Privy Council Appeal No. 17 of 1970

The Commissioner of Inland Revenue – – – *Appellant*

v.

Associated Motorists Petrol Company Limited – – *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 21ST OCTOBER 1970

Present at the Hearing:

LORD DONOVAN
VISCOUNT DILHORNE
LORD WILBERFORCE
LORD PEARSON
SIR FRANK KITTO

[*Delivered by* LORD WILBERFORCE]

This appeal, from the Court of Appeal in New Zealand, arises out of the same set of facts as were involved in the appeal to the Board, No. 20 of 1970. The Commissioner of Inland Revenue v. Europa Oil (N.Z.) Limited. These are fully stated in the judgment of the Board in that appeal and it is unnecessary to repeat them. It is only the following matters which are relevant in this present case. The respondent Associated Motorists Petrol Company Ltd. ("A.M.P.") is a company incorporated in New Zealand. It has an authorised capital of £100 divided into one hundred shares of £1 each, all of which, at all material times, were held by or on behalf of Europa Oil (N.Z.) Ltd.

A.M.P. was a shareholder in Pan Eastern Refining Company Limited ("Pan Eastern") a company incorporated in the Bahama Islands. Pan Eastern's capital was £100,000 divided into 100,000 shares of £1 each of which 50,000 were held by A.M.P., and 50,000 by Propet Co. Limited ("Propet"), a subsidiary of Gulf Oil Corporation of America. Pan Eastern derived no income or profits from New Zealand but in the years ending 31 March 1960 to 31 March 1965 (both inclusive) made large profits under a processing contract with Gulf Oil Corporation. Since Pan Eastern was an overseas corporation, these profits in Pan Eastern's hands were not chargeable with New Zealand income tax, nor subject to New Zealand revenue legislation. But the Commissioner has assessed A.M.P. in respect of one half share of these profits on the basis that they are "proprietary income" of A.M.P. This is under those provisions of the New Zealand legislation which make a shareholder in a proprietary company liable to be assessed to income tax in respect of the income (as defined) of the proprietary company. The amount of proprietary income involved totals, for the six years in question £2,898,026, tax on which

comes to £1,231,661. A.M.P., while admitting that it has received substantial dividends from Pan Eastern in respect of its shareholding, contends that these dividends represent " non-assessable income " and that it ought not to be assessed in respect of any " proprietary income ". That the dividends, as such, are non-assessable is not disputed, so that the issue is whether Pan Eastern is a " proprietary company " and its income, or any part of it, " proprietary income " of A.M.P. If Pan Eastern had been a New Zealand Company, it is common ground that the assessments would have been unchallengeable.

The section of the Land and Income Tax Act 1954 which deals with Proprietary Companies is s.138 and since many of its provisions have been invoked by one side or the other, it is necessary to set out in full subsections (1)–(4) and (11). The following is the form in which these subsections stood at all times material to the assessments under consideration. The words and expressions enclosed in parenthesis represent amendments after 1954.

" 138. Income of proprietary company in certain cases assessable as income of shareholders—

(1) The following provisions shall apply for the purposes of this section, namely:

(*a*) The term ' proprietary company ', in relation to any income year, means a company which at the end of that year is under the control of not more than four persons, or a company which at the end of that year is being or has been wound up and was at the commencement of the winding up under the control of not more than four persons. For the purposes of this paragraph all the members of any partnership shall be deemed to be one person and all the persons interested in the estate of any deceased person (whether as trustees or as beneficiaries) shall be deemed to be one person:

(*b*) The term ' shareholder ', in relation to any company and any income year, means a person by whom or on whose behalf shares in the company are held at the end of that year or, as the case may be, at the date of the final distribution of the assets of the company during that year; and includes a debenture holder:

(*c*) The term ' debenture holder ', in relation to any company and any income year, means a person by whom or on whose behalf debentures issued by the company (being debentures of the kind referred to in section 142 of this Act) are held at the end of that year or, as the case may be, at the date of the final distribution of the assets of the company during that year:

(*d*) The term ' ordinary proprietary company ' means a proprietary company the issued capital of which consists wholly of ordinary shares each of which has the same nominal value and is paid up to the same extent as and ranks in all respects equally with every other share, and which is not a company that has issued debentures of the kind referred to in section 142 of this Act:

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

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

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

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

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

(*h*) The total income derived in any income year by a proprietary company shall be deemed to be income derived in that year from the company by the shareholders of the company. In the case of an ordinary proprietary company the total income shall be deemed to be derived by the shareholders in the proportions which the numbers of shares held by or on behalf of the shareholders respectively bear to the total number of shares issued by the company.

