europa as it had been and still was under the 1956 contract of affreightment.

3112 to 3198

31. The New Zealand Refinery came on stream in 1964 and although for some time petroleum products had still to be imported under the 1956 contracts so that for a limited period the 1956 and 1964 contracts were in operation simultaneously, the operation of the 1956 contracts in due course ceased and were wholly superseded by the provisions of the 1964 contracts which are still current and will remain so until 31st December 1973.

North P. 6064/4-16

32. On 30th March 1965 the Commissioner (then Mr L.J. Rathgen) issued the first of the assessments against Europa with which this appeal is concerned. The said assessment represented a reversal of the opinion of Mr F.R. Macken (who was the Commissioner's predecessor in office) as notified to Europa on 27th June 1963 and the Commissioner purported to justify the assessment by alleging that at all material times discounts

1/13/22

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had been available off posted prices in arms length long-term contracts for the supply of gasoline.

33. The Commissioner's said assessment was made in respect of the year ended 31st March 1959 and he subsequently made further assessments for the years up to and including the year ended 31st March 1965. By each assessment the Commissioner added to the assessable income of Europa an amount equal to one half of the profits of Pan Eastern for the equivalent year and also an amount equal to the profits of Pacific Trading in each of its trading years. The assessments were based on Sections 111 and 108 of the Land and Income Tax Act 1954. Section 111 of the said Act is in the following terms:

"111. Expenditure or loss exclusively incurred in production of assessable income - (1) In calculating the assessable income of any person deriving assessable income from one source only, any expenditure or loss exclusively incurred in the production of the assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived for that year.

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

Section 108 of the said Act is in the following terms:

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"108. Agreements purporting to alter incidence of taxation to be void - Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void in so far as, directly or indirectly, it has or purports to have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax."

34. Europa duly objected to all assessments pursuant to the provisions in that behalf contained in the said Act and its objections were heard by Mr Justice McGregor in the Supreme Court of New Zealand at Wellington on various days between 17th February and 2nd April 1969.

35. Europa in objecting to the assessments under Sections 111 and 108 contended as follows:-

As to Section 111

(a) On the evidence there were no discounts available off posted price of gasoline in 1956 in respect of long term contracts with world-wide availability and in any event it was impossible for Gulf to have granted discounts off the price of gasoline supplied to Europa. As to the 1964 contracts, it was not open on the evidence to find that Europa Refining could have bought its feedstock supplies on the world market at better prices than were contracted for under the agreements negotiated. To assess Europa as if it had obtained

discounts off the contract prices payable under the 1956 and 1964 contracts was to assume that Europa had entered into contracts which in fact it was powerless to make.
Since the incorporation of Pan Eastern and the existence of all related contracts were accepted by the Commissioner as being valid transactions it was therefore not permissible to treat all these transactions as one overall arrangement whereby discounts were received by Europa off contract prices.
In this respect Europa relied principally upon:
Salomon v. Salomon & Co (1897) A.C.22 Duke of Westminster v. Commissioner of Inland Revenue 19 T.C. 490

(b) As to the "dual purpose" argument, Europa submitted that there was only one purpose for the expenditure by Europa of the cost price of trading stock and that was the purpose of acquiring such trading stock for its marketing operations. The earning of profits by Pan Eastern and Pacific Trading was one of the results of such expenditure but not one of its purposes. Europa further submitted that once money was shown to have been expended by a taxpayer under a valid and bona fide contract for the purchase of trading stock, then such trading stock expend-

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iture was not apportionable by the Commissioner on any ground. It was submitted that the Commissioner's "dual purpose" argument was identical with the unsuccessful argument for the Federal Commissioner in Cecil Bros. Pty Ltd. v. Federal Commissioner of Taxation (1964) 111 C.L.R. 430 and that this latter case was rightly decided and should be followed in New Zealand, in which event it would be decisive in Europa's favour.

