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FOOTNOTES (Continued)...


23. Ibid., at 451, CA, per Cooke J.


25. This approach was adopted in Henning v. Ramsay (1963) 81 W.N. (Pt. 1) (N.S.W.) 71, in which Taylor J., with Walsh J. concurring, regarded the condition as placing the case in the third category identified by the High Court in Masters v. Cameron (1954) 91 C.L.R. 353 at 360: "the intention of the parties is not to make a concluded bargain at all unless and until they execute a form of contract".


29. Hinde, McMorland & Sim, Land Law, 1010, para 10.011, n 1, where the situation when no time is specified is also discussed.


35. This is discussed more fully below.


41. An interpretation of the condition in this way by Barrowclough C.J. at first instance in Scott v. Rania ([1966] N.Z.L.R. 176) caused concern at the time (Fox, "Subject to Finance Again" [1966] N.Z.L.R. 426), because one party would then be held to the contract almost at the pleasure of the other, and so was rejected by the Court of Appeal ([1966] N.Z.L.R. 527) which saw it as a matter of law that
THE SECOND RISE AND FALL OF
FUNDAMENTAL BREACH

INTRODUCTION.

Soon after the decision of the House of Lords in the Suisse Atlantique case, the High Court of Australia in Council of the City of Sydney v West, I wrote a paper for the 1966 AULSA Conference under the title of "The Rise and Fall of Fundamental Breach." In the light of what followed that title came to appear at least a little premature! The Suisse Atlantique did come as an end, but as the end, as it turned out, merely of an episode in a continuing story. The recent decision of the House of Lords in Photo Production Ltd v Securior (Transport) Ltd similarly marks an end, but whether of just another episode or of the story as a whole is still uncertain. Accordingly, the title of this present paper is more a concession to symmetry than an attempt to prophesy.

For me, the Securior case draws its meaning and significance from what has led up to it. That is why the first half of the paper deals with the background to the case, even though this involves some repetition of what I have written before. Then follows a discussion of the main points of the decision, as they relate to fundamental breach. Finally, some thoughts are offered about the significance of the decision for the future.

DISCHARGE FOR BREACH AND DEVIATION DISTINGUISHED.

One of the principal difficulties with the concept of fundamental breach has been a tendency to confuse it with discharge for breach and deviation. As a first step, therefore, it would seem desirable to show briefly how the three differ from each other.

Discharge for Breach

In the sense in which it will be used in this paper, discharge for breach is concerned with the position of one party to a contract where the other has so broken his promises that, in a significant way, the injured party is denied the performance for which he bargained. The concern is not so much with the right of that party to damages, but with whether he must complete his own performance as a condition of suing the party in breach. Two hundred years ago, if the promises were classified as dependent, neither party could sue the other unless he had first performed his own side of the bargain. This meant that a party in significant breach was unable to enforce the contract against the injured party, for the simple reason that he was not qualified to do so. In this sense, therefore, the breach of the one party automatically meant the release of the other from the need to continue performing. The history of discharge for

FOOTNOTES

2. Ibid at 267, CA.
3. Idem.
18. It might even be only so precedent and so not intended in any circumstances to have any effect on the contractual relationship itself, but it is submitted that such is not the case with any of the New Zealand decisions to date concerning these kinds of conditions in a vendor and purchaser context.
avoidance. Seen in this way, this is clearly more than an election to affirm the contract for oneself, thereby destroying one's own right of avoidance; it is a waiver which does this and destroys the other party's right of avoidance. It may well be questioned whether a waiver at this point is of a benefit belonging exclusively to the party waiving it - if it is not, then Scott v. Rania may have been right after all.

Lastly with regard to waiver, it must be remembered that it is difficult to distinguish waiver both from variation and from promissory estoppel. In the present context such issues generally arise when there has been an extension of the time for the fulfilment of the condition. Because there is an adequate discussion of these points elsewhere, it is not repeated here.

Conclusion

I believe it is impossible to accept all of the decisions, even in New Zealand since 1958, as correct, because some are basically irreconcilable with others. The only satisfactory way to resolve this is to attempt an analysis from first principles. This I have done with regard, insofar as I have had to use the labels "precedent" and "subsequent" and give them meanings, to what is most useful in practice. I have then examined the decisions and the operational rules in the light of the structure which emerged from the analysis. It is impossible to foresee or to answer all of the questions to which conditions might give rise, but I hope that the foregoing does provide at least the basic structure for their consideration.

breach since then has been of a series of explanations for this phenomenon, each of which tended to take on a life of its own. Several of them involved the idea of "condition" in one form or another, doubtless because, originally, the rights of a party to sue were conditioned on his own prior performance.

Thus developed eventually the Sale of Goods Act division of contract terms into so-called conditions and warranties. The idea became current that the release of the injured party involved the 'rescission' of the contract and that the right to 'rescind' arose on the breach of a condition. In Hirji Mulji v Cheong Yue, Lord Sumner, for the Privy Council, likened discharge for breach to frustration and ascribed it to the failure of a condition subsequent. Then, in Main v Tate & Lyle, the House of Lords saw discharge for breach as having the same incidents as deviation. By contrast, a few years after that, in Heyman v Darwins, the House assimilated discharge for breach to anticipatory breach. The breach by the wrongdoer was a repudiation which gave the injured party the option of discharging the contract. But that discharge was not a literal rescission. The contract as a whole remained in being for the purpose of assessing damages.

In recent years, the House of Lords has, in Moschi v LEP Air Services, produced yet another analysis. On a discharge for breach, the contract does terminate, in the sense that primary obligations to perform are replaced by secondary obligations to pay damages. But those obligations are to be measured by reference to the contract as a whole.

Deviation

The characteristic feature of deviation in contracts for the carriage of goods by sea is that, from the moment the ship departs from the contract route, it automatically loses the protection, not only of its exception clauses, but also of the common law exceptions of the act of God and the actions of the Queen's enemies. The ship becomes absolutely liable for any loss of, or damage to, the goods carried, the only defence being that that loss or damage would have occurred anyway. Similar incidents occur throughout bailment where they bear the label of "quasi deviation", Lilley v Doubleday being a well-known illustration.

As already mentioned, the House of Lords tried, in Main v Tate & Lyle, to explain these incidents as being the result of a discharge for breach. That meant, they thought, that a discharge for breach automatically rescinded the contract, at least in futuro, unless it were affirmed. That analysis is, of course, quite inconsistent with the version given in Heyman v Darwins. Under that version, there would be no literal rescission, nor would there be any discharge unless the injured party so elected. Even then the contract as a whole would continue to govern the remedies available to him.
Several explanations have been given for the phenomena associated with deviation. One has been that it derived from marine insurance and refers back to the difficulties of communication in the days of sailing ships. Another, given by Lord Wright in *Randall v Arco*, was that the exception clauses have reference only to the risks to be encountered along the contract route and, hence, have no reference to the altered risks of the deviation. The true explanation, it is submitted, lies in the nature of a bailment relationship. Though such relationships tend to be seen as imposing burdens, they are equally a form of protection to the bailee. But the protection lasts only so long as the bailee holds the bailed goods within any limits the bailor has placed on his right to possession. If he steps outside those limits he holds, not as a bailee, but as a mere detainor and as such becomes absolutely liable for loss or damage to the goods so detained. Neither the construction nor the bailment explanation presupposes any termination of the contract.

For present purposes, though, the important point is that if the incidents of deviation and quasi-deviation are taken to be the result of a rescission of the contract, they cannot be explained as flowing from a discharge for breach as it was analysed in *Heyman v Darwins*. On the other hand, in the light of House of Lords decisions like *U.S. Shipping Board v Bunge and Born* and *Hain v Tate & Lyle* itself, it seems too late to suppose that deviation can be seen by the Courts to turn on anything but a rescission. For practical purposes therefore, deviation and quasi deviation would seem to be best regarded as sui generis.

**Fundamental Breach**

The doctrine of fundamental breach, as it developed before the Suisse Atlantique, was a substantive rule of law. It asserted that there were categories of breach and types of contractual term so fundamental that no exception clause, however drawn, could exclude liability for them. It originated in a series of three judgments by Devlin J., in *Chandris v Isbrandtsen-Moller*, *Alexander v Railway Executive*, and *Smeaton Hanscomb v Sassoon I. Setty*. The first two of these cases were contracts for the carriage and bailment of goods, respectively, and the breaches involved were of the "deviation" type. Devlin J. referred to such breaches as "fundamental", which was a word used of them by the House of Lords in *Main v Tate & Lyle*. So far there was no novelty. The real departure came with the *Smeaton Hanscomb* case, where timber sold by description did not comply with specification so that there was a breach of the condition implied by Section 13 of the Sale of Goods Act 1893. But the buyer had failed to take action within a contractual fourteen-day time limit on claims. Devlin J. attempted to generalise a new principle of wider application in words well worth repeating for the light they shed on its incidents and purposes.

When conditions subsequent as described in this paper, are considered, again difficulty arises with the use of the term "precedent" in the New Zealand decisions, and particularly in the majority judgments in *Scott v. Rania*. It has been seen that in those judgments it was found that, having labelled the condition as "precedent", the contract automatically terminated when the condition had not been fulfilled by the specified time. Any waiver of the condition, to be effective, had also, therefore, to occur before that time. But if the analysis suggested in this paper, which basically agrees with the dissenting judgment of Hardie Boys J., is correct, the condition was precedent to performance, not to contract, and was therefore subsequent to contract with non-fulfilment giving rise to a right to avoid the contract. If waiver is effective at any time before the termination of the contract, the statement by the purchaser's solicitor that finance had been arranged and that the contract was unconditional would have constituted a waiver which, on the facts, preceded what could have been construed as the vendor's exercise of the right of avoidance — all of which accords with the judgment of Hardie Boys J.

Where the condition has been labelled as "subsequent", if it is correct that there is a right to waive until the contract is terminated, the right exists not only before, but after, the date specified for the fulfilment of the condition and until the contract is terminated by a party with the right to do so. Clearly the right to waive exists before the fulfilment date. But most of the problems occur when the facts satisfying the condition come about after that date. In doing so, they do not technically satisfy the condition, time being of the essence as to its fulfilment, and the right to avoid the contract continues regardless. The only way for the person having the benefit of the condition then to insure that the contract remains on foot is to waive the condition. For this purpose it appears that a statement of fulfilment is sufficient, but an unequivocal statement of waiver is perhaps more advisable. Although the cases seem to accept that waiver of a condition subsequent is possible after the fulfilment date, it should perhaps be pointed out that, at this stage, what is being waived is not the benefit of the condition but one's own, and presumably the other party's, rights of
There are also conflicting opinions as to whether evidence of the surrounding circumstances is admissible to show that both parties were intended to benefit. Such evidence has been accepted in New Zealand, but might not be admitted in England.

The effect of the two basic views as to benefit stated above upon the two kinds of condition identified in this paper needs now to be considered. The effect upon a condition subsequent has already been stated: the first view of benefit would permit waiver in a wide range of cases, while the second would restrict the right to waive to a very narrow range of cases. The accepted position with regard to waiver and a condition precedent to contract is that such a condition cannot be waived. Certainly neither of the above views of benefit would allow the waiver of such a condition. Waiver of a condition operating within a contractual relationship assumes that the parties are contractually bound by contract. They have defined the time and the manner of agreement that if a certain situation does come about, one or either may terminate the contract. If the party who sought that protection decides to forego it, he can do so by waiver. But, in the case of a condition precedent to contract, the parties have agreed that if a certain situation does come about, they will be bound by contract. They have defined the time and the manner of the creation of the contractual relationship, a definition which can be altered only by agreement. The operation of the condition is so different that waiver is no longer logically possible. The second view of a benefit, the right to freedom from legal obligation, clearly does not apply because until there is a contract there is no obligation from which to obtain freedom. Waiver, therefore, applies only to conditions subsequent, and then only according to the view taken of benefit.

As to when the right of waiver may be exercised, again the simple answer is that it must be exercised before the termination of the contract. This reinforces the opinion that waiver has no application to conditions precedent to contract because there is then no contract to terminate. Waiver is available only to save a contract from termination, not to create a contract.

"It is no doubt a principle of construction that exceptions are to be construed as not being applicable for the protection of those for whose benefit they are inserted if the party who has committed a breach of a fundamental term of the contract, and that a clause requiring the claim to be brought within a specified period is to be regarded as an exception for this purpose: see Atlantic Shipping & Trading Co. v Louis Dreyfus & Co. 29 In that case, the fundamental term was the implied condition of seaworthiness, which is treated, as Lord Sumner said 30 as 'underlying the whole contract of affreightment.' The same principle has been applied in cases of deviation and other fundamental terms. I do not think that what is a fundamental term has ever been clearly defined. It must be something which is narrower than a condition of the contract, for it would be limiting the exceptions too much to say that they applied only to breaches of warranty. It is I think something which underlies the whole contract so that, if it is not complied with, the performance becomes something totally different from that which the contract contemplates. If, for example, instead of delivering mahogany logs the sellers delivered pine logs and the buyers inadvertently omitted to have them examined for fourteen days, it might well be that the sellers could not rely on the time clause. W. D. J., in Pinnock Brothers v. Lewis & Peel Ltd. 31 dealt with the same point in relation to another clause in the same contract which sought to exclude the right of rejection, and in relation to that he said ' . . . the delivery in this case could not properly be described as copra cake at all.' 32 Devlin J. went on to hold that, since the logs delivered were "round mahogany logs", the limitation clause did apply. The learned judge spoke expressly of principle as one of "construction." It was Denning L.J. who subsequently restated it as a substantive rule of law, in the course of his judgment in Karsales v. Wallis. 33 Again it is well worth quoting the actual words he used.

"Notwithstanding earlier cases which might suggest the contrary it is now settled that exempting clauses of this kind, no matter how widely they are expressed, only avail the party when he is carrying out the contract in its essential respects. He is not allowed to use them as cover for misconduct or indifference or to enable him to turn a blind eye to his obligations. They do not avail him when he is guilty of a breach which goes to the root of the contract. It is necessary to look at the contract apart from the exempting clauses to see what are the terms express or implied which impose an obligation on the party. If he has been guilty of a breach of such obligations in a respect which goes to the very root of the contract he cannot rely on the exempting clauses . . . The principle is sometimes said to be that a party cannot rely on an exempting clause when he delivers something 'different in kind' from that contractually term has broken a 'fundamental contractual obligation'. However, I think they are all comprehended by the general principle that a breach which goes to the root of the contract disentitles the party from relying on the exempting clause."

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There are two important points to note about these passages. The first is that, since on past authority "conditions" of the contract could be excluded, the breach of a fundamental term had to be something more fundamental than the breach of a condition, as Devlin J. acknowledged and his decision illustrated. The second is that before the Hong Kong Fir case many, if not most lawyers thought that every discharge for breach was the breach of a condition. In the 1950's, therefore, it followed that a fundamental breach had to be worse than a merely discharging breach. It also meant that for every fundamental breach there ought to be a corresponding fundamental term. That is why commentators in due course subsequently matched the "main objects" of the contract and the condition as to title under the Sale of Goods Act, as fundamental terms, with total failure of consideration as a fundamental breach. Similarly, the "core of the contract" was matched with "difference in kind". After the Hong Kong Fir case had shown that discharge for breach did not have to be the breach of a condition, but could depend on the scale of the breach, a similar change occurred in relation to fundamental terms and fundamental breaches. Instead of being regarded as the two sides to the one coin, they too came to be seen as two different things, depending on the importance of the term and the scale of the breach.

The basic weaknesses of the substantive doctrine of fundamental breach were that as a rule of law it lacked any previous warrant, and that it was conceived as a unified principle, whereas the threads of authority on which it was based were all really quite distinct. Thus, the courts had long been reluctant to construe general words of exception as excluding the warranty of seaworthiness, but the same was true of important terms generally and even of negligence. Moreover, it was clear on earlier authority that, like promissory conditions, the warranty of seaworthiness could be excluded where the words used were apt to do so. The idea that the condition as to title was unexcludable was not only inconsistent with the emptio spei but was hard to reconcile with the fact that the implied condition as to title was itself only a relatively modern development. The very concept of an unexcludable core of obligation was inconsistent with Rose & Frank v Crompton Bros, in which the House of Lords accepted that, even in a commercial agreement, all obligation whatever could be excluded by the use of an "honour clause." And it was difficult to conceive of a term more fundamental than a condition when a condition was a term so vital that any breach justified a discharge of the contract. Again, to apply to a sale of goods contract, on a fundamental breach, the consequences of a deviation would be to deprive a proferens of the protection of his exceptions, even in respect of those breaches which were not fundamental.

This raises the third and last basic issue regarding the operation of conditions - the possibility of waiver. There are two main questions about waiver: who has the right to waive and when may the right be exercised?

The simple answer to the first is that where the condition is exclusively for the benefit of one party, that party may waive the condition and render the contract fully binding on both parties. The difficulty is to know what is meant by "benefit". That is a necessary first step to knowing when the benefit is exclusively one person's. However, the cases give no clear answer. In some the benefit is seen to be the protection from contractual liability afforded to the person(s) requiring that protection. In others, it is seen to be the right to obtain freedom from legal obligation to perform contractual promises upon the non-fulfilment of the condition. If the former is the correct view, waiver will be available in a much greater number of cases than if the latter is adopted. The latter would restrict waiver to those few cases in which the condition operates in no other way than as precedent to the liability of one party. If it also has potential effects as a condition subsequent to the contract so that, subject to the contract itself restricting the right to avoid to one party, it might give the other party a right to avoid the contract, and thereby in these terms confer a benefit upon him, it would make waiver impossible by the party having the benefit in the first sense given above. There is as yet no judicial resolution of this division of views.

It does seem, however, that where the condition is "inextricably mixed up with other parts of the transaction" from which it cannot be severed, as when the terms of the condition fix the settlement date, waiver is not possible. This may also show that the condition operates partly for the benefit of the other party.
the option of the innocent party. This is a peculiar and illogical amalgam of the two sets of rules discussed above in relation to conditions precedent to contract and conditions subsequent. The present concern is with conditions precedent to performance. It is difficult to see why a condition precedent to performance should, on its non-fulfilment, have the effect of rendering the contract automatically void. However, when it is remembered that the effect of the non-fulfilment of a condition precedent to contract is that automatically the contract cannot come into being, the source of the automatic avoidance rule is evident. If this is carried across logically to a condition precedent to performance, the result of non-fulfilment is only that the obligation to perform does not arise; from its classification as precedent to performance it has no logical effect on the contract itself. Indeed, if the condition is intended to have effect on the contract itself, it is as a condition subsequent, so that the rules regarding them which are set out above would apply. Further, if this is correct, it has serious consequences for the validity of the reasoning of the majority of the Court of Appeal in Scott v. Rania.

Once the right to avoid has arisen, it continues to exist in spite of the facts required for the fulfilment of the condition coming about after the time specified for fulfilment. If this happens and the party having the benefit of the condition then wishes the contract to proceed, the proper course is to waive the condition. The right to avoid the contract may, of course, be exercised, or it may be lost in any of three ways. First, it may be lost by the party having the right electing, either by words or by conduct, to affirm the contract. Secondly, even in circumstances where the party having the right cannot be said to have elected to affirm, the right may be lost by estoppel, as was found to have happened in Burton v. Russell. Thirdly, if, after the fulfilment date, one party has the right to waive the condition and does so, the waiver will be effective to destroy the other party's right to avoid the contract.

What gave the new concepts credibility was the view taken by their proponents of the function of exception clauses.

THE FUNCTION OF EXCEPTION CLAUSES

The fundamental breach principle turned on the idea, expressed by Denning L.J. in Karsales v. Wallis, that in construing a contract containing exception clauses it was “necessary to look at the contract apart from the exempting clauses to see what are the terms express or implied which impose an obligation on the party.” It was not the condition or fundamental term which was excluded from the contract. It was liability for its breach which was excused, the exception clause operating as a defence, at the point of adjudication, to accrued rights of action. That, incidentally, helps to explain the early emphasis on fundamental breach and the breach of a fundamental term.

In my book and elsewhere I have argued that exception clauses qualify the promises to which they relate and hence take effect at the formation of the contract rather than as mere defences at the point of adjudication. A party to a contract is subject to primary obligations to perform his undertakings and to corresponding sanctioning or secondary obligations to pay compensation if he commits a breach. At common law the two are inseparable, in the sense that no primary obligation arises unless the party concerned has also accepted the sanctioning obligations that go with it. Exception clauses affect the accrual of these obligations, at the time the contract is formed, either by modifying them or by preventing their arising at all. This they can do in three ways. The first involves excluding the primary obligation directly. So, if I sell a horse warranted sound except for hunting, I accept no primary obligation as to its soundness for hunting. Under the second method the primary obligation is excluded because the secondary obligation which would otherwise attach to it has been excluded. Thus, if I say I will not be liable for loss or damage from my servant's negligence, I not only refuse to pay damages. I accept no primary obligation to ensure that my servants are careful. Under the third, sanctioning obligations are limited, without that fact preventing the initial existence of the primary obligations to which they attach. Accordingly, if I limit my potential liability to $2,600.00, I accept a primary obligation to perform but if I commit a breach, no secondary obligation accrues beyond that to pay $2,600.00 in damages.

The significance of this view of exception clauses in relation to fundamental breach is not just that it means that exception clauses take effect at formation of the contract but also that it leaves no need for the concept of fundamental breach itself. This is because, once the exception clauses have taken effect at the formation of the contract, every breach thereafter of the
residual contractual content of the agreement will be actionable.

The first appearance of this kind of analysis, of the relationship of exception clauses to primary and secondary obligations, in a reported case, seems to have been in Hardwick Game Farm v S.A.A.P.A. The Judge was Diplock L.J. He said much the same thing again in the Heron II later the same year. In due course he was to bring the analysis into Moschi v LEP Air Services and ultimately into the Securior case itself.

THE SUISSE ATLANTIQUE CASE

The weaknesses of fundamental breach as a substantive rule of law did not go unnoticed. A series of dicta from 1964 onwards, by Pearson L.J. and Diplock L.J. in England, and Barwick C.J. and Taylor, Kitto and Windewyer J.J. in the High Court of Australia, all tended towards the view that there was no rule of law but at most only a rule of construction, and it was against this background that the question came before the House of Lords in the Suisse Atlantique case.

Fundamental Breach as a Rule of Law

Since the Suisse Atlantique was perhaps the best known and most discussed contract decision of its time, it would be tedious here to subject it to yet another analysis. For present purposes, though, a few points need to be recalled. The first was, of course, that the House unanimously denied the existence of a substantive rule of fundamental breach. Nevertheless, they left the way open to a resurgence of the doctrine in a number of ways.

The first was that none of the earlier cases was expressly overted. Instead, they were said to be explicable on the basis of construction. That left open the possibility of a continuing "rule of construction". The second was that their Lordships described the incidents of fundamental breach and fundamental terms in words reserved historically for discharge for breach and conditions. At the time, this gave some ground for thinking that the House had accepted that no separate concept of a fundamental breach or a fundamental term could be justified. Nevertheless, their Lordships retained the terminology of fundamental breach. That suggested to readers of the reports that the special concepts not only survived but had continuing relevance to exception clauses. The third respect in which the House left a way open to the resurgence of the doctrine was that they confused and conflated fundamental breach, discharge for breach and deviation. It was this which was to lead before long to Harbutt's "Plasticine." Conversely, it even led to the conclusion that a condition had to have the incidents of a fundamental term. That is what happened in Ashington Piggeries Ltd v Christopher Hill Ltd where the House of Lords concluded that, for there to be a discharging breach of the condition implied by term "precedent" has again caused error to creep into our understanding. However, one preliminary point is clear: if the condition specifies a date for its fulfilment, time is of the essence as to that date without any need expressly to make it so.
achieve their fulfilment. It is accepted that a party cannot take advantage of the non-fulfilment of a condition in order to escape from a contract if the non-fulfilment has come about through his own default. The Courts have expressed this in positive terms by placing an obligation on one of the parties to take all reasonable steps to fulfil the condition, but there has been difficulty in finding a theoretical basis for imposing the obligation. The two viewpoints put forward to date have been, first, that it can be done only by an implied term in a contract, or secondly, by the application of the broader principle that no man can take advantage of his own default. The first of these is merely a narrower view of the second, based on the view that the only default available for the application of the principle is a breach of contract. In Gardner v. Gould the Court of Appeal was unanimously of the opinion that the narrower view was the correct one.

This means that the condition must be one which is operating within a contract before the obligation can become an implied term of the contract; in terms of the present analysis, the condition must be subsequent to contract. However, if virtually all conditions in conveyancing agreements do operate in this way, there is no problem about implying a term. At present, the lack of differentiation between conditions precedent to contract and precedent to performance has led to a belief that the obligation cannot be imposed in the case of a condition precedent as in Scott v. Rania. But if it is recognised that the condition in Scott v. Rania, regardless of the words used to describe it, was precedent only to performance and, in fact, subsequent to contract - these being merely different aspects of the operation of the same condition - then clearly there is a contract into which the obligation may be implied. The correct width of the principle then, perhaps, becomes a matter of only theoretical, academic importance; it certainly need not dictate the labelling of conditions.

The second important issue is the effect of the non-fulfilment of the condition. Although the rules as to the effect of non-fulfilment appear well settled, it will be argued that the confusion over the
consistent not only with Hain v Tate & Lyle 70 but also with dicta in the Suisse Atlantique case itself. 71 And though it deprived a proferens of his exceptions by a rule of law, it was a different rule of law from that which had been condemned by the House of Lords. Moreover, counsel for the defendant had conceded that, if the contract had been discharged, his clients would have lost the protection of their limitation clauses. 72 The other, unstated, premise was that exception clauses take effect, if at all, only as defences at the point of adjudication. Only if this were so could they be denied effect by a rescission of the contract in futuro. If their true effect were to limit the obligations of the promisor, that would have occurred at the time of formation, and no rescission in futuro could affect them. 73 It follows that, whatever its surface attractions, the reasoning in Harbutt's "Plasticine" was vulnerable on two counts. It would collapse if the effect of discharge for breach were not, after all, a literal rescission of the contract. It would suffer the same fate if exception clauses were recognised as being not mere defences, but qualifications of obligation.

During the decade which followed, the application of Harbutt's "Plasticine" became increasingly extreme. In Wathes v Austins (Menswear) Ltd 74 the Court of Appeal held that the principle applied, not only where the contract had been discharged for breach, but also where it had been affirmed by the injured party. The Court purported to follow Charterhouse Credit Co. Ltd. v Tolly 75 on the basis, which was correct, that it had not been expressly overruled in the Suisse Atlantique case. 76 While reference was made to "construction" in the Wathes case there was no analysis of the words used. It appeared to be assumed that the result of the case would turn, not on the wording of the contract, but on whether a fundamental breach had occurred. The significance of this was not lost on Lord Denning M.R. In Levison v Patent Steam Carpet Cleaning Co. 77 and in the Securicor case itself, 78 he reverted to the terminology of the pre-Suisse Atlantique period.

Contrary Trends

As against these developments two other streams of authority emerged which pointed in the opposite direction. The premise that discharge for breach involves a literal rescission, depriving the contract of any future effect, became difficult to reconcile with The Mihalis Angelos 79 in which the Court of Appeal held that, for the purposes of assessing damages, regard had to be given to a clause in favour of the "wrongdoer" which would not have been operative until after the contract had been discharged. Again, in Moschi v Lep Air Services Ltd., 80 the House of Lords appeared to accept the view that, while on a discharge for breach any primary obligations ceased and were replaced by secondary obligations to pay damages, those damages were to be assessed on the

of the condition is something other than solicitor's approval, something such as finance, sale of another property, or the approval of an independent third party, there is a high probability that the condition is one within an existing contract. It may be precedent to the performance of certain of the promises within the contract, though certainly not to the operation of other parts of the contract (such as the obligation to pay the deposit or the running of time under the requisitions clause), but it is subsequent to the creation of binding contractual relations. The principle New Zealand decisions which have labelled such conditions as precedent were examined above - Griffiths v. Ellis, Mullen v. Kelman and the majority judgments in Scott v. Rania. It has been seen that in Griffiths v. Ellis the relevance of the condition was in regard to the obligation to perform certain promises in the contract. In that respect it was properly described as precedent, but, although it was not relevant to mention it, there was an existing contract to which the condition was subsequent. In the other two cases the relevance of the conditions was in regard to the existence of the contract and it is clear that in each case the Court believed that the parties were contractually bound, so that the conditions would have been more accurately and usefully described as subsequent. There was a failure to distinguish clearly between conditions precedent to contract and precedent to performance. Therefore, when one looks at how the conditions have been seen as operating, rather than the labels given to them, the New Zealand cases have consistently treated such conditions as subsequent to contract.

If this is correct, each condition is, regardless of its substance, subject to the same set of rules, unless of course, the parties have made their own by the terms of the contract. It is then a matter of what are the rules prescribed by law. It is proposed to examine here three of the basic matters which have frequently arisen: first, the obligation to take all reasonable steps to achieve the fulfilment of the condition; secondly, what happens if the condition is not fulfilled; and, thirdly, waiver of the condition.

If all of these conditions are within existing contracts, there is no problem about the obligation to take all reasonable steps to
a more positive, requirement than that of "not capriciously" suggested in Boote v. R.T. Shiel & Co. Ltd. However, Holland J. construed the term "conveyancing aspects", as used in Boote v. R.T. Shiel & Co. Ltd., very widely to mean "arising out of the duties and obligation owed by a solicitor to his client when acting for that client and advising concerning a conveyancing matter". That must include, in most cases, a considered view or opinion as to the transaction the client is entering into as a whole. In the circumstances the solicitor for the vendor was entitled honestly to withhold his approval because a better offer was available to his client. The only requirement was that it be the solicitor's own decision. With respect, the width of the matters to which the approval was seen to extend was so great that it is difficult to read the condition so interpreted consistently with the existence of a binding contract. If such an interpretation of the condition is correct, it raises clearly the question, unasked in the judgment, whether the parties had intended to be contractually bound at all pending the outcome of the condition. In the light of the interpretation it might have been more realistic to find that they did not so intend. The finding of Holland J. certainly comes very close to the situation of a bilateral contract binding only one party, which is a legal impossibility.

Some time has been spent discussing solicitor's approval conditions for two reasons. First, they are still largely unexplored territory, though very common in practice, so that some thought needs to be given to exactly what is intended when they are used. Secondly, it is contended that they are probably the only example of a condition in common use in New Zealand which could, and perhaps frequently should, be seen as a condition precedent in the sense in which that term is used here. It is the probable intention of the parties when the substance of the condition is something other than their solicitors' approval that they do intend to be immediately bound and that the condition is to operate within the contract, to be, in my terms, a condition subsequent.

Conditions Subsequent

If the test is accepted as being "when and how do the parties intend to become bound in contract", it is suggested that where the substance of the contract as a whole and not just of selected parts of it.

The premise that exception clauses were mere defences also came in question. In Kenyon Son & Craven Ltd. v Baxter Hoare & Co. Ltd. Donaldson J. distinguished three kinds of exception clause, depending on whether they excluded obligation, excluded liability, or merely limited liability. In respect of at least the first of these, he denied that the court could discover the obligations of the proferens without taking into account any exceptions of those obligations. Soon afterwards, in The Angela, Kerr J. expressed the view that an event covered by an exception of "liability" was not and could never be a breach at all, let alone a fundamental breach. The difference between an exclusion of liability and an exclusion of obligation was merely "semantic". This meant that of Donaldson J.'s three categories of exception clause, it could be said only of limitation clauses that they operated as more defences. It was to the category of limitation clause that the exception in "Harbutt's Plasticine" belonged. But even in respect of this class, Barwick J. and, significantly, Diplock L.J. were already on record as saying that limitation clauses, too, qualified the obligations to which they referred, though this was not a view shared by some of the commentators.

The Revival of the Original Version of Fundamental Breach

The decision in Mathews v Austins (Menswear), though it purport to follow Harbutt's "Plasticine", could be interpreted as a return to the pre-Suisse Atlantique rule of law. But in addition there were two further factors tending in the same direction, the first of them being the dicta of Lord Wilberforce of which mention has already been made and appeared in his judgment in the Suisse Atlantique. There were three. First, he distinguished two meanings which had been given to the expression "fundamental breach". The one he saw as covering fundamental breach in the meaning given it in this paper. The other covered discharge for breach as it is defined in this paper. His second dictum was to the effect that an exception clause could not be allowed to empty a contract of all content. To this extent, there was rule of law. The point he was making related to the formation of the contract and depended on the idea he had expressed elsewhere in his judgment that exception clauses could have/that what would otherwise be a breach would not be a breach at all. Thirdly, he gave deviation, quasi-deviation and "difference in kind" as examples of construction, as being cases where the parties "could hardly have been supposed to contemplate such a mis-performance".

These passages were taken by Fenton Atkinson L.J. in Parnworth Finance Facilities v Attryde and particularly by Donaldson J. in Kenyon, Son & Craven v Baxter Hoare to mean that fundamental breach in the narrower sense in which it has been defined in this paper, had survived the Suisse Atlantique as a rule of law.
Much more important, though, was the second factor. This was that even where the courts purported to apply a rule of construction, they were in fact using the presence or absence of fundamental breach as the determinant of whether the exception clause applied, and hence were applying it as though it were a rule of law.\textsuperscript{94} That was true of \textit{Wathes v Austins (Menswear)}.\textsuperscript{95} It was also very vividly illustrated in the unreported case of \textit{Prince v Brown Bros. and Merseyside & North Wales Electricity Board},\textsuperscript{96} which concerned an indemnity given by an employer to the Electricity Board, which failed to turn off the power to a transformer which the employer’s workmen were to paint. When one of their number was electrocuted, the remainder not unnaturally refused for a time to continue, though in due course they went back to work. It was held that since work had been resumed and completed, no “fundamental breach” had occurred. Accordingly the Electricity Board were protected by their indemnity. Had the question asked been not “was the breach ‘fundamental’?” but “Was it serious?” the whole enquiry would have been transformed. The act of the Board in putting the lives of the workmen in jeopardy was not only appallingly serious in its possible consequences. It was also probably a breach of the duty of common humanity as well.\textsuperscript{97} To hold that the indemnity protected the Board was to hold, not just that an insurance risk had been allocated between commercial parties, but that an employer had bargained away the legal responsibility of the party whose role it was to ensure that the lives of the workmen were not endangered. Whether that truly was the intention expressed or implied in the contract could not, on the approach followed, be even considered.

Some reaction against these developments seems to have at least begun before the \textit{Securicor} case. In 1977, Griffiths J. in \textit{Green v Cade Bros.}\textsuperscript{98} showed that he believed something was wrong when he said:

"Nor do I find much help in approaching the question of construction by applying the label ‘fundamental’ to the breach or to the term breached. The Court has to look at the facts that constitute the breach and the circumstances surrounding it and ask itself whether the clause could have been intended by the parties to apply to such a situation and the nature of the breach must loom large in such consideration."\textsuperscript{99}

However, while it was a step forward that the seriousness of the breach, or the importance of the term, should have been seen as more relevant than its belonging to a particular technical category, it has to be noted that the facts and surrounding circumstances to which the learned judge referred were those of the breach instead of, as construction would normally require, those attending the formation of the contract.\textsuperscript{1}

Outside England and Wales, the revival of the substantive doctrine of more than fundamental breach seems to have been matched in Canada. But from the reported cases, it appears to have had much less impact in Scotland, Australia and New Zealand.\textsuperscript{2}

Whatever label Cooke J. might have placed upon the condition, he clearly saw it as a condition operating within an existing contractual relationship. Hence the constraints upon the solicitor’s power to withhold approval. With respect, it is agreed that, given this premise, such constraints are necessary. Freed from the unusual factor in \textit{Frampton v. McCully} (the vendor's solicitor was also the registered proprietor of the land as trustee for the vendor) the wording of the condition might also permit the imposition of the constraints. However, in \textit{Frampton v. McCully} Cooke J. had spoken of “the unrestricted wording of the condition” as the other reason for being unable to impose constraints, and the wording of the condition in \textit{Boote v. R.T. Shiels & Co. Ltd.} is no different in substance. More important, however, is the unquestioned premise that the parties in \textit{Boote v. R.T. Shiels & Co. Ltd.} had intended to be contractually bound before the outcome of the condition was determined. This might not have been their intention at all, and if it was not, there was no reason to place any constraints upon the solicitor’s power to withhold approval. Indeed, it would not have been possible to do so and “the unrestricted wording of the condition” would have been given its full effect. It is therefore suggested that it would have been equally possible to regard the solicitor’s approval condition in \textit{Boote v. R.T. Shiels & Co. Ltd.} as a condition precedent to the existence of the contractual relationship with no constraints upon the solicitor’s power to withhold approval and that this might have been more in accord with the parties' intention.

Similar comments may be made about the judgment of Holland J. in \textit{Provost Developments Ltd. v. Collingwood Towers Ltd.}\textsuperscript{26} The agreement, which was in the form used in the Auckland area, was subject to the approval of the solicitors of both parties. The vendor’s solicitor withheld consent “primarily because he felt confident that his client was able to get an agreement on better terms.” Holland J. found that the parties had concluded an immediately binding, but conditional, contract. Thus, the solicitors had to “act honestly and reasonably, and not from mere caprice”. This is perhaps a narrower, and certainly...
However, Boote v. R.T. Shields & Co. Ltd.,22 the third case to at least contain obiter reference to the interpretation of a solicitor's approval clause, also came from Christchurch. The Court of Appeal, in a judgment again delivered by Cooke J., felt that there was no difficulty in regarding the condition as a term of the contract; it did not prevent an effective offer and acceptance. In the written offer made by the purchaser was the clause, "This offer is subject to my solicitor's approval within seven days from acceptance date". It therefore clearly contemplated an effective acceptance before the outcome of the condition was known. The Court did not have to consider the operation of this condition as a part of the ratio of its decision, but it did comment, obiter, that "we think that the solicitor's approval could not be withheld capriciously or merely on the instructions of his client, but was meant to ensure that the conveyancing aspects of the transaction were satisfactory from the purchaser's point of view".23

Several comments may be made on this. The Court made no attempt to label the condition as precedent or subsequent, though the similarly worded finance condition in Scott v. Rania, 24 which required the purchaser to find the finance "within 14 days of acceptance hereof", had been labelled "precedent" by the majority of the Court. In terms of the analysis suggested above, the question is whether the parties intended to be bound before, or only when, the particular condition was fulfilled. In the case of a finance condition it is suggested that they would probably intend to be bound before the outcome of the condition was known. On the definitions of the labels proposed in this paper, the condition would then be described as subsequent to the contractual relationship, though it might also be precedent to the obligation to perform some of the premises. In the case of the solicitor's approval condition, however, it is not so clear. The parties might intend an effective offer and acceptance but might not intend to be contractually bound unless and until the approval was given, 25 in which case

THE SECURICOR CASE

The Case at First Instance

Photo Production Ltd. v Securicor (Transport) Ltd. 3 involved a 1968 agreement under which Securicor was to provide a patrol service to Photo Productions' premises at a charge which worked out at about 26 pence per visit.4 The agreement included Standard Conditions of which 1 provided that "under no circumstances [should] the Company be responsible for any injurious act or default by any employee of the Company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer..." Condition 2 allowed for limitations of liability should any liability on the part of the Company arise "notwithstanding the foregoing provision." Whilst on an inspection of the premises, one of Securicor's employees deliberately started a fire which resulted in loss totalling $615,000. The employee in due course was convicted of arson and sentenced to three years' imprisonment. In the meantime Photo Production Ltd. re-engaged Securicor under a new contract.5

Photo Productions' claim in the High Court was for damages in contract or tort, or both. They alleged that the contract contained two implied terms, one that the patrolmen would exercise all reasonable diligence, skill and care, and the other that Securicor would itself exercise all proper care in the selection, training, supervision, employment and use of their patrolmen. The trial judge, McKenna J., rejected the first of these implied terms as inconsistent with Condition 1 of the Standard Conditions. As to the second, he held that there had been no want of care or diligence on the part of Securicor as employers. But for Condition 1, Securicor would also have been vicariously liable in tort for their servant's criminal act,6 but since that act was not one Securicor could have foreseen and avoided, their responsibility for this too had been excluded. The provision was a reasonable one and there was no cause for the Court to put a strained meaning on its language. Photo Productions had also argued that Securicor had committed a fundamental breach which prevented their relying on Condition 1. As to this, McKenna J. held that if a contract provided that one of the parties to it should not be "responsible" if a particular event occurred, the occurrence of that event could not be treated as being a breach of contract by that party. If it could not be treated as a breach, it could not be treated as a fundamental breach, however serious its consequences. He referred to the judgment of Kerr J. in The Angelia.7

Of the two grounds upon which the reasoning in Harbutt's "Plasticine" could be challenged, from the nature of discharge for breach and from the
function of exception clauses, McKenna J. had chosen the latter. Though his decision apparently caused “astonishment” in some quarters,¹ he had in large measure foreshadowed it in the earlier case of Mayfair Photographic Suppliers v Baxter Hoare & Co. Ltd.⁸

The Case in the Court of Appeal

But if the judgment at first instance came as a surprise, that could hardly be said of the reaction of the Court of Appeal (Lord Denning M.R., Shaw and Waller L.J.J.) in unanimously allowing the appeal.¹⁰ In his judgment, Lord Denning accepted that, taken in their natural and ordinary meaning, Conditions 1 and 2 either exempted or limited Securicor’s liability but held, nevertheless, that on three grounds the Company were not entitled to rely upon those clauses. His first ground was based on Harbutt’s “Plasticine”, but restated in terms reminiscent of the pre-Suisse Atlantique substantive doctrine. “The Court itself” he said “deprives the party of the benefit of an exemption or limitation clause if he has been guilty of a breach of a fundamental term or of a fundamental breach of one of the terms of the contract.”¹¹ His second ground was that the courts were entitled to construe a contract in the light of the presumed intentions of the parties as reasonable persons, and could say in the present case that they would not have intended the Conditions to apply in the events which had occurred. His final ground was that the courts would not allow a party to rely on an exemption or limitation clause where it would not be fair or reasonable for the party to do so. The other members of the court both held that, by reason of their fundamental breach, Securicor had lost the protection of their exception clauses but that, in any event, on their proper construction, the Conditions did not apply in the events which had occurred.

