Judgment 14, 1970

IN THE PRIVY COUNCIL

17 OF 1970

ON APPEAL

FROM THE COURT OF APPEAL OF NEW ZEALAND

BETWEEN:

THE COMMISSIONER OF INLAND REVENUE — Appellant

- and -

ASSOCIATED MOTORISTS PETROL COMPANY LIMITED — Respondent

CASE FOR RESPONDENT PURSUANT TO RULE 60

THE CIRCUMSTANCES OUT OF WHICH THE APPEAL ARISES

1. This appeal is from a Judgment of the Court of Appeal of New Zealand which unanimously dismissed an Appeal from the Judgment of McGregor J. in the Supreme Court of New Zealand.

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Record.

2. The Respondent is a private limited liability company incorporated in New Zealand. It is a holding company, with an authorised but uncalled capital of £100. 0. 0. divided into one hundred ordinary shares of £1. 0. 0. each. At all material times its shares were wholly owned by Europa Oil (N.Z.) Limited (hereinafter referred to as "Europa") and held by Europa as to 98 shares and by two others on behalf of Europa as to one of the remaining shares each. The Respondent was a shareholder in Pan Eastern Refining Company Limited (hereinafter referred to as "Pan Eastern").

p.2 lines 11 to 30

North P. p.124 line 15 to p.125 line 8

3. Pan Eastern was a duly incorporated limited liability company incorporated in the Bahama

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Islands. Its fully paid issued capital was £100,000. 0. 0. divided into 100,000 ordinary shares of £1. 0. 0. each of which 50,000 of such shares were held by the Respondent and the remaining 50,000 by Propet Co. Limited, a subsidiary of Gulf Oil Corporation of America (hereinafter referred to as "Gulf").

North P. p.125 line 9 to line 18

4. In the years in question very large profits were made by Pan Eastern from a processing contract made between Gulf and Pan Eastern the broad terms of which were that Pan Eastern was entitled to share in the refiner's calculated margin on the quantity of crude oil required to supply the equivalent of Europa's requirements of gasoline. It is common ground that Pan Eastern being an overseas corporation earning profits abroad is in no way subject to the revenue laws of New Zealand.

p.2 line 31 to line 35

p.5 lines 1 to 6

5. In furnishing returns of income to the Commissioner of Inland Revenue (the Appellant), the Respondent declared that it had derived non-assessable income during the income years ended on 31st day of March 1960 to 1965 inclusive in respect of the dividends which it received from Pan Eastern and the Appellant issued assessments of the Respondent's liability to pay ordinary income tax and social security income tax based on those returns.

p.5 line 22 to line 28

6. On the 30th day of March 1965 the Appellant made an amended assessment of the Respondent's liability for tax in respect of the income derived during the income year ended on 31st day of March 1960 which included the dividends from Pan Eastern as proprietary income pursuant to s. 138 of the Land and Income Tax Act 1954 (hereinafter referred to as "s.138").

p.7 lines 1 to 5

p.8 lines 11 to 15

7. The Respondent objected to the amended assessment and to amended assessments made thereafter in respect of the income derived by the Respondent from Pan Eastern during the income years ended on 31st day of March 1961 to 1965 inclusive.

8. McGregor J.'s Judgment in the Supreme Court may be conveniently divided into five parts:

Part I:	The presumption that legislation applies only to persons within the jurisdiction of the legislature although general words are used.	McGregor J. p.112 line 43 to p.113 line 44
Part II:	A consideration of s.138 (and with it ss.165 and 166) whereby he held that the Respondent did not derive proprietary income and had therefore derived non-assessable income in respect of dividends received from Pan Eastern.	p.113 line 45 to p.117 line 10
Part III:	The principle that a taxing Act is interpreted in favour of the taxpayer where there is a question of doubt in its construction.	p.117 line 11 to p.118 line 14
Part IV:	The effect of s. 26 of the Land and Income Tax Assessment Act (No. 2) 1968 which amended s.138.	p.118 line 15 to p.119 line 6
Part V:	The Appellant having assessed Europa under s.111 or s.108 exercised an election and could not also assess the Respondent under s.138 on the same income.	p.118 line 7 to p.120 line 22

9. The effect of the Judgments in the Court of Appeal is as follows:

(a) The learned President, North P. delivered a separate Judgment and Turner and McCarthy JJ delivered a joint Judgment.

