EVASION AND AVOIDANCE OF TAXATION

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1. INTRODUCTION:

For the purpose of income tax law, "income" does not include all the realisable wealth which, in a physical sense, "comes in". Its meaning is limited by two cardinal principles, either or both of which are involved in every decided case on the subject.

The first of these principles is that income comprises only amounts which arise or result from the pursuit of gain - gain from the use of capital, from labour or from both combined. The second principle is that income means net income, or "incoming" less certain "outgoings" or expenditure. This latter rule concerns the problem of what deductions may legally be made from gross income in order to arrive at the net income on which to levy tax. These deductions include depreciation on income producing assets, rates, land tax and other business expenditure allowable on the condition that they are exclusively incurred in the production of assessable income for the income year.

Certain concessions are also allowed to individual taxpayers for dependents, life, sickness and accident insurance premiums, superannuation payments, donations and school fees. These expenditures not associated with the earning of income result in an erosion of the tax base. The exemption of certain income from taxation also amounts to an erosion of the tax base. These simple forms of erosion to the tax base are aggravated further by both income tax evasion and avoidance.

2. TAXATION BASES:

Taxes on individuals and businesses are levied on the three bases of income, expenditure and wealth.

Consumption or expenditure taxes are generally levied on producers or distributors of goods, who pass them on to consumers in the form of higher prices. Such levies are often referred to as "hidden taxes". In their more general forms they are levied as sales tax at wholesale stages, as tariffs or customs duties on imports or exports. In their more limited form they appear as excises on liquor, tobacco and luxuries. A consumption or expenditure tax base is often referred to in New Zealand as indirect taxation, whereas a tax on income is referred to as a direct tax. Customarily classified as direct, are ordinary income tax, social security income tax, land tax, stamp, estate and gift duties. Indirect taxes include customs and excise duties, sales tax, racing revenues, beer duty. Bonus issue tax, land tax, estate and gift duties are wealth taxes.

New Zealand's tax revenues were initially derived wholly from indirect sources, but in the intervening years there has been a steady trend away from indirect to direct tax, so much so, that at present New Zealand has the highest ratio in round figures of direct to indirect taxation (70% - 30%) of any country in the world. It is, however, expected that increased indirect taxation during the 1967/68 income year will increase the revenue by $35,826,000 with the result that the total indirect taxation receipts will rise to 32.7% in the 1968 fiscal year.

The various types of effective rate structure are progressive, proportional and regressive. The distinction depends upon the ratio of tax liability to net income. If the ratio rises as income rises the tax is progressive. If the ratio is constant, it is proportional. If it declines with rising incomes, it is regressive. In the direct tax field, income tax, estate and gift duties are progressive.

In any taxation system it should be possible to measure progression by relating the tax paid to income as it would be assessed assuming there was no erosion, avoidance or evasion. In practice, however, direct tax is measured in relation to taxable income.

3. EQUITY AND FAIRNESS IN TAXATION:

If there is a fundamental principle underlying revenue legislation, it must be, that a tax must be clearly imposed before it becomes exigible.

It can be accepted that tax evasion and avoidance stem largely from a high and progressive rate structure and a narrow tax base. Selection by the legislature of the individual rather than the family as a basic tax unit also assists to promote avoidance, particularly in the splitting of income. It is significant that the Report of the Taxation Review Committee on "Taxation in New Zealand" published in October 1967, has recommended that the rate structure be altered and the tax base broadened, with consequent suggestions as to how loopholes which permit the avoidance of taxation should be closed. The Committee is of the view that before equity in taxation can be determined, it must be decided what overall pattern of income distribution (after tax) is considered desirable. In its view there are two major aspects of equity; first, the like treatment of persons in like circumstances, and secondly, the ability to pay, which is related to the economic wellbeing or standard of living to be enjoyed by an individual.

In any assessment of ability to pay the Committee considered it is not sufficient to judge the position in relation to one particular tax. This ability or "taxable capacity" as they refer to it, should be measured in relation to the tax system as a whole and embrace taxation on all the tax bases - income, expenditure and wealth. They are also of the opinion that equity in the taxation system should not be confused with equality. While the community has long accepted that the tax system should operate to reduce inequalities in the distribution of income and wealth, this desire for equality should not in their view be pressed to a point where it could have serious repercussions on personal savings, and such incentives to economic activity as effort, investment, enterprise and the willingness to take risks.