The Case in the House of Lords

Before the House of Lords, the two basic issues were whether, on their proper construction, Conditions 1 and 2 could apply and, if so, whether Securicor were prevented from relying upon them because of fundamental breach or on any other ground. As to the construction point, their Lordships were unanimous that the words used in Condition 1 were apt to protect Securicor. On the second issue, they unanimously denied the existence of any substantive doctrine of fundamental breach, with the reservation, in the case of Lord Diplock, that the agreement must still exhibit “the legal characteristics of a contract”.¹² Harbutt’s “Plasticine” and Mathews v Austin (Menswear) Ltd.¹³ were both overruled, as was Charterhouse Credit v Tolly,¹⁴ the decision relied on in the Mathews case. Nor did Lord Denning’s alternative grounds of “presumed intention” and his test of reasonableness find favour. The House reaffirmed that, within the limits of legality, the parties were free to contract on terms of their own choice, and to agree beforehand what the consequences of breach should be.

Wilson J. clearly regarded a condition precedent as being necessarily a part of a binding contractual relationship which would prevent either party from withdrawing while awaiting the outcome of the condition. He made no reference to the relation between such a condition and the scope of the grounds for withholding approval. It is suggested that had Wilson J. conceived of a condition precedent operating outside of and precedent to the contractual relationship itself, this might have provided an equally acceptable alternative interpretation of the facts before him.

A similar view may be taken of the facts in Freempton v McCully. The Court of Appeal does not appear to have considered the possibility that the parties might have agreed on terms but not intended to be contractually bound until the approval was given. Instead, it rejected the view that there might have been a counter-offer which had been accepted giving rise to a contract subject to a condition precedent of the solicitor’s approval, because the grounds on which that approval might be withheld could not, on the facts, be restricted. Given the view of a condition precedent on which this reasoning is based, i.e. that the parties are bound by contract while awaiting the outcome of the condition, the inability to restrict the scope of the approval is a valid reason for rejecting the interpretation. But again, if a condition precedent is seen as operating outside of and precedent to the contractual relationship itself, so that neither party is contractually bound unless and until the approval is given, there is no reason why there should be any restrictions at all on the scope of the matters subject to the approval or even on the ability of the client to instruct the solicitor to withhold approval. In Freempton v McCully the issues would then have been, first, whether an offer intended to be capable of acceptance was being made; if it was, secondly, whether it had been accepted; and, thirdly, because intention is a third and separate element in the making of a contract, whether the time when and the manner in which the parties intended to become contractually bound was dependent on the vendor’s solicitor’s approval. The giving of such approval would then have been the event which caused a contract on the agreed terms to become automatically binding on both parties. It is suggested that the results in both of these cases might be attributed, first, in part to the written offer and acceptance process of contract making used in Christchurch which directs attention to the offer and the acceptance and away from the contract, and, secondly, in part to the restricted view of a condition precedent taken by the Court in each case.
In this case, then, the condition attached to the vendor’s offer prevented an effective offer from being made until the condition was fulfilled. Clearly the purchaser’s purported "acceptance" in such a situation was not an acceptance of the offer in contractual terms, but could only be an indication that he would await the outcome of the solicitor’s decision. Such an interpretation of the events which occurred in Buhrer v. Tweedie is perfectly feasible in law and is clearly distinguishable, as Wilson J. pointed out, from a condition precedent to a contract, though his Honour’s view of a condition precedent is different from that suggested here.

The second decision, which also came out of the Christchurch process of contract formation, was Frampton v. McCully in which, again, the purported "acceptance" was expressed to be "subject to Mr. Frampton [the vendor’s solicitor] approval". Clearly, a conditional acceptance cannot bring about a contract so that it was readily found that this "acceptance" had never resulted in a contract between the parties. As to the obvious possibility of treating the "acceptance" as a counter-offer, because the Court of Appeal, in its judgment delivered by Cooke J., did not consider that any restrictions could be placed upon the grounds on which the solicitor could refuse his approval, given the facts of the particular case, the Court thought that it would be "unreal to treat the conditional acceptance as a counter-offer capable, if itself accepted, of giving rise to a conditional contract of sale". The vendor was therefore taken merely to have indicated the terms on which it would accept if its solicitor approved.

On analysis, there appears to be very little difference between these two cases. Both properly concluded that an "acceptance" subject to solicitor’s approval cannot operate as an acceptance to form a contract but can be treated only as a counter-offer. In Buhrer v. Tweedie it was construed, not as an offer capable of acceptance, but only as an indication of the terms of the offer which would be made if the solicitor approved. However, the prospective purchaser had written under the "acceptance" the words "I agree" followed by his signature and the date. From the discussion on p. 520 of the report, The Rejection of Harbutt’s "Plasticine"

The reaffirmation of what had been decided in Suisse Atlantique no doubt disposed of the more recent developments, so far as they were a direct revival of the former substantive doctrine, and also of the Harbutt’s "Plasticine" principle in the form in which it had recently been expressed. But it did not necessarily dispose of the reasoning on which Harbutt’s "Plasticine" itself was based. As we have seen, there were two grounds on which that could be attacked. Of their Lordships, all except Lord Diplock chose the route of discharge for breach. This made it necessary to distinguish the deviation cases and to hold that discharge for breach did not mean a rescission of the contract. In his leading judgment, Lord Wilberforce accepted the Heyman v. Darwins analysis. Upon a discharge for breach the contract remained in being for the purposes of assessing damages, and this included any provisions of the contract which dealt with damages, whether they liquidated, limited or excluded them. In a sense, the choice of the Heyman v. Darwins analysis was an arbitrary one. It was put forward in my book and two earlier articles because it was at that time the most recent. But since then the House of Lords has produced a new analysis in the LEP Air Services case. Since it is the more recent analysis it ought arguably to have been the one to follow. A possible reason why this did not happen will be suggested in due course. As to the deviation cases, Lord Wilberforce recalled that in the Suisse Atlantique he had said it was a matter of the parties’ intentions whether, and to what extent, clauses in shipping contracts could be applied after a deviation. He allowed that it might be preferable to consider them "as a body of authority sui generis with special rules derived from historical and commercial reasons." But on either view, what they could not do was to lay down different rules, as to contracts generally, from those stated by the House in Heyman v. Darwins.

Because of his part in formulating the rather different analysis in Moschi v. LEP Air Services, it was not easy for Lord Diplock to dispose of Harbutt’s "Plasticine" by a simple reliance on Heyman v. Darwins. Under the LEP Air Services case, the contract determined on a discharge for breach, in that primary obligations were replaced by secondary ones. That would suggest that clauses irrelevant until adjudication would come too late to take effect. Lord Diplock was able to overrule Harbutt’s "Plasticine" by following the second route, that of the function of exception clauses. Both primary and secondary obligations were the product of the contract as a whole, including any exception or limitation clause, and came into existence as modified by them. This also meant that he was able to conclude, with McKenna J. below, that Securicor’s primary obligation to procure visits by persons who would exercise skill and care was not absolute but had been modified by Condition 1.
It was limited to the exercise of due diligence by Securicor in their capacity as employer, to procure that those persons would exercise reasonable skill and care.  

Construction of the Exception Clause

The other major issue discussed by their Lordships was that of construction. None had any doubt that in its natural and ordinary meaning Condition 1 covered the events which had occurred. The question was, rather, whether there was any reason why the natural and ordinary meaning should not be applied. Though regard had to be had to the contra proferentem rule, this was a commercial contract and negotiated between businessmen capable of looking after their own interests and of deciding how risks inherent in performance ... [could] be most economically borne (generally by insurance) ... The risk concerned was a "misfortune risk" of the kind that the reasonable diligence of neither party could prevent. The fee charged by Securicor was modest and would probably have been less than the reduction in premiums. Photo Productions might have enjoyed as a result of obtaining their services. The allocation of risk in the contract was fair, reasonable and probably the most economical. A businessman entering the contract could have had no doubt as to the real meaning of Condition 1 and would have made his insurance arrangements accordingly. In these circumstances it would be wrong to place a strained construction upon the words used when they were clear, and fairly susceptible of only one meaning.

In treating these factors as relevant to the question of construction their Lordships were applying established principles. As we have seen, it has been settled since the judgment of Lord Reid in the Suisse Atlantique that the construction of a contract can vary depending on whether it is a commercial or a consumer one or negotiated as distinct from being a contract of adhesion. While the reasonableness or otherwise of a provision is not at common law a ground for modifying it once a true construction has been arrived at, such considerations are certainly relevant to the process of arriving at a true construction in the first place, provided the words used are properly capable of more than one meaning. It is also an established test that the words used should be clear to the class of persons to whom they are addressed.

THE SIGNIFICANCE OF SEURICOR FOR THE FUTURE

Fundamental Breach

In the course of his judgment in Securicor, Lord Wilberforce gave some prominence to his view that the passing of the Unfair Contract Terms Act 1977 had made the doctrine of fundamental breach superfluous. That was true, if the condition were fulfilled by the specified time, time being of the essence, the contractual relationship would automatically arise. If the condition were not fulfilled by that time, the contract dependent upon it would simply not come into being. These are the logical results of there being no contract between the parties and, clearly, an intending purchaser under such an arrangement would have far less security than under an option to purchase acquired for valuable consideration. The only way to avoid these results within the structure of a condition precedent, as defined, would be to set up a collateral contract, but this seems a cumbersome and unnecessary process when either an option or a contract of sale with the obligation to perform some of the terms suspended could be entered into. It is therefore supposed that such conditions precedent would be intended only very rarely by the parties and that, in current New Zealand conveyancing practice, this might be an appropriate classification only for some solicitor's approval conditions.

The New Zealand decisions on solicitor's approval conditions to date have not provided any very clear guidance as to their effect. The first two decisions arose out of the introduction of this type of condition into the conveyancing practice for the making of agreements for sale and purchase in Christchurch. This involves the agent obtaining the signatures of the prospective parties to an offer and acceptance form. In Buhre v. Tweedie the purchaser had made an offer on such a form. The vendor then changed two of the terms of the offer, signed an "acceptance" and added after his signature that the "acceptance is subject to final approval by my solicitors". Such an acceptance is, of course, a counter-offer and the solicitor's approval qualification attached to the offer was construed by Wilson J. as making the offer unavailable for acceptance until the solicitor's approval had been given. The prospective vendor was taken merely to have indicated the terms on which he would make an offer if his solicitor approved. If the approval were given, a firm offer would still have to be made and accepted before there would be a contract. It is difficult to imagine that the solicitors for either party, let alone the parties themselves, would have foreseen the need for this ritual in the light of what had already passed between them.
a condition which is a term of an existing contract may, in addition to being subsequent to the contractual relationship, also be precedent to the obligation to perform some or all of the basic promises within that relationship, but to describe a condition in this twofold way is not helpful unless the primary and secondary aspects of the description are distinguished. When, as is often the case, the basic concern is with whether the condition can be used by one of the parties to escape from the contract, or perhaps with whether there is a contract, the primary aspect of the condition must be that it is subsequent to the contractual relationship. This approach to conditions has some judicial support but it has never been strongly accepted up to now in New Zealand, and even less have its implications been fully and logically followed through. The major effect of the adoption of the approach on earlier New Zealand decisions would be that the conditions in issue in Griffiths v. Ellis, Mulvena v. Kelman, and Scott v. Rania would be labelled more clearly and helpfully as conditions subsequent to the contractual relationships.

Adopting the terms precedent and subsequent with the meanings suggested for them above, each of the two kinds of condition will now be looked at separately with detailed reference to the major aspects of their operation.

Conditions Precedent

If, by the term 'condition precedent', is meant a condition precedent to the very existence of the contractual relationship, so that there is no intention to contract unless and until the condition is met, it must be admitted that such conditions will be rare. This would inevitably be so if the intention of the parties were determined in the light of the manner in which such a condition must necessarily operate. Because there would be no contract before the fulfilment of the condition, either party would be free to withdraw before that time or to re-open negotiations as to terms; there could be no obligation on either party to take any steps to achieve the fulfilment of the condition; and neither party could have any right to waive the condition so as unilaterally to impose a contract on the other.

he thought, not only of contracts falling within the Act but also of those outside it. The very fact that the Act had not been made to apply to commercial contracts otherwise than on one party's standard form confirmed that the parties to such contracts were intended by the legislature to be left free to make

Moreover, while he acknowledged that, despite its imperfections and doubtful parentage, fundamental breach had served a useful purpose, Lord Wilberforce was otherwise dismissive of it. His references to "a legal complex so uncertain as the doctrine of fundamental breach must be" and to "analysis, which becomes progressively more refined, of decisions in other cases leading to inevitable appeals" suggest that he would be content to see it disappear altogether. It is far from certain, however, that that is what will happen.

A first point is that not all the contracts excluded from the Unfair Contract Terms Act are commercial. Contracts not on one party's standard terms, where neither deals in the course of business, also fall outside it. Even in respect of contracts within it, the Act says nothing about the initial construction and interpretation of the clauses concerned and, since fundamental breach has until now been seen as relevant to those questions, it would require a major change in attitudes to make it irrelevant hereafter. For similar reasons fundamental breach is likely to be seen as relevant to the statutory requirement of reasonableness and, possibly, to the reasonable expectation postulated by section 3(2)(b)(i). As for common law countries with no equivalent to the Unfair Contract Terms Act, the pressures to retain a fundamental breach principle will remain unchanged.

Conceivably, in countries without equivalent legislation, and in England itself in respect of non-business contracts outside the Act, there might be a temptation to distinguish Securicor on the ground that it applies only to contracts in respect of which the new Act has made fundamental breach unnecessary. But that would be a travesty of legal reasoning, since the contract in Securicor antedated the Act and had therefore to be decided on ordinary common law principles, as Lords Diplock and Salmon were careful to emphasise. Almost as bad would be an attempt to distinguish the case on the grounds that it was confined to reasonable, negotiated, arrangements for the allocation of insurance risks between commercial parties. Of course those factors were relevant, but only to the issue of construction. On the substantive points covered in the judgments, the reasoning of the House of Lords applies just as strongly to all types of contract.

When it comes to questions of construction there would, despite Lord Wilberforce's strictures, seem to be sufficient material available to enable
any country to retain fundamental breach should it wish to do so. Initially
the concept would be retained as a guide to construction. But the pressures
towards treating it once more as a rule of law could be expected to build
quite rapidly. The point is that, apart from negativing the Harbutt's
"Plasticine" version of fundamental breach, the Securicor decision has left
things fairly much as they were after the Suisse Atlantique. In the first place,
no pre-Suisse Atlantique case other than Charterhouse Credit & Tolly44 has
actually been overruled. Secondly, the terminology of fundamental breach has
in substance been retained, in all its ambiguity.45 Accordingly, and this is the
third factor, there is little in Securicor to prevent lawyers, so-minded,
concluding that a rule of "construction" remains, to the effect that exception
clauses do not apply to fundamental breaches. On past experience, that will
almost certainly mean that the enquiry will be directed, not to the words used,
but to the presence or absence of fundamental breach as the determinant. In
consequence the test will in reality be applied as one of law. Fourthly,
the fact that Hain v Tate & Lyle46 has been distinguished in no way affects
its application to deviation and quasi-deviation. Those breaches will continue
to deny the proferens the protection of his exception clauses. The temptation
to generalise from these breaches to others outside bailment will remain, if only
because the concept of deviation is not very clearly understood. Firstly,
there remain those dicta of Lord Wilberforce in the Suisse Atlantique case which
misled Fenton Atkinson L.J. and Donaldson J.47 His Lordship was prepared
neither to qualify nor to explain them in Securicor. Moreover, his dictum about
there being a rule of law which would not allow an exception clause to empty
a contract of all content has now been echoed by Lord Diplock. Of course the
reference of both dicta was to the formation of the contract, and pre-supposed
that exception clauses define obligation. But in a world of lawyers who see
exception clauses as mere defences, that qualification seems no more likely now
to be accepted than it was after Suisse Atlantique.

If construction was what Suisse Atlantique and Securicor were really
about, two changes in approach ought to occur. The enquiry of the courts ought
in the first place to be directed to finding the meaning of the words used, in
the light of the contract as a whole, and of the surrounding circumstances at the
time the contract was formed. Of course it would be relevant to that enquiry
that the acts or events claimed to be covered by the exceptions were of a serious
nature. The more serious they were, the clearer the words used should be.
But it would be the degree of seriousness which would count, not whether they
were "fundamental" in any technical sense. Secondly, a return might be expected
to the principles which have heretofore governed the construction of exception
clauses. I have attempted to list some of these elsewhere48. Nevertheless,
so much water has passed under the bridge since 1953 that it may be asking too
much to expect either change to occur, at least in England and Canada where
fundamental breach has had its greatest influence.

conditions, this potential is far from realized in the
New Zealand cases to date. Rather, the primary impression
is one of somewhat vague and confused use of the terms leaving
someone seeking the solution to a problem with no clear statement
or understanding of the law. Nevertheless, it is suggested that
there are a couple of clues in the New Zealand judgments to workable
definitions of each term.

I have argued elsewhere15 that, to achieve clear thought
and communication when the terms 'precedent' and 'subsequent' are
used, there must be some agreement as to the temporal point to which
the terms are related and that the most useful point to choose is the
time of the creation of the contract.

There are several reasons for this. First, the suggestion
has the virtue of simplicity.16 Secondly, most disputes involving
conditions are concerned in some way with whether there ever was a
contract or whether the contract has been or can be determined, which
focuses attention on the existence of the contract. Thirdly, the
existence and substance of the condition are factors which should in
any event be considered in determining "the intention of the parties
as to the time when and the manner in which they will become bound by
contract".17 If this time were also chosen as the reference point
for the terms 'precedent' and 'subsequent', the fixing of this time
would decide whether the condition were precedent or subsequent to the
contract. Fourthly, because the operation of a condition is quite
different according to whether it precedes or is a part of the contractual
relationship, the proposal makes more obvious the inconsistencies in our
present understanding of the operation of conditions, clarifies how the
rules might be improved, and enables us to formulate a workable set of
rules for the operation of each kind of condition which would then be
inherent in the use of the labelling terms.

If the time of creation of the contract is taken as the reference
point, there would then be only two kinds of conditions: those which
are precedent to the existence of contractual relations, i.e. there
is no intention to contract unless and until the condition is met;
and those which are subsequent to the existence of contractual relations,
i.e. which are terms of existing contracts. It is acknowledged that
Nevertheless, similar reasoning was adopted by the majority of the Court of Appeal in Scott v. Rania,12 in attaching the label 'precedent' to the finance condition in that case, thus lending the weight of that Court to the perpetuation of the confusion and establishing in New Zealand law an unhelpful view of conditions. North P., who had earlier decided Griffiths v. Ellis, labelled the condition as precedent on the basis of the same reasoning as had Henry J. in Mulvena v. Kelman, i.e. that the condition was contained in the offer and is subject to the same criticism. McCarthy J. felt that the wording of the condition was closer to that in Griffiths v. Ellis than that in Barber v. Crickett and on that basis labelled it precedent rather than subsequent thus apparently taking no account of the way in which the condition was intended to operate in regard to the contractual relationship. Also, as in Griffiths v. Ellis and Mulvena v. Kelman, it is evident from the judgments as a whole that both North P. and McCarthy J. regarded the parties as in a contractual relationship which had to be terminated on the non-fulfilment of the condition. Thus again, a condition was labelled 'precedent' which was in fact operating as subsequent to the contractual relationship it affected.

With the majority judgments in Scott v. Rania reported litigation ended for some years, and in Auckland at least, a finance clause was included in the standard form agreement for sale and purchase incorporating the law as apparently settled by those judgments. In the two later decisions which there have been, the Courts did not attach a label to the conditions involved, but in each case certainly treated the finance condition as being a part of an existing contract. In Gardner v. Gould13 it can be assumed that the condition was regarded as subsequent since it was found that an obligation to take all reasonable steps to fulfill the condition could be imposed only by an implied term in an existing contract. In Barton v. Russell14 the problem ultimately centred on the interpretation to be placed on the word 'void' in the finance condition in the contract, but the use of this word can be traced back to the reliance upon the majority reasoning in Scott v. Rania.

Thus it is evident that, whatever the potential of the shorthand labels 'precedent' and 'subsequent' to assist in the discussion of

The Function of Exception Clauses

Since Lord Diplock concurred in overruling Harbutt's "Plasticine", he can be taken to have affirmed his earlier-expressed view that even limitation clauses qualify the (secondary) obligations to which they relate. To that extent, the gap left after The Angelia49 has been closed.

On the other hand, Lord Wilberforce did not advert to the function of exception clauses at all. More than that, he chose to overrule Harbutt's "Plasticine" by applying the Heyman v. Darwins analysis of discharge for breach rather than by adopting the more recent analysis in the LEP Air Services case. To adopt the latter could have involved his accepting Lord Diplock's approach to the function of exception clauses. This may tend to suggest that he has changed his mind since his dictum in Suisse Atlantique. What is perhaps at least as likely is that, in a case which he could decide without having to advert to the point, Lord Wilberforce simply preferred to "leave well alone". That, certainly, is what he did earlier when he was in a similar position in the Furyvmedon.50 The difficulty is that if the House of Lords were to decide, definitively, that exception clauses are more than mere defences, the repercussions would not be confined to discharge for breach, or to exception clauses intended to benefit third parties,51 but would extend across the whole spectrum. In particular such a finding could have radical consequences for the Unfair Contract Terms Act which was drafted throughout on the premise that exceptions are mere defences. It could be rendered in some respects largely ineffective if a different approach were to be followed.52

The fact that Lord Diplock has now based a judgment on the "qualification" view of exception clauses at House of Lords level adds that much force to what he has said previously on the topic.53 But it is scarcely likely that, on that account, an idea which has been mooted now for 43 years will overnight win general acceptance.54

Rescission

One other point that might be made concerns rescission ab initio. Before the recent case of Johnson v. Agnew55 English Chancery lawyers appeared to believe that the only remedy for a party to a sale of land who had suffered a serious breach and wished to terminate his obligations was to rescind ab initio, with a restitutio in integrum, but without damages. Now that the House of Lords have, in Johnson v. Agnew,56 agreed with the courts of Australia and New Zealand in holding that the common law remedy of discharge for breach with damages is available, the pendulum seems to be swinging to the opposite extreme and it is being said that rescission ab initio without damages is not an option open to the injured party.57
Past authority has supported the existence of both remedies as well as of a third remedy of rescission followed by a claim for a quantum meruit. At least, it is submitted that neither Securicor nor Heyman v Darwins is inconsistent with there being such a choice, where the appropriate conditions of the remedy can be met. That in turn would depend inter alia on the terms of the contract, including any exception clauses. But if the three remedies do co-exist, it is possible to foresee the emergence of yet another substantive defence. It would involve rescission of the contract ab initio followed by a claim in tort or quasi contract.

The Contractual Remedies Act

For New Zealand lawyers, the most pressing problem arising from the concept of fundamental breach is to assess the impact on it of the Contractual Remedies Act 1979. One of the principle objects of that Act was, of course, to unify the law relating to discharge for breach. That aspect was dealt with at length in the N.Z. Law Society seminars earlier this year. The aspect calling for treatment here is the effect of the Act on fundamental breach in the narrow sense in which it has been defined in this paper.

Section 8 of the new Act, while not identical with either the Heyman v. Darwins or the LEP Air Services analyses, is certainly inconsistent with Harbutt's Plasticine. That case would therefore have ceased to apply in New Zealand even without the Securicor case. But other questions remain.

The first is the effect of section 5 of the Act which states:

"If a contract expressly provides for a remedy in respect of misrepresentation or repudiation or breach of contract or makes express provision for any of the other matters to which sections 6 to 10 of this Act relate, those sections shall have effect subject to that provision."

It would seem clear enough that under this section limitation clauses like that in Harbutt's "Plasticine" will be able to take full force and effect. The consequences for clauses which exclude obligations or liability altogether are less obvious. The answer will almost certainly depend on what the New Zealand courts see as the function of exception clauses. If they opt for the view exemplified by Lord Diplock, Barwick C.J., and Kerr and McKenna J.J. they will hold that exceptions of obligation or liability prevent the act complained of being a breach. In that case neither section 5 nor any other part of the act relating to breach will apply. On the other hand if they opt for the view exemplified in the judgments of Lord Denning M.R. and treat that relationship is the focal point in regard to which the condition is viewed. The finding in Barber v. Cricket that the condition was subsequent was followed, on the basis of an agreement between counsel, in both Knots v. Gray and Martin v. Macarthur.

In the next case to arise, Mulvena v. Kelman, Henry J. reverted to the view of North J. in Griffiths v. Ellis and preferred to regard the finance condition as a condition precedent. This conclusion was based on the fact that the purchaser had made a conditional offer to purchase which was accepted by the vendor. But, regardless of the label used, it is evident from a closer reading of the judgment that Henry J. regarded the parties as contractually bound before the outcome of the condition was known. The reliance upon Griffiths v. Ellis fails to take account of the way in which North J. actually used the term 'precedent' in that case, i.e., as precedent to performance, so that it is inappropriate when, as in Mulvena v. Kelman, the contractual relationship is the focus of attention. In addition, the reasoning used by Henry J., relating to the terms of the offer and acceptance, is invalid in that, because any acceptance must be of an offer exactly as made if a contract is to result, all conditions, precedent to performance or subsequent to contract, must be contained in the offer. Those intended to be precedent to the contractual relationship itself might be separated off from those which are within an existing contractual relationship by an intention that, although there has been an agreement as to terms by offer and acceptance, there should not be a binding contract unless and until the circumstances described by the condition should have come about. The labelling of the condition in Mulvena v. Kelman as precedent is therefore, it is submitted, based on an incomplete analysis and understanding, and, in the light of the immediately preceding decisions which labelled the same type of condition as subsequent, is confusing, giving an appearance of randomness to the labelling process. Given that the importance of the condition in the case was its bearing on the contractual relationship, it would have been more accurately labelled as subsequent.
As Cooke J. goes on to observe in Hunt v. Wilson, the meaning of the terms 'precedent' and 'subsequent' must be made specific "by explaining to what the condition in question is seen as precedent or subsequent". The terms may be used in regard to the existence of contractual relations or to the obligation to perform one or more promises within an existing contract. In the New Zealand decisions of the last 20 years, the precise sense in which the condition is classed as precedent or subsequent has rarely been made unambiguously explicit. Primarily, when a condition is described as 'precedent', it is rarely, if ever, clearly stated whether it is precedent to the very existence of the contract, to one, some, or even all the promises within an existing contract. 4

In Griffiths v. Ellis, North J. described the condition as a "condition precedent in the strict sense of the term" which suggests that it is precedent to the existence of the contract. However, when the judgment is read more carefully, it is clear that his Honour accepted that there was an existing contract between the parties and that some obligations within it were current and not subject to the condition precedent.

The condition was therefore not treated as precedent in the strict sense of the term, and would, had the contractual relationship itself been the focal point of the labelling, have more correctly been described as subsequent, although its description as precedent was more useful in the circumstances of the case, because the emphasis was on the obligation to perform.

In Barber v. Crickett, however, in a judgment given about 5 weeks after that in Griffiths v. Ellis, but without mentioning the earlier Court of Appeal decision and perhaps without knowing of it, Cleary J. in the Supreme Court found that a finance condition was a condition subsequent. This was largely based on the degree of control over the outcome of the condition which the purchaser had and the Australian approach to such a situation which is to class the condition as subsequent. 7

While the end result accords with the view proposed in this paper, it is suggested that a better basis for labelling the condition as subsequent would be simply that there is a contractual relationship between the parties to which the operation of the condition is subsequent and that the exception clauses as mere defences, section 5 and the Act itself will, so far as relevant, govern the case. One has only to think of excepted perils in contracts in the carriage of goods by sea, where the provision of a "remedy" would defeat the purpose of the exceptions, to appreciate how important the answer given by the Courts will be.

The second problem is the extent to which fundamental breach has any continuing relevance to the interpretation and construction of exception clauses. The Act of course does not purport to deal with questions of interpretation and construction so that, prima facie, fundamental breach could remain relevant as a "rule of construction". The extent to which this is so may depend on how "fundamental breach" is perceived in this country. In a situation where the expression "fundamental breach" has been used as synonymous with "discharge for breach" and where the distinctive nature and function of fundamental breach itself may have been lost sight of, it is conceivable that the words "fundamental breach" will disappear from the New Zealand legal vocabulary and be substituted by the new concept of "cancellation". That happened any "rule of construction" would no doubt be applied to acts which (the exception clause apart) would fall within section 7(4)(a) and (b). If that became so, the new rule of construction would in effect apply to discharging breaches generally and in consequence would be considerably more wide-ranging than the original fundamental breach rule as Devlin J. conceived it. That effect would be compounded if the new rule of construction came to be applied as the determiner of the result. Much the more flexible solution for the courts to adopt would be to make construction turn not on the technical categorisation of the breach, but on the seriousness of the term broken or the consequences of the breach, following the approach that the more serious they were, the clearer the words used must be.

A final point concerns deviation. Under the Act, deviation will no longer bring about a rescission of the contract and Hain v. Tate & Lyle will therefore cease to apply. However, that does not in itself mean that the exception clauses will protect the deviating party. Both on the construction theory, that the exceptions cover only the risks of the contract voyage, and on the bailment theory I have put forward, the non-application of the exceptions to the altered risks does not depend on any supposed "rescission". And a positive gain from the new Act is that, unless the cargo owner should actively cancel the contract, the shipowner will once more be entitled to his freight should he deliver the cargo to its destination without defeating the purpose of the contract. This was almost certainly the law in the first half of the 19th century, and remained the understanding in commercial circles at least into the 1930's.
CONCLUSION

By reaffirming Suisse Atlantique and overruling Harbutt's "Plasticine", the House of Lords has done what it can to remove two obvious distortions from the law. But neither action, by itself, can solve the continuing problem of unacceptable contractual terms generally. Neither "construction" nor a third revival of fundamental breach can provide a fully satisfactory answer. The better approach, it is submitted, would be the development of an overall control based on reasonableness or, less radically, on unconscionability. Nor, in logic, should such a control be restricted to only one form of contract term.

It may be that in a country like Canada, where the approach to law appears to be rather more functional than it is in, say, England, Australia or New Zealand, such a control could be evolved by the courts themselves. But in countries where attitudes are more analytical, it would seem far too late, now, to expect any such development to be possible. For such countries, the need is surely for statutory intervention, as Lord Reid indicated 14 years ago in the Suisse Atlantique.

A PRACTITIONERS’ GUIDE TO CONDITIONS PRECEDENT AND SUBSEQUENT

In spite of the cri de coeur by Richardson J. in Hunt v. Wilson1 that the "nature and effect of conditions of various kinds have been the subject of almost endless discussion by Judges and academic writers", it probably remains true that a practitioner faced with a dispute centering on a condition precedent or subsequent in an agreement for sale and purchase will be in a quandary as to the exact legal position of his client at the time and as to the steps he must take to achieve the result his client desires. It would be presumptuous to assume that one short paper will, or could, resolve all the difficulties, but it may be useful to help identify issues involved and direct inquiry along appropriate paths.

Precedent or Subsequent?

In Hunt v. Wilson Cooke J. said:2

"I venture to think that the ambiguous labels 'precedent' and 'subsequent', when applied to conditions, are seldom of real help in solving issues in this branch of contract law."

Certainly, on the authorities as they stand at present, the labels are used too loosely to be of any help at all and, indeed, are only confusing. But if clear definitions were given to the terms, and if the most useful definitions were chosen as those to be given, the terms could be of great assistance. It needs to be remembered that, like many such terms in the law, they are merely shorthand ways of stating sets of detailed rules. If the circumstances which call for different rules were clearly differentiated and if the most apposite sets of rules were devised for those circumstances, there is no reason why the shorthand labels should not perform the same useful function that such labels commonly perform in legal language. After looking briefly at the present state of the New Zealand authorities with regard to the use of these particular labels, more precise definitions or usages of each will be suggested and the detailed rules of operation of each category then examined with regard both to our present understanding and to changes either required by logic or suggested by the usefulness of their practical operation.
Footnotes

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2. (1965) 114 C.L.R. 481.


10. There is further discussion in Exception Clauses, Chapter 5, and in [1970] C.L.J. 221.


14. Loss from inherent vice would seem to be about the only possibility.

15. (1881) 7 Q.B.D. 510.


18. (1937) 43 Com. Cas. 1, 15.

19. Accordingly, affirmation would not by itself make the exceptions re-apply. The contract would need to be varied to make the exceptions cover the risks of the new route.
This explanation is discussed more fully in Exception Clauses, pp. 89-93. It accounts for the fact that the liability of the deviator is absolute, and not that of a bailee.

Thus, even the deviating shipowners' right to freight on a timeous delivery, long recognised by the commercial community, can be explained as arising under the contract, either as on a substantial performance, or under the equivalent of a "warranty ex post facto".

For a fuller treatment see (1967) 40 I.L.J. 336.

(1925) 42 T.L.R. 174; Exception Clauses, pp. 82, n.15 and 93 n.86.

(1951) 1 K.B. 240.
(1951) 2 K.B. 882.
(1953) 1 W.L.R. 1468.
(1936) 2 All E.R. 597.

In The Albion [1953] 1 W.L.R. 1026, the Court of Appeal confirmed that the expressions "fundamental term" and "fundamental breach" had no special significance outside "deviation".

[1922] 2 A.C. 250 (H.L.).
Ibid., 260.
[1923] 1 K.B. 690.
[1953] 1 W.L.R. 1468, 1470.

Hong Kong Fir Shipping Co. v. Kawasaki Kisen Kaisha [1962] 2 Q.B. 26 (C.A.) (hereafter "the Hong Kong Fir").

This was, incidentally, reflected in the title of chapter 5 of Exception Clauses. The book was based on a dissertation written in the 1950's.


As to "difference in kind" see Exception Clauses, chapter 3 ("Exception Clauses and a Physical Subject-Matter"); Correspondence with Description in the Law of Sale of Goods", (1976) 50 A.L.J. 17.

These matters are discussed in greater detail in (1967) 40 A.L.J. 336, 337-341.

As late as Morely v. Attenborough (1849) 3 Ex.500 there was held to be no implied warranty of title on sales of goods.
emphasized added.

ibid., 4293.

ibid., 4293-4.

ibid., 6009.

ibid., 4294-5.

(1958) 98 C.L.R.2, 7.

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47. Exception Clauses, Chapter 1.


51. The idea that exception clauses could have a substantive effect seems to have originated with Professor J. C. Montrose who applied it to the sale of goods by description in (1937) 15 C.B.R. 760, as did Professor Unger subsequently in [1957] Bus. L.R. 30. Exception Clauses applies the idea to exception clauses generally.

Dicta or decisions since 1964 accepting the idea in whole or in part include:


I thought so in 1966. But by 1970, it had become apparent that the concept had survived. Hence the return, in [1970] C.L.J. 221, to a plea that "fundamental breach" and discharge for breach be recognised as different things.

On the other hand, it was already clear in 1966 that discharge for breach and deviation had been confused. Harbutts "Plasticine" Ltd. v. Wayne Tank and Pump Co. Ltd. [1970] 1 Q.B. 447.


At p. 10 infra.


ibid., 405-406.


57 ibid., 4067.

58 ibid., 4067.


59 (1971) 71 A.T.C. 6018.

60 ibid., 6018.

61 ibid., 6020.

62 ibid., 6020.

63 ibid., 6021.

64 ibid., 6021.

Newton's case (1958) 98 C.L.R. 2, 8 per Lord Denning.


69 ibid., 6050.


73 ante.


75 ibid., 4179.

75 [1972] 111 C.L.R. 430.

77 ante.

77 ante.

78 ibid., 134.

79 ibid., 94.

80 ibid., 92.

81 ibid., 90.

82 ibid., 435.

83 ibid., 435.

84 ibid., 435.

85 ibid., 6.

86 ibid., 6007, emphasis added.

87 ibid., 6007.

88 ibid., 436.

89 ibid., 435.

90 ibid., 435.

91 ibid., 441 per Menzies J.

92 ibid., 6005.

93 ibid., 6005.

94 ibid., 6010.

95 ibid., 6010.

96 Cecil Bros., ante. at 435.

97 ibid., 6010.

98 ibid., 6009.

99 ibid., 6009.

100 emphasis added.

101 ibid., 6010.

102 ibid., 6007, emphasis added.

102A ibid., 6007.


103 ibid., 6010.


104 ibid., 4236.

105 ibid., 4236.

106 ibid., 4236.


108 ibid., 92.

109 ibid., 94.


113 ibid., 4293.
1 (1921) 29 C.L.R. 416.
2 (1958) 98 C.L.R. 2.
3 ibid., 8.
5 ibid., 191.
6 emphasis added.
7 (1971) A.C. 739.
8 ibid., 750.
9 ibid., 750.
11 ibid., 179.
12 ante.
13 ibid., 192, emphasis added.
14 ante.
15 (1920) 28 C.L.R. 77.
16 ibid., 94.
17 (1964) 111 C.L.R. 443.
19 A discussion of the annihilation issue is contained in the final section of this paper.
20 ibid., 469.
21 ibid., 469.
22 ibid., 469, emphasis added.
23 ibid., 469.
25 ibid., 476.
26 (1971) A.C. 739, 749.
27 ibid., 751.
28 ibid., 478.
29 ibid., 478.
30 ibid., 479.
32 (1971) 125 C.L.R. 647.
34 ibid., 342.
35 ibid., 657.
36 (1962) 111 C.L.R. 443, 460.
37 (1977) 77 A.T.C. 4045.
38 (1977) 77 A.T.C. 4048.
40 emphasis added.
42 ibid., 320.
43 emphasis added.
44 ibid., 321.
46 (1962) 111 C.L.R. 430.
47 ibid., 322.
48 ibid., 322.
49 (1973) 73 A.T.C. 6067.
50 ibid., 6068.
51 (1977) 77 A.T.C. 4478.
52 (1962) 111 C.L.R. 443, emphasis added.
53 (1977) 77 A.T.C. 4045.
54 (1977) 77 A.T.C. 4058.
55 ibid., 4050.
56 ante.

FOOTNOTES


68. [1970] 1 Q.B. 447 (hereafter Harbutt's "Plasticine")
70. [1936] 2 All E.R. 597.
71. [1967] 1 A.C. 361, 398 per Lord Reid. 419, per Lord Upjohn.
73. At (1971) 87 L.Q.R. 515, 520, Leigh-Jones and Pickering, while characterising such an approach as "unrealistic", acknowledged that if it were accepted the result in Harbutt's "Plasticine" would be "altogether short-circuited."
75. [1963] 2 Q.B. 683.
76. At (1966) 29 M.L.R. 546, 550, Professor Treitel argued the need for it to be overruled by the House of Lords. On the other hand, the actual result could easily have been reached as a matter of construction: Exception Clauses p. 116, n.89.
78. [1978] 1 W.L.R. 856, 863.
82. Ibid., 532.
90. Ibid., 432. See also Laskin C.J.C. in B.G. Linton Construction Ltd. v. C.N. Railway Co. (1974) 49 D.L.R. (3d) 548, 552; Aita v. Silverstone Towers Ltd. (1978) 86 D.L.R. (3d) 439 (whether a right arbitrarily to withdraw from agreement); Metrotex Pty. Ltd. v. Freight Investments Pty. Ltd. [1969] V.R. 9, 19. Conversely, if the agreement were not intended to be a contract, or were intended as a unilateral rather than a bilateral contract, this constraint would not apply: Rose & Frank v. Compton & Bros. [1924] A.C. 445; MacRobertson Miller Airline Services v. Commissioner of State Taxation, (W.A.) (1975) 133 C.L.R. 125.

91. Ibid, 433.


97. I have argued in (1975) 125 N.L.J. 752, not only that this duty is not confined to occupier’s liability but also that it would be open to the courts to hold it unexcludable on grounds of public policy.


99. From the date of his judgment (October 1977) it may be that Griffiths J. had in mind Prince v. Brown Brothers & Merseyside & North Wales Electricity Board.