Europa further submitted that the cases intended to be relied on by the Commissioner, namely Ward & Co. v. Commissioner of Taxes (1923) A.C. 145, Aspro Ltd. v. Commissioner of Taxes (1932) A.C. 683, Johnson Bros. & Co. v. Inland Revenue Commissioner (1919) 2 K.B. 717 and Ronpibon Tin N.L. v. Federal Commissioner of Taxation (1949) 78 C.L.R. 47 were all cases in which a proportion of expenditure was disallowed because it was a voluntary payment not related to the production of assessable income. It was conceded by Europa that apportionment of a taxpayer's expenditure by the Commissioner was legitimate in order to exclude voluntary payments of that kind, just as it is legitimate to separate capital expenditure from revenue expenditure, but that in the case of

Europa all its trading stock expenditure was made on the best contractual terms which could be made and that no part of such expenditure was "voluntary" or unnecessary for the production of assessable income.

It was further contended by Europa that the Commissioner's argument under the "dual purpose" heading of Section 111, as applied to the present facts, was directly in conflict with established principles of deductibility in income tax law. If the Commissioner's argument was right, then in a case where a parent company in New Zealand bought trading stock from a subsidiary in New Zealand, the proportion of the subsidiary's annual profit derived from such sales could be deducted by the Commissioner from the total trading stock expenditure of the parent company in order to compute the assessable income of the parent company, notwithstanding that the same profits earned by the subsidiary would be taxed as income of the subsidiary. It was pointed out to McGregor J. that this process had in fact been carried out in the case of Pacific Trading. That company had paid New Zealand income tax on all its profits, but the Commissioner had then assessed Europa by deducting an amount equal to those profits from the trading stock expenditure

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of Europa. The result was that in effect the profits of Pacific Trading were sought to be taxed twice. Though this does not amount to "double taxation" in the strict sense, since the tax on the same amount is being paid by different taxpayers, yet the ordinary presumption against double taxation ought by analogy to apply.

As to Section 108

Europa was precluded from arguing -

(a) That Section 108 had no fiscal effect

(b) That if it does have fiscal effect, Section 108 is limited in its application to an accrued incidence or liability to tax

because those two submissions had already been determined in favour of the Commissioner by the New Zealand Court of Appeal in Elmiger v. Commissioner of Inland Revenue (1967) N.Z.L.R. 161 but Europa reserved the right to advance those submissions, if necessary, before the Judicial Committee of the Privy Council. Europa therefore submitted under Section 108:

(a) That Section 108 is not applicable to this case because the section can only apply where a taxpayer derives the income in question in New Zealand

(b) That Section 108 is not applicable to this case because it can only have even prima facie application where, on the facts,

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if it had not been for the arrangement the moneys in question would have come into the hands of the taxpayer as assessable income. In this case, there would have been no income without the "arrangement". It was the "arrangement" itself which produced the moneys sought to be taxed. This was a new source of income.

(c) That if contrary to the above submissions Section 108 was capable of application to the present case it nevertheless cannot apply on the facts because this was a commercial bargain negotiated at armslength between two companies, and it is impossible to hold on the evidence that the transactions had the purpose or effect designated by Section 108. The transactions of 1956 and 1964 constitute ordinary commercial or business dealings which cannot be labelled as tax-avoiding schemes or arrangements.

Europa cited in support of this submission -

Newton v. Federal Commissioner of Taxation (1958) A.C. 450

B.P. Australia Ltd. v. Federal Commissioner of Taxation (1966) A.C. 224

(d) That even if Section 108 did apply on the facts, the effect of applying the Section must be to annihilate (inter alia) the petroleum products sales contract

and this would leave no income to be taxed in the hands of Europa. Further, the vital contract was the processing contract made between Gulf and Pan Eastern which are two foreign corporations not resident or carrying out business in New Zealand. Consequently this contract and the incorporation of Pan Eastern itself, are both incapable of "annihilation" under Section 108 for the purpose of affecting the tax liability of a New Zealand taxpayer.

Exhaustion of statutory discretion and estoppel -

Europa contended that the letter of the Commissioner dated 27th June 1963 precluded him from making his amended assessments up to and including the year ended 31st March 1964 because:

(a) the decision notified to Europa in the said letter was a final exercise of the Commissioner's discretion conferred by section 22 of the said Act to issue amended assessments of income tax,

(b) the notification contained in the said letter operated against the Commissioner by way of promissory estoppel, since Europa had acted in reliance on the notification and had altered its position to its own detriment in two respects -

(i) by negotiating the 1964 contracts in their existing form

(ii) by passing on to its share-

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holders by way of dividend in 1964 the sum of £2,300,000 representing accrued profits of Pan Eastern, thereby depriving itself of the taxable fund from which the assessed tax could have been paid.