The rule of "equal treatment for equals" sounds acceptable and simple, but it involves some very complex matters. The concept of ability to pay may best be expressed as unequal treatment of people in unlike circumstances. This involves the difficult question of how much more or how much less tax should be paid by different taxpayers having regard to the inequalities that exist between them.

The "benefit" principle requires that equity achieve equal treatment of people who receive equal benefits from the State, and that people who receive different benefits should pay different taxes, in proportion to the benefits they receive. The difficulty of measuring most Government benefits and the desirability of providing many services on the basis of need, does limit the application of the benefit principle. It is pertinent also that many services and benefits are provided by Government, for example, defence and justice, and these accrue to the whole community and not to individuals as such. In addition one of the purposes of taxation today is to regulate the distribution of income and wealth and is therefore imposed regardless of benefits derived.

The "ability to pay" principle is now generally recognised throughout the Western World as being a fairer basis for taxation. It is generally accepted that people who have the same ability to pay should pay equal taxes and that people who have greater ability to pay should pay more to the Government than those who have less. While net income is widely recognised as the best index it is, however, only one element by which to measure ability to pay. The tax laws also take into account the factor of personal responsibilities in the provision of a code of exemptions and other concessions.

Attempts by earlier economists to justify the ability to pay principle on the basis of measurement of sacrifices is today unacceptable. The principle itself and its acceptance lies largely in the hands of the voters at election time. Fairness and diminishing inequality must always be considered as features of any equitable

system of taxation. The latter implies that a richer person should not only pay more taxes quantatively, but more taxes proportionate to his total income than does a poorer person. This implies a higher rate per dollar as incomes increase and is the basis of the progressive rate structure in the New Zealand taxation system.

4. EVASION AND AVOIDANCE:

Evasion and avoidance in themselves both create equity problems. It is much easier for some people than for others to avoid or evade their taxation responsibilities to the State and for this reason, the fair distribution of the tax burden among citizens as intended by Parliament, can be, and is often varied substantially.

The New Zealand maximum rate of tax is reached at a taxable balance of $7,201 which is comparatively low by world standards. This fact, together with the narrow tax base is responsible, in large measure, for the evasion and avoidance of taxation as practised in New Zealand. The effect of evasion and avoidance, together with the granting of liberal allowances, deductions and exemptions often leaves a very unequal pattern in distribution of income after tax has been deducted and this runs counter as to how it was intended the tax burden should be distributed.

Leaving aside for the moment the question of equity, which must be paramount in any taxation system in a democratic State, tax evasion and avoidance result in themselves in a waste of economic resources. They divert the minds and energies of taxpayers and their advisers towards unproductive ends and result in Revenue Authorities having to add to their administrative problems and most importantly, an increase in inspecting staff.

Although the dividing line between tax avoidance and tax evasion is not always clear cut, the former amounts to action taken by a taxpayer within the existing law to arrange his affairs so that his taxation liability is reduced. Evasion, on the other hand, is the wilful deprivation or attempted deprivation of the State's taxes by the falsification or suppression of some material fact. Put another way, tax evasion refers to all activities deliberately undertaken by a taxpayer to free himself from tax which the law charges upon his income, e.g. the falsification of books or accounts. To constitute evasion there must be an intention to deceive.

The Report of the Inland Revenue Department to the Minister of Finance for the year ended 31 March 1967 disclosed that penal tax assessed in cases of evasion in the year ended 31 March 1967 amounted to £105,207 ($210,414). The examination of records of employers by P.A.Y.E. Inspectors showed amounts totalling £359,379 ($718,758) representing either deductions from wages not paid to the Department or amounts not deducted from source deduction payments.

These figures prove quite conclusively that evasion is still being practised in New Zealand. Nonetheless it is my view that it is not practised to nearly the same extent as it was in the immediate post-war years and is not considered as being a major threat to the taxation system. Judging from the number of investigations - 786 in the 1967 year - the imposition of penal tax of £105,207 ($210,414) does not reflect grave concern in this area. However, it cannot be denied that the Department's investigation programme and a well trained inspecting staff act as deterrents to tax evasion.