(b) The learned President in his Judgment dealt with parts I and II of McGregor J.'s Judgment, that is with the general presumption that legislation applies only to persons within the jurisdiction and a consideration of ss.138, 165 and 166. He did not deal with the other three parts of McGregor J.'s Judgment. — North P. p.126 line 8 to p.136

(c) In their joint Judgment Turner and McCarthy JJ. dealt with Part II of — Turner and McCarthy JJ.

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p.138 line 22 to p.155 line 6

p.145 lines 20 and 21 p.155 line 7 to p.156 line 31

McGregor J.'s Judgment, that is with ss. 138, 165 and 166 but did not deal with Part I (the presumption that the legislation applied only to persons within the jurisdiction) nor with Part III (the doubt being interpreted in favour of the taxpayer) but in passing referred to Part IV (s.26 of the Land and Income Tax Amendment Act No. 2, 1968). They rejected Part V of McGregor J.'s Judgment that the Appellant having assessed Europa under s.111 or s.108 had exercised an election which prevented him also assessing the Respondent under s.138. In the Court of Appeal the Respondent had not sought to uphold this part of the Judgment.

10. CONTENTIONS TO BE URGED BY THE RESPONDENT

North P. at p.133 line 12 p.134 line 7 McGregor J. at p. 112 line 44 to p.113 line 41

(a) As a matter of principle the ordinary presumption that Parliament does not legislate for other than its own nationals or persons residing within its jurisdiction applies and accordingly the Parliament of New Zealand is not legislating in the Land and Income Tax Act 1954 in respect of a company which resides outside its territory and does not derive any income in New Zealand: Colquhoun v. Heddon (1890) 25 Q.B.D. 129 and in particular per Lord Esher at pp.134 to 135 adopted by North P. in the Court of Appeal and McGregor J. in the Supreme Court: Boots Chemists (N.Z.) Limited v. Chemists Guild of New Zealand (Inc.) (1968) A.C. 457 Mapp v. Oram (1969) 3 W.L.R. 557.

(b) Jurisdiction is restricted by the Land and Income Tax Act itself in ss.165 and 166 thereof. The following companies are taxable in New Zealand:

A. Companies incorporated in New Zealand (s.166(2)(a)).

B. Companies not incorporated in New Zealand but having their head office

and centre of management in New Zealand (s.166(2)(b) and s.166(3)).

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C. Overseas Companies deriving income from New Zealand (s.165(1) and (2))

(i) It is common ground that Pan Eastern is not resident in New Zealand, has never derived income from New Zealand and is not a company which is taxable in New Zealand.

North P. p.125 lines 15 to 18

(ii) Although the Appellant has submitted in the Lower Courts that the principle in Colquhoun v. Heddon (supra) does not apply because the Appellant is not seeking to deal with the income of Pan Eastern under s.138 but to deal with the New Zealand shareholder (the Respondent) nevertheless the Appellant must deal with proprietary companies in s.139. This section entitles the Appellant to disallow excessive remuneration paid by a proprietary company to a shareholder director or relative in calculating the assessable income of the proprietary company. In addition to this s.140 makes provision for temporary relief in the case of proprietary companies establishing new industries in New Zealand. Under both s.139 and s.140 the Appellant deals with the proprietary company and neither, it is submitted, can apply to a company not liable to New Zealand Income Tax.

(iii) The definition of "shareholder" in s.138(1)(b) bears examination as it has inherent in the Respondent's submissions, the same restriction contended by

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the Respondent: that the shareholder must be liable for New Zealand tax.

(iv) On its face "shareholder" in relation to any company means "a person" by whom or on whose behalf shares in the company are held. The definition of "person" in s.2 includes a company and a local or public authority; and also includes an unincorporated body of persons. It is significant that "company" is included in this definition, and of course it is included in s.138(1)(a). There is no restriction on jurisdiction but given its apparent meaning, Propet Co. Ltd., the other shareholder in Pan Eastern is within this definition and liable to assessment for proprietary income. This has not been contended for by the Appellant in the Lower Courts.