36. In support of his said assessments the Commissioner submitted before McGregor J.:

As to Section 111

(a) The incorporation of Pan Eastern and all the contracts made between Gulf and Pan Eastern and Europa, although accepted as being valid transactions and not shams, nevertheless amounted to one overall arrangement whereby Europa received a discount off the cost of supplies of gasoline and other products and later feedstocks. The amount of such discount was equivalent to half the profits of Pan Eastern in each year and that accordingly the Commissioner was entitled to disallow as part of Europa's cost of purchases an amount equal to half the Pan Eastern profits in each year.

In the case of Pacific Trading the earnings of that company in the United Kingdom, represented a discount of 10% off the cost price of gas oil and lighting kerosene purchased by Europa in New Zealand from BP New Zealand

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Ltd. The Commissioner was accordingly entitled to disallow as part of Europa's cost of purchases an amount equal to the whole profit of Pacific Trading in each of its trading years.

(b) Alternatively, the expenditure by Europa on oil supplies from Gulf was incurred for two purposes -

(i) to produce income for Europa

(ii) to produce income for Pan Eastern and that insofar as the expenditure was incurred to produce income for Pan Eastern it was not "exclusively incurred in the production of the assessable income" of Europa.

Similarly it was contended in relation to Pacific Trading that the expenditure by Europa on purchases of gas oil and lighting kerosene under the contract with BP New Zealand Ltd. was incurred for two purposes -

(i) to produce income for Europa

(ii) to produce income in the United Kingdom for Pacific Trading

and that insofar as the expenditure was incurred to produce income for Pacific Trading it was not "exclusively incurred in the production of the assessable income" of Europa.

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In support of the "dual purpose" argument the Commissioner relied principally upon:

Ward & Co. v. Commissioner of Taxes (1923) A.C. 145

Aspro Limited v. Commissioner of Taxes (1932) A.C. 145

Johnson Bros. & Co. v. Inland Revenue Commissioner (1919) 2 K.B. 717

Ronpibon Tin No Liability v. Federal Commissioner of Taxation (1949) 78 C.L.R. 47

As to Section 108

(a) The 1956 and 1964 series of contracts entered into between Gulf and Pan Eastern and Europa and also the incorporation of Pan Eastern itself together constituted an "arrangement" which had the purpose or effect of altering the incidence of income tax on Europa or relieving Europa from its liability to pay income tax.

(b) The effect of applying Section 108 was to annihilate the incorporation of Pan Eastern, the petroleum products sales contract of 1956, the feedstock supply contract of 1964, and all contracts made between the parties and between either of them and Pan Eastern in 1956 and 1964.

(c) The result of annihilation of the incorporation of Pan Eastern and of all related contracts was to leave in the hands of Europa sums of money equal to half the purported profits of

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Pan Eastern in each year which thereupon attracted income tax as being the assessable income of Europa.

37. McGregor J. gave judgment in favour of the Commissioner on 8th May 1969.

As to Section 111

McGregor J. 6011/24-36 6019/5-8

His Honour held

(a) that although posted prices of gasoline represented market prices in 1956, and although Europa had no option but to make its supply contract at posted prices because under the prevailing circumstances it was impossible for Gulf to sell gasoline to Europa at a discount, nevertheless it was unrealistic to regard the various contracts as separate transactions, and the overall result or effect of the various contracts and the incorporation of Pan Eastern was to provide Europa with a price concession based on the volume of its purchases of gasoline, and this was an indirect discount. Consequently the Commissioner was correct in excluding from Europa's cost of trading stock purchases in the years in question an amount equal to half the profit derived by Pan Eastern in each year. His Honour held that on this view of the matter the fact that Europa's expenditure for gasoline

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supplies arose from payments which were contractual and not voluntary was beside the point. His Honour applied the same reasoning in holding that the Pacific Trading profits represented a discount in the hands of Europa.

(b) His Honour further held that there was a dual purpose in the payments made to Gulf and BP New Zealand Ltd. respectively for petroleum products, and accepted the Commissioner's contention that the expenditure which he had disallowed was referable to the purpose of creating a profit for Pan Eastern and Pacific Trading respectively, and for that reason was not exclusively incurred in the production of Europa's assessable income.