To constitute "tax avoidance" it is not essential merely, that less tax is payable as a result of a re-arrangement of a person's affairs, than would otherwise be the case. My present thoughts are that, although many arrangements entered into for commercial or family reasons have tax advantages, they do not necessarily amount to tax avoidance. Indeed the legislature itself provides for certain tax advantages; life insurance and superannuation contributions are examples. A person who takes advantage of these latter benefits could not be held out as having practised tax avoidance. To quote the words of Professor I.L.M. Richardson, Professor of English and New Zealand Law in Victoria University and an accepted authority on

taxation matters "The expression refers to transactions designed to achieve tax benefits other than tax benefits specially provided for in the legislation".[1]

Quoting again from Professor Richardson's address:

> Tax avoidance takes many forms, some simple and some extraordinarily complex, but most avoidance schemes fall within three general areas, each of which relates to a basic feature of the tax system. The first arises from the premise that the subject of the tax is income, not capital, and involves taking what would otherwise constitute an income gain in the form of capital: the second stems from the fact that it is the individual and not the family who is the taxable unit or entity, and involves spreading the income between members of a family instead of concentrating it in the hands of one member: the third arises from the fact that what is taxable is income minus permitted deductions and is designed to achieve benefits by the creation or inflation or deflation of deductions.[2]

No modern and effective taxation system can afford to lend itself to wholesale tax avoidance schemes. The four principal reasons which militate against any condoning of such schemes are:

(a) Loss of Revenue to the State.
(b) Destruction of the principle of ability to pay.
(c) Shifting of the tax burden from the shoulders of some taxpayers on to the shoulders of others.
(d) Costly administration at Government level to police schemes involving tax avoidance.

Tax avoidance in this country is practised by a far greater number of individuals than is tax evasion. References made in the Report of the Taxation Review Committee indicate that it is growing every year. Family Trusts are the most widely used media of tax avoidance. It is estimated by the Inland Revenue Department that at 31 March 1965 there were 6,500 family trusts in New Zealand and the number is on the increase. The annual loss in tax revenue through family trusts alone is estimated at $4.5 million and this will grow if present circumstances remain.

There are definite grounds for believing that tax avoidance poses a very serious problem in the administration of the taxation laws in New Zealand. It has been found that various parts of the Land and Income Tax Act 1954, in conjunction with the general law, have been used by ingenious taxpayers and their advisers to avoid or diminish their liability for income tax which would otherwise be payable.

Apart from trusts, such taxpayers operate principally upon those sections of the Act which deal with companies and partnerships. Although such schemes are for the most part legal, nonetheless they are quite often inequitable in that they result in the shifting of the tax burden from themselves to other taxpayers and therefore are contrary to the public interest.

The position is adequately summed up in the following extract:

> The provisions of the Assessment Act and the rates of tax levied from time to time are designed to secure to the Treasury a predetermined quantum of Revenue for carrying on the Government of the country, and if, by the ingenious use of the provisions of the Act, and of the general law, a significant number of taxpayers are able to diminish their tax liability or avoid it altogether, it follows that the consequential loss of revenue must be made good by the remaining body of taxpayers who either have not the same knowledge or opportunity of avoiding tax or are unwilling to

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1. "Attitudes to Income Tax Avoidance" (1967), 30 New Zealand Journal of Public Administration, 6.
2. Ibid.,6.

lend themselves to schemes to thwart the apparent intention of the legislature.[3]

The same source[4] indicates that it is people in the upper income groups who have the greatest incentives (high tax rates), opportunities (sources of income that can be spread or shifted), and ability (means of hiring expert advice) for avoidance. The same position applies in New Zealand, and the problem overall is considered to be sufficiently large to threaten the equity of the tax system.

It has been suggested that tax avoidance, in general, is engendered by a complicated tax system and there can be no doubt that precise laws and simple administrative procedures are the best means to minimise tax avoidance.

5. FRINGE BENEFITS:

These benefits constitute an area of tax avoidance and are no doubt the by-product of the progressive rate of taxation under which the maximum rate is reached at such a low level as $7,201. Section 88(1)(b) of the Land and Income Tax Act 1954 provides that all salaries, wages, or allowances (whether in cash or otherwise) shall be included as assessable income. The term "allowances" is not defined in the Section, though specific allowances in the nature of board, lodging and house allowances are referred to in s.89.