In the case of a proprietary company other than an ordinary proprietary company the total income shall be deemed to be derived by the shareholders in proportions determined in such manner as may be prescribed by regulations made under this Act, or in default of any such regulations or so far as they do not extend, in such proportions as the Commissioner thinks just and reasonable, having regard to the nature and relative importance of the interests of the shareholders in the company:

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

(*j*) The term 'proprietary assessment', in relation to any taxpayer and any income year, means an assessment which includes, in addition to any other income, the whole of the proprietary income derived by the taxpayer in that year:

(*k*) The term 'non-proprietary assessment', in relation to any taxpayer and any income year, means an assessment which does not include any of the proprietary income which the taxpayer has derived in that year:

(*l*) Where pursuant to section 141 of this Act the Commissioner treats as a single company two or more companies any one or more of which holds shares in another company, the companies

so treated as a single company shall be deemed to be one shareholder of that other company, and, for the purpose of paragraph (*a*) of this subsection, to be one person:

(*m*) Where two or more companies (in this paragraph referred to as the holding companies) which are under the control of the same persons hold such shares or debentures in any other company that if the holding companies were a single company the other company would be a proprietary company from which that single company would derive proprietary income, the other company shall be deemed to be a proprietary company and the income derived therefrom by the holding companies shall be deemed to be proprietary income of the holding companies:

(*n*) Where a proprietary company derives proprietary income, either directly or through any intermediate proprietary company or companies, from another proprietary company, and that other proprietary company also derives proprietary income from the proprietary company first mentioned, whether directly or through any intermediate proprietary company or companies, the Commissioner may, notwithstanding anything in paragraph (*g*) of this subsection, exclude from the total income of any of the proprietary companies concerned such portion of the proprietary income derived by that company as he determines and may allocate to the shareholders of that company such portion of the total income derived by that company as he thinks just and reasonable, having regard to the nature and relative importance of the interests of the shareholders in that company.

(2) The proprietary income derived by any shareholder in any income year shall be deemed to be assessable income or (as the case may require) non-assessable income for that year, and, where a proprietary assessment is made, shall be included in that assessment accordingly. The [ordinary income tax] payable for any year by any shareholder shall be either:

[(*a*) The ordinary income tax assessed for that year in a proprietary assessment made on the shareholder, after—

(i) Making the deduction provided for by paragraph (*c*) of subsection (3) of this section; and

(ii) Where the shareholder is a company that is not resident in New Zealand, allowing a rebate of a sum equal to five per cent of the amount of any taxable proprietary income included in that assessment; or]

(*b*) The [ordinary income tax] assessed for that year in a non-proprietary assessment made on the shareholder,—

whichever amount of [ordinary income tax] is the greater, and the shareholder shall be assessable and liable for [ordinary income tax] accordingly.

(3) The following provisions shall apply with respect to every proprietary assessment made under this section in respect of income derived by any shareholder during any income year:

(*a*) No portion of any loss incurred by any taxpayer (being a loss of the kind referred to in section 137 of this Act) shall be deducted from or set off against his proprietary income:

(*b*) All deductions from the assessable income by way of special exemption shall, to the extent of the portion of the assessable

income that is not proprietary income, be made from that portion, and the balance (if any) shall be deducted from the assessable proprietary income:

(c) Where the proprietary income of the shareholder or any portion thereof is taxable under this section and that income is also taxable in the same year of assessment as being income derived by a proprietary company, there shall be deducted from [the ordinary income tax] payable by the shareholder a sum equal to the [ordinary] income tax payable by the company in respect of that income.

(4) The assessment of any shareholder of a proprietary company in accordance with the provisions of this section shall not affect the assessment or liability for tax of that proprietary company.

. . . . . .

[(11) This section shall not apply so as to affect the assessment or liability for tax of any taxpayer who is not a company] "

It will be seen that, upon a literal reading of subsection (1), Pan Eastern satisfies the definition of a proprietary company, since it was under the control of two persons- ("persons" includes "companies" by virtue of s.2 of the Act)- namely A.M.P. and Propet. But the question is whether this section in a New Zealand Act should be read as applying to a company incorporated, and having its head office, i.e., centre of administrative management (s.166) outside New Zealand.

In this context two other sections of the Act are relevant.

In section 2 which is a definition section applying unless the context otherwise requires, "Company" is defined as meaning "any body corporate, whether incorporated in New Zealand or elsewhere". The Commissioner relies strongly on this definition.

On the other hand, section 165 reads as follows:

"**165. Liability for assessment of income derived from New Zealand and abroad**—

(1) Subject to the provisions of this Act, all income derived by any person who is resident in New Zealand at the time when he derives that income shall be assessable for income tax, whether it is derived from New Zealand or from elsewhere.