Section 260 Income Tax Assessment Act (Commonwealth)

"Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes 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."

(a) Subsections (2) to (5) of this section shall not be applied with respect to that arrangement or, as the case may be, with respect to that part so long as that arrangement or, as the case may be, that part is so prevented from being discontinued and is continued strictly in accordance with the requirements of the aforementioned terms or conditions thereof; and

(b) So long as the said subsections (2) to (5) of this section are not applied with respect to that arrangement or, as the case may be, with respect to that part in accordance with paragraph (a) of this subsection, the section for which section 108 of the Land and Income Tax Act 1954 was substituted by section 9 of the Land and Income Tax Amendment Act (No. 2) 1974 shall, notwithstanding the repeal thereof by the said section 9, be deemed to remain in full force and effect in relation to that arrangement or, as the case may be, in relation to that part.
(a) That person would have, or might be expected to have, or would in all likelihood have, derived if that arrangement had not been made or entered into;

or

(b) That person would have derived if he had been entitled to the benefit of all income, or of such part thereof as the Commissioner considers proper, derived by any other person or persons as a result of that arrangement.

(4) (Deemed derivation of income) Where any income is included in the assessable income of any person pursuant to subsection (3) of this section, then, for the purposes of this Act, that income shall be deemed to have been derived by that person and shall be deemed not to have been derived by any other person.

(5) (Sale of shares) Without limiting the generality of the foregoing provisions of this section, where, in any income year, any person sells or otherwise disposes of any shares in any company under an arrangement (being an arrangement of the kind referred to in subsection (2) of this section) under which that person receives, or is credited with, or there is dealt with on his behalf, any consideration (whether in money or money's worth) for that sale or other disposal, being consideration the whole or a part of which, in the opinion of the Commissioner, represents, or is equivalent to, or is in substitution for, any amount which, if that arrangement had not been made or entered into, that person would have derived or would derive, or might be expected to have derived or to derive, or in all likelihood would have derived or would derive, as income by way of dividends in that income year, or in any subsequent income year or years, whether in one sum in any of those years or otherwise however, an amount equal to the value of that consideration or, as the case may be, of that part of that consideration shall be deemed to be a dividend derived by that person in that first-mentioned income year.

(6) (Discontinuance prevented) Where any arrangement has been made or entered into before the 1st day of October 1974 and the Commissioner is satisfied, in respect of that arrangement or, as the case may be, in respect of a part of that arrangement, that the terms or conditions of that arrangement or, as the case may be, of that part (being legally binding terms or conditions which were agreed upon in writing before that date) prevent the discontinuance of that arrangement or, as the case may be, of that part, -

Continued...
11. Ibid., 863.
12. The fact that the point presupposes that exception clauses can prevent the accrual of obligation may explain why it was taken by Lord Wilberforce in the *Suisse Atlantique*, and by Lord Diplock but not by Lord Wilberforce in *Securicor*. See post, p. 18.
23. Ibid., 292, 296.
24. Ibid., 295, 296, 297, 298.
25. Ibid., 296, 297.
26. Ibid., 297.
27. Ibid., 291, 298.
28. Ibid., 298.
29. Ibid., 298.
30. Ibid., 291.
31. Ibid., 296-297.
32. Ibid., 297-298.
33. Ibid., 296, 297.
34. See cases at notes 63-65 ante.

**APPENDIX**

**SEC. 99**

Agreements purporting to alter incidence of tax to be void

(1) For the purposes of this section-

"Arrangement" means any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect:

"Liability" includes a potential or prospective liability in respect of future income:

"Tax avoidance" includes-

(a) Directly or indirectly altering the incidence of any income tax:

(b) Directly or indirectly relieving any person from liability to pay income tax:

(c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax.

**SEC. 99(2)**

(2) (Void arrangements) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly,-

(a) Its purpose or effect is tax avoidance; or

(b) Where it has two or more purposes or effects, one of its purposes or effects (not being a merely incidental purpose or effect) is tax avoidance, whether or not any other or others of its purposes or effects relate to, or are referable to, ordinary business or family dealings,-

whether or not any person affected by that arrangement is a party thereto.

**SEC. 99(3)**

(3) (Adjustment of income) Where an arrangement is void in accordance with subsection (2) of this section, the assessable income of any person affected by that arrangement shall be adjusted in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that person from or under that arrangement, and, without limiting the generality of the foregoing provisions of this subsection, the Commissioner may have regard to such income as, in his opinion, either-
When it is recalled that Newton’s case was a 'dividend stripping' case with facts almost identical to Patcor and Slutskin one can be forgiven for wondering how this 'antecedent transaction' theory was revived? Perhaps the answer is best given by pointing out that the only recent authority - or if it is preferred - the basis of the revival of the theory is Europa Oil (No.2), upon the Board of which Barwick C.J. sat as the Australian member.

Furthermore, it should be noted that the Privy Council decision not only cites no authority, but flies in the face of Newton, is contrary to Mangin, clashes with the clear objectives of s.99 and, it is submitted, is nothing more than an unauthorised castration of s.99.

In conclusion therefore, it can be said that in regard to the use of a trust, where tax diminution or avoidance is achieved, s.99 will only apply if the steps of implementation are not referable to ordinary business or family dealing. The recent Australian developments in the application of a section very similar to s.99 are, it is submitted, not well founded and are seen as a poor base upon which to build any tax planning arrangements. In regard to what is 'ordinary', it would seem that provided the steps are not tortuous, or artificial, then the permanent divestment of a source of income to a trust would be acceptable. However, in regard to the divestment of assets and their lease back to the assignor by the assignee, the position is still unclear. There are two lines of authority in New Zealand and there is little if anything to separate or distinguish them. The result is that in any such arrangement one can only proceed with extreme caution.

39. Ibid., 289.
40. Sections 11(3) and 3(1).
43. [1980] 2 W.L.R. 283, 293, 297.
44. [1963] 2 Q.B. 683.
45. Lord Diplock would reserve the word "fundamental" for a discharge for breach based on the scale of the breach, or of its consequences, as in the Hong Kong Fir: [1980] 2 W.L.R. 283, 294.
46. [1936] 2 All E.R. 597.
47. Ante, p.10.
51. In The Eurymedon, supra, 182, Lord Simon (dissenting) made the point that to accept the argument based on the "qualification" view would mean that Midland Silicones Ltd. v. Scruttons Ltd. [1962] A.C. 446 "should have been decided the other way".
53. See cases cited at p.10 fn.85 ante.
54. See p.7, fn 51 ante.
55. [1979] 1 All E.R. 883.
56. Supra.
the arrangement was nothing more than the attempt by the taxpayer to
either take advantage of business deduction sections of the Act, or to
'spread' income to entities in which the assessment of the income would
result in tax savings.

Patcorp, in the judgment of Jacobs J. (with whom Stephen J. agreed),
gives rise to the second of the above doctrines or theories, that is,
the antecedent transaction theory. His Honour finds that if the
Commissioner's argument is upheld, and s.260 is said to apply, the
purchase of the shares, the declaration of the dividend, and the later
sale of the shares, there would be no income, as distinct from capital,
which could be taxed.

In Mullens, the taxpayers sought to take advantage of provisions of the
Act which provided that moneys paid on petroleum shares shall be
allowable deductions. The shareholder of a petroleum company being at
the time financially unable to take up his rights - issue agreed that the
taxpayer may pay the moneys owing on the rights issue. This left the
taxpayer as beneficial owner of the shares. The taxpayer also gave an
option to purchase those rights to the original shareholder. By the
arrangement the taxpayer was entitled to the special deduction on the
moneys paid on the petroleum shares and the shareholder was entitled at
a subsequent time to purchase the shares. So held the High Court.
The majority considered s.260 had no application. The criticism of
the decision is not for the fact that s.260 was held not to apply, but
the reasons therefor. The reasons were basically two: first, the
taxpayer had done no more than bring himself within the provisions of the
Act (the choice theory); and secondly, if s.260 did apply, there was no
earlier transaction or situation which did not entitle the taxpayer to the
deductions claimed under the Act (the so-called 'antecedent transaction
theory').

In Slutzkin the High Court, on the basis of the same two theories or
principles held that a shareholder of a company loaded with undistributed
reserves who sold his shares to a 'dividend stripper' was not liable to
tax on the 'capital' receipts he received on the sale. The authority
for so holding was essentially Barwick J.'s judgment in Mullens.
Accordingly, it is Mullens that must be analysed.
This statement is Privy Council recognition that, having found that the particular payments came within a specific provision of the Act, it was not then open, for whatever reason, to attempt to avoid such payments under s.260.

It is submitted that the basis of any limitation on the "choice-principle" is the words of the majority judgment in Keighery where it was said in regard to the function of s.260:

"the section intends only to protect the general provisions of the Act from frustration..."

It is further submitted that the reference to the protection of the general provisions of the Act, must refer to the protection of the policy behind each of the general provisions, whether it be a charging, deduction or concessionary provision.

This was the approach of the High Court in Mullens v. FCT. In this case certain allottees of shares in a petroleum exploration company who could not afford to make further payments on their shares, and to thereby obtain the deduction allowed by s.77A (Commonwealth) declared themselves as trustees of the shares for members of the Mullens group. It was the members of the Mullens group who paid the amounts necessary on the shares, and thereby acquired the concessions under s.77A. As part of the arrangement, the Mullens group gave an option to the original shareholders to repurchase the shares at par in the future. It was held that s.260 did not avoid the arrangement, and accordingly, the taxpayers were entitled to their concessions under s.77A. As Barwick C.J. says:"

"It is of advantage, and indeed critical, at this point to examine the structure and operation of s.77A(4) and the policy it expresses." 115

The Chief Justice proceeds to examine these aspects. He concludes:

"That the policy was the encouragement of capital contribution to petroleum exploration companies which earmark that capital for petroleum prospecting and thus advance petroleum exploration... the section does not attempt to specify or regulate what may or may not be done..." 116

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**THE APPLICATION OF SECTION 99 OF THE INCOME TAX ACT 1976 TO TRUSTS**

The prominence of trusts today has been greatly influenced by the high and progressive nature of the rates of personal income tax. The trust has become to the income tax planner, a major device for effecting distribution of income.

There are two major uses of trusts in this area. Firstly, as a means to reduce the overall percentage of income paid in tax, the trust has been employed to achieve a diversion of income from the principal income producer to other members of his family, and to thereby achieve a spreading of the income with the resulting reduction in the overall tax paid. This spreading of income is usually achieved by the transferring of income producing assets to the trust. Secondly, to achieve a reduction in the taxable income of the principal income earner, a trust is used to acquire plant, buildings and other equipment which are necessary to the derivation of income by the principal income earner. In this way the deductions available to the taxpayers are syphoned through the trust to other members of the family.

The problem is, how does s.99 affect trusts? Any trust which effects a spreading of income, will have the consequence of reducing the liability to pay income tax. Hence, on a plain reading of the section, it would seem that such a use of trusts would be avoided by s.99.

However, since the High Court of Australia decision in FCT v. Purcell held that the then almost identical Australian Section to s.99 did not extend to the case of a bona fide disposition of a right to receive income, it is clear that the effect of the section was not that which would be presumed from a plain reading of the actual words of the section.

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In Purcell’s case the owner of certain pastoral holdings declared himself a trustee of them for himself, his wife and his daughter equally, but reserved to himself very wide powers of management, control and investment. Notwithstanding the tax diminution effects of the arrangement, it was held that the declaration created a trust which was valid and binding and not affected by the provisions of the predecessor of the Australian s.260.

How can the apparent conflict between the plain meaning of the words of s.99 and the Australian decision in Purcell’s case be resolved? It can only be in the construction of s.99.

The leading authority attempting such a construction of the meaning of the words of the section, was the Privy Council decision of Newton v. FCT. Although concerned with the application of the section to a dividend-stripping operation, the Privy Council underlined the potential impasse that a literal interpretation of s.99 would cause, and therefore set about construing a general test for the application of s.99 to all arrangements which had the effect of diminishing tax payable.

The section, as Lord Denning says: 3

"is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only the means which they employ to do it... In applying the section you must, by the very words of it, look at the arrangement itself, and see which is its effect - which it does - irrespective of the motives of the persons who made it... In order to 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... The section can still work if one of the purposes was to avoid liability for tax. The section distinctly says 'so far as it has' the purpose or effect. This seems to their Lordships to import that it need not be the sole purpose."

"Implemented in that Particular Way"

The Newton test specifically directs the application of the section to the overt acts by which the arrangement is implemented. It is the enunciation of this test, Lord Denning, specifically approved the decision in Keighery. Walsh J. thereby infers that the Newton test is an alternative test to the earlier choice-principle propounded in Keighery.

This approval by the Privy Council in Keighery, together with the number of judges in Casuarina approving the reasoning of Keighery, rather suggests that to attempt now to mount an attack on the "choice-principle" by directing criticism at these two High Court judgments would be unproductive. It is suggested that as an alternative to criticising the reasoning of the High Court in these two earlier decisions, the illustration of the absurd consequence of unquestioned appliance of the choice-principle may possibly be the most effective criticism of that principle.

This criticism is based on an overall view of the charging to tax function of the Act as a collection of charging provisions, each specifically charging to tax certain defined classes of income. In the sense that certain "income" not within a particular charging provision will not be liable to tax under that provision, the Act can be viewed as granting a whole series of choices. That is to say, a taxpayer may choose to which charging provision he shall subject his income by deriving that income in a particular manner or through a particular structure. It would be equally arguable on the reasoning of the "choice-principle" that such a taxpayer, by deriving the income in a particular manner or through a particular structure, is permitted therefore to "choose" to circumvent totally all the charging provisions of the Act. Seeing the specific provisions in this way makes it clear that the application of the "choice-principle" to s.260 will render s.260 inoperative. The reasoning of the court in Keighery gives no operation at all to s.260. However, it is one of the canons of statutory interpretation that any interpretation of a statute must be such as to give that legislation some fair meaning. For this reason it would seem that, while the "choice-principle" has been accepted by the courts, it can only be accepted with limitations. The question therefore becomes; what are these limitations? It is submitted that whatever these limitations are, the same limitations must also apply to the very wide statement of Lord Diplock in Europa Oil (No.2) that: 111

"finding that the monies paid...is deductible under s(51)...is incompatible with those contracts being liable to avoidance under s.(260)."
Walsh J. analysed the actual steps of the transaction, and concluded that the critical step for the purposes of tax avoidance was the allotment of the preference shares. If s.260 applied to avoid this allotment, the result would be that the taxpayer would have remained a private company and incurred the appropriate tax liabilities to that class of company. Walsh J. was emphatic that it was not the function of s.260 to avoid the steps taken by a taxpayer to place himself within any particular class or category. He relied on Keighery's case to hold that the right to choose the category is a right given the taxpayer by the Act. Further, it is a right which should be taken away by s.260.

Accordingly, notwithstanding that the steps which have placed the taxpayer in another tax category have also effected a tax diminution, s.260 was held not to apply.

It is submitted that in reaching this conclusion his Honour did not give the consideration necessary to the application of the Newton predication test. It was found as a fact, that the holders of the preference shares had come to an "understanding" that there would be no interference in the affairs of the taxpayer. The question therefore to be asked, and which was asked in the dissenting judgment of McTierman J., for what purpose other than to achieve the public company status for tax diminution reasons, would any shareholder subscribe and be content with a fixed preferred interest of fifty one dollars in a company capital of $12,200.00? Clearly, such action is not capable of explanation as an ordinary business dealing. It was for this reason that McTierman J. found in the minority that s.260 applied. However, Walsh J. does not seek to rely upon the Newton predication test, his Honour points out that immediately after the method of implementing the transaction which attracted the provisions of the Australian s.260 and the New Zealand predecessor to s.99.

The question then became what methods of implementation are permissible? It is submitted that the Privy Council has provided within the Newton test itself the answer to this enquiry.

The methods of implementation which are not allowed are those which it can be predicated that their purpose was tax avoidance. The Newton test directs that we predicate a purpose of tax avoidance to any method of implementation which is artificial or unduly complex, to the extent that it is not referable to the implementation of ordinary business or family dealings of the same consequence.

Newton's case invokes as a test the ordinary business or family dealings as to the artificiality of the method of implementation of the transaction in question.

"So as to avoid tax"

The section avoids transactions which not only have the effect of avoiding taxation, but also the effect of altering the incidence of tax or relieving any person from any liability to pay income tax. It can therefore be said that the section is not aimed only at arrangements which effect total tax avoidance but also at any arrangement which effects any diminution in the tax that would otherwise have been payable AND is not capable of explanation as ordinary business or family dealing.

The mere fact that a transaction effects a tax diminution is not sufficient to warrant application of the section. The transaction must have been implemented in that way "so as to avoid tax". The essential aspect of the Newton test is that it predicates such a purpose to any transaction where the method of implementation is not capable of explanation by reference to ordinary business or family dealing.

It is at this stage necessary to analyse the effect of the 1974 New Zealand legislative changes to s.108 in enacting what is now s.99 of the Income Tax Act 1976. S.99(1) defines "tax avoidance" to include (a) directly or indirectly altering the incidence of any income tax; and
they received would include dividends the subject of a rebate. In other words, where the Act gives a taxpayer the choice or the opportunity to structure his affairs in a particular way, then s.260 cannot be invoked to deprive the taxpayer of the benefits of that choice. This is called the choice theory.

This 'principle' was first enunciated in the High Court of Australia in Keighery Pty. Ltd. v. FTC. In this case involved the avoiding of the liability for tax on retained earnings of a company imposed by Division 7 of the Act. The taxpayer company was a dividend repository company. To avoid the provisions of Division 7 of the Act, the company issued twenty redeemable preference shares, one each to twenty persons. These preference shares had voting rights, and a right to a very minor dividend. The company had the right to redeem these shares, except during the period from 24th June to 7th July. It was this restriction on redemption which purported to give the company its public status for the purposes of Division 7. However the Commissioner assessed the company as a private company, maintaining that the issue of the preference shares was void as an arrangement to avoid tax.

The majority, in a joint judgment, said in regard to the applicability of s.260 to the arrangement:

"the section is...not to deny to taxpayers any rights of choice between alternatives which the Act itself leaves open to them."

Further, in holding that s.260 did not apply, the majority were of the opinion that the taking of measures to ensure a particular status of the taxpayer:

"cannot be to defeat, evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act."

This decision of the majority was approved in the Privy Council in Newton's case.

The decision of the High Court in Keighery was followed by the High Court decision in FTC v. Casuarina. In this case, by the issue of 51 redeemable preference shares in the taxpayer company to a group of interlocking subsidiaries of two public companies, the taxpayer acquired
The Choice and Antecedent Transaction Doctrines

If one looks at the three Australian decisions *Patcorp*[^2] , *Mullens*[^3], and *Slutzkin*[^4], there are to be found dicta statements in each which give support to the existence of the above theories. First, that where a taxpayer structures himself to take advantage of a specific provision of the Act, then s.99 has no effect - referred to as the 'choice' principle. Secondly, that unless there was an antecedent transaction to the one under attack by the Commissioner which, when the one under attack is avoided, leaves the taxpayer with assessable income, then s.99 would not apply - referred to as the antecedent transaction doctrine.

*Patcorp* was a dividend stripping operation whereby *Patcorp* entered into an agreement to buy the whole of the issued capital of the company to be stripped. The operation was that *Patcorp* buy the shares, receive the dividend, and collect the dividend rebate allowable, and the loss on sale of the 'stripped' shares allowable to *Patcorp* as a share-trader.

The High Court of Australia held that the fact that *Patcorp* was not registered as a shareholder at the time of the dividend did not deny it shareholder status if it was in fact the owner of shares and was subsequently registered as such. Furthermore, subject to s.260, *Patcorp* was entitled to a deduction under s.51 in respect of the expenditure incurred in the purchase of the shares. In regard to s.260, Gibbs and Jacobs JJ (with whom Stephen J. agreed) held that s.260 did not apply to a taxpayer who was entitled to rebates in respect of dividends simply because he arranged to receive dividends. Gibbs J. says:[^5]

> "an arrangement whose purpose is to reduce the amount of tax that a taxpayer will have to pay is not necessarily an arrangement whose purpose is to avoid a liability to tax..."

His Honour proceeded to find that in this case there was no arrangement:

> "whose purpose was to avoid tax. The purpose was to buy, and later resell, shares the dividends from which would be rebateable."[^6]

However, his Honour came to this conclusion after stating that s.260 did not prevent taxpayers from arranging their affairs so that income that behind the Newton test was that unless the proponent of the arrangement could come up with no other purpose for the arrangement than a reduction of tax (a situation difficult to imagine existing in reality), one did not look at the purposes or effects of the arrangement (whether ordinary business or otherwise), but one looked at the overt steps of implementation to determine whether the purpose was "tax avoidance". Under this former test it was the steps of implementation that one had to refer to ordinary business or family dealing, NOT the purpose of the arrangement. Surely this is exactly what s.99(2)(b) says? It says not to look to justify the arrangement by showing one of its purposes or effects relates to ordinary business or family dealing. If one purpose (irrespective of any other purpose) is tax avoidance, then s.99 will apply. This is then in fact a restatement of s.99(2)(a) excluding though as not relevant, any question of second or other business or family purposes. One is left then with deciding when is a purpose of a transaction "tax avoidance" which, due to the definition of "tax avoidance", is the same question as was asked under the former s.108 (and the Australian s.260) the answer to which was set out by the Privy Council in Newton's case.

It is submitted here that the words of that test crucial to this issue are the following:

> "irrespective of the motives of the perpetrators" ...

and,

> "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".

To this writer the test to be applied can be set out in three propositions:

(a) That the "purpose" of any arrangement is to be ascertained by a consideration of the consequences of that arrangement, rather than by any consideration of the intentions of the perpetrators at the time of effecting the arrangement;

(b) The section will apply to avoid an arrangement if from a consideration of the steps of implementation of the arrangement, it can be said that the arrangement was implemented in that particular way so as to avoid tax;
An arrangement will be presumed to be implemented in a particular way so as to avoid tax, unless the steps of implementation are capable of explanation by reference to ordinary business or family dealing.

It is submitted that these propositions can be conveniently restated in the following statement.

"To determine whether purpose or effect was tax avoidance one must analyse the method of achieving the purpose and if the method (as distinct from the intention) is not referable to any business or family dealing, then the arrangement will be avoided."

**Trusts**

Where does the above restatement leave trusts in relation to s. 99? When will the section avoid the use of trusts for income spreading (and therefore tax diminution) activities effected by the disposition of assets to or the acquisition of assets by the trust; or the use of a trust to receive what are business deductions to the principal income earner?

From Purcell's case where a grazier declared himself trustee for himself, and his wife of his business as a grazier, it is clear that the mere disposition of income producing property to a trust, will not, without more, attract the avoiding provisions of s.99. The problem is, what other components of any trust arrangement will invoke the avoiding provisions of s.99?

The key concept therefore, is that of ordinary business or family dealing. However, the meaning of this phrase is difficult to ascertain. The phrase has been used and abused by both judges and writers. But a close analysis of the cases will elucidate some general principles and guidelines.

**Ordinary Business or Family Dealing**

Notwithstanding the wide acceptance and purported application of the Newton principles, the meaning of the words ordinary business or family dealing remains unclear. The concept of categorising business or family dealings as ordinary or otherwise is difficult to apply.

First, what is 'ordinary' at one point in time, may not be categorised as such at another point in time.

In Halliwell Casey J. in the High Court was faced with the decision of the Privy Council in Europa (No.2) and with the earlier decision of the Court of Appeal in Wisheart. It will be recalled that Wisheart involved the transfer to a service trust of certain plant, equipment and library, and its subsequent lease-back to the partnership. Of this transaction, notwithstanding the very clear statements of the Privy Council, Casey J. held that s.108 was not precluded from application by Europa (No.2). In reaching this conclusion, his Honour relied on the words of what he suggested to be the ratio decidendi of Europa (No.2):

"In order to carry on its business of marketing refined petroleum products in New Zealand the Taxpayer Company had to purchase feedstocks from someone. In respect of these contracts, the case is on all fours with Cecil Bros. 102

Casey J. then looked at the situation in Cecil Bros., where, in order to carry on its business, his Honour was of the opinion the taxpayer also had to buy its trading stock from somebody. In the case of professional service trusts, such as that in Phillips and Halliwell, the same necessity to "buy its trading stock from somebody" would not normally exist where the assets to be leased to the taxpayer are first assigned by the taxpayer to the service trust. This was the situation in Halliwell and it was on this ground that Casey J. distinguished Europa (No.2). and held that s.108 applied.

It is submitted that the reasoning of Casey J. can be restated as follows: that because the plant and equipment had originally been owned by the taxpayer, this assignment and lease-back arrangement was not ordinary business or family dealing. Thus s.108 would apply. If this restatement of Casey J’s reasoning is correct then Halliwell falls into line with Wisheart and Lawler as saying the assignment to and lease back of assets, whether through a service trust or company is not ordinary business or family dealing and s.99 will apply. In this regard Casey J. considered s.260 did not apply to the hire of equipment purchased by the trust, not previously owned by the taxpayer, and subsequently leased by the trust to the taxpayer. That is, without this 'antecedent transaction', s.99 would not have been held to apply. It is therefore necessary to examine this final aspect, the necessity of an antecedent transaction for the applicability of s.99.
It is submitted that such a cavalier approach goes to the very heart of s.99. The Privy Council in three sentences, in relation to the conflict of ss.104 and 99 stated that unless there is some contractually bound benefit acquired, which is of a capital or non-revenue nature, any payments made for trading stock no matter how made, to whom, or for how much, are not subject to the application of s.99. Suffice to say at this stage, the Privy Council gave no reasons, nor did it discuss the overall applicability of s.99 to the specific sections of the Act.

Further, notwithstanding that the Privy Council in Europa (No.2) was sitting in its New Zealand jurisdiction, no reference was made to the earlier decision of the New Zealand Court of Appeal in Wisheart.

It is respectfully submitted that the Privy Council missed the point of Newtons case. That is, that unless the arrangement is explicable as ordinary business or family dealing, it is avoided by s.99. The fact that the arrangement involves making deductions under s.104 is not at all relevant to the essential test of whether the method of implementation is ordinary or otherwise.

Accordingly, it is submitted that this aspect of Europa Oil (No.2) is not helpful. The law is perhaps better understood in terms of the subsequent judgment of Waddell J. in Phillips where he saw the Europa Oil cases and Cecil Bros, as saying that even if s.260 did apply, it did not permit the Commissioner to reconstruct the deductions properly allowable under s.104. Due to the words of s.99(3) this is not now the position in New Zealand and it is submitted that the fundamental test here in regard to allowable deductions is the question of the acceptability of the steps of implementation of the arrangement as ordinary business or family dealings. Recalling that the facts in Cecil Bros. were held by at least two Judges to not be ordinary, should cause taxpayers in New Zealand to pause before entering into transactions involving several trusts or companies.

The recent New Zealand decision of Halliwell v. CIR. is of particular interest. Essentially, the case involved a dentist who formed a family trust to which he sold all his plant and equipment. Thereafter the trust leased back to the taxpayer the same plant and equipment.

Secondly, there is no ascertainable or definable norm or reference point.

Is it ordinary business to sell an income producing asset to a trust? Is it ordinary business or family dealing to lease an income producing asset or for a trust to employ the settlor as a farm-hand, consultant or manager?

The courts have often found it more convenient to say what is not ordinary business or family dealing than to attempt any all encompassing definition. This was the approach of the New Zealand Court of Appeal and the Privy Council in Margin v. CIR. There the trust scheme involved a father (taxpayer) who had until the date of the scheme, owned and farmed his farm. The taxpayer then leased a particular paddock, or paddocks, to the trustees of his family trust. The lease permitted the trustee to crop and market all that which the paddocks the subject of the lease produced during the period of the lease. As was usual in 'paddock-trust' schemes, the taxpayer was employed by the trustees, to crop and market the produce for the trustees. In this case the taxpayer actually collected the proceeds of sale of the crop and paid them to the trustees as income from the farming activities of the trustees. The Commissioner relied on s.108 to treat the sale of the crop as income of the taxpayer. In so doing the Commissioner was ignoring the lease to the trustees, and the contract of employment of the taxpayer with the trustees. Turner J. in analysing these facts, decided that there was no ordinary family dealing, as the beneficiaries of the arrangement received no actual benefaction.

On appeal, the Privy Council quoted with approval the following portion of the judgment of Turner J. in the New Zealand Court of Appeal:

"It was an essential part of this scheme that while the lease of the wheat paddock was for one year, in the following year another paddock was to be leased - and again another the following year. It was the rotation of crops, of course, which made this kind of thing necessary - but which at the same time made this kind of transaction one particularly unfit to be the basis of a family trust providing assured regular income for its beneficiaries. I cannot think that successive one year leases of that particular paddock of the farm which by crop rotation happened to be the wheat paddock can be described as an ordinary family dealing..."
The Court here made a close analysis of the consequences of the transaction. These consequences were (i) that the trustees retained the possession of a paddock for only one year, (ii) that there was therefore a continual rotation resulting in no lasting benefaction, and (iii) that income which would have otherwise been derived by the father, settlor, was derived by the trustees. It was this continual rotation of paddocks which "made this kind of transaction one particularly unfit to be the basis of a family trust." It was not that the income was derived by the trustees rather than the settlor, which was unacceptable, but that the method chosen by the taxpayer to implement this result was not considered to be ordinary family dealing. The Court was of the view that the method of implementation gave no actual benefaction to the beneficiaries, and the method therefore was not referable to ordinary family dealing.

A similar approach to the term "ordinary family dealing" had been taken by the New Zealand Court of Appeal in Emliger v. CIR. In that case the business was that of agricultural contracting. The nature of the business necessitated the use of heavy earthmoving machinery. The owners of the business, two brothers, established a family trust for their respective families, appointing the one the trustee for the other and vice versa. The equipment was acquired from the business by the trusts, and then leased back to the business. The business, in addition to a rental, was to bear all the expenses in running and maintaining the equipment that it had theretofor paid. The trustees under the deeds of settlement, had very wide discretionary powers in respect of the machinery. Furthermore, upon the expiration of a certain period of time, the capital of the trust, which would have essentially been represented by the machinery, was to revert to the trustees for themselves. North P. in determining the application of s.108 to the facts said:

"The facts speak not in a whisper, but in a loud and clear voice. There was no change in the practical operation of the partnership business, the same plant and equipment were used throughout. At the end of the stipulated period the remaining capital of the trust reverted to the appellants...All in all, then, I cannot accept for one moment... that this arrangement, and the steps taken to carry it into effect, is capable of explanation by reference to family dealing." 11

Although North P. does not expressly elucidate the meaning of the clause "capable of explanation by reference to family dealing", it is suggested standing the specific provisions of the Act, that s.99 should apply to those arrangements or transactions which are artificial to the extent that they are contrived, not for ordinary business or family consequences, but for the specific purpose of circumventing a charging provision or taking advantage of a deduction provision. Seen in this way, s.99 can perform the role of policeman.

It is against this background, that the Privy Council decided Europa Oil (N.Z.) Ltd. (No.2).

Lord Diplock, delivering the judgment of the majority, held that it was incompatible that s.108 could apply to a deduction properly allowable under the then s.111. In so doing, the Privy Council upheld the decision of the majority of the High Court in Cecil Bros.

The majority were of the opinion that the case was on all fours with Cecil Bros. Lord Diplock quoted with approval the statement of Owen J.:

"It is not for the Court or the Commissioner to say from what the taxpayer ought to spend in obtaining his income."

To this statement the Privy Council added:

"It is not for the Court or Commissioner to say from whom the taxpayer should purchase the stock in trade acquired by him for the purpose of obtaining his income."

The majority of the Privy Council held:

"Finding that the monies paid by the taxpayer company to Europa Refining is deductible under s. (104) as being the actual price paid by the taxpayer company for its stock in trade under contracts for the sale of goods entered into with Europa Refining, is incompatible with those contracts being liable to avoidance under s. (99)."

A further reason for the decision of the majority is apparent from the words:

"In order to carry on its business of marketing refined petroleum products in New Zealand the taxpayer company had to purchase feedstocks from someone." 100
s.99 could still apply to any scheme whose steps of implementation were not referable to ordinary business or family dealing.

It can be seen therefore that at the time of Wishart there were two schools of thought as regards the application of s.108 to avoid what would be otherwise a valid deduction of expenses under s.104 against assessable income. In Australia, in the High Court in Cecil Bros, three judges had expressed the opinion that s.260 had no application in such an instance, while Owen and Menzies JJ and, in New Zealand, the Chief Justice, and the full Court of Appeal had all held the section applicable proceeded to apply s.108.

Before proceeding further, it is imperative to examine the consequence of the issue that was being discussed in Cecil Bros. It was not just whether s.108 would apply to avoid a deduction properly allowable under the then s.111. The issue hit at the very existence of s.108. The section, widely drawn, is worded so that its net overlaps many of the specific provisions of the Act. It could be argued by taxpayers that where a transaction is subject to the charges to tax imposed by a specific provision of the Act, then s.99 can not operate. Tax is liable without more. That is, the section operates only where a particular transaction escapes the specific provisions of the Act. The very wide operative words of s.99 must draw on the norms created by decisions interpreting and giving context to the specific provisions to define the liability and, therefore, the degree of circumvention of them. Viewed statically, s.99 is either completely tautological or it must invariably give way to specific provisions. Viewed in a dynamic sense, it is an integral part of the process of creating and revising norms construing the specific provisions of the Act.

The problem with applying s.99 to disallow deductions properly allowable under s.104 is that to do so, is to impose on s.104 deductions, the criteria of s.99. That is, the present wide penumbral area of s.104 would be reduced to allow only those deductions that were incurred under a contract, arrangement or transaction referable to ordinary business or family dealing, and not implemented in that particular way so as to avoid tax.

It is submitted however, that this would not be an unduly restrictive test as it is suggested that it was the intention of the legislature notwith-
However it is the opinion of this writer, that such difficulties as the reconciliation of the cases and the prediction of the applicability of s.99 can largely be overcome by the application of the test derived above to the fact situation in question.

To test the validity of this restatement of Newton, it is now proposed having analysed some of the New Zealand cases, to analyse a few of the more important Australian decisions.

The Australian Authorities

The first major judicial consideration in Australia of the application of the Australian equivalent of the former New Zealand s.108 to trusts was in PCT v. Purcell. In this case, as already noted, the High Court agreed that the section was not to prohibit the disposition of property. The purpose of the section was to avoid contracts which placed the incidence or burden of tax upon some person other than the person contemplated by the Act.

If the Newton test as explained in this paper were applied to the facts of Purcell, it is suggested that the result obtained may well have been to avoid the transaction. To this extent Purcell is the only case that can not be reconciled by the application of this restatement of the Newton test. Although the declaration of trust did not attract the provisions of s.260, the provisions of the declaration in Purcell were of such a nature as to lead Isaacs J. in Purcell v. PCT to the conclusion that:

"what the declaration gives, it assumes to take away. It purports to create rights, and then immediately to deny any obligation to observe them... As a mass, the provisions of the declaration are repugnant to the gift regarded as a gift of shares in the business assets themselves." 15

The subject of that particular decision was whether the declaration of trust executed by Purcell was a bill of sale within the meaning of the Bills of Sale Act 1891 (Qld.), and being unregistered, was it void? The Court was not called upon in that decision, to decide the applicability of s.260.

Similar judgments were delivered by the remaining two judges in the New Zealand Court of Appeal, Turner and Haslam JJ.

Although each of the three judges said it was not necessary to distinguish Cecil Bros. from Wisheart, each judge stated that such a distinction could possibly be found in the words "genuinely paid out". It was unanimously suggested that perhaps the High Court saw the payments by Cecil Bros. Pty. Ltd. to Breckler Ltd. as 'genuine': a description their Honours were not prepared to extend to the payments in Wisheart.

However it is submitted firstly, that there is in fact little, if any, difference between the payments in Cecil Bros. and those in Wisheart; and secondly, this so-called distinction was purely a political tactic to avoid the necessity to reject outright the decision of the Australian High Court. From the facts of the cases, the payments in Wisheart were no more or less genuine than those in Cecil Bros. The Court of Appeal decision that s.108 applied was unanimous. As North P. concludes:

"The inference is irresistible that the 'arrangement' in the present case was 'implemented in that particular way so as to avoid tax'. It is plain that the transaction is 'incapable of explanation by reference to ordinary business or family dealing without necessarily being labelled as a means to avoid tax'." 16

North P. proceeds to comment on the result of the application of s.108. While the Commissioner had only reassessed the taxpayer to include in the assessable income of the taxpayer that portion of the payment which was profit to the service company, his Honour points out that there is no authority for such action. As s.108 applies to avoid the arrangement involving the lease of the dictaphones the Commissioner was therefore in a position to disallow as deductions, not just a part of the payments, but the full payments made by the taxpayer for the dictaphones. The remaining judges were in agreement with this conclusion.

The difference between Wisheart and Cecil Bros. is the result of applying s.108. Wisheart may well be wrong on the reconstruction issue, or the result of applying s.108, but due to s.99(3) that is now irrelevant. But as regards the applicability of s.99 to business deductions the New Zealand Court and two of the Australian judges were all prepared to accept that notwithstanding the legitimacy of the business expense under s.104,
"This means s.260 has been regarded as a warrant for disregarding part of the price actually paid pursuant to contracts, the validity of which remains unaffected." 91

Menzies J. was of the opinion that the assessment was an attempt to use s.260 to reconstruct or modify, when its sole function is to destroy. His Honour did not see it as necessary to decide whether s.260 applied, he was satisfied to state that the application of s.260 could not support the assessments of the Commissioner, and accordingly he allowed the appeal of the taxpayer.

Due to the inclusion of s.99(3) in the New Zealand legislation it is suggested here that if s.260 did apply to the facts of Cecil Bros. and it would seem that Owen J. was of the opinion that it did, then s.99 would have supported the Commissioner's assessment of Cecil Bros. Pty. Ltd. of the profit derived by Breckler Pty. Ltd.

In New Zealand the first case where business deductions to a related entity was at issue was Wisheart. In Wisheart the court had to determine whether payments made by a law practice to a company owned by the family trusts of the partners in the law practice were allowable deductions in calculating the assessable income of the practice. In Wisheart there were three arrangements. One of these three arrangements is particularly relevant here. It involved an agreement to lease dictating machines from the family controlled company at a profit of twenty per centum to that company. The taxpayers relied on Cecil Bros. to submit that s.108 could not apply to avoid an expense properly allowable under the then s.111.

North P. summarises the situation succinctly when he points out that:

"a majority of the members of the High Court appear to have been of the opinion that the Australian equivalent of our s.108 could not be invoked once the item of expenditure was shown to be deductible under s.111...in the Europa Oil case, their Lordships were at pains to reserve their opinion whether this second conclusion reached in the High Court of Australia was correct." 92

His Honour found nothing in the Europa Oil (No.1) case to support the submission of the taxpayer that s.108 could not apply. North P. finally rejected this submission with the words:

"I am not in any way persuaded that the Cecil Bros. case was correctly decided on this point." 93

However, it can be seen from the above quoted passage of the dissenting judgment of Issacs J. that the actual nature of the benefaction in Peate's case was similar to that of the New Zealand cases, and had the Newton test as restated here been applied, it might well have been decided that the method of implementation was not ordinary business or family dealing.

Possibly the most authoritative post-Newton decision in regard to trusts is Peate's case 17 which subsequently went on appeal to the Privy Council. 18 The discussion of the term 'ordinary business or family dealing' in the context of the Newton predication test was however limited to the High Court of Australia, in particular Menzies J. at first instance and Windeyer J. on appeal. The Privy Council debate centered almost exclusively on the question of annihilation. 19

In Peate's case a group of doctors were practising in partnership. The partnership was dissolved and a company A.E. Westbank Pty. Ltd., was formed having as one of its objects to carry on the business of providing medical, surgical and hospital facilities and services. Each doctor then incorporated a family company and each established a family trust, the trustee of which was the respective family company. The doctors were directors of A.E. Westbank Pty. Ltd., and the family trusts were the beneficial owners of the shares in that company. The doctors, of which the appellant was one, then sold their interests in the respective family companies to their family companies which in turn contracted to supply medical services for the use of A.E. Westbank Pty. Ltd. The doctors themselves, having entered into service contracts with their family trusts performed the medical services required as 'employees' of the respective trusts. In this way each doctor substantially reduced his personal income in favour of his family trust. Accounts for the medical services performed were sent on the doctors' stationery. The money was received by the doctors, who then paid it to A.E. Westbank Pty. Ltd. All expenses of the practice were met by A.E. Westbank Pty. Ltd., and the net income paid to the family companies, which in turn paid each doctor his contractual salary. The balance remaining thereafter being held by each respective family company as trustee for the wives and children of the doctors.

In the High Court of Australia, Kitto J. with whom McTiernan and Owen JJ. agreed, restated the Newton test. Unfortunately, the restatement
neglected any reference to the term 'ordinary business or family dealing', and in so doing, it is submitted, set the course for a decision, while in itself not incorrect, is not capable of proper rationalisation with the predication test as stated by Lord Denning.