Allowances covered by s.88 (apart from those specifically covered by s.89) are only those paid in cash or which are capable of being converted into cash and therefore confer a benefit on the taxpayer; Stagg v. Commissioner of Inland Revenue [1959] N.Z.L.R. 1252.

Fringe benefits are another means of tax avoidance; and the way the law is framed there is little one can do to assess for tax the fringe benefits which are now being given in many avenues of employment and which are often an inducement to staff. Many taxpayers deliberately seek positions with fringe benefits and are prepared to take a lesser remuneration. This attitude of mind is growing and is clearly a device to reduce personal taxation commitments and shift the burden of taxation on to the shoulders of others.

Fringe benefits take many forms. Instances are free use of cars, free travel, discount buying, cheap interest rates and stock options.

6. STATUTORY MEASURES FOR THE PREVENTION OF TAX AVOIDANCE:

Certain provisions designed to counter tax avoidance are contained in many of the sections of the Land and Income Tax Act 1954. Without limiting the matter in any way the following examples are evidence of the legislature's desire to curtail tax avoidance. Section 9 provides for consequential adjustments on change in return date. Section 84A requires a child's vested or contingent interest in certain trust income to be taken into account in determining whether a dependent child exemption is to be allowed. The purpose of the section is to discourage parents from divesting themselves of a portion of their property, in the form of trusts for their children, with a view to reducing the tax they would otherwise pay. Section 94(1) provides that where a deduction has been accepted and the liability has subsequently been remitted the assessable income of the taxpayer is to be increased accordingly. Section 98(7) deems amounts received upon the sale of trading stock or any interest therein to be income. Section 101 deems a disposal of trading stock or any interest therein with other assets at a global price to be a sale at market price. This measure prevents a taxpayer deflating the value of trading stock. Section 102 deems a sale of trading stock for an inadequate consideration to be a sale at market price. Section 105 provides that income

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3. Taxation in Australia : Agenda for Reform, 131.
4. Ibid., 132.

assigned by a taxpayer, otherwise than by Will, to any person or for any specified purpose or object, for less than a prescribed period, is to be treated as that taxpayer's income for tax purposes. Section 106 empowers the Commissioner in certain circumstances, to allocate for tax purposes, profits or income, to relatives employed or in business, as he considers reasonable. Section 107 provides for adjustments where rentals payable under leases or between relatives are deemed to be inadequate.

Section 139 empowers the Commissioner in certain circumstances to restrict excess remuneration payable to shareholders, directors or relatives in proprietary companies. Section 141 provides for the joint assessment of companies with similar shareholding or under the same control if formed, wholly or partly, for the purpose of reducing taxation. Section 142 provides that where the rate of interest on debentures is not fixed, but determined by reference to a dividend payment or otherwise, no deduction is permitted from the assessable income of the company which issued the debentures. Section 143A deems amounts owing under convertible notes to be share capital in certain cases, and interest is not deductible. Section 147A deems the distribution of trading stock to shareholders to be a sale at market price. Section 155(f) provides, in certain circumstances, for the joint assessment of trusts created by the same person for the same beneficiaries.

Since the very earliest days of revenue legislation, the New Zealand legislature has signified its disapproval of schemes devised by taxpayers for the purpose of avoiding their taxation obligations and has written into the taxation laws a general provision to counter avoidance measures. This general provision is contained in s.108 of the Land and Income Tax Act 1954 and provides that:

> 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.

The far reaching ramifications of the Section and the increasing prominence it is assuming warrants my discussing it in some detail.

7. SECTION 108 OF THE LAND AND INCOME TAX ACT 1954:

It is important to remember that the Section has an annihilating effect only. That is to say it does not entitle the Commissioner to substitute for an arrangement set aside an alternative arrangement. Section 108 is not a discretionary provision.

The Section is directed to schemes which are genuine in the sense that they give rise to legal rights and duties. Schemes which purport to be what they are not, i.e. shams, are not affected by the section. This type of scheme requires no legislation to nullify it. It is a nullity, in the sense that it gives rise to no legal rights and duties, from the outset.