McGregor J. 6021/49 to 6022/3

38. As to Section 108

His Honour held on the facts that it was not the purpose of Europa when it entered into the 1956 arrangements to avoid any tax liability. Apart from that finding, His Honour did not find it necessary to reach any conclusion as to the application of Section 108.

McGregor J. 6038/5-11

39. As to exhaustion of statutory discretion and estoppel

His Honour held

(a) that although there was no intentional non-disclosure by Europa of material facts, the

McGregor J. 6030/6 to 6031/39

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Commissioner was nevertheless not in possession as at 27 June 1963 of all the relevant information necessary for him to reach a final conclusion as to the validity of the 1956 contracts for tax purposes.

(b) Even if the letter of 27 June 1963 could be regarded as an exercise of the Commissioner's discretion under Sections 22 and 111 of the said Act, the Commissioner's lack of knowledge of some relevant facts as at 27 June 1963 entitled him to exercise his discretion under the said sections again once the full facts were known. McGregor J. 6032/32-37

(c) The Commissioner was not exercising a statutory discretion when he reached the decision notified in his letter of 27 June 1963. 6033/38-42

(d) The doctrine of estoppel could not operate against the Commissioner, firstly because he did not have all the relevant information as at 27 June 1963, and secondly because the operation of the doctrine would prevent the performance of the statutory obligation on the part of the Commissioner to assess Europa for income tax. 6033/38 to 6034/40

40. The appeal by Europa against this judgment was heard by the Court of Appeal of New Zealand between 25 August and 8 September 1969. The submissions of Europa as appellant

were the same as in the Supreme Court, set out in paragraph 35 of this Case, but three further authorities were referred to by Europa.

In support of the submission that the contracts of 1956 and 1964, not being attacked as shams, must each be given its true legal effect, Europa cited Commissioner of Inland Revenue v. Wesleyan and General Assurance Society (1946) 30 T.C.11 In support of the submission that the earnings of profits by Pan Eastern and Pacific Trading respectively were consequences of, and not purposes of, the expenditure by Europa on supplies of petroleum products, Europa adopted the phraseology of Lord Donovan in Inland Revenue Commissioner v. Korner (1969) 1 A.E.R. 679 and submitted that the profit earned by Pan EAstern and Pacific Trading was a "by-product" and not a "purpose" of the respective expenditure.

With reference to the decision in Littlewoods Mail Order Stores Ltd. v. James McGregor (Inspector of Taxes) (1969) 1 W.L.R. 1241, which, like the decision in Korner's case, had not been available in New Zealand at the time of the Supreme Court hearing, Europa submitted that this was merely an example of expenditure being apportioned as between capital and revenue.

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41. The submissions of the Commissioner as respondent in the Court of Appeal were the same as in the Supreme Court, being set out in paragraph 36 of this Case. The Commissioner cited Littlewoods Mail Order Stores Ltd. v. James McGregor as further authority for his submission that in a proper case the Commissioner was entitled to apportion business expenditure so as to exclude in arriving at the assessable income of a taxpayer any expenditure not exclusively incurred in the production of the assessable income.

42. In its judgment delivered on 21 November 1969 the Court of Appeal unanimously allowed Europa's appeal. The following is a summary of the reasons for judgment of the Court of Appeal:

43. As to Section 111

(a) The Court of Appeal rejected the argument of the Commissioner that the A.M.P. share of Pan Eastern earnings constituted a discount in the hands of Europa. They pointed out that since the contracts of 1956 and 1964 were accepted by the Commissioner as being valid transactions and not shams, it followed that their form and legal effect could not be disregarded. North P. stated that the result of those transactions was that Pan Eastern was a company

North P. 6062/47 to 6063/24

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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.

(b) The Court of Appeal emphasised the status of Pan Eastern as a corporate entity separate from Europa and Gulf. Turner J. stated the question for determination as being whether the profit derived by Pan Eastern could be called a "discount" in the hands of Europa. He said he could not see, notwithstanding the contrary conclusion of McGregor J., that this was possible. The opinions of the other Judges were to the same effect.

Turner J. 6093/48 to 6094/3

(c) In respect of Pacific Trading, the Court of Appeal held that the 10% commission which BP Trading was prepared to allow Pacific Trading was a collateral benefit which attracted tax in its own right, which BP Trading was not prepared to grant to Europa, and which was independent of the agreed price for gas oil supplied by BP New Zealand Ltd. to Europa. The Court of Appeal emphasised the fact that Europa could not buy from BP New Zealand Ltd. at a discount and also the fact that Pacific Trading was a corporate entity separate from Europa.