Kitto J. correctly states that the Newton test makes it clear that the question whether an arrangement has or purports to have the purpose or effect of avoiding a liability to tax under the Act is a question as to the purposes or consequences of the arrangement itself, rather than of the purposes in the minds of the parties. That is to say it is:

"whether, upon consideration of the overt acts which have been done in carrying out the plan the arrangement is to be recognised as a means for the avoidance of a tax liability, whether or not it be a means to other ends also."

Secondly, Kitto J. identified the several purposes and consequences of the transaction, "some of then unconnected with taxation." Then followed what should have been the ratio of this judgment, at least, in so far as the issue of whether s.260 was applicable to the facts of the case:

"But the question remains, whether the overt acts that were done under the plan are fairly explicable without an inference being drawn that tax-avoidance is a purpose of the arrangement as a whole."

Having identified the issue, he should have simply concluded that the overt acts were not so explicable and accordingly s.260 would apply. But no, the learned Judge went further, and appears to have decided the case not in relation to the overt acts, but on the fact that the overt acts had as one of their results the reduction in tax. Kitto J. seems from the following words to prefer to rely on this aspect to find s.260 applied:

"purpose of providing for the doctors' families, and doing so quite honestly...but what was equally evident was a purpose of doing so by a method which will direct income away from the participating doctors...to the end that a substantial part of the tax might be avoided. The case falls within the annihilation of s.260."

It is suggested here that Kitto J. was wrong in finding s.260 applied for this reason. The words of the Newton test are quite clear.

The Commissioner therefore, must succeed under s.99, if he is to be successful in preventing the situation of service trusts deriving profits from the allowable business deductions of trading entities.

The Avoidance of Service Trust Arrangements

The Australian Section 260 was argued by the Commissioner in support of his assessments in Cecil Bros. However, on appeal by the taxpayer from the decision of Owen J.; Dixon C.J., Kitto, Taylor and Windeyer JJ, were of the opinion that, once a deduction was allowable under the Australian equivalent of s.104, there was no way s.260 could be invoked to extinguish the deduction.

The application of s.260 was considered only by Owen J. at first instance in the High Court, and Menzies J. on appeal. Owen J. said:

"Section 260 is being called in aid to reduce the amount of the taxpayer's outgoings and thus increase its taxable income, but I can see no reason why it should not be invoked for that purpose." 88

His Honour then proceeded from the Newton test to say that:

"if what is done does not fall within (the description of ordinary business or family dealing) and tax is in the result avoided, the section operates." 89

Owen J. relied upon the:

"relationship between the two companies and their directorates and shareholders" 90

to hold that the arrangement could not reasonably be explained by reference to ordinary business or family dealing.

Menzies J. was also of the opinion that, notwithstanding the validity of the deduction under s.104, if the circumstances so warranted, s.260 could apply to reduce the amount of the taxpayer's outgoings. His Honour then examined the result of applying s.260. The assessments the Commissioner sought to justify by the application of s.260, were assessments of the taxpayer, Cecil Bros. Pty. Ltd. of the amount of profit made by the related intermediary Breckler Ltd.
The judgment of the majority clearly indicates, that in reaching a conclusion different to that of the earlier Board, they have relied strongly on the words of the majority in the earlier decision:

"The Crown must show that as part of the contractual arrangement under which the stock was acquired some advantage was gained." 86

And further,

"Taxation by end result, or by economic equivalence, is not what the section achieves." 87

It is using these words that the majority, notwithstanding that the taxpayer continued to receive the 'rebates', held that the provisions of s.104 applied to allow the total payments by the taxpayer for its oil stocks as a deduction from its assessable income. It is submitted that the majority were in effect saying that there is no legally enforceable contractual arrangement, and the fact that the taxpayer still received the payments, is not relevant in a section which does not tax by economic equivalence.

That the majority in Europa Oil (N.Z.) Ltd. (No.2) have construed the above quoted words of the earlier decision, to arrive at a conclusion different in the extreme from the earlier decision is perhaps best evidenced by the strong dissenting judgment of Lord Wilberforce. It should be noted that Lord Wilberforce was the only judge common to both Boards, and further, it was Lord Wilberforce who delivered the majority judgment in the Europa No. 1 decision.

It is significant for present purposes to observe, however, that Europa Oil (N.Z.) Ltd. (No.2) makes it abundantly clear, that the unanimous decision of the judges in Cecil Bros. was correct in that s.104 will apply to allow the whole of the business expense as a deduction from assessable income, notwithstanding that in making that expense some further benefit was also obtained provided that such further benefit does not arise as part of a contractual arrangement under which some advantage not related to the production of the income is gained. Section 104 does not apply to disallow all or any portion of such payments.

They state clearly that notwithstanding a tax avoiding purpose or consequence, if the way in which the transaction was implemented can be explained by reference to ordinary business or family dealing then the section will not apply. This is quite a different test than that which Kitto J. applied in the above quotation. The basis of Kitto J.'s statement is that not only must the arrangement be "fairly explicable", but also there must be no inference that tax avoidance was a purpose of the arrangement. As purpose is determined by effect or consequence, Kitto J. is in fact saying that not only must it be fairly explicable, but also effect no tax avoidance. It is submitted that such a test is not only unduly restrictive, but also quite contrary to the Newton test.

The fallacy in the reasoning of Kitto J. lies in his limiting the exclusion from the avoiding effect of s.260 to those arrangements where no inference can be drawn that tax avoidance was a purpose of the arrangement.

The result of the reasoning of Kitto J. is that any arrangement which has the purpose or consequence of diminishing tax is within the section.

It is submitted this cannot be correct. Even at the time of this judgment there were cases and decisions which gave the lie to such a conclusion. Purcell's case is support for the proposition that certain situations, which, even though they effected a reduction in taxation, were acceptable as legitimate transactions. The Privy Council itself in Newton's case cited W.P. Keighery Pty. Ltd. v. FCIO 24 and Purcell's case as examples of transactions of which it could not be predicated that they were for the avoidance of tax, even though an effect of the transactions was the diminution of tax payable.

It is suggested that like Mangin's case, Elsmiger's case and the Marx and Carlson cases, the approach of Kitto J. in Peate's case is another example of a court or judge, while purporting to follow the original Newton test, restates or redefines that test, then subsequently reaches a conclusion, the reasoning for which bears no resemblance to the reasoning of the original Newton test.

Taylor J. in Peate's case, also found it more convenient to rely upon the tax diminishing consequence of the arrangement to hold that s.260 applied, than to grapple with the "ordinary business or family dealing" aspect of
the Newton test. When considering a specific submission of the taxpayer relying upon the ordinary business or family effects of the transaction, Taylor J. states:

"It is true, no doubt, that (the transaction) had other ends in view, such as the making of provision for the appellant's wife and children. But avoidance of tax was the means to these ends and a diminution in the appellant's tax was not merely an incident of what might be regarded as an ordinary family settlement." 26

On appeal to the Privy Council, their Lordships dealt exclusively with the annihilation effect of the application of s.260. As Lord Donovan subsequently stated in Mangin's case, in reference to Peate's case (where he also formed a member of the Board):

"in Peate's case the Board was simply concerned with the annihilation effect of s.260..." 27

In point of fact, support for the statement propounded herein that Kitto and Taylor JJ while no doubt correct in their decision, were erroneous in their interpretation of Newton is found in the subsequent Privy Council decision of Mangin where Lord Donovan said in regard to the Newton predication test,

"(it) does not mean that every transaction having as one of its ingredients some tax saving feature thereby becomes caught by a section such as s.108. If a bona fide business transaction can be carried through in two ways one involving less liability to tax than the other, their Lordships do not think s.108 can properly be invoked to declare the transaction wholly or partly void merely because the way involving less tax is chosen." 28

This therefore, leads back to the main argument of this paper that, in the application of the Newton test, the test becomes one single question: viz: are the steps of implementation of the transaction capable of explanation by reference to ordinary business or family dealing?

The reference point therefore, in all trust cases where tax diminution is but one of the effects resulting from a transaction, is the term 'ordinary business or family dealing'. Unfortunately, the meaning of this term, as can be seen from the preceding discussion, is somewhat elusive. It is of vital consequence however, to the rationalisation of s.99 in its application to trusts, that this term be explored further. The interpretation and application of this term in the cases is the key later case were made from Europa Refining under contracts of sale for one or more cargo lots entered into from time to time during the year of assessment.

In considering the application of s.104 in the earlier Europa case, the Privy Council had agreed with the decision of the High Court in Cecil Bros, that it is not for the Commissioner to decide how much a taxpayer should pay for his stock. Lord Wilberforce delivering the decision of the majority of the Privy Council said: 85

"In their Lordships' opinion section (104) does not enable the Crown to disallow expenditure genuinely made whenever it can be found that some economic advantage accrues to the trader as a result of making the expenditure...For a claim to disallow a portion of expenditure incurred in purchasing trading stock to succeed, the Crown must show that, as part of the contractual arrangement under which the stock was acquired some advantage, not identifiable as, or related to the production of, assessable income, was gained, so that a part of the expenditure, which can be segregated and quantified, ought to be considered as consideration given for the advantage."

Applying this to the facts, the Privy Council held that the taxpayer acquired by virtue of the placing of the order for stocks, an enforceable right to have payments made by Gulf to Pan Eastern which, being half owned by the taxpayer, amounted to the payment to the taxpayer of one half of that paid by Gulf to Pan Eastern.

It was therefore found, that there was acquired an enforceable right, besides the right to the stock purchased. The provisions of the New Zealand section at that time allowed only the deduction of expenses exclusively incurred in the production of assessable income. Accordingly, the assessment of the Commissioner disallowing the whole deduction was upheld.

In the later Europa (N.Z.) Ltd. (No.2), the Privy Council seized upon the fact that there was no Organisation Contract in that case to find that there was no contractual obligation on the part of the taxpayer to purchase from Europa Refining. Similarly, it followed that there was no contractual obligation between Gulf and the taxpayer, which would warrant the conclusion that the payment by the taxpayer for stock gave rise to a contractual obligation on Gulf to make the payments under the Refining Contract with Pan Eastern.
The facts of these two cases were similar. There were however, contractual variations which resulted in the cases being differently decided.

The facts were that a member of the Gulf Group of Oil Companies ("Gulf") entered into a supply contract with Europa Refining Co. Ltd. ("Europa Refining"), a member of the New Zealand Todd Group of companies, under which Gulf agreed to supply Europa Refining with all its requirements of semi-refined oil at posted prices. These prices were in accordance with those fixed by agreement between the major international oil companies. The taxpayer company, also a member of the Todd group, then purchased its oil requirements from Europa Refining under separate contracts for each lot. Europa Refining was not a subsidiary of the taxpayer, and neither were the two companies subsidiaries of the same parent company in the Todd group.

In order that the Gulf group should provide the Todd group with an economic concession for its purchases of oil without breaching the system of posted prices by granting a discount, a company Pan Eastern Refining Co. Ltd. ("Pan Eastern"), was formed in the Bahamas. One-half of this company was owned by a subsidiary of the taxpayer and the other half by a company in the Gulf group. Under a processing agreement between Gulf and Pan Eastern, crude oil was sold to Pan Eastern at a certain price. It was then partly refined by Gulf at a price which enabled Pan Eastern to make a sufficient profit so that one-half of the profit would be the amount equivalent to the reduction in price that Gulf would have been prepared to grant to the Todd group on the sale of its oil in the absence of the world price-fixing arrangements.

The significant difference between Europa (N.Z.) Ltd. and Europa (N.Z.) Ltd. (No.2) was that in the earlier situation there was a third contract between the taxpayer and Gulf, called an Organisation Contract, which included a covenant that Gulf would fulfil its obligations to Pan Eastern under the refining arrangements and pay it the moneys due under the Refining Contract. This covenant was in turn dependent on the taxpayer performing its obligation to purchase its oil requirements from Gulf at posted prices. Whereas in the later case, the taxpayer was not a party to any such contract. Further, the taxpayer, was not even contracted to buy its feed stocks from Gulf. All the purchases in the to the synthesis of these cases with each other and more importantly, the key to the applicability of s.99 to any prospective trust arrangement.

While the High Court in Peate's case was unanimous in respect that it found the transactions of that case to be within the scope of s.260, it was Windeyer J. who based this conclusion on what has been submitted as the essence of the Newton test in regard to trusts, that is, a comparative consideration of the steps of implementation of the transaction with the ordinary business or family consequences achieved.

"(A) taxpayer may legitimately regard it as a businesslike action so to arrange his affairs in the interest of himself and his family as to reduce his liability for taxes. But that does not mean that whatever method he adopts to that end can itself be said to be explicable as an ordinary business or family dealing putting it outside s.260." 28

In looking at the method the doctors in Peate's case had chosen to provide for their families, Windeyer J. made the following observations:

"the combined and inter-related activities and purposes of (Westbank Pty. Ltd.) and its companion (the family trust company) are certainly remarkable and out of the ordinary."

And further:

"for a medical practitioner to enter into an arrangement to become the paid servant of a company which was to make its business to hire him out as a servant of another company is surely not an ordinary business dealing." 30

It is submitted that the method of implementing the transaction in Peate's case was clearly complex, or tortured, and as Windeyer J. says, could not in any way be regarded as an ordinary business or family dealing. Accordingly, the section applied to avoid the transaction. Clearly then, of the judgments of the High Court, that of Windeyer J. is the only one which correctly applies the Newton test to the facts.

It is further submitted that the complexity of the arrangement in Peate's case resulted from the fact that the major income producing assets of the
The application of the Newton test to trusts becomes less clear however when the method of implementation is not unduly tortured, artificial or complex. Two cases which illustrate the difficulties are Millard v. FCT.\(^{31}\) and Hollycock v. FCT.\(^{32}\) In the former case, a registered bookmaker sold his bookmaking business to a company, the shareholders of which were the bookmaker himself, his wife and children. The bookmaker agreed with the company that he would thereafter carry on the bookmaking business for and on behalf of the company, and as its agent. In the latter case, the taxpayer, carried on a business as pharmaceutical chemist from a shop in Perth. The taxpayer entered into an agreement whereby he agreed to sell a half share in the business and its assets to his wife. The purchase price was payable to the taxpayer if he demanded it. The deed also provided that the taxpayer would manage the business and hold the assets and income of the business on trust for himself and his wife in equal shares.

Although these cases, but more so Hollycock's case, bear close similarities to Purcell's case, in each case the court came to a contrary result to that reached in Purcell's case.

It was held that the arrangements entered into in Millard and Hollycock were avoided by s.260. Although the decisions of Millard and Hollycock appear contrary to Purcell, it is submitted that the decisions are correct and can be explained by reasoning consistent with that propounded in this paper as being the correct interpretation and application of the Newton test.

Taylor J. in Millard's case founded his decision on the real purpose of the arrangement as it appeared to the Court; namely, tax diminution:

"to my mind it is as plain as it could be that the whole purpose and effect of the agreement was to split the appellant's income into a number of parts in order to minimise the amount of tax which would become payable."\(^{33}\)

In other words, Taylor J., having found a purpose of tax diminution, held s.260 applied. This reasoning is very similar to that of Kitto J. in the normal wholesalers, interposed a company (Breckler Ltd.). Breckler Ltd. was owned by the shareholders and relatives of shareholdes in the taxpayer company. Breckler Ltd. bought the stock from the wholesalers, added a considerable profit and resold the stock to the taxpayer. The Commissioner sought to disallow the deduction claimed by the taxpayer against assessable income for the cost of the stock to the extent that the deduction represented a profit to an associated trading entity.

The Commissioner argued that the deduction claimed was not allowable under s.104; or alternatively, s.99 applied to reduce the deduction claimed by the amount of the profit derived by Breckler Ltd.

Owen J. at first instance in the High Court, held that s.104 would not prevent the total deduction by the taxpayer of the sums paid to Breckler Ltd. for the stock:

"The fact that the taxpayer paid more for its purchases than it would have had it dealt direct with the manufacturers or wholesalers in order that Breckler Ltd. might make a profit... does not prevent the amount which it in fact paid from being regarded, for the purposes of s.104 as an outgoing incurred in gaining its assessable income."\(^{30}\)

His Honour relied upon the earlier decision of Romphion Tin N.L. v. FCT.\(^{81}\) where it was stated:

"It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent."

On appeal to the Full High Court, Dixon C.J., Kitto, Menzies and Windley JJ. were all of the opinion that the deductions claimed by the taxpayer were permitted under s.104. They were not of one mind, though, in regard to the application of s.99 to extinguish any deduction otherwise properly allowable under s.104. However, this aspect of the judgment is the subject of a later discussion.

On the question of the allowability of the deduction against assessable income, the decision in Cecil Bros., was discussed in the Privy Council decisions in CIR v. Europa Oil (N.Z.) Ltd.\(^{83}\) and Europa Oil (N.Z.) Ltd.
sufficient to tilt the balance towards artificiality of what might otherwise be regarded as ordinary business or family dealing. It was certainly not so sufficient in Grierson, Loader and O’Kane but it was in Wisheart, McKay, Lawler, Wells and Dwy. In Phillips, this issue was not taken.

In Phillips, because of the wording of s.260, whether s.260 applied or not made no difference. If s.260 was held to apply it did not give the Commissioner the power to reconstruct the arrangement and notionally affect the income and expenditure accounts of the partnership or the trust. The section only gave the Commissioner the power to avoid, or annihilate the arrangement. This did not alter the fact that payments from the partnership had been made. For this reason, Waddell J. in Phillips was prepared to accept for the purposes of argument that s.260 did apply to the fact situation of Phillips. As stated, the result of applying s.99 in New Zealand is not the same as that of s.260 in Australia. S.99(3) gives the New Zealand Commissioner the power to re-adjust income as he thinks proper. Accordingly, it can be asked, having regard to the differing effects of applying s.99, would a New Zealand Court have found s.99 applied to a Phillips type situation?

It is submitted that the use of a service trust to acquire assets from some unrelated third party does not involve the same issues as the use of that trust to acquire the assets from the taxpayer, which are then bailed to that taxpayer. In the former situation there is no assignment by the taxpayer/bailee, and no diversion to the trust of income previously derived by the assignor/bailee. Although not involving any assignment to the trust by the taxpayer/bailee, such a transaction may be considered as a device to spread income amongst a family unit rather than have the income derived and taxed in the hands of anyone amongst a family unit and is clearly therefore "tax avoidance" in terms of s.99. However, in these circumstances, it would seem difficult to argue that such an "arrangement" was not ordinary business or family dealing. The allowability of the deduction would therefore be determined by the application of s.104.

In considering the allowability of the deduction under s.104, the major authority is Cecil Bros., Pty., Ltd. v. FC 3. In that case the taxpayer, a shoe retailer, instead of buying its trading stock of shoes direct from Peate’s case and accordingly the reasoning (as distinct from the decision) is considered to be incorrect and inconsistent with the reasoning of the Privy Council in Newton and Mangin.

From the above analysis of Newton’s case and the discussion in relation to the decision of the Privy Council in Mangin it can be deduced that a tax diminution purpose or consequence alone, is not sufficient to attract the provisions of s.99. That there did exist consequences other than tax diminution in Millard’s case is clear from the words of Taylor J.:

"Any other effect of the agreement was entirely subsidiary to this." 34

The method of approach deduced from the Privy Council cases of Newton and Mangin, and propounded herein, is that it is not the consequences alone which are the touchstone, it is the purpose or effect as evidenced by the steps or overt acts to implement the arrangement which determine whether the transaction was merely "a means to avoid tax."

Taylor J. proceeded no further than to establish the existence of a tax diminution consequence. It is submitted that had Taylor J. enquired into the complexity of the implementation of the arrangement, his Honour would have had difficulty in showing that the transaction in Millard was at all complex.

The problem is that although it was clear that a consequence of the transactions was tax diminution, in both Millard and Hollyock the steps of implementation were fundamental. However, there is one crucial aspect of the facts of these two cases which requires highlighting. This aspect is that the businesses, the subject of the assignments, unlike graziers in Purcell, were bookmaking and a pharmaceutical chemist respectively and both of which were restricted by statute to being carried on by licensed persons. Taylor J. in Millard’s case chose not to discuss this issue on the basis that he was of the opinion that s.260 applied and this question of statutory illegality was not necessary or relevant to a determination of the applicability of s.260.

Whereas, in Hollyock’s case, Gibbs J. found this question of illegality "an important feature of the case." 35 Gibbs J. also found that due
to the statutory restrictions on the carrying on of the business of a
pharmaceutical chemist, the transaction in question could not be regarded
as an ordinary business or family dealing in relation to pharmaceutical
chemists. Gibbs J. supported his conclusion that s.260 applied by
referring to the words of Menzies J. in Peate's case at first instance
where it was said:

"What outside a profession, might be regarded as an ordinary
business transaction may, within a profession have an altogether
different appearance." 36

Gibbs J. then referred to Millard's case, and, as if in order to align
the decision in that case with that of his own in Hollyock, he drew
attention to the statutory restrictions upon the carrying on of a
bookmaking business, and by inference (as this aspect was not the basis
of Taylor J's decision in Millard) suggested that the decision in Millard
was therefore correct as the assigning of a
company could likewise not be regarded as ordinary business or family
dealing. Clearly Gibbs J., in a very similar situation, declined to
follow Taylor J's reasoning in Millard without first establishing the
statutory illegality as a justification for Taylor J's decision. Gibbs J.
was not prepared to find s.260 applied merely because there was a
consequence of tax diminution.

If the decision in Millard's case is seen as based on this matter of
illegality, on reasoning analogous to that of Gibbs J. in Hollyock's
case, then it is submitted that both decisions are distinguishable from
Purcell and in accord with the basis of the reasoning of the Newton test.

The question of illegality is the subject of further discussion in
connection with two of the latest cases, Bayly v. F.T. 37 and Jones v. F.T. 38
Suffice at this point to note, that apart from the illegality issue, it
would have been difficult to find the necessary tortured, artificial, or
complex steps of implementation to warrant labelling the transactions in
either Millard's case or Hollyock's case as a means to avoid tax.

The New Zealand Authorities

The New Zealand courts have approached the application of s.108 in a manner
similar to that propounded here as the correct application of the Newton

It may be argued that Cecil Bros. Pty. Ltd. 76 is more relevant to the
question of the allowability of the deduction to the bailee under s.104
as an expense incurred in the production of assessable income than it is
to the question of the ordinaries of the use of an associated trust to
derive income that, prior to the assignment of the assets to that trust,
would have been assessable income to the assignor. However, Waddell J.
argued that even if s.260 applied, it did not give the Commissioner the
power to disregard the fact that actual payments had been made. The
application of s.260 did not show that the taxpayer's real outgoings were
any less than those paid to the trust and claimed by the partnership.
Relying on Cecil Bros. case his Honour held that the application of s.260
here could not be regarded as invalidating the contracts between the trust
and the partnership nor as substituting the taxpayer for the trust in the
contracts the trust had made with the employees etc. The contracts as
made, stand.

The danger of Phillips to New Zealand taxpayers is great. A major
difference between the New Zealand and Australian provisions is the New
Zealand s.99 (3). In New Zealand having found an arrangement which
comes with s.99, that is, that artificial, unusual or complex as can
be said of it that it was not implemented in that particular way for
ordinary business or family dealing, but for tax avoidance, then the
Commissioner is entitled to 'reconstruct' the incomes of the persons
involved to assess the taxpayers on what they would have, or might have
been expected to derive if that arrangement had not been made or entered
into.

If the situation of Phillips would be found to be an arrangement for tax
avoidance under s.99, then the decision in New Zealand on the Phillips
facts would undoubtedly have been different than the Australian result.

The question of the s.260 versus s.51 in Australia, and in New Zealand prior
to the enactment of s.99, was well settled by Cecil Bros. Pty. Ltd. cited
with approval in the Privy Council cases in the New Zealand jurisdiction,
of Europa Oil (No. 1) 77 and Europa Oil (No. 2) 78.

It is here submitted that there is an essential relevance of the bailment
back to the assignor. This relevance is whether the bailment back is
There is therefore a second distinction between Peate and Phillips and that is in Peate it was the assignment of an interest in the medical practice to the trust which without more, effected the reduction in the assignor's assessable income, whereas in Phillips the reduction in the assignor's assessable income was achieved by the bailment back to the assignor.

For the purpose of considering this possibly crucial distinction between Peate and Phillips, it is helpful to classify income-producing assets as either of two types: firstly, assets which of themselves produce income, as for example shares in a company, or business; secondly, an asset the use of which will generate income for its owner. This second category must be broad enough to include such items as typewriters, dictaphones, and bulldozers, as well as stock-in-trade of merchants and manufacturers.

In the case of this second category of assets, income is generated from either the purchase and resale of the chattel, or the bailment of the chattel for reward. Where the transaction is a bailment to a person or entity not associated with the trust, then it may well be that the transaction is normal business. However where the asset is leased or bailed for reward to an associated assignor, then the transaction may not be ordinary family dealing. In New Zealand, it was held in Wisheart, McKay, Lawler, Wells and Why that the leasing or bailing for reward to an associated assignor was most "abnormal" and "surprising". While in Grierson, Loader and O'Kane it was quite acceptable.

Unfortunately for New Zealand Phillips did not decide whether the sale and lease-back arrangement was referable to ordinary business or family dealing. Waddell J. saw the central issue being the application of the allowable deduction section, s.51. Waddell J. was of the opinion that even if s.260 did apply, and he was prepared to accept for the purposes of the argument that it did, then there was still no taxable situation resulting which supported the Commissioner's assessment of the partnership without allowing the expenses paid to the trust and deducted by the partnership. He said

"So far as this Court is concerned the submission in relation to s.260 is, I think, governed by the decision of the High Court in Cecil Bros. Pty. Ltd."

"All in all then, I cannot accept for one moment... that this arrangement and the steps taken to carry it into effect, is capable of explanation by reference to family dealing." 40

The President of the Court is saying, in effect, that the applicability of s.108 and therefore s.99 depends upon whether the steps taken to effect the arrangement are capable of explanation by reference to the ordinary business or family consequences achieved.

The Court found in the arrangement in Elmiger's case that the whole transaction and its steps of implementation lacked any explanation by reference to ordinary family dealing. The lack of any real benefaction upon the beneficiaries resulted in the conclusion that the implementation of the arrangement was for the income tax consequences of the arrangement only, and accordingly s.108 applied to avoid the transaction for the purposes of assessing income tax liabilities.

The real confusion in New Zealand has arisen from an incorrect extension of the reasoning of Elmiger, Marx and Carlson. These cases are all examples of the use of a trust to derive income, thereby resulting in tax diminution, without any corresponding permanent benefaction. The reasoning gives no support to hold s.108 would have applied had the assignments been permanent, or had there been a true benefaction. However, the New Zealand Courts seem to have seen in these three earlier cases a line of reasoning which would prohibit the use of a trust to acquire from a taxpayer any income producing asset, and which would also prohibit any arrangement whereby a taxpayer incurred a bona fide deductible expense in favour of his family trust.

It is suggested that the root of this confusion is to be found in the judgment of the Chief Justice of New Zealand in Wisheart v. CIR. 41
In this case, a firm of solicitors, with a view to making financial provision for the wives and families of the partners, set up family trusts. The trustee of each partner's family trust acquired shares in a private company (Marlborough). Three arrangements were entered into between the partnership and Marlborough: First, the balance of the lease of the premises of the practice, the plant, equipment and library were all assigned to Marlborough. The partnership then entered into an agreement whereby Marlborough would supply the use of the above items to the partnership. The fee paid for these services was cost plus fifteen per cent.

Second, when the partnership required dictaphones, these were hired to the partnership by Marlborough at the rental of cost plus twenty per cent.

Third, a valuable assurance agency was terminated by the insurance company, and subsequently granted to Marlborough.

North P. in regard to the submission that the transaction was referable to ordinary business or family dealing states: 42

"In my opinion, it is manifest that this unusual and indeed extraordinary arrangement was as the Chief Justice held, "patently a scheme of tax alteration and relief as surprising, when found within the legal profession, as it was bold.'" 43

Undoubtedly a consequence of the transactions was... to alter the incidence of taxation. But it is respectfully submitted that this in itself was not sufficient to warrant the application of s.108. It is necessary to establish that the "purpose" was tax avoidance. This will be the case if the overt acts of implementation are not referable to ordinary business or family dealing. The consequences in themselves are irrelevant for it is trite, but true, to say any arrangement involving trusts will have some degree of tax diminution consequence. If consequence is relevant, then all trust arrangements must necessarily be void as the use of a trust automatically shifts the incidence. However, it is not the case that all arrangements using trusts will automatically be void.

In considering the first two arrangements in Wisheart, it seems that apart from surprising their Honours, no reason of substance is proffered as to the allowable deduction section, s.51. Waddell J. in the Supreme Court of New South Wales found in favour of the taxpayer under both sections. The judgment, however, dealt principally with the deductibility of the expense incurred under s.51.

It was clear from the evidence, that one of the purposes of the transaction was to reduce income tax. This was stated as one of the two purposes of the scheme contained in the circular forwarded to partners justifying the necessity of the service organisation. The other purpose of the transaction was to remove assets from the partners to minimise the consequences of successful litigation against them.

However, irrespective of the stated intentions of the parties, the Newton test states that a tax avoidance purpose is present if the overt acts of implementation are not referable to ordinary business or family dealing.

The steps of implementation in this case were the establishment of the unit trust, the incorporation of a company and the appointment of that company as manager of the unit trust, the sale of the assets, the transferring of staff, and the whole transaction whereby all these assets and staff were leased back to the partnership in such a way as to result in no outward change in the workings of the partnership business.

This arrangement as a whole is similar to Peate's case, but different in one essential aspect. Peate's case involved the assignment of a share in a medical practice, a practice that could be carried on only by registered medical persons, while in Phillips' case the assets assigned were actual chattels, namely typewriters, books and other office equipment. The legal restrictions on the persons permitted to carry on a medical practice may be the essence of the difference between the normality or ordinariness of Peate compared to Phillips.

However, Phillips went further. To achieve for the assignor a reduction in assessable income, the trust bailed the chattels back to the assignor. It was this bailment back to the assignor, and not the assignment, which effected the reduction in the assignor's income and consequently the tax diminution which may attract s.260 in Phillips' case.
assignee does with the assets assigned to it, whether it leases to a third party or back to the assignor, the fundamental test of validity in terms of s.99 must remain the ordinariness or usualness of the overt acts of implementation. It has been shown that apart from Wisheart, Lawler, McKay, Wells and Udy, an harmonious synthesis of all the Australian and New Zealand cases can be achieved on this test and the fact that the assigned assets are then bailed back to the assignor, which being a factor to be tested, should not give rise to any alteration in the test itself.

This was the attitude taken in the Phillips case,74 the most recent Australian decision involving service trusts and allowable deductions. In this case the court did not discuss the ordinariness of the steps of implementation. The court accepted, for the point of the argument, that s.260 applied and concentrated on the result of applying s.260 to legitimately deductible business expenses having decided, without arguing the issue, that the scheme of the trust, the assignment to the trust and the bailment back to the assignor were avoided as against the Commissioner under s.260.

In Phillips' case the taxpayer was a partner in a firm of accountants. In addition to the usual accounting services, the firm also provided further non-professional services including the maintenance of company share registers, personnel selection, electronic data processing, typing, printing and copying. With the stated purpose of reducing the assets of the partnership itself, a unit trust was formed, the units of which were held by the wives, family trusts, or family companies of the partners. The unit trust, through its management company, then purchased from the partnership all the furniture, office machines, and other equipment, and re-employed the whole of the non-professional staff hitherto employed by the partnership. The unit trust then entered into lease and service agreements whereby the partnership acquired the use of the furniture and office equipment, and the provision of clerical and secretarial services. The rates charged by the unit trust were not in excess of commercial rates. The Commissioner assessed the taxpayer on the basis that amounts incurred by the partnership for the above services and facilities, and interest paid by the partnership on moneys owing to the unit trust, were not deductible in determining the net income of the partnership. The Commissioner relied on s.260 and why such a transaction cannot be regarded as ordinary business or family dealing except perhaps that this is the first of this type of arrangement which came before the Court. The basis of the decision of all three judges in the Court of Appeal appears to be the following words of the Chief Justice at first instance where in finding that s.108 applied said:

"that the purpose, in effect, was to provide for the partners in the law firm an inflated deduction for tax purposes, while at the same time directing a corresponding amount to the families of the respective partners."44

The conclusion being, that if a transaction provided a deduction, and an equal diversion of income to a family trust company, then of itself the arrangement could not be justified as ordinary business or family dealing, and as such arrangements, of their nature, effected a tax diminution, the arrangement was within the ambit of the section.

The reason why the Court here would not follow the earlier decision of the Privy Council, in its New Zealand jurisdiction, in Europe Oil (N.Z.) Ltd. 45 and the High Court of Australia in Cecil Bros. v. IRC. 46 is the subject of a later discussion. Suffice at this point to say that the arguments and conclusions reached in the above two cases were distinguished in Wisheart by all the judges.

Having seemingly established a satisfactory reason for holding that the

first two arrangements in Wisheart's case were not ordinary business or family dealing, North P. concludes his consideration of the application of s.108 with the following statement:

"it follows that it must be accepted by the appellants that s.108 has fiscal effect and that it extends to arrangements by which the legal incidence of tax on the taxpayer's income was distributed so that he would be liable to less tax in the future."47

It is submitted that this statement is too broad. By reference to the Newton predication test alone, it is clear that North P., like Kitto, McIver, Owen and Taylor J.J. in Peate's case, or, Taylor J. in Millard, is effectively ignoring the saving aspect of the Newton test for arrangements which have tax diminution consequences, namely, whether the overt acts of implementation are referable to ordinary business or family dealing. To say that an arrangement cannot be ordinary business or
family dealing if it effects a deduction for tax purposes, while at the same time diverting a corresponding amount to the family of the taxpayer, is to unduly restrict genuine family transactions. To endeavour, as North P. does, 48 to justify such a restriction from the decision of Mangin approving Kilgour and Marx and Carlson, is to ignore the essential ratio of those earlier decisions, and to obscure the vital distinction between those cases and that presently under consideration. That ratio, and this distinction, is that in all three earlier decisions, the arrangements were temporary. There was no real benefaction to the family entity.

Whereas in Wisheart's case the family entity acquired the asset permanently. It was in the use of this asset for genuine economic gain, that leases were entered into with the taxpayers. To regard this as not ordinary business or family dealing, it is submitted, is to unduly restrict the rights of wives and families to own assets and to earn an economic return therefrom.

It is submitted that Wisheart's case is the first major side-track in the New Zealand decisions. The authority of Wisheart for the proposition that income spreading by the use of a family trust, where that trust genuinely owns assets for its own use, enjoyment and gain was not "ordinary", was followed in Lawler v. CIR. 49 In Lawler, a firm of solicitors again sold certain equipment to a company, the shares in which were then transferred to the trustees of the family trusts of each solicitor. Henry J. held that there was a diversion of income from the taxpayers to the company. Accordingly, he found the words of North P. in Wisheart applicable and held s.108 to apply.

It is submitted that the artificiality of the reasoning of Wisheart, and thereby Lawler, becomes obvious when the following words of Henry J. are considered:

"If the matter had gone no further, then it meant that the objectors had really done no more than put under the control of a company all material and services necessary to carry on their combined practice. But the arrangement made does not stop there. Each of the objectors as part of the arrangement, set up a family trust. The shares of the company were divided as to 2,000 to each trust, so the profits to arise from that part of the practice of the objectors, which depended upon the use of the machines, was diverted to the trusts." 50

ordinary family dealing, will result in the avoidance of the transaction under s.99.

In considering trust situations in general, however, it would seem that there are two aspects to be examined. First, is it the assignment, or method of acquisition of the asset by the trust which will attract s.99; or secondly, is it the method the trust then adopts to derive the income which will attract s.99?

It is submitted that s.99 will not avoid every assignment. The section only strikes at assignments which have the consequence if tax diminution. Although all assignments of revenue producing assets will result in tax diminution for the assignor, only those of which the overt acts of implementation cannot be referred to ordinary business or family dealing will be avoided by s.99. Hence any uncomplicated sale of assets by a taxpayer to a family trust should on the Newton test survive s.99. Therefore if s.99 is to apply, it must be as a result of activities after the assignment, or such subsequent activities which when taken together with the original assignment, give rise to saying that the implementation of the arrangement was not referable to ordinary business or family dealing.

It is clear that the fact that the trust derives income from an asset is not necessarily fatal to an arrangement. S.99 would not apply to the purchase by a trust of say a typewriter, or motor vehicle and the subsequent bailment of that asset to an unrelated entity.

Therefore the problem becomes, what derivations of income from assigned assets will attract s.99?

In Wisheart and Lawler taxpayers assigned income producing assets to family trusts. The income of the trust was equal to the reduction in assessable income of the assignor. Section 108 was held to apply in each case.

In Grierson and Loader again taxpayers assigned income producing assets to, in the first case, a family trust and in the latter, a family company. In both cases it was held that s.108 did not apply.

The uncertainty in New Zealand created by these four cases is discussed above. Suffice here to restate that it is submitted that what the
benefaction were not referable to ordinary business or family dealing. It seems clear from the judgments that the Court did not object to the leasing to the trust, and therefore presumably, leasing back from a trust. What the Court found as objectionable was the fact the leases were annual; that the paddocks rotated annually and thereby deprived the arrangement of any real benefaction to the trust and deprived the steps of implementation from any ordinary business or family dealing against which to be referable.

**Trusts and Business Deductions**

At the centre of all trust schemes there is normally an assignment by a taxpayer of income-producing assets to a trust in order that the trust will thereafter derive assessable income. Due to the income spreading effect of a trust, the assignment to a trust will usually result in less tax being payable than if the assignment had not been effected. It is this reduction in income tax payable through the use of a trust which attracts the application of s.99 to the scheme.

That is to say, s.99 is attracted not by the assigning of income-producing assets per se, but by the tax diminution effect of assigning those assets to a trust. This point is made clear by comparing the decisions of the courts in Peate's case with that of Everett's case.

The former case involved the assigning of an interest in a business to a trust. The latter case involved the assigning of the interest in a business to another person. In both cases, a consequence of the assignment was tax diminution. However, in Peate's case the Court held that the steps of achieving the assignment, which included the use of a trust, were complex, artificial and unusual, and therefore the arrangement was avoided. Whereas in Everett's case, the Court held that the assignment was quite a legitimate divestment. In fact, the Commissioner did not attempt to avoid the transaction under s.260.

It follows therefore that what might be a normal business transaction in one context may not be normal when the same result is achieved using a trust. It is submitted that the use of the trust is itself a method of implementation which if not capable of explanation by reference to

It is difficult to comprehend the different effect upon the tax situation of the partnership that leasing equipment from a company will have as compared to leasing from a company, the shares in which are subsequently transferred to family trusts. It is suggested that providing the partners themselves have no interest in the income of the trust, the destination of the income paid by the partnership for the use of equipment genuinely owned by an unrelated legal entity should have no bearing whatsoever upon either the allowability of the deduction to the partnership or the applicability of s.108 to the arrangement.

**A Synthesis of the Australian Authorities**

As a generalisation it can be said that the mere disposition of an asset to a trust is not of itself an arrangement which would attract the provisions of s.99. This is made quite clear from the decision in Purcell's case, a decision which was approved in Newton's case.

However, notwithstanding that the transaction will achieve consequences of tax diminution, s.99 will only apply if the arrangement was entered into with the purpose or intention of tax avoidance. The Newton test makes it clear that an arrangement is implemented to avoid tax or with the purpose of tax avoidance unless the steps of implementation are capable of explanation by reference to ordinary business or family dealing.

In the New Zealand decisions of Elmiger, Marx and Carlson, and Mangin the courts had to consider transactions which involved dispositions by taxpayers to their family trusts. These dispositions were for a very limited period of time, and in such are quite distinguishable from the Purcell situation. Furthermore, the temporary nature of the dispositions distinguishes these arrangements from normal trust situations.

The decision in each of these cases that s.108 applied is no doubt justified on the ground that there was no real and substantive property passing. That is, there was not the ordinary or usual benefaction associated with a disposition of property to a family trust which could justify the whole arrangement as ordinary family dealing.
In Wisheart and Lawler this was not the case. The dispositions to the family trusts were not of a temporary nature. They were permanent assignments of income-producing assets. The New Zealand courts in these cases held that the formation of a trust and the transfer to that trust of assets formerly owned by the taxpayer, and the subsequent leasing by the taxpayer of those assets were transactions of such a nature as not to be referable to concepts of ordinary business or family dealing.

It is submitted here that Wisheart and Lawler are wrong. They are New Zealand decisions which, to date, no Australian court has followed.

In the Australian context there is Peate, Millard and Hollyock. In all three cases s.360 has been held to apply. The reasons varied but in each it could be said that because the settlors/assignors were persons whose businesses could not be owned other than by qualified or registered persons, the method of implementing the purported assignments to the trusts or families were not referable to concepts of ordinary business or family dealing.