The question often asked is to what extent is one entitled to arrange one's affairs so as to incur minimum tax liability. This is a right which has in the past and still is, by many, taken for granted. Lord Tomlin described it in Duke of Westminster v. Commissioner of Inland Revenue, [1936] A.C. 1, 19 thus:

> Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

But, as was observed by Woodhouse, J., in Elmiger v. Commissioner of Inland Revenue, [1966] N.Z.L.R. 683, 686, since 1930 the Legislature and the Courts have become increasingly aware that:

> Ingenious legal devices contrived to enable individual taxpayers to minimise or avoid their tax liabilities are often not merely

sterile or unproductive in themselves (except perhaps in respect of their advantages for the taxpayer concerned), but that they have social consequences which are contrary to the general public interest.

The tax gatherer's case on this point was bluntly put by Danckwerts, L.J., in Inland Revenue Commissioners v. Cleary [1966] 2 All E.R. 19, 23 where he said:

> Gone is the old principle that a citizen was entitled to arrange his affairs so as to minimise his liability to tax.

Clearly in a modern society tax avoidance is contrary to the public interest. The resultant effect is to shift the burden of tax from one section of the community to another. Any right of a person to arrange his affairs to avoid tax is qualified by s.108.

Although s.108 is, in some respects, adequate for its general purpose, it is certainly not clear as to the limits of its application. For instance no words are apparent, specifically, limiting its application only insofar as the Commissioner is concerned. Secondly, the characteristics a scheme or an arrangement must bear before it comes within the section are not clearly defined. Read literally, the section could be effective to nullify for all purposes, almost every family and business transaction which involves any measure of tax relief. Such an interpretation is out of the question. If it were not, the incorporation of a company and its taking over of a business, the permanent gifting of income-producing property by one person to another and the bona fide creation of a trust for the benefit of a taxpayer's dependents, would become things of the past.

If s.108 is not to be given a strictly literal interpretation, the question, then, is as to the area and limits of its application.

It must be conceded that a man cannot be compelled to derive income and if he chooses not to derive any, he obviously cannot be bound to pay income tax. But, such a situation is different from that where income is derived and the income is in reality a taxpayer's, and by some diversion process or the setting up of an artificial deduction, he has purported to eliminate or reduce such income. In Commissioner of Inland Revenue v. King (1947), 14 S.A.T.C. 184, Watermeyer, C.J. said:

> ...there is a real distinction between the case of a man who so orders his affairs that he has no income which would expose him to liability for income tax, and the case of a man who so orders his affairs that he escapes from liability for taxation which he ought to pay upon the income which is in reality his.

It is the latter situation at which s.108 is principally aimed. In Elmiger v. Commissioner of Inland Revenue,[1967] N.Z.L.R. 161 (C.A.), Turner, J., having recognised that no one is bound to derive any specified amount of income, or indeed any income at all, was minded to comment with reference to the arrangement he was considering, at pp. 184-185 in these terms:

> After the arrangement (the Elmiger Brothers) derived the same income as before. They carried on their contracting business after the arrangement just as previously ; so far as the evidence shows they contracted with those with whom they would have contracted, had there been no arrangement; and they charged and collected the same amounts for their services. The only difference which the arrangement made to their returns of income was that, from the same gross income as that which would, without the arrangement, have been returnable, they contended that they were now able, by virtue of the arrangement, to set up a new deduction pursuant to s.111 of the Act.

Consequently, the learned Judge unhesitatingly arrived at the conclusion that the arrangement fell within the ambit of s.108.

As to the type of arrangement caught by s.108, decisions on the Section's Australian counterpart (s.260 of the Income Tax and Social Services Contribution Assessment Act 1936-60) lend certain assistance.

Section 260 provides:

> Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of any way directly or indirectly -
> (a) Altering the incidence of any income tax;
> (b) Relieving any person from liability to pay any income tax or make any return;
> (c) Defeating, evading, or avoiding any duty or liability imposed on any person by this Act;
> or
> (d) Preventing the operation of this Act in any respect,
> be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

It has been acknowledged that this section was modelled upon s.82 of the Land and Income Assessment Act 1900 (New Zealand). Paragraphs (c) and (d) have no counterpart in s.108 and it is the absence from s.108 of a provision such as paragraph (c) of s.260 which has led to the suggestion by some that Australian decisions on s.260 should be treated with caution in considering New Zealand situations.