North P. 6076/41 to 6077/12

Turner J. 6103/7-32

McCarthy J. 6116/22 to 6118/1

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(d) In respect of the "dual purpose" argument, the Court of Appeal held that the inability of Europa to purchase at any better prices than the contract prices was decisive against the Commissioner and that no question of "dual purpose" could arise. North P. 6069/1-38 6072/43 to 6077/12 Turner J. 6078/36 6090/45

The Court of Appeal came to the same conclusion, for the same reason, in the case of the earnings of Pacific Trading. McCarthy J. 6117/47 to 6120/30

(e) As to the question whether the "dual purpose" argument was open at all, having regard to the decisions in Cecil Bros. Pty Ltd. v. Federal Commissioner of Taxation, the Judges of the Court of Appeal expressed different opinions. North P. 6068/30-49 Turner J. 6078/36 to 6087/29

Europa had submitted, in reliance on the judgments in the Cecil Bros. case, that in the case of trading stock expenditure the only inquiry was whether the money had in fact been paid for trading stock. Once this was established then any implication of purpose or motive was irrelevant and the trading stock expenditure was not apportionable on any ground. McCarthy J. 6118/36 to 6120/30

North P. thought there was some difficulty in reconciling the Cecil Bros. decision with the Aspro case, as there seemed to be no distinction between the right to enquire into the quantum of directors' fees and the quantum of trading stock expenditure as items of deductible

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expenditure. Turner J. considered that the Cecil Bros.' case was not reconcilable in principle with the judgment of the Court of Appeal in Littlewoods Mail Order Stores v. Commissioner of Inland Revenue (1969) 1 W.L.R. 1241 where it had been held that payments for rent could be apportioned so as to separate that portion which was being paid for the purpose of acquisition of a capital asset.
Turner J. thought that Littlewoods case was to be preferred to Cecil Bros. as being more in accord with modern developments in taxation law.
McCarthy J. doubted whether the approach adopted in Cecil Bros. was the correct way to approach Section 111 of the New Zealand Act, and preferred to apply the "purpose" test set out in the Aspro and Ward cases.
All the Judges of the Court of Appeal took the view that if Europa's interpretation of the Cecil Bros. case was correct, and if Cecil Bros.was rightly decided, then the case was decisive against the Commissioner's argument under Section 111 irrespective of any question of "purpose".

44. As to Section 108

The Court of Appeal held that the submissions of the Commissioner under this heading must fail because

North P. 6069/39 6072/42

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the transactions between Gulf and Europa were capable of explanation by reference to ordinary commercial dealings. The Court of Appeal further questioned whether, even if the Section did apply, the annihilation of the contracts and of Pan Eastern could result in taxable income reaching the hands of Europa.

Turner J. 6100/46 to 6105/10

McCarthy J. 6120/31 to 6121/20

45. As to exhaustion of statutory discretion and estoppel

The Court of Appeal saw difficulty in accepting Europa's submissions under this heading in view of the fact that the Commissioner's letter of 27 June 1963 was written before his investigation was concluded and when his information was incomplete, and the Court of Appeal also considered that the doctrine of estoppel would not be applicable in view of the statutory duty of the Commissioner to make amended assessments if he thought it right to do so. The Court however did not find it necessary, in view of its findings in favour of Europa under sections 111 and 108, to give further consideration to Europa's submissions on this aspect of the case, although Turner J. indicated that if necessary he would have decided this point against Europa in accordance with the judgment of McGregor J. in the Court below.

CONTENTIONS TO BE URGED
BY THE RESPONDENT

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46. The assessments can not be supported under section 111 of the said Act because:

(a) the A.M.P. share of Pan Eastern earnings does not represent a discount in the hands of the Respondent off the contract prices of supplies procured from Gulf. The Respondent bargained for, and obtained, a share in a defined sector of the overseas refining profits of Gulf. This is the result of the contracts according to their form and effect. It is not contended by the Commissioner that the transactions are or were shams and he concedes that they are valid contracts with binding effect according to their tenor. The evidence in the Supreme Court and the findings made thereon by McGregor J. plainly establish that discounts off posted prices of gasoline could not be obtained in the 1956 period and to hold that the A.M.P. share of Pan Eastern earnings constitutes a discount, or is equivalent to a discount off the contract price, is to assume that the Respondent made a contract which in fact it was powerless to make. Similarly with the 1964 contracts, it has not been shown that the contract prices paid thereunder are anything else than in accord with market prices

from time to time.