Recently in Everett v. FCI [51] the Supreme Court of New South Wales considered the efficacy of a purported assignment to the taxpayer's wife of a one-half share of the taxpayer's interest in a law practice. In this case both the taxpayer and his wife were solicitors. Consequently no question of statutory prohibition or of the application of s.260 arose. The case was determined on a consideration of the principles relating to assignments. Mears J. held that the assignment was effective to transfer the interest in the partnership, and therefore the income derived from that interest was derived by the wife, and not the taxpayer.

This case can most conveniently be compared to Hollyock's case. It seems to follow that Hollyock's case would have been effective to transfer the one-half share in the pharmacy business except that due to the statutory suggested to be an incorrect conclusion is that in the course of his judgment, Casey J. accepts the proposition that for s.108 to apply, tax avoidance had to be the main, or one of the main purposes of the transaction. On the facts of the case before him, Casey J. held that the main purpose or one of the main purposes was tax avoidance. Hence, his Honour also found s.108 to apply on the basis of the sole or principal purpose theory. It is submitted that this may well have influenced his Honour's judgment as regards the aspects of ordinary business or family dealing. In any event it is suggested and hoped, that this decision will be seen, along with Wisheart and Lawler as being incorrect on the question of what is "ordinary" in the area of business and family dealing.

The incredible aspect of all these decisions is that Casey J. in 1977 relies on the 1971 and 1973 decisions of Wisheart and Lawler in regard to what is "ordinary" without reference to the opposite views on this very point expressed in the 1971 and 1974 decisions of Grierson and Loader. Similarly, Henry and Cooke JJ in Grierson and Loader respectively formulate an opposite view to Wisheart and Lawler without so much as a mention of the earlier opposite decisions.

It is because of this present vacillation in the New Zealand Courts that the writer has at length, sought to establish a test derived from the headwaters of this view of authorities, the Newton decision, against which each decision can be evaluated in an effort to reconcile the decided cases and thereby to validate the test derived here, but moreover, to assist in determining the future application of s.99 to trusts.

The position becomes all the more interesting when full battle lines are drawn. Following the Wisheart view that 'sale and lease-back' transactions are not 'ordinary' there is first Lawler, but then there are also the cases of McKay, Wells 7[1] and Ody. 7[1A] On the other hand, finding such transactions as 'ordinary' there is first the cases of Loader and Grierson, but also O'Kane Construction 7[2], and Mangin 7[3].

In Mangin, the Privy Council upheld the decision of the New Zealand Court of Appeal in applying s.260 on the ground that due to the temporary nature of the assignments to the trusts it was difficult to see any real benefaction. Therefore the steps taken to implement a temporary
the sale and lease-back arrangements quite ordinary, notwithstanding that
the Court of Appeal had earlier considered similar transactions as most
unusual.

It is submitted that such cavalier treatment of Wisheart and Lawler is
support for the view expressed here, that the reasoning of both Wisheart
and Lawler is incorrect.

Unfortunately, the matter does not rest there. For recently in
Halliwell, Casey J., in regard to a sale to and lease-back from a
taxpayer's family trust, held s.108 applied.

Halliwell's case involved a dentist who formed a family trust for the
benefit of his wife and children. The taxpayer then proceeded to sell
to the trustees of that trust the plant and equipment hitherto owned and
used in the practice. At the same time the dental mechanic, until then
an employee of the practice, entered the employ of the trustees. There­
after the trust hired the plant and equipment to the taxpayer and supplied
him with the necessary dental mechanical services. All charges were in
line with normal commercial rates.

Casey J. held, following Wisheart, that a trust formed with the intent of
acquiring assets from a person in order to use those assets for the purpose
of giving that person a tax deduction was caught by the provisions of s.108.
His Honour concluded:

"that (the arrangements) were not "ordinary business transactions... and on the overall view they must be labelled as a means to escape
tax."

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It has already been concluded that the reasoning of Wisheart on this point
is not supported by any other decision and is, in fact, incorrect. It is
pertinent to note that just as Wisheart and Lawier were not referred to in
Grierson or Loader, Grierson and Loader are not referred to in Halliwell.
For the arguments already advanced, it is submitted that the reasoning of
this aspect of the decision in Halliwell is also incorrect. It is
important to note, as a reason why Casey J. may have come to what is
prohibition on ownership of pharmacies the steps of implementation of the
arrangement were held not to be referable to ordinary business or family
dealing in relation to the business of a pharmaceutical chemist.

Although not stated as such in the judgment, it has been submitted here
that a similar basis existed in Millard for applying s.260 in respect of
the transfer of a half interest in a bookmaking business.

It is further suggested that although not referred to directly in any of
the judgments in Peate's case, the reason why the Court found the actions
of Peate to be not ordinary business or family dealing was due to the
provisions of the Medical Practitioners Act (N.S.W.) for Menzies J., after
stating that the steps of implementation were not explicable by reference
either to ordinary business or ordinary family dealing, made the following
significant observation:

"Lest, however, it should be thought from my emphasis upon the part
played by the family trustee company that it is only the interposing
of this (family trustee company) between Dr. Peate and E.W. Westbank
Pty. Ltd. that prevents the arrangement as a whole being regarded as
an ordinary business transaction, I should say that this is not my
view. It is true that I do regard the incorporation of (the family
trustee company) and the seven other doctors' family companies as
colouring everything that was done here but, even without this, I
should have concluded that it was not an ordinary business transaction
for a body of professional men who are entitled to sue for fees for medical services to transfer their practices, their
libraries and their instruments to a company which could not sue
for fees and to become that company's servants in the conduct of
their profession... What outside a profession, might be regarded
as an ordinary business transaction may, within a profession, have
an altogether different appearance." 52

The reason why A.E. Westbank Pty. Ltd. could not sue for fees was due to
the provisions of the Medical Practitioners Act (N.S.W.).

Recently, there were the decisions in Bayly v. RCI. 53 and Jones v. RCI. 54
which, while not being trust cases, involve a consideration of the
transfers of income producing assets from the taxpayers, and turn upon
the question of whether such transfers are referable to ordinary business

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or family dealing.

In Bayly's case the taxpayer's wife purchased the goodwill and stock of a pharmacy, and took a lease of the premises from the former owner of the business. Subsequently, the wife closed those particular premises and transferred the business to new premises. Again, the taxpayer was employed as the salaried manager. In evidence, several commercial reasons were advanced for the ownership of the business by the wife, including the fear of the consequences of bankruptcy upon the professional status of the taxpayer.

In holding that s.260 did not apply, Bray C.J. in the Supreme Court of South Australia said:

"was not a sham in any relevant sense of the word... the parties really intended that the legal and equitable ownership of the goodwill and the stock of the pharmacy... should be here."

Although the existence of a 'sham' or act is not considered relevant, perhaps it could be suggested that his Honour was referring by the term 'sham' to the fact that the transaction was an outright sale to the wife. It was not a declaration of trust to circumvent prohibiting legislation.

In Jones v. FCI. the taxpayer, a qualified pharmaceutical chemist purchased a pharmacy. Subsequently the pharmacy business was sold to the taxpayer's wife. The taxpayer remained in the business as the salaried manager. In evidence, several reasons were given for the transaction including the equalisation of the assets of the spouses to provide security for the wife in the event of death or divorce.

Subsequently, while still owning the first pharmacy, the wife purchased a second pharmacy, which she shortly thereafter resold. During this brief period of ownership by the wife, the taxpayer also managed this second pharmacy.

With the enactment of s.99 the so-called sole purpose theory (which was never affirmed or applied in Australia) became extinct. However, the point of these two cases is the attitude of the New Zealand Courts to what is ordinary business or family dealing. Both Judges accepted that the sale to and lease-back from family companies (one of which was owned by a family trust) was quite within the context of ordinary business or family dealing. This is in contra-position to both Wisheart and Lawler.

As only those transactions which have as their purpose or effect tax avoidance are caught by s.99 (as per s.99(2)) AND in view of the test to be applied to determine the purpose or effect of a transaction (developed from Newton earlier in this paper) viz: that no tax avoidance purpose exists if the steps of implementation of the arrangement are referable to ordinary business or family dealing, the above quotation from Henly J. regarding the benevolent application of 'ordinary business' is particularly pertinent and worthy of special reference.

In both Grierson and Loader, family owned entities acquired assets from the taxpayers and bailed these assets back to those entities, thereby giving the taxpayers deductible expenses, and the family entity the assessable income which would have otherwise been assessable to the taxpayers. It will be recalled that in Wisheart, a similar arrangement was said by the then Chief Justice of New Zealand to be "surprising" and "bold", and by the then President of the Court of Appeal to be "unusual" and "extraordinary".

It is clear that Cook J. in Loader (and Henry J. in Grierson), without referring at all to the earlier decisions of Wisheart or Lawler considered case being found to be not tax diminution, but the ensuring of better and more economical control and use of equipment, s.108 was held to be inapplicable.
In that case the taxpayer was one of a ten man partnership carrying on the business of consulting engineers, surveyors and town planners. The partners agreed to incorporate a company, the shareholders of which were to be the families or trustees for the families of each partner. Then the plant, equipment, and certain real estate were sold to the company, the sale price remaining outstanding free of interest. No staff were employed by the company, which had no premises. The partnership then continued as before, except now leasing all that plant, equipment and real estate sold to the company.

Henry J. in the Supreme Court, after quoting the well-known words of the predication test of Lord Denning in Newton's case, proceeded to analyse the consequences of the transaction. In regard to the reference to ordinary business and family dealing his Honour was of the opinion that:

"the sale to a holding company and the hiring back of substantially the whole of a professional business' chattels, essential for its continuance, has not been shown to be a usual procedure in a professional business. But there is no reason why new business procedures should not be adopted. To this extent the term 'ordinary business' may require a benevolent rather than a restricted application." 64

Having effectively stated that there was no reason to consider the arrangement as not ordinary business, his Honour preferred to found his decision upon the words of Turner J. in Mangin's case (approved by the Privy Council in that case) that to be "labelled as a means to avoid tax" 65 under s.108, a scheme must be:

"designed for the sole purpose, or at least the principal purpose of bringing it about that this taxpayer should escape liability on tax." 66

Accordingly, as the principal purpose of the arrangement in Grierson's

As Bray C.J. stated:57

"I see no reason to doubt that the wife bought the second pharmacy as a principal in her own right in every sense."

In regard to the transfer of the original pharmacy to the wife by the taxpayer, Bray C.J. could see nothing in the transaction which would warrant classifying the transfer as not ordinary business or family dealing.

"A redistribution of family assets including a family business, as between husband and wife is an ordinary everyday family transaction which would not normally attract s.260 where there is no professional element in the business. Farmers, shopkeepers, factory owners do it frequently...the fact that the appellant is a registered pharmaceutical chemist makes the transaction appear at first sight unusual to the lawyer's mind...but...there was nothing illegal in the ownership of the pharmacy business by the wife..." 58

The vital distinction between Hollyock and the transfers in Bayly and Jones is that Hollyock declared himself a trustee for his wife to avoid the statutory prohibition on his wife owning the business whereas in Bayly and Jones the legislation in South Australia did not prohibit the acquisition of such businesses by non-professional persons.

There appears nothing in the judgment of Bray C.J. in either Bayly or Jones to suggest that the reasoning of Millard and Hollyock would not have applied had the wife, being illegal for her to acquire in her own name, acquired an interest in the business per the medium of a trust.

Finally, it is submitted that Bray C.J. in Jones, having found that the ownership of the business by the taxpayer's wife was not illegal and that the sale of an interest in a business by a husband to a wife was quite referable to ordinary business or family dealing, could have arrived at a similar decision from an application of what has been suggested here as the approach necessitated by the words of s.99. That is, enquiring as to whether the overt acts of implementation were referable to ordinary business or family dealing.
It follows from the above analysis of the later cases, and their suggested reconciliations with the earlier decisions, that notwithstanding the inherent tax diminution consequences resulting from the formation of trusts and the transfer thereto of income-producing property, unless the steps of implementation of an arrangement are artificial or unduly complex when compared to the ordinary business or family dealing consequences achieved then the arrangement will not attract the application of s.99.

While this position aligns the reasoning of the decisions of Peate, Millard, Hollyock, Bayly and Jones, it is contrary to the two New Zealand decisions of Wisheart and Lawler. As earlier discussed, Wisheart and Lawler held that the mere creation of a trust and the transfer to that trust of income-producing property could not be regarded as ordinary business or family dealing, and accordingly s.108 applied. It has been suggested here that these decisions are incorrect, and their irreconcilability with any other cases is seen as support for this proposition.

One of the rewording differences between the former s.108 and s.99 is the inclusion in the latter of subsection (2)(b) which provides that where an arrangement has two or more purposes or effects and one of them is tax avoidance, then the arrangement is caught. This provision seems to have been enacted to counter the judgments of Cooke J. in Loader v. CIR. 59 and Henry J. in Grierson v. CIR. 60

In Loader's case his Honour interpreted the majority decision of the Privy Council in Mangin to mean that to be caught by the section a scheme must be devised and effected for the sole purpose of bringing about tax avoidance. In Loader the taxpayer carried on the business of earth-moving. Due to the expansion of the business, further heavy machinery and staff had been required. In 1963 the taxpayer sought to re-organise his business. The taxpayer put the following arrangement into effect: firstly, a company was incorporated with himself and his wife as share-holders. Secondly, a family trust was formed, the beneficiaries of which were the taxpayer's mother, wife, children and grandchildren, and the wives and husbands of his children and grandchildren. The taxpayer thereafter sold the greater part of his business to the company, the purchase price being payable upon demand and free of interest. On the same day the balance of the plant and machinery were sold to the trust and immediately bailed back to the company for use in its newly acquired earthmoving business. Again the purchase price from the trust was payable upon demand and interest free.

Cooke J. in the Supreme Court, found that:

"tax saving was one of the motives, but not the principal motive of the (taxpayer) entering into the arrangement." 61

He also found that other purposes of the transaction included:

(i) the advantages of incorporation,
(ii) preservation of valuable assets for the family,
(iii) possible savings in estate duty.62

In regard to the arrangement itself, and its method of implementation:

"it can be said that incorporation of a company, establishment of a family trust, and sales and bailment of machinery are familiar types of transactions, which it would be natural to adopt to achieve the three objects."63

Accordingly, the Judge here found himself faced with a case in which a tax diminution consequence was clear, yet, the overt transactions to implement the arrangement were not unduly complex or artificial. It is submitted that this finding alone, without more, warranted a finding that s.108, and now s.99, did not apply. However, his Honour preferred to say that as tax avoidance was not the sole purpose of the scheme, s.108 did not apply.

Similar reasoning had prevailed in the earlier decision of Grierson.
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It is clear that Cook J. in Loader (and Henry J. in Grierson), without referring at all to the earlier decisions of Wisheart or Lawler considered
the sale and lease-back arrangements quite ordinary, notwithstanding that the Court of Appeal had earlier considered similar transactions as most unusual.

It is submitted that such cavalier treatment of Wisheart and Lawler is support for the view expressed here, that the reasoning of both Wisheart and Lawler is incorrect.

Unfortunately, the matter does not rest there. For recently in Halliwell68 Casey J., in regard to a sale to and lease-back from a taxpayer's family trust, held s.108 applied.

Halliwell's case involved a dentist who formed a family trust for the benefit of his wife and children. The taxpayer then proceeded to sell to the trustees of that trust the plant and equipment hitherto owned and used in the practice. At the same time the dental mechanic, until then an employee of the practice, entered the employ of the trustees. Thereafter the trust hired the plant and equipment to the taxpayer and supplied him with the necessary dental mechanical services. All charges were in line with normal commercial rates.

Casey J. held, following Wisheart, that a trust formed with the intent of acquiring assets from a person in order to use those assets for the purpose of giving that person a tax deduction was caught by the provisions of s.108. His Honour concluded:

"that (the arrangements) were not "ordinary business transactions... and on the overall view they must be labelled as a means to escape tax." 69

It has already been concluded that the reasoning of Wisheart on this point is not supported by any other decision and is, in fact, incorrect. It is pertinent to note that just as Wisheart and Lawler were not referred to in Grierson or Loader, Grierson and Loader are not referred to in Halliwell. For the arguments already advanced, it is submitted that the reasoning of this aspect of the decision in Halliwell is also incorrect. It is important to note, as a reason why Casey J. may have come to what is prohibition on ownership of pharmacies the steps of implementation of the arrangement were held not to be referable to ordinary business or family dealing in relation to the business of a pharmaceutical chemist.

Although not stated as such in the judgment, it has been submitted here that a similar basis existed in Millard for applying s.260 in respect of the transfer of a half interest in a bookmaking business.

It is further suggested that although not referred to directly in any of the judgments in Peate's case, the reason why the Court found the actions of Peate to be not ordinary business or family dealing was due to the provisions of the Medical Practitioners Act (N.S.W.) for Menzies J., after stating that the steps of implementation were not explicable by reference either to ordinary business or ordinary family dealing, made the following significant observation:

"Lest, however, it should be thought from my emphasis upon the part played by the family trustee company that it is only the interposing of this (family trustee company) between Dr. Peate and E.W. Westbank Pty. Ltd. that prevents the arrangement as a whole being regarded as an ordinary business transaction, I should say that this is not my view. It is true that I do regard the incorporation of (the family trustee company) and the seven other doctors' family companies as colouring everything that was done here but, even without this, I should have concluded that it was not an ordinary business transaction for a body of professional men who are entitled to sue for fees for medical services to transfer their practices, their libraries and their instruments to a company which could not sue for fees and to become that company's servants in the conduct of their profession... What outside a profession, might be regarded as an ordinary business transaction may, within a profession, have an altogether different appearance." 52

The reason why A.E. Westbank Pty. Ltd. could not sue for fees was due to the provisions of the Medical Practitioners Act (N.S.W.).

Recently, there were the decisions in Bayly v. FTC 53 and Jones v. FTC 54 which, while not being trust cases, involve a consideration of the transfers of income producing assets from the taxpayers, and turn upon the question of whether such transfers are referable to ordinary business
In Wisheart and Lawler this was not the case. The dispositions to the
family trusts were not of a temporary nature. The New Zealand courts in
these cases held that the formation of a trust and the transfer to that
trust of assets formerly owned by the taxpayer, and the subsequent
leasing by the taxpayer of those assets were transactions of such a
nature as not to be referable to concepts of ordinary business or family
dealing.

It is submitted here that Wisheart and Lawler are wrong. They are New Zealand decisions which, to date, no Australian court has
followed.

In the Australian context there is Peate, Millard and Hollyock. In all
three cases s.260 has been held to apply. The reasons varied but in
each it could be said that because the settlors/assignors were persons
whose businesses could not be owned other than by qualified or registered
persons, the method of implementing the purported assignments to the
trusts or families were not referable to concepts of ordinary business or
family dealing.

Recently in Everett v. FCT, the Supreme Court of New South Wales
considered the efficacy of a purported assignment to the taxpayer's wife
of a one-half share of the taxpayer's interest in a law practice. In
this case both the taxpayer and his wife were solicitors. Consequently
no question of statutory prohibition or of the application of s.260 arose.
The case was determined on a consideration of the principles relating to
assignments. Mears J. held that the assignment was effective to
transfer the interest in the partnership, and therefore the income
derived from that interest was derived by the wife, and not the taxpayer.

This case can most conveniently be compared to Hollyock's case. It
seems to follow that Hollyock's case would have been effective to transfer
the one half share in the pharmacy business except that due to the statutory
suggested to be an incorrect conclusion is that in the course of his
judgment, Casey J. accepts the proposition that for s.108 to apply, tax
avoidance had to be the main, or one of the main purposes of the
transaction. On the facts of the case before him, Casey J. held that
the main purpose or one of the main purposes was tax avoidance. Hence,
his Honour also found s.108 to apply on the basis of the sole or principal
purpose theory. It is submitted that this may well have influenced his
Honour's judgment as regards the aspects of ordinary business or family
dealing. In any event it is suggested and hoped, that this decision
will be seen, along with Wisheart and Lawler as being incorrect on the
question of what is "ordinary" in the area of business and family dealing.

The incredible aspect of all these decisions is that Casey J. in 1977
relies on the 1971 and 1973 decisions of Wisheart and Lawler in regard to
what is "ordinary" without reference to the opposite views on this very
point expressed in the 1971 and 1974 decisions of Grierson and Loader.
Similarly, Henry and Cooke JJ in Grierson and Loader respectively formulate
an opposite view to Wisheart and Lawler without so much as a mention of
the earlier opposite decisions.

It is because of this present vacillation in the New Zealand Courts that
the writer has at length, sought to establish a test derived from the
headwaters of this view of authorities, the Newton decision, against which
each decision can be evaluated in an effort to reconcile the decided cases
and thereby to validate the test derived here, but moreover, to assist in
determining the future application of s.99 to trusts.

The position becomes all the more interesting when full battle lines are
drawn. Following the Wisheart view that 'sale and lease-back' transactions are not 'ordinary' there is first Lawler, but then there are
also the cases of McKay, Wells and O'Kane. On the other hand, finding
such transactions as 'ordinary' there is first the cases of Loader and
Grierson, but also O'Kane Construction, and Mangin.

In Mangin, the Privy Council upheld the decision of the New Zealand Court
of Appeal in applying s.260 on the ground that due to the temporary nature
of the assignments to the trusts it was difficult to see any real
benefaction. Therefore the steps taken to implement a temporary
benefaction were not referable to ordinary business or family dealing. It seems clear from the judgments that the Court did not object to the leasing to the trust, and therefore presumably, leasing back from a trust. What the Court found as objectionable was the fact the leases were annual; that the paddocks rotated annually and thereby deprived the arrangement of any real benefaction to the trust and deprived the steps of implementation from any ordinary business or family dealing against which to be referable.

Trusts and Business Deductions

At the centre of all trust schemes there is normally an assignment by a taxpayer of income-producing assets to a trust in order that the trust will thereafter derive assessable income which would have otherwise been assessable to the assignor. Due to the income spreading effect of a trust, the assignment to a trust will usually result in less tax being payable than if the assignment had not been effected. It is this reduction in income tax payable through the use of a trust which attracts the application of s.99 to the scheme.

That is to say, s.99 is attracted not by the assigning of income-producing assets per se, but by the tax diminution effect of assigning those assets to a trust. This point is made clear by comparing the decisions of the courts in Peate's case with that of Everett's case.

The former case involved the assigning of an interest in a business to a trust. The latter case involved the assigning of the interest in a business to another person. In both cases, a consequence of the assignment was tax diminution. However, in Peate's case the Court held that the steps of achieving the assignment, which included the use of a trust, were complex, artificial and unusual, and therefore the arrangement was avoided. Whereas in Everett's case, the Court held that the assignment was quite a legitimate divestment. In fact, the Commissioner did not attempt to avoid the transaction under s.260.

It follows therefore that what might be a normal business transaction in one context may not be normal when the same result is achieved using a trust. It is submitted that the use of the trust is itself a method of implementation which if not capable of explanation by reference to

It is difficult to comprehend the different effect upon the tax situation of the partnership that leasing equipment from a company will have as compared to leasing from a company, the shares in which are subsequently transferred to family trusts. It is suggested that providing the partners themselves have no interest in the income of the trust, the destination of the income paid by the partnership for the use of equipment genuinely owned by an unrelated legal entity should have no bearing whatsoever upon whether the ability of the deduction to the partnership or the applicability of s.108 to the arrangement.

A Synthesis of the Australian Authorities

As a generalisation it can be said that the mere disposition of an asset to a trust is not of itself an arrangement which would attract the provisions of s.99. This is made quite clear from the decision in Purcell's case, a decision which was approved in Newton's case.

However, notwithstanding that the transaction will achieve consequences of tax diminution, s.99 will only apply if the arrangement was entered into with the purpose or intention of tax avoidance. The Newton test makes it clear that an arrangement is implemented to avoid tax or with the purpose of tax avoidance unless the steps of implementation are capable of explanation by reference to ordinary business or family dealing.

In the New Zealand decisions of Elmiger, Marx and Carlson, and Mangin the courts had to consider transactions which involved dispositions by taxpayers to their family trusts. These dispositions were for a very limited period of time, and in such are quite distinguishable from the Purcell situation. Furthermore, the temporary nature of the dispositions distinguishes these arrangements from normal trust situations.

The decision in each of these cases that s.108 applied is no doubt justified on the ground that there was no real and substantive property passing. That is, there was not the ordinary or usual benefaction associated with a disposition of property to a family trust which could justify the whole arrangement as ordinary family dealing.
family dealing if it effects a deduction for tax purposes, while at the same time diverting a corresponding amount to the family of the taxpayer, is to unduly restrict genuine family transactions. To endeavour, as North P. does, 48 to justify such a restriction from the decision of Mengin approving Ringer, and Marx and Carlson, is to ignore the essential ratio of those earlier decisions, and to obscure the vital distinction between those cases and that presently under consideration. That ratio, and this distinction, is that in all three earlier decisions, the arrangements were temporary. There was no real benefit to the family entity. Whereas in Wisheart's case the family entity acquired the asset permanently. It was in the use of this asset for genuine economic gain, that leases were entered into with the taxpayers. To regard this as not ordinary business or family dealing, it is submitted, is to unduly restrict the rights of wives and families to own assets and to earn an economic return therefrom.

It is submitted that Wisheart's case is the first major side-track in the New Zealand decisions. The authority of Wisheart for the proposition that income spreading by the use of a family trust, where that trust genuinely owns assets for its own use, enjoyment and gain was not "ordinary", was followed in Lawler v. CIR. 49 In Lawler, a firm of solicitors again sold certain equipment to a company, the shares in which were then transferred to the trustees of the family trusts of each solicitor. Henry J. held that there was a diversion of income from the taxpayers to the company. Accordingly, he found the words of North P. in Wisheart opposite and held s.108 to apply.

It is submitted that the artificiality of the reasoning of Wisheart, and thereby Lawler, becomes obvious when the following words of Henry J. are considered:

"If the matter had gone no further, then it meant that the objectors had really done no more than put under the control of a company all material and services necessary to carry on their combined practice. But the arrangement made does not stop there. Each of the objectors as part of the arrangement, set up a family trust. The shares of the company were divided as to 2,000 to each trust, so the profits to arise from that part of the practice of the objectors, which depended upon the use of the machines, was diverted to the trusts." 50

ordinary family dealing, will result in the avoidance of the transaction under s.99.

In considering trust situations in general, however, it would seem that there are two aspects to be examined. First, is it the assignment, or method of acquisition of the asset by the trust which will attract s.99; or secondly, is it the method the trust then adopts to derive the income which will attract s.99?

It is submitted that s.99 will not avoid every assignment. The section only strikes at assignments which have the consequence if tax diminution. Although all assignments of revenue producing assets will result in tax diminution for the assignor, only those of which the overt acts of implementation cannot be referred to ordinary business or family dealing will be avoided by s.99. Hence any uncomplicated sale of assets by a taxpayer to a family trust should on the Newton test survive s.99.

Therefore if s.99 is to apply, it must be as a result of activities after the assignment, or such subsequent activities which when taken together with the original assignment, give rise to saying that the implementation of the arrangement was not referable to ordinary business or family dealing.

It is clear that the fact that the trust derives income from an asset is not necessarily fatal to an arrangement. S.99 would not apply to the purchase by a trust of say a typewriter, or motor vehicle and the subsequent bailment of that asset to an unrelated entity.

Therefore the problem becomes, what derivations of income from assigned assets will attract s.99?

In Wisheart and Lawler taxpayers assigned income producing assets to family trusts. The income of the trust was equal to the reduction in assessable income of the assignor. Section 108 was held to apply in each case.

In Grierson and Loader again taxpayers assigned income producing assets to, in the first case, a family trust and in the latter, a family company. In both cases it was held that s.108 did not apply.

The uncertainty in New Zealand created by these four cases is discussed above. Suffice here to restate that it is submitted that what the
assignee does with the assets assigned to it, whether it leases to a third party or back to the assignor, the fundamental test of validity in terms of s.260 must remain the ordinariness or usualness of the overt acts of implementation. It has been shown that apart from Wisheart, Lawler, McKay, Wells and Udy, an harmonious synthesis of all the Australian and New Zealand cases can be achieved on this test and the fact that the assigned assets are then bailed back to the assignor, which being a factor to be tested, should not give rise to any alteration in the test itself.

This was the attitude taken in the Phillips case, the most recent Australian decision involving service trusts and allowable deductions. In this case the court did not discuss the ordinariness of the steps of implementation. The court accepted, for the point of the argument, that s.260 applied and concentrated on the result of applying s.260 to legitimately deductible business expenses having decided, without arguing the issue, that the scheme of the trust, the assignment to the trust and the bailment back to the assignor were avoided as against the Commissioner under s.260.

In Phillips case the taxpayer was a partner in a firm of accountants. In addition to the usual accounting services, the firm also provided further non-professional services including the maintenance of company share registers, personnel selection, electronic data processing, typing, printing and copying. With the stated purpose of reducing the assets of the partnership itself, a unit trust was formed, the units of which were held by the wives, family trusts, or family companies of the partners. The unit trust, through its management company, then purchased from the partnership all the furniture, office machines, and other equipment, and re-employed the whole of the non-professional staff hitherto employed by the partnership. The unit trust then entered into lease and service agreements whereby the partnership acquired the use of the furniture and office equipment, and the provision of clerical and secretarial services. The rates charged by the unit trust were not in excess of commercial rates. The Commissioner assessed the taxpayer on the basis that amounts incurred by the partnership for the above services and facilities, and interest paid by the partnership on moneys owing to the unit trust, were not deductible in determining the net income of the partnership. The Commissioner relied on s.260 and why such a transaction cannot be regarded as ordinary business or family dealing except perhaps that this is the first of this type of arrangement which came before the Court. The basis of the decision of all three judges in the Court of Appeal appears to be the following words of the Chief Justice at first instance where in finding that s.108 applied said:

"that the purpose, in effect, was to provide for the partners in the law firm an inflated deduction for tax purposes, while at the same time directing a corresponding amount to the families of the respective partners."44

The conclusion being, that if a transaction provided a deduction, and an equal diversion of income to a family trust company, then of itself the arrangement could not be justified as ordinary business or family dealing, and as such arrangements, of their nature, affected a tax diminution, the arrangement was within the ambit of the section.

The reason why the Court here would not follow the earlier decision of the Privy Council, in its New Zealand jurisdiction, in Europe Oil (N.Z.) Ltd. and the High Court of Australia in Cecil Bros. v. PCT is the subject of a later discussion. Suffice at this point to say that the arguments and conclusions reached in the above two cases were distinguished in Wisheart by all the judges.

Having seemingly established a satisfactory reason for holding that the first two arrangements in Wisheart's case were not ordinary business or family dealing, North P. concludes his consideration of the application of s.108 with the following statement:

"it follows that it must be accepted by the appellants that s.108 has fiscal effect and that it extends to arrangements by which the legal incidence of tax on the taxpayer's income was distributed so that he would be liable to less tax in the future."47

It is submitted that this statement is too broad. By reference to the Newton predication test alone, it is clear that North P., like Kitto, Mclnerman, Owen and Taylor J. in Peate's case, or, Taylor J. in Millard, is effectively ignoring the saving aspect of the Newton test for arrangements which have tax diminution consequences, namely, whether the overt acts of implementation are referable to ordinary business or family dealing. To say that an arrangement cannot be ordinary business or
In this case, a firm of solicitors, with a view to making financial provision for the wives and families of the partners, set up family trusts. The trustee of each partner's family trust acquired shares in a private company (Marlborough). Three arrangements were entered into between the partnership and Marlborough: First, the balance of the lease of the premises of the practice, the plant, equipment and library were all assigned to Marlborough. The non-professional staff were all employed by Marlborough. The partnership then entered into an agreement whereby Marlborough would supply the use of the above items to the partnership. The fee paid for these services was cost plus fifteen per cent.

Second, when the partnership required dictaphones, these were hired to the partnership by Marlborough at the rental of cost plus twenty per cent.

Third, a valuable assurance agency was terminated by the insurance company, and subsequently granted to Marlborough.

North P. in regard to the submission that the transaction was referable to ordinary business or family dealing states: 42

"In my opinion, it is manifest that this unusual and indeed extraordinary arrangement was as the Chief Justice held, "patently a scheme of tax alteration and relief as surprising, when found within the legal profession, as it was bold". 43

Undoubtedly a consequence of the transactions was... to alter the incidence of taxation. But it is respectfully submitted that this in itself was not sufficient to warrant the application of s.108. It is necessary to establish that the "purpose" was tax avoidance. This will be the case if the overt acts of implementation are not referable to ordinary business or family dealing. The consequences in themselves are irrelevant for it is trite, but true, to say any arrangement involving trusts will have some degree of tax diminution consequence. If consequence is relevant, then all trust arrangements must necessarily be void as the use of a trust automatically shifts the incidence. However, it is not the case that all arrangements using trusts will automatically be void.

In considering the first two arrangements in Wisheart, it seems that apart from surprising their Honours, no reason of substance is proffered as to the allowable deduction section, s.51. Waddell J. in the Supreme Court of New South Wales found in favour of the taxpayer under both sections. The judgment, however, dealt principally with the deductibility of the expense incurred under s.51.

It was clear from the evidence, that one of the purposes of the transaction was to reduce income tax. This was stated as one of the two purposes of the scheme contained in the circular forwarded to partners justifying the necessity of the service organisation. The other purpose of the transaction was to remove assets from the partners to minimise the consequences of successful litigation against them.

However, irrespective of the stated intentions of the parties, the Newton test states that a tax avoidance purpose is present if the overt acts of implementation are not referable to ordinary business or family dealing.

The steps of implementation in this case were the establishment of the unit trust, the incorporation of a company and the appointment of that company as manager of the unit trust, the sale of the assets, the transfeining of staff, and the whole transaction whereby all these assets and staff were leased back to the partnership in such a way as to result in no outward change in the workings of the partnership business.

This arrangement as a whole is similar to Peate's case, but different in one essential aspect. Peate's case involved the assignment of a share in a medical practice, a practice that could be carried on by registered medical persons, while in Phillips' case the assets assigned were actual chattels, namely typewriters, books and other office equipment. The legal restrictions on the persons permitted to carry on a medical practice may be the essence of the difference between the normality or ordinarity of Peate compared to Phillips.

However, Phillips went further. To achieve for the assignor a reduction in assessable income, the trust bailed the chattels back to the assignor. It was this bailment back to the assignor, and not the assignment, which effected the reduction in the assignor's income and consequently the tax diminution which may attract s.260 in Phillips' case.
There is therefore a second distinction between Peate and Phillips and that is in Peate it was the assignment of an interest in the medical practice to the trust which without more, effected the reduction in the assignor's assessable income, whereas in Phillips the reduction in the assignor's assessable income was achieved by the bailment back to the assignor.

For the purpose of considering this possibly crucial distinction between Peate and Phillips, it is helpful to classify income-producing assets as either of two types: firstly, assets which of themselves produce income, as for example shares in a company, or business; secondly, an asset the use of which will generate income for its owner. This second category must be broad enough to include such items as typewriters, dictaphones, and bulldozers, as well as stock-in-trade of merchants and manufacturers.

In the case of this second category of assets, income is generated from either the purchase and resale of the chattel, or the bailment of the chattel for rent. Where the transaction is a bailment to a person or entity not associated with the trust, then it may well be that the transaction is normal business. However where the asset is leased or bailed for rent to an associated assignor, then the transaction may not be ordinary family dealing. In New Zealand, it was held in Wisheart, McKay, Lawler, Wells and Udy that the leasing or bailing for rent to an associated assignor was most "abnormal" and "surprising". While in Grierson, Lokker and O'Kane it was quite acceptable.

Unfortunately for New Zealand Phillips did not decide whether the sale and lease-back arrangement was referable to ordinary business or family dealing. Waddell J. saw the central issue being the application of the allowable deduction section, s.51. Waddell J. was of the opinion that even if s.260 did apply, and he was prepared to accept for the purposes of the argument that it did, then there was still no taxable situation resulting which supported the Commissioner's assessment of the partnership without allowing the expenses paid to the trust and deducted by the partnership. He said 75

"So far as this Court is concerned the submission in relation to s.260 is, I think, governed by the decision of the High Court in Cecil Bros. Pty. Ltd."

test. That is, the purpose or effect of the arrangement will be presumed to be tax avoidance unless the steps of implementation are capable of explanation by reference to the ordinary business or family dealing having regard to the ordinary business or family consequences achieved. This approach is demonstrated by the words of the judgment of North P. in Elmiger's 39 case...

"All in all then, I cannot accept for one moment... that this arrangement and the steps taken to carry it into effect, is capable of explanation by reference to family dealing." 40

The President of the Court is saying, in effect, that the applicability of s.108 and therefore s.99 depends upon whether the steps taken to effect the arrangement are capable of explanation by reference to the ordinary business or family consequences achieved.

The Court found in the arrangement in Elmiger's case that the whole transaction and its steps of implementation lacked any explanation by reference to ordinary family dealing. The lack of any real benefaction upon the beneficiaries resulted in the conclusion that the implementation of the arrangement was for the income tax consequences of the arrangement only, and accordingly s.108 applied to avoid the transaction for the purposes of assessing income tax liabilities.

The real confusion in New Zealand has arisen from an incorrect extension of the reasoning of Elmiger, Marx and Carlson. These cases are all examples of the use of a trust to derive income, thereby resulting in tax diminution, without any corresponding permanent benefaction. The reasoning gives no support to hold s.108 would have applied had the assignments been permanent, or had there been a true benefaction.

However, the New Zealand Courts seem to have seen in these three earlier cases a line of reasoning which would prohibit the use of a trust to acquire from a taxpayer any income producing asset, and which would also prohibit any arrangement whereby a taxpayer incurred a bona fide deductible expense in favour of his family trust.

It is suggested that the root of this confusion is to be found in the judgment of the Chief Justice of New Zealand in Wisheart v. CIR. 41
to the statutory restrictions on the carrying on of the business of a pharmaceutical chemist, the transaction in question could not be regarded as an ordinary business or family dealing in relation to pharmaceutical chemists. Gibbs J. supported his conclusion that s.260 applied by referring to the words of Menzies J. in Peate's case at first instance where it was said:

"What outside a profession, might be regarded as an ordinary business transaction may, within a profession have an altogether different appearance." 36

Gibbs J. then referred to Millard's case, and, as if in order to align the decision in that case with that of his own in Hollyock, he drew attention to the statutory restrictions upon the carrying on of a bookmaking business, and by inference (as this aspect was not the basis of Taylor J's decision in Millard) suggested that the decision in Millard was therefore correct as the assigning of a bookmaking business to a company could likewise not be regarded as ordinary business or family dealing. Clearly Gibbs J., in a very similar situation, declined to follow Taylor J's reasoning in Millard without first establishing the statutory illegality as a justification for Taylor J's decision. Gibbs J. was not prepared to find s.260 applied merely because there was a consequence of tax diminution.

If the decision in Millard's case is seen as based on this matter of illegality, on reasoning analogous to that of Gibbs J. in Hollyock's case, then it is submitted that both decisions are distinguishable from Purcell and in accord with the basis of the reasoning of the Newton test.

The question of illegality is the subject of further discussion in connection with two of the latest cases, Bayly v. FCT. 37 and Jones v. FCT. 38 Suffice at this point to note, that apart from the illegality issue, it would have been difficult to find the necessary tortured, artificial, or complex steps of implementation to warrant labelling the transactions in either Millard's case or Hollyock's case as a means to avoid tax.

The New Zealand Authorities

The New Zealand courts have approached the application of s.108 in a manner similar to that propounded here as the correct application of the Newton test. It may be argued that Cecil Bros. Pty. Ltd. 76 is more relevant to the question of the allowability of the deduction to the bailee under s.104 as an expense incurred in the production of assessable income than it is to the question of the ordinaries of the use of an associated trust to derive income that, prior to the assignment of the assets to that trust, would have been assessable income to the assignor. However, Waddell J. argued that even if s.260 applied, it did not give the Commissioner the power to disregard the fact that actual payments had been made. The application of s.260 did not show that the taxpayer's real outgoings were any less than those paid to the trust and claimed by the partnership.

Relying on Cecil Bros. case his Honour held that the application of s.260 here could not be regarded as invalidating the contracts between the trust and the partnership nor as substituting the taxpayer for the trust in the contracts the trust had made with the employees etc. The contracts as made, stand.

The danger of Phillips to New Zealand taxpayers is great. A major difference between the New Zealand and Australian provisions is the New Zealand s.99 (3). In New Zealand having found an arrangement which comes with s.99, that is, is that artificial, unusual or complex as can be said of it that it was not implemented in that particular way for ordinary business or family dealing, but for tax avoidance, then the Commissioner is entitled to 'reconstruct' the incomes of the persons involved to assess the taxpayers on what they would have, or might have been expected to derive if that arrangement had not been made or entered into.

If the situation of Phillips would be found to be an arrangement for tax avoidance under s.99, then the decision in New Zealand on the Phillips facts would undoubtedly have been different than the Australian result.

The question of s.260 versus s.51 in Australia, and in New Zealand prior to the enactment of s.99, was well settled by Cecil Bros. Pty. Ltd. cited with approval in the Privy Council cases in the New Zealand jurisdiction, of Europa Oil (No. 1) 77 and Europa Oil (No. 2) 78.