Even so, Australian decisions have been referred to frequently, though not always relied upon, by New Zealand Courts and the Board of Review in cases to be mentioned. In particular, the test propounded by Lord Denning in Newton v. Commissioner of Taxation of the Commonwealth of Australia, [1958] A.C. 450, as to the application of s.260 of the Australian legislation has been given universal acceptance in this country. Lord Denning said at page 465:

> The answer to the problem seems to their Lordships to lie in the opening words of the section. They show that the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax but only with the means which they employ to do it. In order to bring the arrangement within the section you must be able to predicate - by looking at the overt Acts by which it was implemented - that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the Section.

8. DECISIONS ON SECTION 108:

Section 108 was litigated for the first time in 1965, when three solicitors practising in partnership, objected in so far as the Commissioner disallowed a deduction claimed for hire charges of a book-keeping machine, paid to a partnership comprising their respective wives. See Lewis and Anor. v. Commissioner of Inland Revenue, [1965] N.Z.L.R. 634. Each solicitor had previously paid a sum of money to his wife to enable the wives to purchase the machine from Burroughs Ltd. In deciding against the Commissioner, Hardie Boys, J., took the view that s.108 strikes only at transactions which can be set aside as shams. He held that, since the arrangement he was considering could not be described as a sham, and further, that since the expenditure by the solicitors upon hire of the machine from their wives had a basis other than tax avoidance, s.108 had no application. The view that the section strikes only at shams has been refuted by the Court of Appeal in Elmiger v. Commissioner of Inland Revenue, [1967] N.Z.L.R. 161, to which reference is made below.

The next case involving s.108 to go before the Court was Purdie v. Commissioner of Inland Revenue (1965), 9 A.I.T.R. 603. In that case so that charitable purposes benefited, a veterinary surgeon arranged his affairs by entering into a partnership, with a charitable trust set up by him, which owned property acquired

substantially from funds advanced free of interest by the veterinary surgeon. He purported to reduce his assessable income as a consequence. The Commissioner sought to set the arrangement aside under s.108, but Wilson, J., held that the section was not applicable for the reason that, in his view, the predominant purpose and effect of the arrangement was to benefit Charity, and the reduction of his tax liability was merely incidental. The learned Judge also expressed the view that s.108 affected present and not future tax liability. This latter view has also been refuted by the Court of Appeal in Elmiger's Case.

It is in Elmiger v. Commissioner of Inland Revenue, [1966] N.Z.L.R. 683 (S.C.); [1967] N.Z.L.R. 161 (C.A.), that one finds the most up to date authoritative views as to the operation of this contentious section. In that case two brothers who were earth-moving contractors had built up a substantial business. They owned some expensive machinery which they used in their business. In 1962 they arranged for a trust to be formed in favour of their wives and children. They sold two of their machines to the trust on terms which allowed the purchase price to remain owing as an interest-free loan payable on demand. At the same time the brothers agreed to hire the machines from the trust, at hourly rates. The trust deed provided the brothers, who were the trustees, with exceedingly wide powers, and further provided that at the termination of the trust on 31 March 1968 the trust capital should revert to them. The brothers sought to deduct the hire payments in calculating their assessable incomes. The Supreme Court and the Court of Appeal upheld the Commissioner's action in setting the arrangement aside under s.108.

The judgments of the Court of Appeal in this case are confined to a consideration of s.108 in the light of the particular facts. Moreover, while North, P., accepted that the cases on s.260 of the Australian Legislation provided assistance in deciding the issue with which he was faced, Turner, J., and McCarthy, J., refrained from relying on such cases except to propound and accept the test of Lord Denning in Newton's Case.

Elmiger's Case, in a word, established that Lord Denning's test in Newton's Case was an acceptable guide in interpreting s.108 and that having regard to that test and the particular facts of the case, s.108 applied to set the arrangement aside.

It is not necessary that avoidance or relief be the actuating, primary or dominant purpose of an arrangement or scheme before s.108 can apply. It is considered that as long as one of the purposes of an arrangement or a scheme is to avoid, or relieve a person from liability to pay taxation the section can apply. Woodhouse, J., in Elmiger's Case said at p.694:

> ...it is my opinion that family or business dealings will be caught by s.108 despite their characterisation as such, if there is associated with them the additional purpose or effect of tax relief (in the sense contemplated by the section) pursued as a goal in itself and not arising as a natural incident of some other purpose.