(v) The restricted meaning of "shareholder" to a shareholder liable for New Zealand income tax is the same restriction the Respondent contends applies to proprietary companies and is inherent in the context of s.138.

(c) (i) The general submission is made that for a taxpayer to derive proprietary income, the proprietary company is one which must be liable for tax under the Land and Income Tax Act 1954. s.138 uses defined terms.

(ii) The definitions are contained in s.2. It must be noted however that the section commences: "In this Act unless the context otherwise requires..." The Respondent's submission is that the context of s.138 requires

"Company" (which is defined as "any body corporate, whether incorporated in New Zealand or elsewhere, but does not include a local or public authority") to mean a company subject to liability for New Zealand tax.

(iii) S.138(1)(i) contains the definition of the term "proprietary income".

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

(iv) To determine proprietary income in the shareholders' hands reference must be made to its liability to tax in the proprietary Company's hands. The expression "total income" used in paragraph (i) is also used in paragraph (b) and is defined in paragraph (g) as meaning in relation to the proprietary company "the total amount of the

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residual taxable income and non-assessable income".

(v) To find the residual taxable income in relation to the proprietary company reference has to be made to paragraph (f) for a definition that it means "the amount by which the taxable income of the company for that year exceeds the total amount of the income tax payable by the Company in respect of income derived by it during that year".

(vi) "Non-assessable income" means non-assessable income as defined in s.2. Referring then to s.2 the term "non-assessable income" means income of certain classes and refers to some as being "exempt from income tax". Exemption from income tax presupposes a liability to tax. See Australian Mutual Provident Society Limited v. Commissioner of Inland Revenue (1962) N.Z.L.R. 449 P.C.

(vii) Reverting back however to the definition of residual taxable income, this means "the amount by which the taxable income of the Company for that year ... exceeds the total amount of the income tax payable by the Company in respect of income derived by it during that year."

(viii) In the Respondent's submission taxable income and income tax are used as defined in s.2. Taxable income is there defined as:

(a) In relation to ordinary income tax, means the amount of assessable income after deducting the amount of all special exemptions to which the taxpayer is entitled in respect of ordinary income tax.

"Taxpayer" is also defined as

> "a person chargeable with land tax or income tax, as the case may be whether on his own account or as the agent or trustee of any other person, and includes the executor or administrator of a deceased taxpayer."

"Income tax" in turn is defined as

> "income tax imposed under the principal Act; and, as the context may require, either includes both ordinary income tax and social security income tax or means ordinary income tax only or social security income tax only".

In determining proprietary income in the hands of a shareholder one is driven back to the taxable position of the proprietary company.

(ix) If the expressions "income tax" and "taxable income" refer to New Zealand tax the Appellant's assessment fails since there is no taxable income of Pan Eastern which may be used for the calculation. If the Appellant contends that the same expressions are referable to foreign tax then s.138 contains no provisions for equating with New Zealand tax the nature and extent of the foreign tax liability which may be different in form and application from our methods of assessment.

(x) S.170 of the Land and Income Tax Act 1954 provides for a credit against income tax payable in New Zealand where "income tax has been paid overseas" and there is a special definition of income tax so

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that tax paid overseas is credited with a New Zealand equivalent but where it is applied, the Act has made specific provision for it as, for instance s.144(a)(2) where income tax is defined with reference to foreign tax. No such definition is incorporated in s.138.

(xi) S.138(4) preserves the liability for tax (and by s.2 this means income tax) of the proprietary company notwithstanding the re-assessment of the shareholder.

(d) (i) The interpretation of proprietary income as deriving only from a proprietary company liable for tax in New Zealand does not depend on considerations of machinery. The provisions are in one section or group of sections which impose the tax and the true machinery provisions are still found in Part II of the Land and Income Tax Act 1954. S.138 sets out the method of assessment, the imposition of liability and its limits and is a substantive provision.