It is here submitted that there is an essential relevance of the bailment back to the assignor. This relevance is whether the bailment back is
sufficient to tilt the balance towards artificiality of what might otherwise be regarded as ordinary business or family dealing. It was certainly not so sufficient in Grierson, Loader and O’Kane but it was in Wisheart, McKay, Lawler, Wells and Udny. In Phillips, this issue was not taken.

In Phillips, because of the wording of s.260, whether s.260 applied or not made no difference. If s.260 was held to apply it did not give the Commissioner the power to reconstruct the arrangement and notionally affect the income and expenditure accounts of the partnership or the trust. The section only gave the Commissioner the power to avoid, or annihilate the arrangement. This did not alter the fact that payments from the partnership had been made. For this reason, Waddell J. in Phillips was prepared to accept for the purposes of argument that s.260 did apply to the fact situation of Phillips. As stated, the result of applying s.99 in New Zealand is not the same as that of s.260 in Australia. S.99(3) gives the New Zealand Commissioner the power to re-adjust income as he thinks proper. Accordingly, it can be asked, having regard to the differing effects of applying s.99, would a New Zealand Court have found s.99 applied to a Phillips type situation?

It is submitted that the use of a service trust to acquire assets from some unrelated third party does not involve the same issues as the use of that trust to acquire the assets from the taxpayer, which are then bailed to that taxpayer. In the former situation there is no assignment by the taxpayer/bailee, and no diversion to the trust of income previously derived by the assignor/bailee. Although not involving any assignment to the trust by the taxpayer/bailee, such a transaction may be considered as a device to spread income amongst a family unit rather than have the income derived and taxed in the hands of any one member of that family unit and is clearly therefore "tax avoidance" in terms of s.99. However, in these circumstances, it would seem difficult to argue that such an "arrangement" was not ordinary business or family dealing. The allowability of the deduction would therefore be determined by the application of s.104.

In considering the allowability of the deduction under s.104, the major authority is Cecil Bros.Pty.Ltd. v. FC. In that case the taxpayer, a shoe retailer, instead of buying its trading stock of shoes direct from Peate's case and accordingly the reasoning (as distinct from the decision) is considered to be incorrect and inconsistent with the reasoning of the Privy Council in Newton and Mangin.

From the above analysis of Newton's case and the discussion in relation to the decision of the Privy Council in Mangin it can be deduced that a tax diminution purpose or consequence alone, is not sufficient to attract the provisions of s.99. That there did exist consequences other than tax diminution in Millard’s case is clear from the words of Taylor J.:

"[A]ny other effect of the agreement was entirely subsidiary to this." 34

The method of approach deduced from the Privy Council cases of Newton and Mangin, and propounded herein, is that it is not the consequences alone which are the touchstone, it is the purpose or effect as evidenced by the steps or overt acts to implement the arrangement which determine whether the transaction was merely "a means to avoid tax."

Taylor J. proceeded no further than to establish the existence of a tax diminution consequence. It is submitted that had Taylor J. enquired into the complexity of the implementation of the arrangement, his Honour would have had difficulty in showing that the transaction in Millard was at all complex.

The problem is that although it was clear that a consequence of the transactions was tax diminution, in both Millard and Hollyock the steps of implementation were fundamental. However, there is one crucial aspect of the facts of these two cases which requires highlighting. This aspect is that the businesses, the subject of the assignments, unlike graziers in Purcell, were bookmaking and a pharmaceutical chemist respectively and both of which were restricted by statute to being carried on by licensed persons. Taylor J. in Millard’s case chose not to discuss this issue on the basis that he was of the opinion that s.260 applied and this question of statutory illegality was not necessary or relevant to a determination of the applicability of s.260.

Whereas, in Hollyock’s case, Gibbs J. found this question of illegality "an important feature of the case." Gibbs J. also found that due
The application of the Newton test to trusts when personal exertion, the complex transactions of Peate's case resulted.

The application of the Newton test to trusts becomes less clear however when the method of implementation is not unduly tortured, artificial or complex. Two cases which illustrate the difficulties are Millard v. FCT. in the former case, a registered bookmaker sold his bookmaking business to a company, the shareholders of which were the bookmaker himself, his wife and children. The bookmaker agreed with the company that he would thereafter carry on the bookmaking business for and on behalf of the company, and as its agent. In the latter case, the taxpayer, carried on a business as pharmaceutical chemist from a shop in Perth. The taxpayer entered into an agreement whereby he agreed to sell a half share in the business and its assets to his wife. The purchase price was payable to the taxpayer if he demanded it. The deed also provided that the taxpayer would manage the business and hold the assets and income of the business on trust for himself and his wife in equal shares.

Although these cases, but more so Hollyock's case, bear close similarities to Purcell's case, in each case the court came to a contrary result to that reached in Purcell's case.

It was held that the arrangements entered into in Millard and Hollyock were avoided by s.260. Although the decisions of Millard and Hollyock appear contrary to Purcell, it is submitted that the decisions are correct and can be explained by reasoning consistent with that propounded in this paper as being the correct interpretation and application of the Newton test.

Taylor J. in Millard's case founded his decision on the real purpose of the arrangement as it appeared to the Court; namely, tax diminution:

"to my mind it is as plain as it could be that the whole purpose and effect of the agreement was to split the appellant's income into a number of parts in order to minimise the amount of tax which would become payable."33

In other words, Taylor J., having found a purpose of tax diminution, held s.260 applied. This reasoning is very similar to that of Kitto J. in the normal wholesalers, interposed a company (Breckler Ltd.). Breckler Ltd. was owned by the shareholders and relatives of shareholders in the taxpayer company. Breckler Ltd. bought the stock from the wholesalers, added a considerable profit and resold the stock to the taxpayer. The Commissioner sought to disallow the deduction claimed by the taxpayer against assessable income for the cost of the stock to the extent that the deduction represented a profit to an associated trading entity.

The Commissioner argued that the deduction claimed was not allowable under s.104; or alternatively, s.99 applied to reduce the deduction claimed by the amount of the profit derived by Breckler Ltd.

Owen J. at first instance in the High Court, held that s.104 would not prevent the total deduction by the taxpayer of the sums paid to Breckler Ltd. for the stock:

"The fact that the taxpayer paid more for its purchases than it would have had it dealt direct with the manufacturers or wholesalers in order that Breckler Ltd. might make a profit... does not prevent the amount which it in fact paid from being regarded, for the purposes of s.104 as an outgoing incurred in gaining its assessable income."30

His Honour relied upon the earlier decision of Bonplon Tin N.L. v.FCT. 81

where it was stated: 82

"It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income, but only how much he has spent."

On appeal to the Full High Court, Dixon C.J., Kitto, Menzies and Windeyer JJ. were all of the opinion that the deductions claimed by the taxpayer were permitted under s.104. They were not of one mind, though, in regard to the application of s.99 to extinguish any deduction otherwise properly allowable under s.104. However, this aspect of the judgment is the subject of a later discussion.

On the question of the allowability of the deduction against assessable income, the decision in Cecil Bros. was discussed in the Privy Council decisions in CIR v. Europa Oil (N.Z.) Ltd. 83 and Europa Oil (N.Z.) Ltd.
The facts of these two cases were similar. There were however, contractual variations which resulted in the cases being differently decided.

The facts were that a member of the Gulf Group of Oil Companies ("Gulf") entered into a supply contract with Europa Refining Co. Ltd. ("Europa Refining"), a member of the New Zealand Todd group of companies, under which Gulf agreed to supply Europa Refining with all its requirements of semi-refined oil at posted prices. These prices were in accordance with those fixed by agreement between the major international oil companies. The taxpayer company, also a member of the Todd group, then purchased its oil requirements from Europa Refining under separate contracts for each lot. Europa Refining was not a subsidiary of the taxpayer, and neither were the two companies subsidiaries of the same parent company in the Todd group.

In order that the Gulf group should provide the Todd group with an economic concession for its purchases of oil without breaching the system of posted prices by granting a discount, a company Pan Eastern Refining Co. Ltd. ("Pan Eastern"), was formed in the Bahamas. One-half of this company was owned by a subsidiary of the taxpayer and the other half by a company in the Gulf group. Under a processing agreement between Gulf and Pan Eastern, crude oil was sold to Pan Eastern at a certain price. It was then partly refined by Gulf at a price which enabled Pan Eastern to make a sufficient profit so that one-half of the profit would be the amount equivalent to the reduction in price that Gulf would have been prepared to grant to the Todd group on the sale of its oil in the absence of the world price-fixing arrangements.

The significant difference between Europa (N.Z.) Ltd. and Europa (N.Z.) Ltd. (No.2) was that in the earlier situation there was a third contract between the taxpayer and Gulf, called an Organisation Contract, which included a covenant that Gulf would fulfil its obligations to Pan Eastern under the refining arrangements and pay it the moneys due under the Refining Contract. This covenant was in turn dependent on the taxpayer performing its obligation to purchase its oil requirements from Gulf at posted prices. Whereas in the later case, the taxpayer was not a party to any such contract. Further, the taxpayer, was not even contracted to buy its feed stocks from Gulf. All the purchases in the to the synthesis of these cases with each other and more importantly, the key to the applicability of s.99 to any prospective trust arrangement.

While the High Court in Peate's case was unanimous in respect that it found the transactions of that case to be within the scope of s.260, it was Windeyer J. who based this conclusion on what has been submitted as the essence of the Newton test in regard to trusts, that is, a comparative consideration of the steps of implementation of the transaction with the ordinary business or family consequences achieved.

Windeyer J., having acknowledged that several of the consequences of the total scheme could well be explicable as ordinary business or family dealing, proceeded:

"(A) taxpayer may legitimately regard it as a businesslike action so to arrange his affairs in the interest of himself and his family as to reduce his liability for taxes. But that does not mean that whatever method he adopts to that end can itself be said to be explicable as an ordinary business or family dealing putting it outside s.260." 28

In looking at the method the doctors in Peate's case had chosen to provide for their families, Windeyer J. made the following observations:

"the combined and inter-related activities and purposes of (Westbank Pty. Ltd.) and its companion (the family trust company) are certainly remarkable and out of the ordinary."

And further:

"for a medical practitioner to enter into an arrangement to become the paid servant of a company which was to make its business to hire him out as a servant of another company is surely not an ordinary business dealing." 30

It is submitted that the method of implementing the transaction in Peate's case was clearly complex, or tortured, and as Windeyer J. says, could not in any way be regarded as an ordinary business or family dealing. Accordingly, the section applied to avoid the transaction. Clearly then, of the judgments of the High Court, that of Windeyer J. is the only one which correctly applies the Newton test to the facts.

It is further submitted that the complexity of the arrangement in Peate's case resulted from the fact that the major income producing assets of the
the Newton test. When considering a specific submission of the taxpayer relying upon the ordinary business or family effects of the transaction, Taylor J. states:

"It is true, no doubt, that (the transaction) had other ends in view, such as the making of provision for the appellant’s wife and children. But avoidance of tax was the means to these ends and a diminution in the appellant’s tax was not merely an incident of what might be regarded as an ordinary family settlement." 26

On appeal to the Privy Council, their Lordships dealt exclusively with the annihilation effect of the application of s.260. As Lord Donovan subsequently stated in Mangin’s case, in reference to Peate’s case (where he also formed a member of the Board):

"in Peate’s case the Board was simply concerned with the annihilation effect of s.260..." 25

In point of fact, support for the statement propounded herein that Kitto and Taylor JJ while no doubt correct in their decision, were erroneous in their interpretation of Newton is found in the subsequent Privy Council decision of Mangin where Lord Donovan said in regard to the Newton predication test,

"(it) does not mean that every transaction having as one of its ingredients some tax saving feature thereby becomes caught by a section such as s.108. If a bona fide business transaction can be carried through in two ways one involving less liability to tax than the other, their Lordships do not think s.108 can properly be invoked to declare the transaction wholly or partly void merely because the way involving less tax is chosen." 27

This therefore, leads back to the main argument of this paper that, in the application of the Newton test, the test becomes one single question: viz: are the steps of implementation of the transaction capable of explanation by reference to ordinary business or family dealing?

The reference point therefore, in all trust cases where tax diminution is but one of the effects resulting from a transaction, is the term ‘ordinary business or family dealing’. Unfortunately, the meaning of this term, as can be seen from the preceding discussion, is somewhat elusive. It is of vital consequence however, to the rationalisation of s.99 in its application to trusts, that this term be explored further. The interpretation and application of this term in the cases is the key later case were made from Europa Refining under contracts of sale for one or more cargo lots entered into from time to time during the year of assessment.

In considering the application of s.104 in the earlier Europa case, the Privy Council had agreed with the decision of the High Court in Cecil Bros. that it is not for the Commissioner to decide how much a taxpayer should pay for his stock. Lord Wilberforce delivering the decision of the majority of the Privy Council said:

"In their Lordships’ opinion section (104) does not enable the Crown to disallow expenditure genuinely made whenever it can be found that some economic advantage accrues to the trader as a result of making the expenditure...For a claim to disallow a portion of expenditure incurred in purchasing trading stock to succeed, the Crown must show that, as part of the contractual arrangement under which the stock was acquired some advantage, not identifiable as, or related to the production of, assessable income, was gained, so that a part of the expenditure, which can be segregated and quantified, ought to be considered as consideration given for the advantage."

Applying this to the facts, the Privy Council held that the taxpayer acquired by virtue of the placing of the order for stocks, an enforceable right to have payments made by Gulf to Pan Eastern which, being half owned by the taxpayer, amounted to the payment to the taxpayer of one half of that paid by Gulf to Pan Eastern.

It was therefore found, that there was acquired an enforceable right, besides the right to the stock purchased. The provisions of the New Zealand section at that time allowed only the deduction of expenses exclusively incurred in the production of assessable income. Accordingly, the assessment of the Commissioner disallowing the whole deduction was upheld.

In the later Europa (N.Z.) Ltd. (No.2), the Privy Council seized upon the fact that there was no Organisation Contract in that case to find that there was no contractual obligation on the part of the taxpayer to purchase from Europa Refining. Similarly, it followed that there was no contractual obligation between Gulf and the taxpayer, which would warrant the conclusion that the payment by the taxpayer for stock gave rise to a contractual obligation on Gulf to make the payments under the Refining Contract with Pan Eastern.
The judgment of the majority clearly indicates, that in reaching a conclusion different to that of the earlier Board, they have relied strongly on the words of the majority in the earlier decision:

"The Crown must show that as part of the contractual arrangement under which the stock was acquired some advantage was gained." 86

And further,

"Taxation by end result, or by economic equivalence, is not what the section achieves." 87

It is using these words that the majority, notwithstanding that the taxpayer continued to receive the 'rebates', held that the provisions of s.104 applied to allow the total payments by the taxpayer for its oil stocks as a deduction from its assessable income. It is submitted that the majority were in effect saying that there is no legally enforceable contractual arrangement, and the fact that the taxpayer still received the payments, is not relevant in a section which does not tax by economic equivalence.

That the majority in Europa Oil (N.Z.) Ltd. (No.2) have construed the above quoted words of the earlier decision, to arrive at a conclusion different in the extreme from the earlier decision is perhaps best evidenced by the strong dissenting judgment of Lord Wilberforce. It should be noted that Lord Wilberforce was the only judge common to both Boards, and further, it was Lord Wilberforce who delivered the majority judgment in the Europa No. 1 decision.

It is significant for present purposes to observe, however, that Europa Oil (N.Z.) Ltd. (No.2) makes it abundantly clear, that the unanimous decision of the judges in Cecil Bros. was correct in that s.104 will apply to allow the whole of the business expense as a deduction from assessable income, notwithstanding that in making that expense some further benefit was also obtained provided that such further benefit does not arise as part of a contractual arrangement under which some advantage not related to the production of the income is gained. Section 104 does not apply to disallow all or any portion of such payments.

They state clearly that notwithstanding a tax avoiding purpose or consequence, if the way in which the transaction was implemented can be explained by reference to ordinary business or family dealing then the section will not apply. This is quite a different test than that which Kitto J. applied in the above quotation. The basis of Kitto J.'s statement is that not only must the arrangement be "fairly explicable", but also there must be no inference that tax-avoidance was a purpose of the arrangement. As purpose is determined by effect or consequence, Kitto J. is in fact saying that not only must it be fairly explicable, but also effect no tax avoidance. It is submitted that such a test is not only unduly restrictive, but also quite contrary to the Newton test.

The fallacy in the reasoning of Kitto J. lies in his limiting the exclusion from the avoiding effect of s.260 to those arrangements where no inference can be drawn that tax avoidance was a purpose of the arrangement.

The result of the reasoning of Kitto J. is that any arrangement which has the purpose or consequence of diminishing tax is within the section.

It is submitted this cannot be correct. Even at the time of this judgment there were cases and decisions which gave the lie to such a conclusion. Purcell's case is support for the proposition that certain situations, which, even though they effected a reduction in taxation, were acceptable as legitimate transactions. The Privy Council itself in Newton's case cited W.P. Keighery Pty. Ltd. v. F.C.T. 24 and Purcell's case as examples of transactions of which it could not be predicated that they were for the avoidance of tax, even though an effect of the transactions was the diminution of tax payable.

It is suggested that like Mangin's case, Elsmiger's case and the Marx and Carlson cases, the approach of Kitto J. in Peate's case is another example of a court or judge, while purporting to follow the original Newton test, restates or redefines that test, then subsequently reaches a conclusion, the reasoning for which bears no resemblance to the reasoning of the original Newton test.

Taylor J. in Peate's case, also found it more convenient to rely upon the tax diminishing consequence of the arrangement to hold that s.260 applied, than to grapple with the "ordinary business or family dealing" aspect of
neglected any reference to the term 'ordinary business or family dealing', and in so doing, it is submitted, set the course for a decision, while in itself not incorrect, is not capable of proper rationalisation with the predication test as stated by Lord Denning.

Kitto J. correctly states that the Newton test makes it clear that the question whether an arrangement has or purports to have the purpose or effect of avoiding a liability to tax under the Act is a question as to the purposes or consequences of the arrangement itself, rather than of the purposes in the minds of the parties. That is to say it is:

"whether, upon consideration of the overt acts which have been done in carrying out the plan the arrangement is to be recognised as a means for the avoidance of a tax liability, whether or not it be a means to other ends also."

Secondly, Kitto J. identified the several purposes and consequences of the transaction, "some of them unconnected with taxation." Then followed what should have been the ratio of this judgment, at least, in so far as the issue of whether s.260 was applicable to the facts of the case:

"But the question remains, whether the overt acts that were done under the plan are fairly explicable without an inference being drawn that tax-avoidance is a purpose of the arrangement as a whole."

Having identified the issue, he should have simply concluded that the overt acts were not so explicable and accordingly s.260 would apply. But no, the learned Judge went further, and appears to have decided the case not in relation to the overt acts, but on the fact that the overt acts had as one of their results the reduction in tax. Kitto J. seems from the following words to prefer to rely on this aspect to find s.260 applied:

"purpose of providing for the doctors' families, and doing so quite honestly...but what was equally evident was a purpose of doing so by a method which will direct income away from the participating doctors...to the end that a substantial part of the tax might be avoided. The case falls within the annihilation of s.260."

It is suggested here that Kitto J. was wrong in finding s.260 applied for this reason. The words of the Newton test are quite clear.

The Commissioner therefore, must succeed under s.99, if he is to be successful in preventing the situation of service trusts deriving profits from the allowable business deductions of trading entities.

The Avoidance of Service Trust Arrangements

The Australian Section 260 was argued by the Commissioner in support of his assessments in Cecil Bros. However, on appeal by the taxpayer from the decision of Owen J.; Dixon C.J., Kitto, Taylor and Windeyer JJ, were of the opinion that, once a deduction was allowable under the Australian equivalent of s.104, there was no way s.260 could be invoked to extinguish the deduction.

The application of s.260 was considered only by Owen J. at first instance in the High Court, and Menzies J. on appeal. Owen J. said:

"Section 260 is being called in aid to reduce the amount of the taxpayer's outgoings and thus increase its taxable income, but I can see no reason why it should not be invoked for that purpose." 88

His Honour then proceeded from the Newton test to say that:

"if what is done does not fall within (the description of ordinary business or family dealing) and tax is in the result avoided, the section operates." 89

Owen J. relied upon the:

"relationship between the two companies and their directorates and shareholders" 90

to hold that the arrangement could not reasonably be explained by reference to ordinary business or family dealing.

Menzies J. was also of the opinion that, notwithstanding the validity of the deduction under s.104, if the circumstances so warranted, s.260 could apply to reduce the amount of the taxpayer's outgoings. His Honour then examined the result of applying s.260. The assessments the Commissioner sought to justify by the application of s.260, were assessments of the taxpayer, Cecil Bros. Pty. Ltd. of the amount of profit made by the related intermediary Bred'ecler Ltd.
"This means s.260 has been regarded as a warrant for disregarding part of the price actually paid pursuant to contracts, the validity of which remains unaffected." 91

Menzies J. was of the opinion that the assessment was an attempt to use s.260 to reconstruct or modify, when its sole function is to destroy. His Honour did not see it as necessary to decide whether s.260 applied, he was satisfied to state that the application of s.260 could not support the assessments of the Commissioner, and accordingly he allowed the appeal of the taxpayer.

Due to the inclusion of s.99(3) in the New Zealand legislation it is suggested here that if s.260 did apply to the facts of Cecil Bros. and it would seem that Owen J. was of the opinion that it did, then s.99 would have supported the Commissioner's assessment of Cecil Bros. Pty. Ltd. of the profit derived by Breckler Pty. Ltd.

In New Zealand the first case where business deductions to a related entity was at issue was Wisheart. In Wisheart the court had to determine whether payments made by a law practice to a company owned by the family trusts of the partners in the law practice were allowable deductions in calculating the assessable income of the practice. In Wisheart there were three arrangements. One of these three arrangements is particularly relevant here. It involved an agreement to lease dictating machines from the family controlled company at a profit of twenty per centum to that company. The taxpayers relied on Cecil Bros. to submit that s.108 could not apply to avoid an expense properly allowable under the then s.111.

North P. summarises the situation succinctly when he points out that:

"a majority of the members of the High Court appear to have been of the opinion that the Australian equivalent of our s.108 could not be invoked once the item of expenditure was shown to be deductible under s.111...in the Europa Oil case, their Lordships were at pains to reserve their opinion whether this second conclusion reached in the High Court of Australia was correct." 92

His Honour found nothing in the Europa Oil case to support the submission of the taxpayer that s.108 could not apply. North P. finally rejected this submission with the words:

"I am not in any way persuaded that the Cecil Bros. case was correctly decided on this point." 93

However, it can be seen from the above quoted passage of the dissenting judgment of Issacs J. that the actual nature of the benefaction in Purcell's case was similar to that of the New Zealand cases, and had the Newton test as restated here been applied, it might well have been decided that the method of implementation was not ordinary business or family dealing.

Possibly the most authoritative post-Newton decision in regard to trusts is Peate's case 17 which subsequently went on appeal to the Privy Council. 18

The discussion of the term 'ordinary business or family dealing' in the context of the Newton predication test was however limited to the High Court of Australia, in particular Menzies J. at first instance and Windeyer J. on appeal. The Privy Council debate centered almost exclusively on the question of annihilation. 19

In Peate's case a group of doctors were practising in partnership. The partnership was dissolved and a company A.E. Westbank Pty. Ltd., was formed having as one of its objects to carry on the business of providing medical, surgical and hospital facilities and services. Each doctor then incorporated a family company and each established a family trust, the trustee of which was the respective family company. The doctors were directors of A.E. Westbank Pty. Ltd., and the family trusts were the beneficial owners of the shares in that company. The doctors, of which the appellant was one, then sold their interests in the goodwill and other assets of the old partnership to their family companies which in turn contracted to supply medical services for the use of A.E. Westbank Pty. Ltd. The doctors themselves, having entered into service contracts with their family trusts performed the medical services required as 'employees' of the respective trusts. In this way each doctor substantially reduced his personal income in favour of his family trust. Accounts for the medical services performed were sent on the doctors' stationery. The moneys were received by the doctors, who then paid it to A.E. Westbank Pty. Ltd. All expenses of the practice were met by A.E. Westbank Pty. Ltd., and the net income paid to the family companies, which in turn paid each doctor his contractual salary. The balance remaining thereafter being held by each respective family company as trustee for the wives and children of the doctors.

In the High Court of Australia, Kitto J. with whom McTiernan and Owen JJ. agreed, restated the Newton test. Unfortunately, the restatement
However it is the opinion of this writer, that such difficulties as the reconciliation of the cases and the prediction of the applicability of s.99 can largely be overcome by the application of the test derived above to the fact situation in question.

To test the validity of this restatement of Newton, it is now proposed having analysed some of the New Zealand cases, to analyse a few of the more important Australian decisions.

The Australian Authorities

The first major judicial consideration in Australia of the application of the Australian equivalent of the former New Zealand s.108 to trusts was in PT v. Purcell. In this case, as already noted, the High Court agreed that the section was not to prohibit the disposition of property. The purpose of the section was to avoid contracts which placed the incidence or burden of tax upon some person other than the person contemplated by the Act.

If the Newton test as explained in this paper were applied to the facts of Purcell, it is suggested that the result obtained may well have been to avoid the transaction. To this extent Purcell is the only case that can not be reconciled by the application of this restatement of the Newton test. Although the declaration of trust did not affect the provisions of s.260, the provisions of the declaration in Purcell were of such a nature as to lead Issacs J. in Purcell v. PCT to the conclusion that:

"what the declaration gives, it assumes to take away. It purports to create rights, and then immediately to deny any obligation to observe them... As a mass, the provisions of the declaration are repugnant to the gift regarded as a gift of shares in the business assets themselves." 15

The subject of that particular decision was whether the declaration of trust executed by Purcell was a bill of sale within the meaning of the Bills of Sale Act 1891 (Qld.), and being unregistered, was it void? The Court was not called upon in that decision, to decide the applicability of s.260.

Similar judgments were delivered by the remaining two judges in the New Zealand Court of Appeal, Turner and Haslam JJ.

Although each of the three judges said it was not necessary to distinguish Cecil Bros. from Wisheart, each judge stated that such a distinction could possibly be found in the words "genuinely paid out". It was unanimously suggested that perhaps the High Court saw the payments by Cecil Bros. Pty. Ltd. to Breckler Ltd. as 'genuine': a description their Honours were not prepared to extend to the payments in Wisheart.

However it is submitted firstly, that there is in fact little, if any, difference between the payments in Cecil Bros. and those in Wisheart; and secondly, this so-called distinction was purely a political tactic to avoid the necessity to reject outright the decision of the Australian High Court. From the facts of the cases, the payments in Wisheart were no more or less genuine than those in Cecil Bros. The Court of Appeal decision that s.108 applied was unanimous. As North P. concludes:

"The inference is irresistible that the 'arrangement' in the present case was 'implemented in that particular way so as to avoid tax'. It is plain that the transaction is 'incapable of explanation by reference to ordinary business or family dealing without necessarily being labelled as a means to avoid tax'." 16

North P. proceeds to comment on the result of the application of s.108. While the Commissioner had only reassessed the taxpayer to include in the assessable income of the taxpayer that portion of the payment which was profit to the service company, his Honour points out that there is no authority for such action. As s.108 applies to avoid the arrangement involving the lease of the dictaphones the Commissioner was therefore in a position to disallow as deductions, not just a part of the payments, but the full payments made by the taxpayer for the dictaphones. The remaining judges were in agreement with this conclusion.

The difference between Wisheart and Cecil Bros. is the result of applying s.108. Wisheart may well be wrong on the reconstruction issue, or the result of applying s.108, but due to s.99(3) that is now irrelevant.

But as regards the applicability of s.99 to business deductions the New Zealand Court and two of the Australian judges were all prepared to accept that notwithstanding the legitimacy of the business expense under s.104,

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s.99 could still apply to any scheme whose steps of implementation were not referable to ordinary business or family dealing.

It can be seen therefore that at the time of Wisheart there were two schools of thought as regards the application of s.108 to avoid what would be otherwise a valid deduction of expenses under s.104 against assessable income. In Australia, in the High Court in Cecil Bros., three judges had expressed the opinion that s.260 had no application in such an instance, while Owen and Manzies JJ and, in New Zealand, the Chief Justice, and the full Court of Appeal had all held the section applicable proceeded to apply s.108.

Before proceeding further, it is imperative to examine the consequence of the issue that was being discussed in Cecil Bros. It was not just whether s.108 would apply to avoid a deduction properly allowable under the then s.111. The issue hit at the very existence of s.108. The section, widely drawn, is worded so that its net overlaps many of the specific provisions of the Act. It could be argued by taxpayers that where a transaction is subject to the charges to tax imposed by a specific provision of the Act, then s.99 can not operate. Tax is liable without more. That is, the section operates only where a particular transaction escapes the specific provisions of the Act. The very wide operative words of s.99 must draw on the norms created by decisions interpreting and giving context to the specific provisions to define the liability and, therefore, the degree of circumvention of them. Viewed statically, s.99 is either completely tautological or it must invariably give way to specific provisions. Viewed in a dynamic sense, it is an integral part of the process of creating and revising norms construing the specific provisions of the Act.

The problem with applying s.99 to disallow deductions properly allowable under s.104 is that to do so, is to impose on s.104 deductions, the criteria of s.99. That is, the present wide penumbral area of s.104 would be reduced to allow only those deductions that were incurred under a contract, arrangement or transaction referable to ordinary business or family dealing, and not implemented in that particular way so as to avoid tax.

It is submitted however, that this would not be an unduly restrictive test as it is suggested that it was the intention of the legislature notwith-
The Court here made a close analysis of the consequences of the transaction. These consequences were (i) that the trustees retained the possession of a paddock for only one year, (ii) that there was therefore a continual rotation resulting in no lasting benefit, and (iii) that income which would have otherwise been derived by the father, settlor, was derived by the trustees. It was this continual rotation of paddocks which "made this kind of transaction one particularly unfit to be the basis of a family trust." It was not that the income was derived by the trustees rather than the settlor, which was unacceptable, but that the method chosen by the taxpayer to implement this result was not considered to be ordinary family dealing. The Court was of the view that the method of implementation gave no actual benefit to the beneficiaries, and the method therefore was not referable to ordinary family dealing.

A similar approach to the term "ordinary family dealing" had been taken by the New Zealand Court of Appeal in Elmiger v. CIT. In that case the business was that of agricultural contracting. The nature of the business necessitated the use of heavy earthmoving machinery. The owners of the business, two brothers, established a family trust for their respective families, appointing the one the trustee for the other and vice versa. The equipment was acquired from the business by the trustees, and then leased back to the business. The business, in addition to a rental, was to bear all the expenses in running and maintaining the equipment that it had theretofore paid. The trustees under the deeds of settlement, had very wide discretionary powers in respect of the machinery. Furthermore, upon the expiration of a certain period of time, the capital of the trust, which would have essentially been represented by the machinery, was to revert to the trustees for themselves. North P. in determining the application of s.108 to the facts said:

"The facts speak not in a whisper, but in a loud and clear voice. There was no change in the practical operation of the partnership business, the same plant and equipment were used throughout. At the end of the stipulated period the remaining capital of the trust reverted to the appellants...All in all, then, I cannot accept for one moment... that this arrangement, and the steps taken to carry it into effect, is capable of explanation by reference to family dealing." 11

Although North P. does not expressly elucidate the meaning of the clause "capable of explanation by reference to family dealing", it is suggested standing the specific provisions of the Act, that s.99 should apply to those arrangements or transactions which are artificial to the extent that they are contrived, not for ordinary business or family consequences, but for the specific purpose of circumventing a charging provision or taking advantage of a deduction provision. Seen in this way, s.99 can perform the role of policeman.

It is against this background, that the Privy Council decided Europe Oil (N.Z.) Ltd. (No.2). Lord Diplock, delivering the judgment of the majority, held that it was incompatible that s.108 could apply to a deduction properly allowable under the then s.111. In so doing, the Privy Council upheld the decision of the majority of the High Court in Cecil Bros.

The majority were of the opinion that the case was on all fours with Cecil Bros. Lord Diplock quoted 95 with approval the statement of Owen J. 96

"It is not for the Court or the Commissioner to say how much a taxpayer ought to spend in obtaining his income."

To this statement the Privy Council added: 97

"It is not for the Court or Commissioner to say from whom the taxpayer should purchase the stock in trade acquired by him for the purpose of obtaining his income."

The majority of the Privy Council held: 98

"Finding that the monies paid by the taxpayer company to Europa Refining is deductible under s.104 as being the actual price paid by the taxpayer company for its stock in trade under contracts for the sale of goods entered into with Europa Refining, is incompatible with those contracts being liable to avoidance under s.99."

A further reason for the decision of the majority is apparent from the words: 99

"In order to carry on its business of marketing refined petroleum products in New Zealand the taxpayer company had to purchase feedstocks from someone."

100
It is submitted that such a cavalier approach goes to the very heart of s.99. The Privy Council in three sentences, in relation to the conflict of ss.104 and 99 stated that unless there is some contractually bound benefit acquired, which is of a capital or non-revenue nature, any payments made for trading stock no matter how made, to whom, or for how much, are not subject to the application of s.99. Suffice to say at this stage, the Privy Council gave no reasons, nor did it discuss the overall applicability of s.99 to the specific sections of the Act.

Further, notwithstanding that the Privy Council in Europa (No.2) was sitting in its New Zealand jurisdiction, no reference was made to the earlier decision of the New Zealand Court of Appeal in Wiseheart.

It is respectfully submitted that the Privy Council missed the point of Newtons case. That is, that unless the arrangement is explicable as ordinary business or family dealing, it is avoided by s.99. The fact that the arrangement involves making deductions under s.104 is not at all relevant to the essential test of whether the method of implementation is ordinary or otherwise.

Accordingly, it is submitted that this aspect of Europa Oil (No.2) is not helpful. The law is perhaps better understood in terms of the subsequent judgment of Waddell J. in Phillips where he saw the Europa Oil cases and Cecil Bros. as saying that even if s.260 did apply, it did not permit the Commissioner to reconstruct the deductions properly allowable under s.104. Due to the words of s.99(3) this is not now the position in New Zealand and it is submitted that the fundamental test here in regard to allowable deductions is the question of the acceptability of the steps of implementation of the arrangement as ordinary business or family dealings. Recalling that the facts in Cecil Bros. were held by at least two Judges to not be ordinary, should cause taxpayers in New Zealand to pause before entering into transactions involving several trusts or companies.

The recent New Zealand decision of Halliwell v. CIR 101 is of particular interest. Essentially, the case involved a dentist who formed a family trust to which he sold all his plant and equipment. Thereafter the trust leased back to the taxpayer the same plant and equipment.

Secondly, there is no ascertainable or definable norm or reference point.

Is it ordinary business to sell an income producing asset to a trust?
Is it ordinary business or family dealing to lease an income producing asset or for a trust to employ the settlor as a farm-hand, consultant or manager?

The courts have often found it more convenient to say what is not ordinary business or family dealing than to attempt any all encompassing definition. This was the approach of the New Zealand Court of Appeal and the Privy Council in Margin v. CIR.7 There the trust scheme involved a father (taxpayer) who had until the date of the scheme, owned and farmed his farm. The taxpayer then leased a particular paddock, or paddocks, to the trustees of his family trust. The lease permitted the trustee to crop and market all that which the paddocks the subject of the lease produced during the period of the lease. As was usual in 'paddock-trust' schemes, the taxpayer was employed by the trustees, to crop and market the produce for the trustees. In this case the taxpayer actually collected the proceeds of sale of the crop and paid them to the trustees as income from the farming activities of the trustees. The Commissioner relied on s.108 to treat the sale of the crop as income of the taxpayer. In so doing the Commissioner was ignoring the lease to the trustees, and the contract of employment of the taxpayer with the trustees. Turner J. in analysing these facts, decided that there was no ordinary family dealing, as the beneficiaries of the arrangement received no actual benefaction.

On appeal, the Privy Council quoted with approval the following portion of the judgment of Turner J. in the New Zealand Court of Appeal:8

"It was an essential part of this scheme that while the lease of the wheat paddock was for one year, in the following year another paddock was to be leased - and again another the following year. It was the rotation of crops, of course, which made this kind of thing necessary - but which at the same time made this kind of transaction one particularly unfit to be the basis of a family trust providing assured regular income for its beneficiaries. I cannot think that successive one year leases of that particular paddock of the farm which by crop rotation happened to be the wheat paddock can be described as an ordinary family dealing..."
An arrangement will be presumed to be implemented in a particular way so as to avoid tax, unless the steps of implementation are capable of explanation by reference to ordinary business or family dealing.

It is submitted that these propositions can be conveniently restated in the following statement.

"To determine whether purpose or effect was tax avoidance one must analyse the method of achieving the purpose and if the method (as distinct from the intention) is not referable to any business or family dealing, then the arrangement will be avoided."

Trusts

Where does the above restatement leave trusts in relation to s.99? When will the section avoid the use of trusts for income spreading (and therefore tax diminution) activities effected by the disposition of assets to or the acquisition of assets by the trust; or the use of a trust to receive what are business deductions to the principal income earner?

From Purcell's case where a grazier declared himself trustee for himself, and his wife of his business as a grazier, it is clear that the mere disposition of income producing property to a trust, will not, without more, attract the avoiding provisions of s.99. The problem is, what other components of any trust arrangement will invoke the avoiding provisions of s.99?

The key concept therefore, is that of ordinary business or family dealing. However, the meaning of this phrase is difficult to ascertain. The phrase has been used and abused by both judges and writers. But a close analysis of the cases will elucidate some general principles and guidelines.

Ordinary Business or Family Dealing

Notwithstanding the wide acceptance and purported application of the Newton principles, the meaning of the words ordinary business or family dealing remains unclear. The concept of categorising business or family dealings as ordinary or otherwise is difficult to apply.

First, what is 'ordinary' at one point in time, may not be categorised as such at another point in time.
The Choice and Antecedent Transaction Doctrines

If one looks at the three Australian decisions Patcorp, Mullens, and Slutskin, there are to be found dicta statements in each which give support to the existence of the above theories. First, that where a taxpayer structures himself to take advantage of a specific provision of the Act, then s.99 has no effect - referred to as the 'choice' principle. Secondly, that unless there was an antecedent transaction to the one under attack by the Commissioner which, when the one under attack is avoided, leaves the taxpayer with assessable income, then s.99 would not apply - referred to as the antecedent transaction doctrine.

Patcorp was a dividend stripping operation whereby Patcorp entered into an agreement to buy the whole of the issued capital of the company to be stripped. The operation was that Patcorp buy the shares, receive the dividend, and collect the dividend rebate allowable, and the loss on sale of the 'stripped' shares allowable to Patcorp as a share-trader.

The High Court of Australia held that the fact that Patcorp was not registered as a shareholder at the time of the dividend did not deny it shareholder status if it was in fact the owner of shares and was subsequently registered as such. Furthermore, subject to s.260, Patcorp was entitled to a deduction under s.51 in respect of the expenditure incurred in the purchase of the shares. In regard to s.260, Gibbs and Jacobs JJ (with whom Stephen J. agreed) held that s.260 did not apply to a taxpayer who was entitled to rebates in respect of dividends simply because he arranged to receive dividends. Gibbs J. says:

"..."an arrangement whose purpose is to reduce the amount of tax that a taxpayer will have to pay is not necessarily an arrangement whose purpose is to avoid a liability to tax..."

His Honour proceeded to find that in this case there was no arrangement:

"whose purpose was to avoid tax. The purpose was to buy, and later resell, shares the dividends from which would be rebateable."

However, his Honour came to this conclusion after stating that s.260 did not prevent taxpayers from arranging their affairs so that income that behind the Newton test was that unless the proponent of the arrangement could come up with no other purpose for the arrangement than a reduction of tax (a situation difficult to imagine existing in reality), one did not look at the purposes or effects of the arrangement (whether ordinary business or otherwise), but one looked at the overt steps of implementation to determine whether the purpose was "tax avoidance". Under this former test it was the steps of implementation that one had to refer to ordinary business or family dealing, NOT the purpose of the arrangement. Surely this is exactly what s.99(2)(b) says? It says not to look to justify the arrangement by showing one of its purposes or effects relates to ordinary business or family dealing. If one purpose (irrespective of any other purpose) is tax avoidance, then s.99 will apply. This is then in fact a restatement of s.99(2)(a) excluding though as not relevant, any question of second or other business or family purposes. One is left then with deciding when is a purpose of a transaction "tax avoidance" which, due to the definition of "tax avoidance", is the same question as was asked under the former s.108 (and the Australian s.260) the answer to which was set out by the Privy Council in Newton's case.

It is submitted here that the words of that test crucial to this issue are the following:

"irrespective of the motives of the perpetrators"...

and,

"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".