Possibly the section would not operate in the case where permanent capital assets such as blocks of shares (other than in bogus service companies), blocks of flats, other land and buildings, farm properties or interests therein, are transferred outright to the relative or family trust no matter how favourable the terms of transfer are, e.g. sale with interest free loan.

The Board of Review has had occasion to consider the section at least twice since the Elmiger judgment, viz. in 3 N.Z.T.B.R. Case 32 and in 3N.Z.T.B.R. Case 38.

In the former case, two taxpayers who were dentists shared the same premises. They each paid an annual fee to a partnership comprising trustees of family trusts who purportedly provided the taxpayers with services. The fee charged was calculated to ensure that the partnership would show a good profit. During the year

ended 31 March 1963, one taxpayer paid fees totalling £5,400 to the partnership, the other paid £5,200. The partnership made a profit of £2,229.4.7. which was allocated between the two trusts. In assessing the taxpayers for tax for the year ended 31 March 1963, the Commissioner on the ground that s.108 operated to nullify the arrangement involving the partnership of the trustees disallowed a proportion of the fees claimed. The proportion disallowed was the share of profit allocated by the partnership to the respective trusts. The Board upheld the assessment, expressly relying on the test in Newton's Case and adopted in Elmiger's Case.

In the second case two taxpayers who were public accountants sold to and hired back from a partnership comprising their wives, office equipment comprising a book-keeping machine and an electric typewriter. The taxpayers claimed in their partnership tax return for the year ended 31 March 1962, a deduction of £865.10.0 representing hire charges paid to their wives for the equipment in question. The Commissioner sought to set aside the transactions relating to the sale and hiring back of the equipment under s.108, to disallow the deduction claimed by way of hire charges, and to allow actual costs and depreciation in lieu thereof.

Again, the Board relied upon Elmiger's Case and upheld the Commissioner. It is of interest to note that the Board, having regard to the views expressed by the Court of Appeal in Elmiger's Case in relation to both of the grounds upon which the judgment in Lewis' Case was based, saw no necessity to follow the latter case. There was, in any event, a distinction between Lewis' Case and that being considered, in so far as the equipment in the former never belonged to the taxpayers' husbands, while in the present case, the taxpayers' husbands were the original owners of the equipment so that the annihilating effect of s.108 was that the equipment, after the arrangement was set aside, reverted to the original owners.

9. TAXATION REVIEW COMMITTEE RECOMMENDATIONS:

The Committee in its report expressed concern as to the extent of tax avoidance. It recommended inter alia that legislative amendments be made to ensure the assessment of fringe benefits such as the use of cars, cheap interest rates, travel concessions and stock options, also excessive lump sum benefits granted on retirement and suggested alterations to the definition of dividends for taxation purposes. These recommendations were made with a view to achieving greater equity in the tax system and eliminating areas of tax avoidance. Other far-reaching recommendations dealt with trusts, arrangements under s.108 and intra-family arrangements. The Committee's views on the latter tax aspects I have recorded in some detail.

(a) Arrangements to Alter the Incidence of Tax - Section 108:

The Committee expressed doubts as to the exact scope of s.108 and the provision that "every contract, agreement or arrangement... shall be absolutely void ..." appears in its view, to have the effect of voiding such arrangements not only against the Commissioner of Inland Revenue, but also as between the parties themselves. This matter was recognised in Australia and remedied by the addition of the words "as against the Commissioner". Concern was also expressed that no re-construction provisions are embodied in the legislation. If a contract, an agreement or an arrangement is voided, the taxpayers concerned must be assessed as though the transaction had not taken place. To overcome these defects the Committee recommends:

(i) That the scope of the section be clearly defined and made to embrace all financial arrangements or transactions between members of a family (however remote the relationship) which would not be made between parties at arms length, but excluding arrangements or transactions involving completed gifts. Such a provision would in its view provide for great equity among taxpayers.

(ii) That the section be re-worded so as to make it clear that

contracts, agreements and arrangements, caught by the section are void only as against the Commissioner of Inland Revenue or in regard to proceedings under the Act.

(iii) That where the section is invoked, the Commissioner be empowered to determine the liability for tax of the taxpayers concerned as though the contract, agreement or arrangement had not been entered into or carried out, or in such other manner as in the circumstances of the case, the Commissioner considers appropriate for the prevention or diminution of tax avoidance - that is to say by assessing tax as though the transaction had been a normal one between parties at arms length and containing terms usual in such a transaction.[5]

(b) Intra Family Arrangements:

The Committee feels that there is a need for special provisions enabling realistic arrangements to be substituted for those actually entered into between parties not at arms length, such as -

Mortgages free of interest on property sold to family trusts or relatives.