The basic flaw in the Commissioner's argument under this heading has been to assume that because the net economic result to the Respondent has been the derivation of non-assessable income representing a share in the earnings of Pan Eastern, that the supply contracts with Gulf ought therefore to be read as if they contained a contractual provision for a discount or rebate off the contract prices. The contract prices payable by the Respondent for petroleum products under the 1956 contracts and for feedstocks under the 1964 contracts always remained payable irrespective of the earnings of Pan Eastern.

In any event, the argument that part of the Pan Eastern earnings represent a discount in the hands of Europa fails on a separate ground, namely the status of Pan Eastern as a separate corporate entity.

The same contentions on the part of the Respondent apply, mutatis mutandis, to the earnings of Pacific Trading.

(b) The Commissioner argues in the alternative under section 111 that the trading stock expenditure of Europa was in relation to Pan Eastern and Pacific Trading respectively incurred for a dual purpose, one purpose being to produce assessable income for

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Europa, the other purpose being to create an income for Pan Eastern or Pacific Trading as the case may be. It is contended by the Respondent that the "dual purpose" argument disappears once it is shown, as it has been in this case, that the Respondent was unable to purchase its trading stock at any better prices than contract prices.

(c) In the opinion of the Judges of the Court of Appeal it was not necessary for them to come to any final conclusion as to the applicability of Cecil Bros. Pty Ltd. v. Federal Commissioner of Taxation to section 111 of the New Zealand Act. They held that the inability of Europa to purchase oil and oil products from Gulf and BP New Zealand Ltd. at any better prices than the contract prices disposed of any argument that there was a "dual purpose" in paying the contract prices. With this view the Respondent respectfully agrees, but contends nevertheless that the Cecil Brothers case was rightly decided and is entirely applicable to section 111 of the New Zealand Act.

It is contended that trading stock expenditure stands in a different category from the voluntary expenditure which was considered in the Ward, Aspro, Johnson Bros. and Ronpibon Tin cases, and that

Littlewood's case is merely an example of separating capital and revenue expenditure. The Federal Commissioner's "dual purpose" argument in the Cecil Brothers case contained a flaw which becomes apparent if one considers the consequences of the Federal Commissioner's argument succeeding. The result would have been that the deductible trading stock expenditure of Cecil Bros. Pty Ltd. would have been reduced by the amount of Breckler Pty Ltd. profit. But Breckler Pty Ltd. would have been liable to pay income tax on that profit because it represented the net trading profit resulting from the moneys actually paid to it by Cecil Bros. Pty Ltd. for trading stock. Thus the contract prices paid by Cecil Bros. Pty Ltd. for trading stock would have been accepted, and necessarily accepted, by the Federal Commissioner in assessing Breckler Pty Ltd., whereas the same contract prices would have been rejected by the Federal Commissioner, and altered to different prices, for the purpose of assessing Cecil Bros. Pty Ltd. It is contended that this process contravenes a basic principle of English, Australian and New Zealand income tax law, namely that in the absence of any special statutory provision to the contrary, where a trader sells

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trading stock to another trader, the assessment to income tax of buyer and seller respectively must each be based on the same contract price.

It is further submitted in support of the correctness of the Cecil Brothers decision that the only inquiry in respect of trading stock expenditure is whether the money was in fact paid for trading stock under a valid and bona fide contract of sale. It is not for the revenue authorities to say what price should be paid. Any other view would lead to the assumption by the revenue authorities of control over the day to day prices paid by taxpayers for their trading stock. The Respondent cites in this context the judgment of the House of Lords in Craddock v. Zevo Finance Co. Ltd. (1946) 27 T.C. 267 and in particular draws attention to the opinion of Lord Simon in which at page 287 the following passage appears:

"To put the matter in its simplest form, the profit or loss to a trader in dealing with his stock-in-trade is arrived at for Income Tax purposes by comparing what his stock in fact cost him with what he in fact realised on re-sale. It is unsound to substitute alleged market values for what it in fact cost him. The deduction from gross receipts,

which is not prohibited by Rule 3 of Cases I and II of Schedule D, is that of expenses "wholly and exclusively" laid out for the purposes of the trade, even though the outlay is unnecessarily large ..... The test is what was in fact the cost of the stock".