To this writer the test to be applied can be set out in three propositions:

(a) That the "purpose" of any arrangement is to be ascertained by a consideration of the consequences of that arrangement, rather than by any consideration of the intentions of the perpetrators at the time of effecting the arrangement;

(b) The section will apply to avoid an arrangement if from a consideration of the steps of implementation of the arrangement, it can be said that the arrangement was implemented in that particular way so as to avoid tax;
(b) directly or indirectly relieving any person from liability to pay income tax. These two sub-paragraphs when read with s.99 (2) could be rewritten as every arrangement shall be void as far as, directly or indirectly, its purpose or effect is to in any way alter the incidence of income tax, or relieve any person from his liability to pay income tax. If it is accepted that this is an accurate restatement of s.99 2(a) (incorporating the definition of "tax avoidance" in s.99 (1)(a) and (b)) then, to this point, it must be accepted that the 1974 amendments achieved no significant alteration to the then s.108 for the above restatement is in fact a very close paraphrasing of the former s.108. Any changes resulting from the rewriting of the section must therefore be contained in either s.99(1)(c) or s.99 2(b).

S.99 (1)(c) includes in the definition of "tax avoidance" the avoiding, reducing or postponing of any liability to income tax. It is helpful to recall that prior to 1916 the predecessor to s.108 was very similar to the present Australian s.260 and specifically included 'defeating, evading or avoiding'. The 1916 restatement of s.108 omitted these aspects and this point was the subject of judicial examination in Marx v. C.I.R. and Carlson v. C.I.R. where North P. said after examining the words of the former section, the Australian section and the then s.108, that the difference in the language did not have any great practical significance. Again, to this second stage it must be conceded that the new wording of s.99 effected no significant change in the former s.108 and the test formulated in Newton's case would still be the test to determine the application of s.99.

If there is any change arising from the 1974 restatement, then it must be in s.99 (2)(b). This sub paragraph says that where an arrangement has two or more purposes or effects, then if one of those purposes or effects is "tax avoidance", as defined, then the agreement is void irrespective of whether there is any other purpose or effect referable to ordinary business or family dealing. Is not this a restatement of s.99(2) (a) with the addition that because there is another purpose or effect (other than "tax avoidance") this is no reason for the non-application of s.99? If so, then there is again no departure from the former s.108 for in the application of that former provision (per the Newton test) having a purpose other than tax avoidance was never a saving factor. Clearly the reasoning they received would include dividends the subject of a rebate. In other words, where the Act gives a taxpayer the choice or the opportunity to structure his affairs in a particular way, then s.260 can not be invoked to deprive the taxpayer of the benefits of that choice. This is called the choice theory.

This 'principle' was first enunciated in the High Court of Australia in Keighery Pty. Ltd. v. FTC. This case involved the avoiding of the liability for tax on retained earnings of a company imposed by Division 7 of the Act. The taxpayer company was a dividend repository company. To avoid the provisions of Division 7 of the Act, the company issued twenty redeemable preference shares, one each to twenty persons. These preference shares had voting rights, and a right to a very minor dividend. The company had the right to redeem these shares, except during the period from 24th June to 7th July. It was this restriction on redemption which purported to give the company its public status for the purposes of Division 7. However the Commissioner assessed the company as a private company, maintaining that the issue of the preference shares was void as an arrangement to avoid tax.

The majority, in a joint judgment, said in regard to the applicability of s.260 to the arrangement:

"the section is...not to deny to taxpayers any rights of choice between alternatives which the Act itself leaves open to them."

Further, in holding that s.260 did not apply, the majority were of the opinion that the taking of measures to ensure a particular status of the taxpayer:

"cannot be to defeat, evade or avoid a liability imposed on any person by the Act or to prevent the operation of the Act."

This decision of the majority was approved in the Privy Council in Newton's case.

The decision of the High Court in Keighery, was followed by the High Court decision in FTC v. Casuarina. In this case, by the issue of 51 redeemable preference shares in the taxpayer company to a group of interlocking subsidiaries of two public companies, the taxpayer acquired
the necessary status of a public company. The right to redeem the preference shares was not exercisable between the 24th June and the 7th July. That is, for one week on either side of the tax year the taxpayer was, for the purposes of Division 7 of the Act, a public company.

On appeal to the full High Court from the decision of Windeyer J., the leading judgment was delivered by Walsh J. with Barwick C.J., Owen and Gibbs JJ. all writing short concurring judgments. McTierman J. dissented.

Walsh J. analysed the actual steps of the transaction, and concluded that the critical step for the purposes of tax avoidance was the allotment of the preference shares. If s.260 applied to avoid this allotment, the result would be that the taxpayer would have remained a private company and incurred the appropriate tax liabilities to that class of company.

Walsh J. was emphatic that it was not the function of s.260 to avoid the steps taken by a taxpayer to place himself within any particular class or category. He relied on Reighery's case to hold that the right to choose the category is a right given the taxpayer by the Act. Further, it is a right which should be taken away by s.260.

Accordingly, notwithstanding that the steps which have placed the taxpayer company in another tax category have also effected a tax diminution, s.260 was held not to apply.

It is submitted that in reaching this conclusion his Honour did not give the consideration necessary to the application of the Newton predication test. It was found as a fact, that the holders of the preference shares had come to an "understanding" that there would be no interference in the affairs of the taxpayer. The question therefore to be asked, and which was asked in the dissenting judgment of McTierman J., for what purpose other than to achieve the public company status for tax diminution reasons, would any shareholder subscribe and be content with a fixed preferred interest of fifty one dollars in a company capital of $12,200.007?

Clearly, such action is not capable of explanation as an ordinary business dealing. It was for this reason that McTierman J. found in the minority that s.260 applied. However, Walsh J. does not seek to rely upon the Newton predication test, his Honour points out that immediately after the method of implementing the transaction which attracted the provisions of the Australian s.260 and the New Zealand predecessor to s.99.

The question then became what methods of implementation are permissible? It is submitted that the Privy Council has provided within the Newton test itself the answer to this enquiry.

The methods of implementation which are not allowed are those which it can be predicated that their purpose was tax avoidance. The Newton test directs that we predicate a purpose of tax avoidance to any method of implementation which is artificial or unduly complex, to the extent that it is not referable to the implementation of ordinary business or family dealings of the same consequence.

Newton's case invokes as a test the ordinary business or family dealings as to the artificiality of the method of implementation of the transaction in question.

"So as to avoid-tax"

The section avoids transactions which not only have the effect of avoiding taxation, but also the effect of altering the incidence of tax or relieving any person from any liability to pay income tax. It can therefore be said that the section is not aimed only at arrangements which effect total tax avoidance but also at any arrangement which effects any diminution in the tax that would otherwise have been payable and is not capable of explanation as ordinary business or family dealing.

The mere fact that a transaction effects a tax diminution is not sufficient to warrant application of the section. The transaction must have been implemented in that way "so as to avoid tax". The essential aspect of the Newton test is that it predicates such a purpose to any transaction where the method of implementation is not capable of explanation by reference to ordinary business or family dealing.

It is at this stage necessary to analyse the effect of the 1974 New Zealand legislative changes to s.108 in enacting what is now s.99 of the Income Tax Act 1976. S.99(1) defines "tax avoidance" to include (a) directly or indirectly altering the incidence of any income tax; and...
In Purcell's case the owner of certain pastoral holdings declared himself a trustee of them for himself, his wife and his daughter equally, but reserved to himself very wide powers of management, control and investment. Notwithstanding the tax diminution effects of the arrangement, it was held that the declaration created a trust which was valid and binding and not affected by the provisions of the predecessor of the Australian s.260.

How can the apparent conflict between the plain meaning of the words of s.99 and the Australian decision in Purcell's case be resolved? It can only be in the construction of s.99.

The leading authority attempting such a construction of the meaning of the words of the section, was the Privy Council decision of Newton v. FCT.² Although concerned with the application of the section to a dividend-stripping operation, the Privy Council underlined the potential impasse that a literal interpretation of s.99 would cause, and therefore set about construing a general test for the application of s.99 to all arrangements which had the effect of diminishing tax payable.

The section, as Lord Denning says:³

"is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only the means which they employ to do it... In applying the section you must, by the very words of it, look at the arrangement itself, and see which is its effect - which it does - irrespective of the motives of the persons who made it... In order to 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... The section can still work if one of the purposes was to avoid liability for tax... The section distinctly says 'so far as it has' the purpose or effect. This seems to their Lordships to import that it need not be the sole purpose."

"Implemented in that Particular Way"

The Newton test specifically directs the application of the section to the overt acts by which the arrangement is implemented. It is the enunciation of this test, Lord Denning, specifically approved the decision in Keighery. Walsh J. thereby infers that the Newton test is an alternative test to the earlier choice-principle propounded in Keighery. This approval by the Privy Council in Keighery, together with the number of judges in Casuarina approving the reasoning of Keighery, rather suggests that to attempt now to mount an attack on the "choice-principle" by directing criticism at these two High Court judgments would be unproductive. It is suggested that as an alternative to criticising the reasoning of the High Court in these two earlier decisions, the illustration of the absurd consequence of unquestioned appliance of the choice-principle may possibly be the most effective criticism of that principle.

This criticism is based on an overall view of the charging to tax function of the Act as a collection of charging provisions, each specifically charging to tax certain defined classes of income. In the sense that certain "income" not within a particular charging provision will not be liable to tax under that provision, the Act can be viewed as granting a whole series of choices. That is to say, a taxpayer may choose to which charging provision he shall subject his income by deriving that income in a particular manner or through a particular structure. It would be equally arguable on the reasoning of the "choice-principle" that such a taxpayer, by deriving the income in a particular manner or through a particular structure, is permitted therefore to "choose" to circumvent totally all the charging provisions of the Act. Seeing the specific provisions in this way makes it clear that the application of the "choice-principle" to s.260 will render s.260 inoperative. The reasoning of the court in Keighery gives no operation at all to s.260. However, it is one of the canons of statutory interpretation that any interpretation of a statute must be such as to give that legislation some fair meaning. For this reason it would seem that, while the "choice-principle" has been accepted by the courts, it can only be accepted with limitations. The question therefore becomes; what are these limitations? It is submitted that whatever these limitations are, the same limitations must also apply to the very wide statement of Lord Diplock in Europa Oil (No.2) that;⁴

"finding that the monies paid...is deductible under s(51)...is incompatible with those contracts being liable to avoidance under s.(260)."
This statement is Privy Council recognition that, having found that the particular payments came within a specific provision of the Act, it was not then open, for whatever reason, to attempt to avoid such payments under s.260.

It is submitted that the basis of any limitation on the "choice-principle" is the words of the majority judgment in Keighrey where it was said in regard to the function of s.260:

"the section intends only to protect the general provisions of the Act from frustration..."

It is further submitted that the reference to the protection of the general provisions of the Act, must refer to the protection of the policy behind each of the general provisions, whether it be a charging, deduction or concessionary provision.

This was the approach of the High Court in Mullens v. FCT. In this case certain allottees of shares in a petroleum exploration company who could not afford to make further payments on their shares, and to thereby obtain the deduction allowed by s.77A (Commonwealth) declared themselves as trustees of the shares for members of the Mullens group. It was the members of the Mullens group who paid the amounts necessary on the shares, and thereby acquired the concessions under s.77A. As part of the arrangement, the Mullens group gave an option to the original shareholders to repurchase the shares at par in the future. It was held that s.260 did not avoid the arrangement, and accordingly, the taxpayers were entitled to their concessions under s.77A. As Barwick C.J. says:

"It is of advantage, and indeed critical, at this point to examine the structure and operation of s.77A(4) and the policy it expresses." 114

The Chief Justice proceeds to examine these aspects. He concludes:

"That the policy was the encouragement of capital contribution to petroleum exploration companies which earnmark that capital for petroleum prospecting and thus advance petroleum exploration... the section does not attempt to specify or regulate what may or may not be done..."

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**THE APPLICATION OF SECTION 99 OF THE INCOME TAX ACT 1976 TO TRUSTS**

The prominence of trusts today has been greatly influenced by the high and progressive nature of the rates of personal income tax. The trust has become to the income tax planner, a major device for effecting distribution of income.

There are two major uses of trusts in this area. Firstly, as a means to reduce the overall percentage of income paid in tax, the trust has been employed to achieve a diversion of income from the principal income producer to other members of his family, and to thereby achieve a spreading of the income with the resulting reduction in the overall tax paid. This spreading of income is usually achieved by the transferring of income producing assets to the trust. Secondly, to achieve a reduction in the taxable income of the principal income earner, a trust is used to acquire plant, buildings and other equipment which are necessary to the derivation of income by the principal income earner. In this way the deductions available to the taxpayers are syphoned through the trust to other members of the family.

The problem is, how does s.99 affect trusts? Any trust which effects a spreading of income, will have the consequence of reducing the liability to pay income tax. Hence, on a plain reading of the section, it would seem that such a use of trusts would be avoided by s.99.

However, since the High Court of Australia decision in FCT v. Purcell 1 held that the then almost identical Australian Section to s.99 did not extend to the case of a bona fide disposition of a right to receive income, it is clear that the effect of the section was not that which would be presumed from a plain reading of the actual words of the section.

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Finding that the fact situation of this case was within the intention and policy of the Act, Barwick C.J. found s.260 not applicable. As Stephen J., in the same case, says: 117

"Section 260 of the Act, in performing its task of "protecting the general provisions of the Act", cannot be allowed to negative the Act's specific and particular provisions..."

He also examines the policy behind s.77A of the Act, and concludes that the transaction here, notwithstanding it is an arrangement to acquire the benefit of the concession and will certainly have the consequence of tax diminution, is nevertheless within the policy of the section and therefore s.260 can not apply.

It is submitted that to limit the application of the "choice-principle" to cases where, after an examination of the policy of the specific provision, it can be said that the arrangement effects no objective or consequence contrary to that policy, is to define a working relationship between s.260 and the specific provisions of the Act, and to reinstate s.260 as an integral part of the process of creating and revising the norms applicable to the specific provisions.

On the other hand, if the 'choice principle' is taken to justify situations where advantage is taken of any particular section of the Act by a structure or arrangement which is not referable to ordinary business or family dealing, then it is submitted that the theory would be unacceptable. To hold that irrespective of the steps of implementation s.99 has no application where the taxpayer structures himself "inside" or "outside" one of the specific provisions of the Act, is to render s.99 either in total conflict with each of the specific provisions of the Act or to render it tautologous and nugatory.

The conclusion therefore is that where the steps to implement the arrangement are referable to ordinary business or family dealing, then arrangements to take advantage of any of the specific sections of the Act will not be affected by s.99.

This restatement is supported in New Zealand by the cases wherein the Courts have on numerous occasions held transactions void under s.108 where
the arrangement was nothing more than the attempt by the taxpayer to
either take advantage of business deduction sections of the Act, or to
'spread' income to entities in which the assessment of the income would
result in tax savings.

Patcorp, in the judgment of Jacobs J. (with whom Stephen J. agreed),
gives rise to the second of the above doctrines or theories, that is,
the antecedent transaction theory. His Honour finds that if the
Commissioner's argument is upheld, and s.260 is said to apply, the
purchase of the shares, the declaration of the dividend, and the later
sale of the shares, there would be no income, as distinct from capital,
which could be taxed.

In Mullens, the taxpayers sought to take advantage of provisions of the
Act which provided that moneys paid on petroleum shares shall be
allowable deductions. The shareholder of a petroleum company being at
the time financially unable to take up his rights - issue agreed that the
taxpayer may pay the moneys owing on the rights issue. This left the
taxpayer as beneficial owner of the shares. The taxpayer also gave an
option to purchase those rights to the original shareholder. By the
arrangement the taxpayer was entitled to the special deduction on the
moneys paid on the petroleum shares and the shareholder was entitled at
a subsequent time to purchase the shares. So held the High Court.
The majority considered s.260 had no application. The criticism of
the decision is not for the fact that s.260 was held not to apply, but
the reasons therefor. The reasons were basically two: first, the
taxpayer had done no more than bring himself within the provisions of the
Act (the choice theory); and secondly, if s.260 did apply, there was no
earlier transaction or situation which did not entitle the taxpayer to the
deductions claimed under the Act (the so-called 'antecedent transaction
theory').

In Slutzkin the High Court, on the basis of the same two theories or
principles held that a shareholder of a company loaded with undistributed
reserves who sold his shares to a 'dividend stripper' was not liable to
tax on the 'capital' receipts he received on the sale. The authority
for so holding was essentially Barwick J.'s judgment in Mullens.
Accordingly, it is Mullens that must be analysed.
It is submitted that the antecedent transaction doctrine arises from the prohibition on reconstruction principle and in itself the principle is relevant if at all, to the result of applying s.260, not as a determinant to the application of s.99 or otherwise. Unfortunately the dicta although not based on precedent or reason, seem to have gathered legitimacy from repetition and could become law notwithstanding their suspect basis in law and policy.

The basis of Barwick C.J. views in Mullens is the P.C. in its New Zealand jurisdiction in Europa (No.2) where it is said:

"The section does not strike at new sources of income or restrict the right of the taxpayer to arrange his affairs in relation to income from a new source in such a way as to attract the least possible liability to tax."

Barwick C.J. continues:

"It would have been otherwise if there had been some antecedent transaction between the parties, for which the transaction under attack was substituted in order to obtain the benefit of the particular provisions of the Act. S.260 is not directed to tax on income to which the taxpayer is entitled only by reason of the actual transaction into which the parties have entered."

It is paramount that one is not overcome by the authority of the decision and the clarity of its expression. The question is, why has it been so long for this theory to develop? The answer is that it is not a new theory. The original exponent of the theory was in fact Barwick Q.C. as Counsel for the taxpayer in Newton's case.

And what did the P.C. say:

"Sir Garfield Barwick submitted that in s.260 (c) the words 'liability imposed on any person' meant a liability which had already accrued; and that 'avoid' meant displace. He said that in order that an arrangement should be avoided, it must be an arrangement which sought to displace a liability which had already come home to a taxpayer - in respect of income which had already been derived by him. Their Lordships cannot accept this submission. They are clearly of opinion that the word 'avoid' is used in its ordinary sense - in the sense in which a person is said to avoid something which is about to happen to him...If the submission of Sir Garfield Bandick were accepted, it would deprive the words of any effect: for no one can displace a liability to tax which has already accrued due, or in respect of income which has already been derived."
When it is recalled that Newton's case was a 'dividend stripping' case with facts almost identical to Patco and Slutskin one can be forgiven for wondering how this 'antecedent transaction' theory was revived. Perhaps the answer is best given by pointing out that the only recent authority - or if it is preferred - the basis of the revival of the theory is Europa Oil (No.2), upon the Board of which Barwick C.J. sat as the Australian member.

Furthermore, it should be noted that the Privy Council decision not only cites no authority, but flies in the face of Newton, is contrary to Mangin, clashes with the clear objectives of s.99 and, it is submitted, is nothing more than an unauthorised castration of s.99.

In conclusion therefore, it can be said that in regard to the use of a trust, where tax diminution or avoidance is achieved, s.99 will only apply if the steps of implementation are not referable to ordinary business or family dealing. The recent Australian developments in the application of a section very similar to s.99 are, it is submitted, not well founded and are seen as a poor base upon which to build any tax planning arrangements. In regard to what is 'ordinary', it would seem that provided the steps are not tortuous, or artificial, then the permanent divestment of a source of income to a trust would be acceptable. However, in regard to the divestment of assets and their lease back to the assignor by the assignee, the position is still unclear. There are two lines of authority in New Zealand and there is little if anything to separate or distinguish them. The result is that in any such arrangement one can only proceed with extreme caution.


39. Ibid., 289.
40. Sections 11(3) and 3(1).
[1978] 1 Q.B. 69, 81, per Lord Denning M.R.
43. [1980] 2 W.L.R. 283, 293, 297.
44. [1963] 2 Q.B. 603.
45. Lord Diplock would reserve the word "fundamental" for a discharge for breach based on the scale of the breach, or of its consequences, as in the Hong Kong Fir: [1980] 2 W.L.R. 283, 294.
46. [1936] 2 All E.R. 597.
47. Ante, p.10.
50. A.M. Satterthwaite & Co. Ltd. v. N.Z. Shipping Co. (The Eurymedon)
51. In The Eurymedon, supra, 182, Lord Simon (dissenting) made the point that to accept the argument based on the "qualification" view would mean that Midland Silicones Ltd. v. Scruttons Ltd. [1962] A.C. 446 "should have been decided the other way".
53. See cases cited at p.10 fn.85 ante.
54. See p.7, fn 51 ante.
55. [1979] 1 All E.R. 883.
56. Supra.
11. Ibid., 863.
12. The fact that the point presupposes that exception clauses can prevent the accrual of obligation may explain why it was taken by Lord Wilberforce in the *Suisse Atlantique*, and by Lord Diplock but not by Lord Wilberforce in *Securicor*. See post, p.
18. Ibid., 318.
23. Ibid., 292, 296.
24. Ibid., 289, 296, 297, 298.
25. Ibid., 296, 297.
26. Ibid., 297.
27. Ibid., 291, 298.
28. Ibid., 298.
29. Ibid., 298.
30. Ibid., 291.
31. Ibid., 296-297.
32. Ibid., 297-298.
33. Ibid., 296, 297.
34. See cases at notes 63-65 ante.

**APPENDIX**

**SEC. 99.** Agreements purporting to alter incidence of tax to be void

(1) For the purposes of this section -

"Arrangement" means any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect:

"Liability" includes a potential or prospective liability in respect of future income:

"Tax avoidance" includes -

(a) Directly or indirectly altering the incidence of any income tax;

(b) Directly or indirectly relieving any person from liability to pay income tax;

(c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax.

**SEC. 99 (2).**

(2) (Void arrangements) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly, -

(a) Its purpose or effect is tax avoidance; or

(b) Where it has two or more purposes or effects, one of its purposes or effects (not being a merely incidental purpose or effect) is tax avoidance, whether or not any other or others of its purposes or effects relate to, or are referable to, ordinary business or family dealings, -

whether or not any person affected by that arrangement is a party thereto.

**SEC. 99 (3).**

(3) (Adjustment of income) Where an arrangement is void in accordance with subsection (2) of this section, the assessable income of any person affected by that arrangement shall be adjusted in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that person from or under that arrangement, and, without limiting the generality of the foregoing provisions of this subsection, the Commissioner may have regard to such income as, in his opinion, either -

Continued...
(a) That person would have, or might be expected to have, or would in all likelihood have, derived if that arrangement had not been made or entered into;

or

(b) That person would have derived if he had been entitled to the benefit of all income, or of such part thereof as the Commissioner considers proper, derived by any other person or persons as a result of that arrangement.

(4) (Deemed derivation of income) Where any income is included in the assessable income of any person pursuant to subsection (3) of this section, then, for the purposes of this Act, that income shall be deemed to have been derived by that person and shall be deemed not to have been derived by any other person.

(5) (Sale of shares) Without limiting the generality of the foregoing provisions of this section, where, in any income year, any person sells or otherwise disposes of any shares in any company under an arrangement (being an arrangement of the kind referred to in subsection (2) of this section) under which that person receives, or is credited with, or there is dealt with on his behalf, any consideration (whether in money or money's worth) for that sale or other disposal, being consideration the whole or any part of which, in the opinion of the Commissioner, represents, or is equivalent to, or is in substitution for, any amount which, if that arrangement had not been made or entered into, that person would have derived or would have derived, or might be expected to have derived or to derive, or in all likelihood would have derived or would derive, as income by way of dividends in that income year, or in any subsequent income year or years, whether in one sum or in any of those years or otherwise however, an amount equal to the value of that consideration or, as the case may be, of that part of that consideration shall be deemed to be a dividend derived by that person in that first-mentioned income year.

(6) (Discontinuance prevented) Where any arrangement has been made or entered into before the 1st day of October 1974 and the Commissioner is satisfied, in respect of that arrangement or, as the case may be, in respect of a part of that arrangement, that the terms or conditions of that arrangement or, as the case may be, of that part (being legally binding terms or conditions which were agreed upon in writing before that date) prevent the discontinuance of that arrangement or, as the case may be, of that part,
SEC. 99 (6) Continued

(a) Subsections (2) to (5) of this section shall not be applied with respect to that arrangement or, as the case may be, with respect to that part so long as that arrangement or, as the case may be, that part is so prevented from being discontinued and is continued strictly in accordance with the requirements of the aforementioned terms or conditions thereof; and

(b) So long as the said subsections (2) to (5) of this section are not applied with respect to that arrangement or, as the case may be, with respect to that part in accordance with paragraph (a) of this subsection, the section for which section 108 of the Land and Income Tax Act 1954 was substituted by section 9 of the Land and Income Tax Amendment Act (No. 2) 1974 shall, notwithstanding the repeal thereof by the said section 9, be deemed to remain in full force and effect in relation to that arrangement or, as the case may be, in relation to that part.

The former New Zealand Section 108 read:

"Every contract, agreement, or arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes 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."

Section 260 Income Tax Assessment Act (Commonwealth)

"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 in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax -

(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."

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A discussion of the annihilation issue is contained in the final section of this paper.


54. Council of the City of Sydney v. West (1965) 114 N.L.R. 481, 495-496.

55. I thought so in 1966. But by 1970, it had become apparent that the concept had survived. Hence the return, in [1970] C.L.J. 221, to a plea that "fundamental breach" and discharge for breach be recognised as different things.


59. At p. 10 infra.


62. Ibid., 405-406.


115 emphasis added.
116 ibid., 4293.
117 ibid., 4293-4.
118 ibid., 6009.
119 ibid., 4294-5.
120 (1958) 98 C.L.R. 2-7.

47. Exception Clauses, Chapter 1.

51. The idea that exception clauses could have a substantive effect seems to have originated with Professor J. C. Montrose who applied it to the sale of goods by description in (1937) 15 C.B.R. 760, as did Professor Unger subsequently in [1957] Bus. L.R. 30. Exception Clauses applies the idea to exception clauses generally.

Dicta or decisions since 1964 accepting the idea in whole or in part include:


This explanation is discussed more fully in Exception Clauses, pp. 89-93. It accounts for the fact that the liability of the deviator is absolute, and not that of a bailee.

Thus, even the deviating shipowners' right to freight on a timeous delivery, long recognised by the commercial community, can be explained as arising under the contract, either as on a substantial performance, or under the equivalent of a "warranty ex post facto".

For a fuller treatment see (1967) 40 L.L.J. 336.

[1925] 42 T.L.R. 174; Exception Clauses, pp. 82, n.15 and 93 n.86.

(1925) 42 T.L.R. 174; Exception Clauses, pp. 82, n.15 and 93 n.86.

For a fuller treatment see (1967) 40 L.L.J. 336.


[1936] 2 All E.R. 597.
[1936] 2 All E.R. 597.

In The Albion [1953] 1 W.L.R. 1026, the Court of Appeal confirmed that the expressions "fundamental term" and "fundamental breach" had no special significance outside "deviation".

[1922] 2 A.C. 250 (H.L.).
[1922] 2 A.C. 250 (H.L.).

Ibid., 260.
Ibid., 260.

[1923] 1 K.B. 690.
[1923] 1 K.B. 690.

[1953] 1 W.L.R. 1468, 1470.
[1953] 1 W.L.R. 1468, 1470.


Hong Kong Fir Shipping Co. v. Kawasaki Kisen Kaisha [1962] 2 Q.B. 26 (C.A.) (hereafter "the Hong Kong Fir").

This was, incidentally, reflected in the title of chapter 5 of Exception Clauses. The book was based on a dissertation written in the 1950's.


As to "difference in kind" see Exception Clauses, chapter 3 ("Exception Clauses and a Physical Subject-Matter"); "Correspondence with Description in the Law of Sale of Goods", (1976) 50 A.L.J. 17.


These matters are discussed in greater detail in (1967) 40 A.L.J. 336, 337-341.

As late as Morely v. Attenborough (1849) 3 Ex.500 there was held to be no implied warranty of title on sales of goods.
By reaffirming *Suisse Atlantique* and overruling Harbutt's "Plasticine", the House of Lords has done what it can to remove two obvious distortions from the law. But neither action, by itself, can solve the continuing problem of unacceptable contractual terms generally. Neither "construction" nor a third revival of fundamental breach can provide a fully satisfactory answer. The better approach, it is submitted, would be the development of an overall control based on reasonableness or, less radically, on unconscionability. Nor, in logic, should such a control be restricted to only one form of contract term.

It may be that in a country like Canada, where the approach to law appears to be rather more functional than it is in, say, England, Australia or New Zealand, such a control could be evolved by the courts themselves. But in countries where attitudes are more analytical, it would seem far too late, now, to expect any such development to be possible. For such countries, the need is surely for statutory intervention, as Lord Reid indicated 14 years ago in the *Suisse Atlantique*.

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**A PRACTITIONERS' GUIDE TO CONDITIONS PRECEDENT AND SUBSEQUENT**

In spite of the cri de coeur by Richardson J. in *Hunt v. Wilson* that the "nature and effect of conditions of various kinds have been the subject of almost endless discussion by Judges and academic writers", it probably remains true that a practitioner faced with a dispute centering on a condition precedent or subsequent in an agreement for sale and purchase will be in a quandary as to the exact legal position of his client at the time and as to the steps he must take to achieve the result his client desires. It would be presumptuous to assume that one short paper will, or could, resolve all the difficulties, but it may be useful to help identify issues involved and direct inquiry along appropriate paths.

**Precedent or Subsequent?**

In *Hunt v. Wilson* Cooke J. said:

"I venture to think that the ambiguous labels 'precedent' and 'subsequent', when applied to conditions, are seldom of real help in solving issues in this branch of contract law."

Certainly, on the authorities as they stand at present, the labels are used too loosely to be of any help at all and, indeed, are only confusing. But if clear definitions were given to the terms, and if the most useful definitions were chosen as those to be given, the terms could be of great assistance. It needs to be remembered that, like many such terms in the law, they are merely shorthand ways of stating sets of detailed rules. If the circumstances which call for different rules were clearly differentiated and if the most opposite sets of rules were devised for those circumstances, there is no reason why the shorthand labels should not perform the same useful function that such labels commonly perform in legal language. After looking briefly at the present state of the New Zealand authorities with regard to the use of these particular labels, more precise definitions or usages of each will be suggested and the detailed rules of operation of each category then examined with regard both to our present understanding and to changes either required by logic or suggested by the usefulness of their practical operation.
As Cooke J. goes on to observe in Hunt v. Wilson, the meaning of the terms 'precedent' and 'subsequent' must be made specific "by explaining to what the condition in question is seen as precedent or subsequent". The terms may be used in regard to the existence of contractual relations or to the obligation to perform one or more promises within an existing contract. In the New Zealand decisions of the last 20 years, the precise sense in which the condition is classed as precedent or subsequent has rarely been made unambiguously explicit. Primarily, when a condition is described as 'precedent', it is rarely, if ever, clearly stated whether it is precedent to the very existence of the contract, or to one, some, or even all the promises within an existing contract.

In Griffiths v. Ellis, North J. described the condition as a "condition precedent in the strict sense of the term" which suggests that it is precedent to the existence of the contract. However, when the judgment is read more carefully, it is clear that his Honour accepted that there was an existing contract between the parties and that some obligations within it were current and not subject to the condition precedent.

The condition was therefore not treated as precedent in the strict sense of the term, and would, had the contractual relationship itself been the focal point of the labelling, have more correctly been described as subsequent, although its description as precedent was more useful in the circumstances of the case, because the emphasis was on the obligation to perform.

In Barber v. Crickett, however, in a judgment given about 5 weeks after that in Griffiths v. Ellis, but without mentioning the earlier Court of Appeal decision and perhaps without knowing of it, Cleary J. in the Supreme Court found that a finance condition was a condition subsequent. This was largely based on the degree of control over the outcome of the condition which the purchaser had and the Australian approach to such a situation which is to class the condition as subsequent.

While the end result accords with the view proposed in this paper, it is suggested that a better basis for labelling the condition as subsequent would be simply that there is a contractual relationship between the parties to which the operation of the condition is subsequent and that the exception clauses as mere defences, section 5 and the Act itself will, so far as relevant, govern the case. One has only to think of excepted perils in contracts in the carriage of goods by sea, where the provision of a "remedy" would defeat the purpose of the exceptions, to appreciate how important the answer given by the Courts will be.

The second problem is the extent to which fundamental breach has any continuing relevance to the interpretation and construction of exception clauses. The Act of course does not purport to deal with questions of interpretation and construction so that, prima facie, fundamental breach could remain relevant as a "rule of construction". The extent to which this is so may depend on how "fundamental breach" is perceived in this country. In a situation where the expression "fundamental breach" has been used as synonymous with "discharge for breach" and where the distinctive nature and function of fundamental breach itself may have been lost sight of, it is conceivable that the words "fundamental breach" will disappear from the New Zealand legal vocabulary and be substituted by the new concept of "cancellation". If that happened any "rule of construction" would no doubt be applied to acts which (the exception clause apart) would fall within section 7(4)(a) and (b). If that became so, the new rule of construction would in effect apply to discharging breaches generally and in consequence would be considerably more wide-ranging than the original fundamental breach rule as Devlin J. conceived it. That effect would be compounded if the new rule of construction came to be applied as the determiner of the result. Much the more flexible solution for the courts to adopt would be to make construction turn not on the technical categorisation of the breach, but on the seriousness of the term broken or the consequences of the breach, following the approach that the more serious they were, the clearer the words used must be.

A final point concerns deviation. Under the Act, deviation will no longer bring about a rescission of the contract and Hain v. Tate & Lyle will therefore cease to apply. However, that does not in itself mean that the exception clauses will protect the deviating party. Both on the construction theory, that the exceptions cover only the risks of the contract voyage, and on the bailment theory I have put forward, the non-application of the exceptions to the altered risks does not depend on any supposed "rescission". And a positive gain from the new Act is that, unless the cargo owner should actively cancel the contract, the shipowner will once more be entitled to his freight should he deliver the cargo to its destination without defeating the purpose of the contract. This was almost certainly the law in the first half of the 19th century, and remained the understanding in commercial circles at least into the 1930's.
Past authority has supported the existence of both remedies as well as of a third remedy of rescission followed by a claim for a quantum meruit. At least, it is submitted that neither Securicor nor Heyman v Darwins is inconsistent with there being such a choice, where the appropriate conditions of the remedy can be met. That in turn would depend inter alia on the terms of the contract, including any exception clauses. But if the three remedies do co-exist, it is possible to foresee the emergence of yet another substantive version of fundamental breach amongst those who see exception clauses as mere defences. It would involve rescission of the contract ab initio followed by a claim in tort or quasi contract.

The Contractual Remedies Act

For New Zealand lawyers, the most pressing problem arising from the concept of fundamental breach is to assess the impact on it of the Contractual Remedies Act 1979. One of the principle objects of that Act was, of course, to unify the law relating to discharge for breach. That aspect was dealt with at length in the N.Z. Law Society seminars earlier this year. The aspect calling for treatment here is the effect of the Act on fundamental breach in the narrow sense in which it has been defined in this paper.

Section 8 of the new Act, while not identical with either the Heyman v. Darwins or the LEP Air Services analyses, is certainly inconsistent with Harbutt's Plasticine. That case would therefore have ceased to apply in New Zealand even without the Securicor case. But other questions remain.

The first is the effect of section 5 of the Act which states:

"If a contract expressly provides for a remedy in respect of misrepresentation or repudiation or breach of contract or makes express provision for any of the other matters to which sections 6 to 10 of this Act relate, those sections shall have effect subject to that provision."

It would seem clear enough that under this section limitation clauses like that in Harbutt's "Plasticine" will be able to take full force and effect. The consequences for clauses which exclude obligations or liability altogether are less obvious. The answer will almost certainly depend on what the New Zealand courts see as the function of exception clauses. If they opt for the view exemplified by Lord Diplock, Barwick C.J., and Kerr and McKenna J.J. they will hold that exceptions of obligation or liability prevent the act complained of being a breach. In that case neither section 5 nor any other part of the act relating to breach will apply. On the other hand if they opt for the view exemplified in the judgments of Lord Denning M.R. and treat that relationship is the focal point in regard to which the condition is viewed. The finding in Barber v. Crickett that the condition was subsequent was followed, on the basis of an agreement between counsel, in both Knotts v. Gray and Martin v. Macarthur.

In the next case to arise, Mulvena v. Kelman, Henry J. reverted to the view of North J. in Griffiths v. Ellis and preferred to regard the finance condition as a condition precedent. This conclusion was based on the fact that the purchaser had made a conditional offer to purchase which was accepted by the vendor. But, regardless of the label used, it is evident from a closer reading of the judgment that Henry J. regarded the parties as contractually bound before the outcome of the condition was known. The reliance upon Griffiths v. Ellis fails to take account of the way in which North J. actually used the term 'precedent' in that case, i.e., as precedent to performance, so that it is inappropriate when, as in Mulvena v. Kelman, the contractual relationship is the focus of attention. In addition, the reasoning used by Henry J., relating to the terms of the offer and acceptance, is invalid in that, because any acceptance must be of an offer exactly as made if a contract is to result, all conditions, precedent to performance or subsequent to contract, must be contained in the offer. Those intended to be precedent to the contractual relationship itself might be separated off from those which are within an existing contractual relationship by an intention that, although there has been an agreement as to terms by offer and acceptance, there should not be a binding contract unless and until the circumstances described by the condition should have come about. The labelling of the condition in Mulvena v. Kelman as precedent is therefore, it is submitted, based on an incomplete analysis and understanding, and, in the light of the immediately preceding decisions which labelled the same type of condition as subsequent, is confusing, giving an appearance of randomness to the labelling process. Given that the importance of the condition in the case was its bearing on the contractual relationship, it would have been more accurately labelled as subsequent.
Nevertheless, similar reasoning was adopted by the majority of the Court of Appeal in Scott v. Rania in attaching the label 'precedent' to the finance condition in that case, thus lending the weight of that Court to the perpetuation of the confusion and establishing in New Zealand law an unhelpful view of conditions. North P., who had earlier decided Griffiths v. Ellis, labelled the condition as precedent on the basis of the same reasoning as had Henry J. in Mulvena v. Kelman, i.e. that the condition was contained in the offer and is subject to the same criticism. McCarthy J. felt that the wording of the condition was closer to that in Griffiths v. Ellis than that in Barber v. Crickett and on that basis labelled it precedent rather than subsequent thus apparently taking no account of the way in which the condition was intended to operate in regard to the contractual relationship. Also, as in Griffiths v. Ellis and Mulvena v. Kelman, it is evident from the judgments as a whole that both North P. and McCarthy J. regarded the parties as in a contractual relationship which had to be terminated on the non-fulfilment of the condition. Thus again, a condition was labelled 'precedent' which was in fact operating as subsequent to the contractual relationship it affected.

With the majority judgments in Scott v. Rania reported litigation ended for some years, and in Auckland at least, a finance clause was included in the standard form agreement for sale and purchase incorporating the law as apparently settled by those judgments. In the two later decisions which there have been, the Courts did not attach a label to the conditions involved, but in each case certainly treated the finance condition as being a part of an existing contract. In Gardner v. Cold, it can be assumed that the condition was regarded as subsequent since it was found that an obligation to take all reasonable steps to fulfil the condition could be imposed only by an implied term in an existing contract. In Barton v. Russell the problem ultimately centred on the interpretation to be placed on the word 'void' in the finance condition in the contract, but the use of this word can be traced back to the reliance upon the majority reasoning in Scott v. Rania.

Thus it is evident that, whatever the potential of the shorthand labels 'precedent' and 'subsequent' to assist in the discussion of

The Function of Exception Clauses

Since Lord Diplock concurred in overruling Harbutt's "Plasticine", he can be taken to have affirmed his earlier-expressed view that even limitation clauses qualify the (secondary) obligations to which they relate. To that extent, the gap left after The Angelia has been closed.

On the other hand, Lord Wilberforce did not advert to the function of exception clauses at all. More than that, he chose to overrule Harbutt's "Plasticine" by applying the Heyman v Darwins analysis of discharge for breach rather than by adopting the more recent analysis in the LEP Air Services case. To adopt the latter could have involved his accepting Lord Diplock's approach to the function of exception clauses. This may tend to suggest that he has changed his mind since his dictum in Suisse Atlantique. What is perhaps at least as likely is that, in a case which he could decide without having to advert to the point, Lord Wilberforce simply preferred to "leave well alone". That, certainly, is what he did earlier when he was in a similar position in the Furymedon. The difficulty is that if the House of Lords were to decide, definitively, that exception clauses are more than mere defences, the repercussions would not be confined to discharge for breach, or to exception clauses intended to benefit third parties, but would extend across the whole spectrum. In particular such a finding could have radical consequences for the Unfair Contract Terms Act which was drafted throughout on the premise that exceptions are mere defences. It could be rendered in some respects largely ineffective if a different approach were to be followed.

The fact that Lord Diplock has now based a judgment on the "qualification" view of exception clauses at House of Lords level adds that much force to what he has said previously on the topic. But it is scarcely likely that, on that account, an idea which has been mooted now for 43 years will overnight win general acceptance.