Substantial services given free of charge to family trusts or in respect of income-producing property transferred to relatives.

Unrealistic rental charges under leases where the parties are not at arms length.

Distortion of dividend distribution in family companies.

It considers that while some of these arrangements may be set aside by s.108 and some by s.107, they result in a greater diversion of income than would otherwise be the case. The Committee recommend that, when arrangements are entered into between persons, including a trustee for a relative, who are not at arms length and those arrangements result in a reduction of the tax which would have been payable had the transaction been at arms length, the Commissioner of Inland Revenue should have power to substitute, for tax purposes, the terms which would normally apply to a transaction of a similar nature made at arms length.[6]

10. ESTATE AND GIFT DUTIES:

It will be evident, from what has been said up to this point, that the fields in which evasion and avoidance can be exploited, pose problems in the administration of the income tax laws. Seldom is evasion practised with estate and gift duty. There have, however, from time to time, been observed trends which have indicated that means have been discovered whereby the duties could unreasonably be avoided.

The existing legislation, so far as it relates to what falls to be included in an estate for estate duty purposes, or a disposition of property for gift duty, is materially the same as it was in the Death Duties Act 1921. The Estate and Gift Duties Act 1955 does not offer much reward to the eager searcher for loopholes. It might well be otherwise if, as has so often happened in other statutes, the basis of the tax had been eroded by special exemptions being given to different classes of property. Despite sectional representations made over the years, estate duty still remains a levy on the total wealth of a deceased which passes by his will or intestacy with the exception of -

The wood value of trees.

Devises to the New Zealand Historic Places Trust.

To illustrate the dangers of creating privileged classes of property it can be mentioned that in the United Kingdom concessions were granted in respect of agricultural property and industrial

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5. Taxation in New Zealand : Report of the Taxation Review Committee, 1967, paragraph 663.
6. Ibid., paragraph 696.

hereditaments. This was intended to give a fillip to production in those fields. Such property soon became much sought after by people who were not so much interested in increased production as the concession for estate duty purposes. The concession was thereby diverted to sources never intended, and with the demand, prices of this class of property rose. The Agricultural Development Conference set up a few years ago declined to support the suggestion that a similar concession be introduced in this country.

The statute provides adequate safeguards to prevent a person achieving inter vivos, what is tantamount to a testamentary devise or bequest, and provides for the inclusion in estate accounts of what is termed "notional" assets. Thus it will not avail a person if he settles property during his lifetime, but retains an interest in it, so that absolute ownership does not pass until his death or within three years of it. The law does recognise a person's inherent right to reduce his estate by making outright gifts subject to a possible liability for gift duty. Any gifts made within three years of his death, however, will fall to be included in his estate.

The "notional" estate like the "actual" estate, provides for few exemptions from duties. The only exemptions which permit the avoidance of duties are:

Pensions from group superannuation schemes, up to $1000 per annum.

Joint Family Homes, except to the extent that the value of the half share of the first spouse to die exceeds $8000.

Outright gifts, inter vivos to charities.

Gifts under $200 and gifts for education and maintenance of relatives.

Estate and Gift Duty law has been amended occasionally from time to time when Court decisions have revealed loopholes not intended by the legislature and the Taxation Review Committee has drawn attention to two further avenues of possible avoidance. It is considered, however, that the structure of the legislation is basically sound.

11. CONCLUSION:

From the views expressed in this paper and the recommendations of the Taxation Review Committee it seems that a large number of taxpayers practise income tax avoidance in some form or other. Evasion, while evident, is no great threat to the taxation system. As between taxpayers, these practices in themselves lead to inequities in the taxation system, and result in some taxpayers bearing a greater burden of tax than was envisaged by the legislature. It is not my function to suggest remedies, rather that I point to the areas and extent of the erosion to the tax base. To confine this erosion is a matter for Government. The Taxation Review Committee's report has highlighted the topic, and resulted in considerable publicity being given to inequities, which many citizens wanted to know little about and others were quite content to forget.

J.L. Fahy