Reference is also made to the opinion of Lord Simonds in which the following passage appears at page 295:

"I cannot distinguish between consideration and purchase price, and (using again the language of the Master of the Rolls) I find that, acquiring the investments "under a bona fide and unchallengeable contract" they paid the price which that contract required, a price which, whether too high or low according to the views of third parties, was the price upon which those parties agreed."

47. The assessments cannot be supported under section 108 because:

(a) Section 108 does not have fiscal effect. In respect of a contract agreement or arrangement to which the section applies it is designed to operate solely inter partes. Insofar as they are to the contrary effect, the decisions of the New Zealand Court of Appeal in Elmiger v. Commissioner of Inland Revenue (1967) N.Z.L.R.161, Marx and Carlson v. Commissioner

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of Inland Revenue (unreported) and Mangin v. Commissioner of Inland Revenue (unreported) are erroneous in law.

(b) If, contrary to the foregoing submission, section 108 does have fiscal effect, then its operation is limited to cases where the incidence or liability to tax has already accrued. The phrase "incidence of income tax" is not apt to describe the situation before a liability to tax has accrued. It is not appropriate when there is a mere inchoate future liability which may or may not fall. It is only referable within the context of the section and the Act as a whole to a situation where there is a definite ascertained amount of tax for which the taxpayer is presently liable. Similarly the word "relieving" in the section connotes exemption from the legal consequences of an existing condition. Insofar as they are to the contrary effect, the decisions of the New Zealand Court of Appeal in Elmiger v. Commissioner of Inland Revenue (1967) N.Z.L.R.161, Marx and Carlson v. Commissioner of Inland Revenue (unreported) and Mangin v. Commissioner of Inland Revenue (unreported) are erroneous in law.

(c) Section 108 is only applicable to a case where the taxpayer has

derived the income. The phraseology of the section is not apt to describe a situation where the taxpayer has not derived income in the first place, because the liability to tax sought to be enforced by section 108 can only arise upon derivation of income. Insofar as they are to the contrary effect, the decisions of the New Zealand Court of Appeal in Marx and Carlson v. Commissioner of Inland Revenue (unreported) and Mangin v. Commissioner of Inland Revenue (unreported) are erroneous in law.

(d) Section 108 is only applicable to a case where the taxpayer has derived or alternatively will derive income which is assessable to New Zealand income tax. The real contention of the Commissioner in this case is that there was a "relieving" from liability to pay New Zealand income tax because the Respondent failed so to arrange its affairs as to earn the Pan Eastern profits in a form which would make them assessable to New Zealand income tax. Such a construction of section 108 is not warranted by the terms of the section.

(e) Section 108 is not applicable to this case because it can only have even prima facie application where, on the facts, if it had not been for the arrange-

ment the moneys in question would have come into the hands of the taxpayer as assessable income. In this case, there would have been no income without the "arrangement". It was the "arrangement" itself which produced the moneys sought to be taxed.

In all the Australian cases under section 260 of the Commonwealth Act where the Federal Commissioner has succeeded, and in all the cases under section 108 where the New Zealand Commissioner has succeeded, the "arrangement" has varied or affected an existing source of income. The present case is not in this category. Here the "arrangement" originated a new source of income.

(f) The Commissioner seeks to deny to the Respondent under section 108 a deduction to which the Respondent is entitled under section 111. Once a taxpayer becomes entitled to a deduction under section 111, there can then be no room for the operation of section 108 in relation to that same deduction.

(g) That if contrary to the above submissions section 108 is capable of application to the present case it nevertheless cannot apply on the facts because this was a commercial bargain negotiated at arms length between two companies, and it

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is impossible to hold on the evidence that the transactions had the purpose or effect designated by section 108. The transactions of 1956 and 1964 constitute ordinary commercial or business dealings which cannot be labelled as tax-avoiding schemes or arrangements.