(ii) Even if it were considered as a machinery section, it may, nevertheless, still point towards applying only in New Zealand because machinery sections may do so. See Colquhoun v. Brooks (1889) 14 App. Cas. 493.

(iii) It was contended in the Lower Courts by the Appellant that the shareholder would have no difficulty in supplying the information required for the assessment as it must have at least a quarter share in the proprietary company. In reply it must be borne in mind that not only may the proprietary company on the Appellant's view be outside New Zealand but that it in turn may be a shareholder in another proprietary

company also outside New Zealand and the Appellant contends that each of these proprietary companies and shareholders is such as to be caught within the meaning of the Act. This could result in difficulties in the supply of information for the Appellant's assessment on the Respondent.

(e) (i) By the Land and Income Tax Amendment Act (No. 2) 1968 s.26 amended s.138 in many respects. It repealed s.138(1)(f) and changed the meaning of "residual taxable income" by expressly providing for the case of a proprietary company which did not derive income from New Zealand. It also provided by subs. 3(c) and subs. 3(d) for income tax to have the same meaning as subs. (1) of s.170 of the Land and Income Tax Act 1954 (which converts "income tax" outside New Zealand to New Zealand income tax) and provided other machinery for assessment of overseas tax. The context of Section 138 was changed to provide the calculation of proprietary income where the proprietary company was not resident and did not derive income in New Zealand.

Section 26(9) provided however:

> Where any objection has been made, whether before or after the passing of this Act, to an assessment of income tax in respect of income derived in any income year which ended not later than the thirty first day of March, nineteen hundred and sixty eight, then, notwithstanding anything in any other enactment or in any rule of law relating to the interpretation of legislative enactments, nothing in subsections (1) to (7) of this section shall in determining

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that objection and every appeal against determination thereof be construed as altering the law in force before the passing of this Act, and the objection and every appeal against the determination thereof shall be heard and determined as if sub-sections (1) to (7) of this section had not been enacted.

McGregor J. p.118 Line 15 to p.119 line 6

(ii) Because of certain discussions between the Appellant's legal advisers and the Respondent's legal advisers before the said s.26 was passed the Respondent took the view that it could advance the amendment as an aid to interpreting the s.138 as it had previously stood because the amendment was remedial. The Respondent advanced argument in the Supreme Court but McGregor J. rejected this submission. The Respondent accepted the Judgment on this point in the Court of Appeal. It does not therefore advance argument on it before your Lordships.

McGregor J. p.118 line 7 to p.120 line 22

(f) As to election, this argument had not been presented by the Respondent before McGregor J. and it did not seek to uphold the Judgment on this point. The Respondent does not therefore advance this argument before your Lordships.

McGregor J. p.117 line 11 to p.118 line 14

(g) In the event of the construction of the Statute being one of doubt then the Respondent adopts the approach of McGregor J. in the Supreme Court in construing the Act in favour of the tax-payer.

(h) In the event that the assessment by the Appellant of Europa is upheld on the ground that s.108 applies to the transactions whereby Pan Eastern had funds available for distribution to its shareholders and as a consequence the incorporation of Pan Eastern is declared void, then the Respondent contends that the

present assessment of the Appellant cannot be upheld.

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11. The Respondent respectfully submits that this Appeal should be dismissed and that the Order of the Court of Appeal should be affirmed, and that the Appellant should be ordered to pay the Respondent's costs and disbursements for the following among other

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REASONS

(a) Because the decision of the Court of Appeal was right for the reasons given in the Judgments of North P. and of Turner and McCarthy JJ.

(b) Because as a matter of interpretation "proprietary income" payable by a New Zealand taxpayer under the provisions of the Land and Income Tax Act 1954 cannot be derived by the taxpayer where
20 the Company from which the income is derived is not also a New Zealand taxpayer.

P.T MAHON Counsel

RAMON PETHIG Counsel

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Appellant

- and -

ASSOCIATED MOTORISTS PETROL COMPANY LIMITED

Respondent

CASE FOR THE RESPONDENT PURSUANT TO RULE 60

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