(2) Subject to the provisions of this Act, all income derived from New Zealand shall be assessable for income tax, whether the person deriving that income is resident in New Zealand or elsewhere.

(3) Subject to the provisions of this Act, no income which is neither derived from New Zealand nor derived by a person then resident in New Zealand shall be assessable for income tax."

The respondent relies on this as stating a general principle of territoriality as regards the assessment of income tax. The force of this contention is affected by the qualification that the section is subject to the provisions of the Act.

Their Lordships were invited to take as their starting point the principle that, where general words are used in a statute, the legislature should be assumed to be dealing only with such persons or things as are within its proper jurisdiction. They were referred to the well known passage in the judgment of Lord Esher in *Colquhoun v. Heddon* (1890) 25 Q.B.D. 129, 134–5. This is a principle the soundness of which has been repeatedly reasserted and which has often been applied in relation to fiscal legislation in Commonwealth countries. Their Lordships have no desire to weaken it or to engraft any qualification upon it. But even full acceptance of it does not determine the present case, for what may be said of s.138, is

that it does not impose any liability for tax directly, or even indirectly, upon the proprietary company itself, but instead seeks to assess for tax one or more of its shareholders. So long as these persons are within the reach of the New Zealand revenue laws (as being incorporated or having their head office in New Zealand), the principle that revenue legislation should only operate within the sphere of its proper jurisdiction is preserved.

The question for decision, then, requires to be stated more particularly. It is this: whether, as a matter of construction of s.138, in the context of the Act as a whole, and considering the interrelation between the calculation of the proprietary income of the shareholder on the one hand, and the prescribed calculation of the total income of the company on the other hand, the conclusion ought to be reached, or indeed can reasonably be reached, that shareholders in overseas proprietary companies were intended to be within the grip of this section.

On this question their Lordships consider that the crucial provisions of s.138 are those contained in subsections (1) (*f*), (*g*), (*h*), and (*i*). These have been subjected to a careful analysis both in argument at the bar, and in each of the judgments appealed from. Though these may differ somewhat in emphasis, and in the order of the steps of their argument, they come so closely to the same conclusion that their Lordships think it would be supererogatory to trace once again the argument in detail. The paragraphs referred to represent, in their Lordships' opinion, in whichever order they are taken, a logical and consistent progression, which requires to be followed before arriving at the final sum which represents what is assessable in the hands of the shareholder. This leads through the accounts of the company to the ascertainment of " assessable income ", " taxable income " and finally of " total income " of the company and requires an imposition upon the crude figures of the company's revenue of a number of detailed provisions of New Zealand tax legislation, not merely of those contained in the paragraphs referred to, but elsewhere in the Act, which are quite inappropriate in the case of an overseas company. Their Lordships adopt, as a convincing summary of the objections against applying these provisions to an overseas company, a passage in the joint judgment of Turner and McCarthy J.J.:

> " It seems to us impossible to make any sense out of attempting to carry out, in regard to a company which neither is resident in New Zealand nor derives income from New Zealand, the calculation of its " total income " as defined by section 23 of the Act of 1939 [the predecessor of s.138]—*i.e.*, to ascertain and add together its " taxable income " and its " non-assessable income ". *Non-assessable income* it may have, for by this term is to be understood, not simply income which is not assessable, but income of one or more of the special categories expressly defined in the Act. But *taxable income*, so it seems to us, is something that such a company cannot have.
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> . . . . . .
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> It seems to us inescapable that if a company neither is resident in New Zealand, nor derives income from New Zealand, it derives no income assessable for tax. This is merely another way of saying that it derives no assessable income. Not deriving assessable income, it can derive no taxable income, for taxable income is only the residue of assessable income. Deriving no taxable income, it cannot have a total income, unless by straining the provisions of the section so as to catch companies which derive only unassessable income. If it has no total income, it is impossible to apply to it the provisions of section 138."

Their Lordships agree therefore with the judgments of McGregor J. and of the Court of Appeal that the assessments cannot be supported upon the terms of s.138. An argument based upon election, which is referred to in certain of the judgments was not relied upon before the Board.

Their Lordships finally wish to make it clear that they leave open the case, should it arise, where an overseas company derives income from within New Zealand: the present is not such a case.

Their Lordships will humbly advise Her Majesty that this appeal be dismissed. The appellant must pay the costs of the appeal.

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In the Privy Council

THE COMMISSIONER OF INLAND REVENUE

v.

ASSOCIATED MOTORISTS PETROL COMPANY LIMITED

DELIVERED BY
LORD WILBERFORCE

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