(h) That even if section 108 did apply on the facts, the effect of applying the section must be to annihilate (inter alia) the petroleum products sales contract and this would leave no income to be taxed in the hands of Europa. Further, the vital contract was the processing contract made between Gulf and Pan Eastern which are two foreign corporations not resident or carrying out business or deriving income in New Zealand. Consequently this contract and the incorporation of Pan Eastern itself, are both incapable of "annihilation" under section 108 for the purpose of affecting the tax liability of a New Zealand taxpayer.

48. The Respondent contends that the Commissioner by reason of his letter of 27 June 1963 was precluded from issuing amended or original assessments against the Respondent for any year up to and including the year ended 31 March 1964, for the following reasons:

(a) The Commissioner's determination

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notified in his said letter was an exercise by him of his statutory discretion under s.22 of the Land and Income Tax Act 1954, whereby he determined that he would not in relation to Pan Eastern earnings amend the assessments already made against the Respondent for the years up to and including the year ended 31st March 1962.

(b) By issuing amended assessments on 30 March 1965 and on subsequent dates in relation to the years ended 31st March 1960, 1961 and 1962 the Commissioner purported to exercise again a statutory discretion which was already exhausted.

(c) (i) The Commissioner's letter to the Respondent dated 27 June 1963 constituted a promise that the Commissioner would not

(a) amend the original assessments up to and including the year ended 31st March 1962

(b) issue assessments for the years ended 31st March 1963 and 1964

so as to include in the assessable income of the Respondent any part of the Pan Eastern earnings derived under the 1956 Contracts.

(ii) The Respondent in reliance on such promise acted to its detriment or altered its position in two respects -

(a) by distributing to its shareholders on 24 April 1964 as

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dividends, retained earnings of Pan Eastern amounting to £2,300,000 obtained by Associated Motorists Petrol Company Ltd. from Pan Eastern by way of dividend on 18 March 1964

(b) by executing on 10 March 1964 the ten year supply contract, freight contract, and associated Pan Eastern contracts relating to importations of feedstocks for the Marsden Point refinery.

(d) The Respondent accordingly submits that the doctrine of promissory estoppel operates in its favour in relation to any Pan Eastern earnings derived under the 1956 Contracts sought to be assessed as income of the Respondent for any year up to and including the year ended 31st March 1964.

49. The Respondent humbly submits that the decision of the Court of Appeal was right and that this Appeal should be dismissed with costs for the following among other

REASONS

(a) The Commissioner's assessments cannot be supported under section 111 of the Land and Income Tax Act 1954 because:

(i) The Respondent at no time received a discount off the contract prices which it paid for trading stocks

(ii) The earning of profits by Pan Eastern and Pacific Trading respectively was a by-product or consequence of the trading stock expenditure, not a purpose thereof

(iii) In any event, in the case of trading stock expenditure the only question under section 111 is whether such expenditure was incurred under valid and bona fide contracts of sale and purchase. Once that question is answered in the affirmative, any implication of motive or purpose or quantum of expenditure is irrelevant.

(b) The Commissioner's assessments cannot be supported under section 108 of the said Act because:-

(i) section 108 does not have fiscal effect

(ii) the operation of section 108 is limited to cases where the incidence or liability to tax has already accrued

(iii) section 108 is only applicable to a case where the taxpayer has derived the income

(iv) section 108 is only applicable to a case where the taxpayer has derived or alternatively will derive income which is assessable to New Zealand income tax.

(v) section 108 is not applicable to this case because here it was the "arrangement" itself which produced the income

(vi) the trading stock expenditure of the Respondent is deductible in full under section 111, and thus there is no room for the operation of section 108

(vii) even if section 108 is capable of application to the present case, nevertheless it cannot apply on the facts because the contracts in question were and are ordinary commercial dealing

(viii) even if section 108 did apply on the facts, the annihilation of such contracts or legal transactions as are capable of annihilation would not leave exposed any income taxable in the hands of the Respondent.

(c) Even if the Respondent were liable under either section 111 or section 108, the Commissioner was nevertheless precluded by his decision and his notification of that decision contained in his letter of 27 June 1963 from issuing any assessment or amended assessment up to and including the year ended 31 March 1964 relating to the earnings of Pan Eastern because:

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(i) such assessments constituted the exercise of a statutory discretion already exercised

(ii) the said letter raises a promissory estoppel against the Commissioner in favour of the Respondent

(d) The decision of the New Zealand Court of Appeal was correct.

Counsel

Counsel