Rescission

One other point that might be made concerns rescission ab initio. Before the recent case of Johnson v Agnew English Chancery lawyers appeared to believe that the only remedy for a party to a sale of land who had suffered a serious breach and wished to terminate his obligations was to rescind ab initio, with a restitutio in integrum, but without damages. Now that the House of Lords have, in Johnson v Agnew, agreed with the courts of Australia and New Zealand in holding that the common law remedy of discharge for breach with damages is available, the pendulum seems to be swinging to the opposite extreme and it is being said that rescission ab initio without damages is not an option open to the injured party.
any country to retain fundamental breach should it wish to do so. Initially
the concept would be retained as a guide to construction. But the pressures
towards treating it once more as a rule of law could be expected to build
quite rapidly. The point is that, apart from negativing the Harbutt's
"Plasticine" version of fundamental breach, the Securicor decision has left
things fairly much as they were after the Suisse Atlantique. In the first place,
no pre-Suisse Atlantique case other than Charterhouse Credit & Tolly44 has
actually been overruled. Secondly, the terminology of fundamental breach has
in substance been retained, in all its ambiguity.45 Accordingly, and this is the
third factor, there is little in Securicor to prevent lawyers, so-minded,
concluding that a rule of "construction" remains, to the effect that exception
clauses do not apply to fundamental breaches. On past experience, that will
almost certainly mean that the enquiry will be directed, not to the words used,
but to the presence or absence of fundamental breach as the determinant. In
consequence the test will in reality be applied as one of law. Fourthly,
the fact that Hain v Tate & Lyle46 has been distinguished in no way affects
its application to deviation and quasi-deviation. Those breaches will continue
to deny the proferens the protection of his exception clauses. The temptation
to generalise from these breaches to others outside bailment will remain, if only
because the concept of deviation is not very clearly understood. Firstly,
there remain those dicta of Lord Wilberforce in the Suisse Atlantique case which
misled Fenton Atkinson L.J. and Donaldson J.47 His Lordship was prepared
neither to qualify nor to explain them in Securicor. Moreover, his dictum about
there being a rule of law which would not allow an exception clause to empty
a contract of all content has now been echoed by Lord Diplock. Of course the
reference of both dicta was to the formation of the contract, and pre-supposed
that exception clauses define obligation. But in a world of lawyers who see
exception clauses as mere defences, that qualification seems no more likely now
to be accepted than it was after Suisse Atlantique.

If construction was what Suisse Atlantique and Securicor were really
about, two changes in approach ought to occur. The enquiry of the courts ought
in the first place to be directed to finding the meaning of the words used, in
the light of the contract as a whole, and of the surrounding circumstances at the
time the contract was formed. Of course it would be relevant to that enquiry
that the acts or events claimed to be covered by the exceptions were of a serious
nature. The more serious they were, the clearer the words used should be.
But it would be the degree of seriousness which would count, not whether they
were "fundamental" in any technical sense. Secondly, a return might be expected
to the principles which have hitherto governed the construction of exception
clauses. I have attempted to list some of these elsewhere 48. Nevertheless,
so much water has passed under the bridge since 1953 that it may be asking too
much to expect either change to occur, at least in England and Canada where
fundamental breach had its greatest influence.
a condition which is a term of an existing contract may, in
addition to being subsequent to the contractual relationship, also
be precedent to the obligation to perform some or all of the basic
promises within that relationship, but to describe a condition in
this twofold way is not helpful unless the primary and secondary
aspects of the description are distinguished. When, as is often
the case, the basic concern is with whether the condition can be used
by one of the parties to escape from the contract, or perhaps with
whether there is a contract, the primary aspect of the condition must
be that it is subsequent to the contractual relationship. This
approach to conditions has some judicial support but it has never
been strongly accepted up to now in New Zealand, and even less have
its implications been fully and logically followed through. The
major effect of the adoption of the approach on earlier New Zealand
decisions would be that the conditions in issue in Griffiths v. Ellis,
Mulvena v. Kelman, and Scott v. Rania would be labelled more clearly
and helpfully as conditions subsequent to the contractual relationship.

Adopting the terms precedent and subsequent with the meanings
suggested for them above, each of the two kinds of condition will now
be looked at separately with detailed reference to the major aspects
of their operation.

Conditions Precedent

If, by the term 'condition precedent', is meant a condition
precedent to the very existence of the contractual relationship, so
that there is no intention to contract unless and until the condition
is met, it must be admitted that such conditions will be rare. This
would inevitably be so if the intention of the parties were determined
in the light of the manner in which such a condition must necessarily
operate. Because there would be no contract before the fulfilment
of the condition, either party would be free to withdraw before that
time or to re-open negotiations as to terms; there could be no
obligation on either party to take any steps to achieve the fulfilment
of the condition; and neither party could have any right to waive the
condition so as unilaterally to impose a contract on the other.

he thought, not only of contracts falling within the Act but also of those
outside it. The very fact that the Act had not been made to apply to commercial
contracts otherwise than on one party's standard form confirmed that the parties
to such contracts were intended by the legislature to be left free to make
their own arrangements.

Moreover, while he acknowledged that, despite its imperfections and
doubtful parentage, fundamental breach had served a useful purpose, Lord Wilber-
force was otherwise dismissive of it. His references to "a legal complex so
certain as the doctrine of fundamental breach must be" and to "analysis,
which becomes progressively more refined, of decisions in other cases leading to
inevitable appeals" suggest that he would be content to see it disappear
altogether. It is far from certain, however, that that is what will happen.

A first point is that not all the contracts excluded from the Unfair
Contract Terms Act are commercial. Contracts not on one party's standard
terms, where neither deals in the course of business, also fall outside it.
Even in respect of contracts within it, the Act says nothing about the initial
construction and interpretation of the clauses concerned and, since fundamental
breach has until now been seen as relevant to those questions, it would require
a major change in attitudes to make it irrelevant hereafter. For similar
reasons fundamental breach is likely to be seen as relevant to the statutory
requirement of reasonableness and, possibly, to the reasonable expectation
postulated by section 3(2)(b)(i). As for common law countries with no equivalent
to the Unfair Contract Terms Act, the pressures to retain a fundamental breach
principle will remain unchanged.

Conceivably, in countries without equivalent legislation, and in England
itself in respect of non-business contracts outside the Act, there might be a
so far as it denies the existence of a rule of law,
temptation to distinguish Securicor on the ground that it applies only to
contracts in respect of which the new Act has made fundamental breach unnecessary.
But that would be a travesty of legal reasoning, since the contract in Securicor
antedated the Act and had therefore to be decided on ordinary common law principles,
as Lords Diplock and Salmon were careful to emphasise. Almost as bad
would be an attempt to distinguish the case on the grounds that it was
confined to reasonable, negotiated, arrangements for the allocation of
insurance risks between commercial parties. Of course those factors were
relevant, but only to the issue of construction. On the substantive points
covered in the judgments, the reasoning of the House of Lords applies just
as strongly to all types of contract.

When it comes to questions of construction there would, despite Lord
Wilberforce's strictures, seem to be sufficient material available to enable
It was limited to the exercise of due diligence by Securicor in their capacity as employer, to procure that those persons would exercise reasonable skill and care.22

Construction of the Exception Clause

The other major issue discussed by their Lordships was that of construction. None had any doubt that in its natural and ordinary meaning Condition 1 covered the events which had occurred. The question was, rather, whether there was any reason why the natural and ordinary meaning should not be applied. Though regard had to be had to the contra proferentem rule,23 this was a commercial contract24 "negotiated between businessmen capable of looking after their own interests and of deciding how risks inherent in performance . . . [could] be most economically borne (generally by insurance) . . . .25 The risk concerned was a "misfortune risk" of the kind that the reasonable diligence of neither party could prevent.26 The fee charged by Securicor was modest27 and would probably have been less than the reduction in premiums Photo Productions might have enjoyed as a result of obtaining their services.28 The allocation of risk in the contract was fair,29 reasonable30 and probably the most economical.31 A businessman entering the contract could have had no doubt as to the real meaning of Condition 1 and would have made his insurance arrangements accordingly.32 In these circumstances it would be wrong to place a strained construction upon the words used when they were clear, and fairly susceptible of only one meaning.33

In treating these factors as relevant to the question of construction their Lordships were applying established principles. As we have seen, it has been settled since the judgment of Lord Reid in the Suisse Atlantique that the construction of a contract can vary depending on whether it is a commercial contract or a consumer one or negotiated as distinct from being a contract of adhesion.34 While the reasonableness or otherwise of a provision is not at common law a ground for modifying it once a true construction has been arrived at,35 such considerations are certainly relevant to the process of arriving at a true construction in the first place, provided the words used are properly capable of more than one meaning.36 It is also an established test that the words used should be clear to the class of persons to whom they are addressed.37

THE SIGNIFICANCE OF SECURICOR FOR THE FUTURE

Fundamental Breach

In the course of his judgment in Securicor, Lord Wilberforce gave some prominence to his view that the passing of the Unfair Contract Terms Act 1977 had made the doctrine of fundamental breach superfluous.38 That was true, if the condition were fulfilled by the specified time, time being of the essence, the contractual relationship would automatically arise. If the condition were not fulfilled by that time, the contract depended upon it would simply not come into being. These are the logical results of there being no contract between the parties and, clearly, an intending purchaser under such an arrangement would have far less security than under an option to purchase acquired for valuable consideration. The only way to avoid these results within the structure of a condition precedent, as defined, would be to set up a collateral contract, but this seems a cumbersome and unnecessary process when either an option or a contract of sale with the obligation to perform some of the terms suspended could be entered into. It is therefore supposed that such conditions precedent would be intended only very rarely by the parties and that, in current New Zealand conveyancing practice, this might be an appropriate classification only for some solicitor's approval conditions.

The New Zealand decisions on solicitor's approval conditions to date have not provided any very clear guidance as to their effect. The first two decisions arose out of the introduction of this type of condition into the conveyancing practice for the making of agreements for sale and purchase in Christchurch. This involves the agent obtaining the signatures of the prospective parties to an offer and acceptance form. In Buehrer v. Tweedie39 the purchaser had made an offer on such a form. The vendor then changed two of the terms of the offer, signed an "acceptance" and added after his signature that the "acceptance is subject to final approval by my solicitors". Such an acceptance is, of course, a counter-offer and the solicitor's approval qualification attached to the offer was construed by Wilson J. as making the offer unavailable for acceptance until the solicitor's approval had been given. The prospective vendor was taken merely to have indicated the terms on which he would make an offer if his solicitor approved. If the approval were given, a firm offer would still have to be made and accepted before there would be a contract. It is difficult to imagine that the solicitors for either party, let alone the parties themselves, would have foreseen the need for this ritual in the light of what had already passed between them.
In this case, then, the condition attached to the vendor's offer prevented an effective offer from being made until the condition was fulfilled. Clearly the purchaser's purported "acceptance" in such a situation was not an acceptance of the offer in contractual terms, but could only be an indication that he would await the outcome of the solicitor's decision. Such an interpretation of the events which occurred in Buhrer v. Tweedie is perfectly feasible in law and is clearly distinguishable, as Wilson J. pointed out, from a condition precedent to a contract, though his Honour's view of a condition precedent is different from that suggested here.

The second decision, which also came out of the Christchurch process of contract formation, was Frampton v. McCully11 in which, again, the purported "acceptance" was expressed to be "subject to Mr. Frampton [the vendor's solicitor] approval". Clearly, a conditional acceptance cannot bring about a contract so that it was readily found that this "acceptance" had never resulted in a contract between the parties. As to the obvious possibility of treating the "acceptance" as a counter-offer, because the Court of Appeal, in its judgment delivered by Cooke J., did not consider that any restrictions could be placed upon the grounds on which the solicitor could refuse his approval, given the facts of the particular case, the Court thought that it would be "unreal to treat the conditional acceptance as a counter-offer capable, if itself accepted, of giving rise to a conditional contract of sale". The vendor was therefore taken merely to have indicated the terms on which it would accept if its solicitor approved.

On analysis, there appears to be very little difference between these two cases. Both properly concluded that an "acceptance" subject to solicitor's approval cannot operate as an acceptance to form a contract but can be treated only as a counter-offer. In Buhrer v. Tweedie it was construed, not as an offer capable of acceptance, but only as an indication of the terms of the offer which would be made if the solicitor approved. However, the prospective purchaser had written under the "acceptance" the words "I agree" followed by his signature and the date. From the discussion on p.520 of the report, the interpretation of Harbutt's "Plasticine"

The reaffirmation of what had been decided in Suisse Atlantique no doubt disposed of the more recent developments, so far as they were a direct revival of the former substantive doctrine, and also of the Harbutt's "Plasticine" principle in the form in which it had recently been expressed. But it did not necessarily dispose of the reasoning on which Harbutt's "Plasticine" itself was based. As we have seen, there were two grounds on which that could be attacked. Of their Lordships, all except Lord Diplock chose the route of discharge for breach. This made it necessary to distinguish the deviation cases and to hold that discharge for breach did not mean a rescission of the contract. In his leading judgment, Lord Wilberforce accepted the Heyman v Darwin analysis. Upon a discharge for breach the contract remained in being for the purposes of assessing damages, and this included any provisions of the contract which dealt with damages, whether they liquidated, limited or excluded them.16 In a sense, the choice of the Heyman v Darwin analysis was an arbitrary one. It was put forward in my book and two earlier articles because it was at that time the most recent. But since then the House of Lords has produced a new analysis in the LEP Air Services case.17 Since it is the more recent analysis it ought arguably to have been the one to follow. A possible reason why this did not happen will be suggested in due course.18 As to the deviation cases, Lord Wilberforce recalled that in the Suisse Atlantique he had said it was a matter of the parties' intentions whether, and to what extent, clauses in shipping contracts could be applied after a deviation. He allowed that it might be preferable to consider them "as a body of authority sui generis with special rules derived from historical and commercial reasons." But on either view, what they could not do was to lay down different rules, as to contracts generally, from those stated by the House in Heyman v Darwin.

Because of his part in formulating the rather different analysis in Moschi v LEP Air Services,19 it was not easy for Lord Diplock to dispose of Harbutt's "Plasticine" by a simple reliance on Heyman v Darwin. Under the LEP Air Services case, the contract determined on a discharge for breach, in that primary obligations were replaced by secondary ones. That would suggest that clauses irrelevant until adjudication would come too late to take effect. Lord Diplock was able to overrule Harbutt's "Plasticine" by following the second route, that of the function of exception clauses. Both primary and secondary obligations were the product of the contract as a whole, including any exception or limitation clause, and came into existence as modified by them.20 This also meant that he was able to conclude, with McKenna J. below, that Securicor's primary obligation to procure visits by persons who would exercise skill and care was not absolute but had been modified by Condition 1.
function of exception clauses, McKenna J. had chosen the latter. Though his decision apparently caused "astonishment" in some quarters, he had in large measure foreshadowed it in the earlier case of Mayfair Photographic Suppliers v Baxter Hoare & Co. Ltd. 9

The Case in the Court of Appeal

But if the judgment at first instance came as a surprise, that could hardly be said of the reaction of the Court of Appeal (Lord Denning M.R., Shaw and Waller L.J.J.) in unanimously allowing the appeal. 10 In his judgment, Lord Denning accepted that, taken in their natural and ordinary meaning, Conditions 1 and 2 either exempted or limited Securicor's liability but held, nevertheless, that on three grounds the Company were not entitled to rely upon those clauses. His first ground was based on Harbutt's "Plasticine", but rephrased in terms reminiscent of the pre-Suisse Atlantique substantive doctrine. "The Court itself" he said "deprives the party of the benefit of an exemption or limitation clause if he has been guilty of a breach of a fundamental term or of a fundamental breach of one of the terms of the contract." 11 His second ground was that the courts were entitled to construe a contract in the light of the presumed intentions of the parties as reasonable persons, and could say in the present case that they would not have intended the Conditions to apply in the events which had occurred. His final ground was that the courts would not allow a party to rely on an exemption or limitation clause where it would not be fair or reasonable for the party to do so. The other members of the court both held that, by reason of their fundamental breach, Securicor had lost the protection of their exception clauses but that, in any event, on their proper construction, the Conditions did not apply in the events which had occurred.

The Case in the House of Lords

Before the House of Lords, the two basic issues were whether, on their proper construction, Conditions 1 and 2 could apply and, if so, whether Securicor were prevented from relying upon them because of fundamental breach or on any other ground. As to the construction point, their Lordships were unanimous that the words used in Condition 1 were apt to protect Securicor. On the second issue, they unanimously denied the existence of any substantive doctrine of fundamental breach, with the reservation, in the case of Lord Diplock, that the agreement must still exhibit "the legal characteristics of a contract". 12 Harbutt's "Plasticine" and Wathes v Austin (Menswear) Ltd. 13 were both overruled, as was Charterhouse Credit v Tolly, 14 the decision relied on in the Wathes case. Nor did Lord Denning's alternative grounds of "presumed intention" and his test of reasonableness find favour. The House reaffirmed that, within the limits of legality, the parties were free to contract on terms of their own choice, and to agree beforehand what the consequences of breach should be.

Wilson J. clearly regarded a condition precedent as being necessarily a part of a binding contractual relationship which would prevent either party from withdrawing while awaiting the outcome of the condition. He made no reference to the relation between such a condition and the scope of the grounds for withholding approval. It is suggested that had Wilson J. conceived of a condition precedent operating outside of and precedent to the contractual relationship itself, this might have provided an equally acceptable alternative interpretation of the facts before him.

A similar view may be taken of the facts in Frampton v McCully. The Court of Appeal does not appear to have considered the possibility that the parties might have agreed on terms but not intended to be contractually bound until the approval was given. Instead, it rejected the view that there might have been a counter-offer which had been accepted giving rise to a contract subject to a condition precedent of the solicitor's approval, because the grounds on which that approval might be withheld could not, on the facts, be restricted. Given the view of a condition precedent on which this reasoning is based, i.e. that the parties are bound by contract while awaiting the outcome of the condition, the inability to restrict the scope of the approval is a valid reason for rejecting the interpretation. But again, if a condition precedent is seen as operating outside of and precedent to the contractual relationship itself, so that neither party is contractually bound unless and until the approval is given, there is no reason why there should be any restrictions at all on the scope of the matters subject to the approval or even on the ability of the client to instruct the solicitor to withhold approval. In Frampton v McCully the issues would then have been, first, whether an offer intended to be capable of acceptance was being made; if it was, secondly, whether it had been accepted; and, thirdly, because intention is a third and separate element in the making of a contract, whether the time when and the manner in which the parties intended to become contractually bound was dependent on the vendor's solicitor's approval. The giving of such approval would then have been the event which caused a contract on the agreed terms to become automatically binding on both parties. It is suggested that the results in both of these cases might be attributed, first, in part to the written offer and acceptance process of contract making used in Christchurch which directs attention to the offer and the acceptance and away from the contract, and, secondly, in part to the restricted view of a condition precedent taken by the Court in each case.
However, Boote v. R.T. Shills & Co. Ltd., \textsuperscript{22} the third case to at least contain obiter reference to the interpretation of a solicitor's approval clause, also came from Christchurch. The Court of Appeal, in a judgment again delivered by Cooke J., felt that there was no difficulty in regarding the condition as a term of the contract: it did not prevent an effective offer and acceptance. In the written offer made by the purchaser was the clause, "This offer is subject to my solicitor's approval within seven days from acceptance date". It therefore clearly contemplated an effective acceptance before the outcome of the condition was known. The Court did not have to consider the operation of this condition as a part of the ratio of its decision, but it did comment, obiter, that "we think that the solicitor's approval could not be withheld capriciously or merely on the instructions of his client, but was meant to ensure that the conveyancing aspects of the transaction were satisfactory from the purchaser's point of view".\textsuperscript{23} 

Several comments may be made on this. The Court made no attempt to label the condition as precedent or subsequent, though the similarly worded finance condition in Scott v. Rania, \textsuperscript{24} which required the purchaser to find the finance "within 14 days of acceptance hereof", had been labelled "precedent" by the majority of the Court. In terms of the analysis suggested above, the question is whether the parties intended to be bound before, or only when, the particular condition was fulfilled. In the case of a finance condition it is suggested that they would probably intend to be bound before the outcome of the condition was known. On the definitions of the labels proposed in this paper, the condition would then be described as subsequent to the contractual relationship, though it might also be precedent to the obligation to perform some of the promises. In the case of the solicitor's approval condition, however, it is not so clear. The parties might intend an effective offer and acceptance but might not intend to be contractually bound unless and until the approval was given,\textsuperscript{25} in which case

\begin{center}
\textbf{THE SECURICOR CASE}
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\textbf{The Case at First Instance}
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Photo Production Ltd. v Securicor (Transport) Ltd. \textsuperscript{3} involved a 1968 agreement under which Securicor was to provide a patrol service to Photo Productions' premises at a charge which worked out at about 26 pence per visit.\textsuperscript{4} The agreement included Standard Conditions of which 1 provided that "under no circumstances [should the Company be responsible for any injurious act or default by any employee of the Company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer...". Condition 2 allowed for limitations of liability should any liability on the part of the Company arise "notwithstanding the foregoing provision." Whilst on an inspection of the premises, one of Securicor's employees deliberately started a fire which resulted in loss totalling £615,000. The employee in due course was convicted of arson and sentenced to three years' imprisonment. In the meantime Photo Production Ltd. re-engaged Securicor under a new contract.\textsuperscript{5} 

Photo Productions' claim in the High Court was for damages in contract or tort, or both. They alleged that the contract contained two implied terms, one that the patrolmen would exercise all reasonable diligence, skill and care, and the other that Securicor would itself exercise all proper care in the selection, training, supervision, employment and use of their patrolmen: The trial judge, McKenna J., rejected the first of these implied terms as being inconsistent with Condition 1 of the Standard Conditions. As to the second, he held that there had been no want of care or diligence on the part of Securicor as employers. But for Condition 1, Securicor would also have been vicariously liable in tort for their servant's criminal act,\textsuperscript{6} but since that act was not one Securicor could have foreseen and avoided, their responsibility for this too had been excluded. The provision was a reasonable one and there was no cause for the Court to put a strained meaning on its language. Photo Productions had also argued that Securicor had committed a fundamental breach which prevented their relying on Condition 1. As to this, McKenna J. held that if a contract provided that one of the parties to it should not be "responsible" if a particular event occurred, the occurrence of that event could not be treated as being a breach of contract by that party. If it could not be treated as a breach, it could not be treated as a fundamental breach, however serious its consequences. He referred to the judgment of Kerr J. in the Evans cases, \textsuperscript{7} 

Of the two grounds upon which the reasoning in Harbutt's "Plasticine" could be challenged, from the nature of discharge for breach and from the
Much more important, though, was the second factor. This was that even where the courts purported to apply a rule of construction, they were in fact using the presence or absence of fundamental breach as the determinant of whether the exception clause applied, and hence were applying it as though it were a rule of law. It was also very vividly illustrated in the unreported case of Prince v Brown Bros. and Merseyside & North Wales Electricity Board which concerned an indemnity given by an employer to the Electricity Board, which failed to turn off the power to a transformer which the employer’s workmen were to paint. When one of their number was electrocuted, the remainder not unnaturally refused for a time to continue, though in due course they went back to work. It was held that since work had been resumed and completed, no “fundamental breach” had occurred.

Accordingly the Electricity Board were protected by their indemnity. Had the question asked been not “was the breach ‘fundamental’?” but “was it serious?” the whole enquiry would have been transformed. The act of the Board in putting the lives of the workmen in jeopardy was not only appallingly serious in its possible consequences. It was also probably a breach of the duty of common humanity as well. To hold that the indemnity protected the Board was to hold, not just that an insurance risk had been allocated between commercial parties, but that an employer had bargained away the legal responsibility of the party whose role it was to ensure that the lives of the workmen were not endangered. Whether that truly was the intention expressed or implied in the contract could not, on the approach followed, be even considered.

Some reaction against these developments seems to have at least begun before the Securicor case. In 1977, Griffiths J. in Green v Cade Bros. showed that he believed something was wrong when he said:

“Nor do I find much help in approaching the question of construction by applying the label ‘fundamental’ to the breach or to the term breached. The Court has to look at the facts that constitute the breach and the circumstances surrounding it and ask itself whether the clause could have been intended by the parties to apply to such a situation and the nature of the breach must loom large in such consideration.”

However, while it was a step forward that the seriousness of the breach, or the importance of the term, should have been seen as more relevant than its belonging to a particular technical category, it has to be noted that the facts and surrounding circumstances to which the learned judge referred were those of the breach instead of, as construction would normally require, those attending the formation of the contract.

Outside England and Wales, the revival of the substantive doctrine of more than fundamental breach seems to have been matched in Canada. But from the reported cases, it appears to have had much less impact in Scotland, Australia and New Zealand.
must include, in construing the suggestion in Boote v. R.T. Shields & Co. Ltd., very widely to mean "arising out of the duties and obligation owed by a solicitor to his client when acting for that client and advising concerning a conveyancing matter". That must include, in most cases, a considered view or opinion as to the transaction the client is entering into as a whole. In the circumstances the solicitor for the vendor was entitled honestly to withhold his approval because a better offer was available to his client. The only requirement was that it be the solicitor's own decision. With respect, the width of the matters to which the approval was seen to extend was so great that it is difficult to read the condition so interpreted consistently with the existence of a binding contract. If such an interpretation of the condition is correct, it raises clearly the question, unasked in the decision, whether the parties had intended to be contractually bound at all pending the outcome of the condition. In the light of the interpretation it might have been more realistic to find that they did not so intend. The finding of Holland J. certainly comes very close to the situation of a bilateral contract binding only one party, which is a legal impossibility.

Some time has been spent discussing solicitor's approval conditions for two reasons. First, they are still largely unexplored territory, though very common in practice, so that some thought needs to be given to exactly what is intended when they are used. Secondly, it is contended that they are probably the only example of a condition in common use in New Zealand which could, and perhaps frequently should, be seen as a condition precedent in the sense in which that term is used here. It is the probable intention of the parties when the substance of the condition is something other than their solicitors' approval that they do intend to be immediately bound and that the condition is to operate within the contract, to be, in my terms, a condition subsequent.

Conditions Subsequent

If the test is accepted as being "when and how do the parties intend to become bound in contract", it is suggested that where the substance the basis of the contract as a whole and not just of selected parts of it.

The premise that exception clauses were mere defences also came in question. In Kenyon Son & Craven Ltd. v Baxter Hoare & Co. Ltd. Donaldson J. distinguished three kinds of exception clause, depending on whether they excluded obligation, excluded liability, or merely limited liability. In respect of at least the first of these, he denied that the court could discover the obligations of the proferens without taking into account any exceptions of those obligations. Soon afterwards, in The Angelia, Kerr J. expressed the view that an event covered by an exception of "liability" was not and could never be a breach at all, let alone a fundamental breach. The difference between an exclusion of liability and an exclusion of obligation was merely "semantic". This meant that, of Donaldson J.'s three categories of exception clause, it could be said only of limitation clauses that they operated as more defences. It was to the category of limitation clause that the exception in "Harbutt's Plasticine" belonged. But even in respect of this class, Barwick C.J. and, significantly, Diplock L.J. were already on record as saying that limitation clauses, too, qualified the obligations to which they referred, though this was not a view shared by some of the commentators.

The Revival of the Original Version of Fundamental Breach

The decision in Mathies v Austins (Menswear), though it purported to follow Harbutt's "Plasticine", could be interpreted as a return to the pre-Suisse Atlantique rule of law. But in addition there were two further factors tending in the same direction, the first of them being the dicta of Lord Wilberforce of which mention has already been made and rephrased in his judgment in the Suisse Atlantique. There were three. First, he distinguished two meanings which had been given to the expression "fundamental breach". The one he saw as covering fundamental breach in the meaning given it in this paper. The other covered discharge for breach as it is defined in this paper.

The second dictum was to the effect that an exception clause could not be allowed to empty a contract of all content. To this extent, there was rule of law. The point he was making related to the formation of the contract and depended on the idea he had expressed elsewhere in his judgment that exception clauses could have/that what would otherwise be a breach would not be a breach at all. Thirdly, he gave deviation, quasi-deviation and "difference in kind" as examples of construction, as being cases where the parties "could hardly have been supposed to contemplate such a mis-performance".

These passages were taken by Fenton Atkinson L.J. in Farnsworth Finance Facilities v Attryde and particularly by Donaldson J. in Kenyon, Son & Craven v Baxter Hoare to mean that fundamental breach in the narrower sense in which it has been defined in this paper, had survived the Suisse Atlantique as a rule of law.
consistent not only with *Hain v Tate & Lyle* but also with dicta in the *Suisse Atlantique* case itself. And though it deprived a proferens of his exceptions by a rule of law, it was a different rule of law from that which had been condemned by the House of Lords. Moreover, counsel for the defendant had conceded that, if the contract had been discharged, his clients would have lost the protection of their limitation clauses. The other, unstated, premise was that exception clauses take effect, if at all, only as defences at the point of adjudication. Only if this were so could they be denied effect by a rescission of the contract in futuro. If their true effect were to limit the obligations of the promisor, that would have occurred at the time of formation, and no rescission in futuro could affect them. It follows that, whatever its surface attractions, the reasoning in Harbutt's "Plasticine" was vulnerable on two counts. It would collapse if the effect of discharge for breach were not, after all, a literal rescission of the contract. It would suffer the same fate if exception clauses were recognised as being not mere defences, but qualifications of obligation.

During the decade which followed, the application of Harbutt's "Plasticine" became increasingly extreme. In *Wathes v Austins (Menswear)* Ltd the Court of Appeal held that the principle applied not only where the contract had been discharged for breach, but also where it had been affirmed by the injured party. The Court purported to follow *Charterhouse Credit Co. Ltd. v Tolly*, on the basis, which was correct, that it had not been expressly overruled in the *Suisse Atlantique* case. While reference was made to "construction" in the *Wathes* case there was no analysis of the words used. It appeared to be assumed that the result of the case would turn, not on the wording of the contract, but on whether a fundamental breach had occurred. The significance of this was not lost on Lord Denning M.R. In *Levieson v Patent Steam Carpet Cleaning Co.*, and in the *Securicor* case itself, he reverted to the terminology of the pre-*Suisse Atlantique* period.

**Contrary Trends**

As against these developments two other streams of authority emerged which pointed in the opposite direction. The premise that discharge for breach involves a literal rescission, depriving the contract of any future effect, became difficult to reconcile with *The Mihalis Angelos* in which the Court of Appeal held that, for the purposes of assessing damages, regard had to be given to a clause in favour of the "wrongdoer" which would not have been operative until after the contract had been discharged. Again, in *Moschi v Lgp Air Services Ltd.*, the House of Lords appeared to accept the view that, while on a discharge for breach any primary obligations ceased and were replaced by secondary obligations to pay damages, those damages were to be assessed on the basis of the condition is something other than solicitor's approval, something such as finance, sale of another property, or the approval of an independent third party, there is a high probability that the condition is one within an existing contract. It may be precedent to the performance of certain of the promises within the contract, though certainly not to the operation of other parts of the contract (such as the obligation to pay the deposit or the running of time under the requisitions clause), but it is subsequent to the creation of binding contractual relations. The principle New Zealand decisions which have labelled such conditions as precedent were examined above - *Griffiths v. Ellis*, *Mulvena v. Kelman* and the majority judgments in *Scott v. Rania*. It has been seen that in *Griffiths v. Ellis* the relevance of the condition was in regard to the obligation to perform certain promises in the contract. In that respect it was properly described as precedent, but, although it was not relevant to mention it, there was an existing contract to which the condition was subsequent. In the other two cases the relevance of the conditions was in regard to the existence of the contract and it is clear that in each case the Court believed that the parties were contractually bound, so that the conditions would have been more accurately and usefully described as subsequent. There was a failure to distinguish clearly between conditions precedent to contract and precedent to performance. Therefore, when one looks at how the conditions have been seen as operating, rather than the labels given to them, the New Zealand cases have consistently treated such conditions as subsequent to contract.

If this is correct, each condition is, regardless of its substance, subject to the same set of rules, unless of course, the parties have made their own by the terms of the contract. It is then a matter of what are the rules prescribed by law. It is proposed to examine here three of the basic matters which have frequently arisen: first, the obligation to take all reasonable steps to achieve the fulfilment of the condition; secondly, what happens if the condition is not fulfilled; and, thirdly, waiver of the condition.

If all of these conditions are within existing contracts, there is no problem about the obligation to take all reasonable steps to
achieve their fulfilment. It is accepted that a party cannot take advantage of the non-fulfilment of a condition in order to escape from a contract if the non-fulfilment has come about through his own default. The Courts have expressed this in positive terms by placing an obligation on one of the parties to take all reasonable steps to fulfil the condition, but there has been difficulty in finding a theoretical basis for imposing the obligation. The two viewpoints put forward to date have been, first, that it can be done only by an implied term in a contract, or secondly, by the application of the broader principle that no man can take advantage of his own default. The first of these is merely a narrower view of the second, based on the view that the only default available for the application of the principle is a breach of contract. In Gardner v. Gould, the Court of Appeal was unanimously of the opinion that the narrower view was the correct one.

This means that the condition must be one which is operating within a contract before the obligation can become an implied term of the contract; in terms of the present analysis, the condition must be subsequent to contract. However, if virtually all conditions in conveyancing agreements do operate in this way, there is no problem about implying a term. At present, the lack of differentiation between conditions precedent to contract and precedent to performance has led to a belief that the obligation cannot be imposed in the case of a condition precedent as in Scott v. Rania. But if it is recognised that the condition in Scott v. Rania, regardless of the words used to describe it, was precedent only to performance and, in fact, subsequent to contract - these being merely different aspects of the operation of the same condition - then clearly there is a contract into which the obligation may be implied. The correct width of the principle then, perhaps, becomes a matter of only theoretical, academic importance; it certainly need not dictate the labelling of conditions.

The second important issue is the effect of the non-fulfilment of the condition. Although the rules as to the effect of non-fulfilment appear well settled, it will be argued that the confusion over the
residual contractual content of the agreement will be actionable.

The first appearance of this kind of analysis, of the relationship of exception clauses to primary and secondary obligations, in a reported case, seems to have been in Hardwick Game Farm v S.A.A.P.A. The Judge was Diplock L.J. He said much the same thing again in the Heron II later the same year. In due course he was to bring the analysis into Moschi v LEP Air Services and ultimately into the Securior case itself.

THE SUISSE ATLANTIQUE CASE

The weaknesses of fundamental breach as a substantive rule of law did not go unnoticed. A series of dicta from 1964 onwards, by Pearson L.J. in England, and Diplock L.J. in Australia, all tended towards the view that there was no rule of law but at most only a rule of construction, and it was against this background that the question came before the House of Lords in the Suiss Atlantique case.

Fundamental Breach as a Rule of Law

Since the Suiss Atlantique was perhaps the best known and most discussed contract decision of its time, it would be tedious here to subject it to yet another analysis. For present purposes, though, a few points need to be recalled. The first was, of course, that the House unanimously denied the existence of a substantive rule of fundamental breach. Nevertheless, they left the way open to a resurgence of the doctrine in a number of ways.

The first was that none of the earlier cases was expressly overruled. Instead, they were said to be explicable on the basis of construction. That left open the possibility of a continuing "rule of construction". The second was that their Lordships described the incidents of fundamental breach and fundamental terms in words reserved historically for discharge for breach and conditions. At the time, this gave some ground for thinking that the House had accepted that no separate concept of a fundamental breach or a fundamental term could be justified. Nevertheless, their Lordships retained the terminology of fundamental breach. That suggested to readers of the reports that the special concepts not only survived but had continuing relevance to exception clauses. The third respect in which the House left a way open to the resurgence of the doctrine was that they confused and conflated fundamental breach, discharge for breach and deviation. It was this which was to lead before long to Harbutts' "Plasticine. Conversely, it even led to the conclusion that a condition had to have the incidents of a fundamental term. That is what happened in Ashington Piggeries Ltd v Christopher Hill Ltd where the House of Lords concluded that, for there to be a discharging breach of the condition implied by term "precedent" has again caused error to creep into our understanding. However, one preliminary point is clear: if the condition specifies a date for its fulfilment, time is of the essence as to that date without any need expressly to make it so. The consequences of non-fulfilment therefore occur immediately and automatically on the specified date.

If a condition precedent to the contract should fail, the contract simply never comes into being. The parties have stated their intention as to how and when there is to be a contract between them. If the circumstances described in the condition do not come into being, neither does the contract.

Conditions described as subsequent are said to give rise on their non-fulfilment to a right to avoid the contract. The non-fulfilment of the condition, therefore, merely brings this right into being: a party wishing to exercise the right must then make a positive act to do so, and thus terminate the contract, before the right is lost. Dealing with non-fulfilment in this way both allows for those cases in which the outcome of the condition can be affected by the conduct of one party, and gives greater flexibility to the parties than would exist if the contract were automatically terminated. With regard to the former, if one party brings about the non-fulfilment of the condition by his conduct, the other party alone may avoid the contract; but if neither party is responsible for the non-fulfilment, then each has the right. These rules appear sensible and satisfactory. They dovetail with the obligation to take all reasonable steps to fulfil the condition and they leave both parties some further room for manoeuvre if the condition is not fulfilled within the time.

Again, however, difficulty arises because of the failure to distinguish in the use of the term "precedent" between precedent to contract and precedent to performance. It is understood that if a condition described as "precedent" is unfulfilled at the time specified for fulfilment, the contract is immediately and automatically terminated, unless the condition has failed because of the default of one party having an obligation to take all reasonable steps to achieve its fulfilment, in which case the contract is voidable at
the option of the innocent party. This is a peculiar and illogical amalgam of the two sets of rules discussed above in relation to conditions precedent to contract and conditions subsequent. The present concern is with conditions precedent to performance. It is difficult to see why a condition precedent to performance should, on its non-fulfilment, have the effect of rendering the contract automatically void. However, when it is remembered that the effect of the non-fulfilment of a condition precedent to contract is that automatically the contract cannot come into being, the source of the automatic avoidance rule is evident. If this is carried across logically to a condition precedent to performance, the result of non-fulfilment is only that the obligation to perform does not arise; from its classification as precedent to performance it has no logical effect on the contract itself. Indeed, if the condition is intended to have effect on the contract itself, it is as a condition subsequent, so that the rules regarding them which are set out above would apply. Further, if this is correct, it has serious consequences for the validity of the reasoning of the majority of the Court of Appeal in Scott v. Rania.

Once the right to avoid has arisen, it continues to exist in spite of the facts required for the fulfilment of the condition coming about after the time specified for fulfilment. If this happens and the party having the benefit of the condition then wishes the contract to proceed, the proper course is to waive the condition. The right to avoid the contract may, of course, be exercised, or it may be lost in any of three ways. First, it may be lost by the party having the right electing, either by words or by conduct, to affirm the contract. Secondly, even in circumstances where the party having the right cannot be said to have elected to affirm, the right may be lost by estoppel, as was found to have happened in Burton v. Russell. Thirdly, if, after the fulfilment date, one party has the right to waive the condition and does so, the waiver will be effective to destroy the other party’s right to avoid the contract.

What gave the new concepts credibility was the view taken by their proponents of the function of exception clauses.

THE FUNCTION OF EXCEPTION CLAUSES

The fundamental breach principle turned on the idea, expressed by Denning L.J. in Karsales v. Wallis, that in construing a contract containing exception clauses it was “necessary to look at the contract apart from the exempting clauses to see what are the terms express or implied which impose an obligation on the party.” It was not the condition or fundamental term which was excluded from the contract. It was liability for its breach which was excused, the exception clause operating as a defence, at the point of adjudication, to accrued rights of action. That, incidentally, helps to explain the early emphasis on fundamental breach and the breach of a fundamental term.

In my book and elsewhere I have argued that exception clauses qualify the promises to which they relate and hence take effect at the formation of the contract rather than as mere defences at the point of adjudication. A party to a contract is subject to primary obligations to perform his undertakings and to corresponding sanctioning or secondary obligations to pay compensation if he commits a breach. At common law the two are inseparable, in the sense that no primary obligation arises unless the party concerned has also accepted the sanctioning obligations that go with it. Exception clauses affect the accrual of these obligations, at the time the contract is formed, either by modifying them or by preventing their arising at all. They can do so in three ways. The first involves excluding the primary obligation directly. So, if I sell a horse warranted sound except for hunting, I accept no primary obligation as to its soundness for hunting. Under the second method the primary obligation is excluded because the secondary obligation which would otherwise attach to it has been excluded. Thus, if I say I will not be liable for loss or damage from my servant’s negligence, I not only refuse to pay damages. I accept no primary obligation to ensure that my servants are careful. Under the third, sanctioning obligations are limited, without that fact preventing the initial existence of the primary obligations to which they attach. Accordingly, if I limit my potential liability to $2,600.00, I accept a primary obligation to perform but if I commit a breach, no secondary obligation accrues beyond that to pay $2,600.00 in damages.

The significance of this view of exception clauses in relation to fundamental breach is not just that it means that exception clauses take effect at formation of the contract but also that it leaves no need for the concept of fundamental breach itself. This is because, once the exception clauses have taken effect at the formation of the contract, every breach thereafter of the
There are two important points to note about these passages. The first is that, since on past authority "conditions" of the contract could be excluded, the breach of a fundamental term had to be something more fundamental than the breach of a condition, as Devlin J. acknowledged and his decision illustrated. The second is that before the Hong Kong Fir case many, if not most lawyers thought that every discharge for breach was the breach of a condition. In the 1950's, therefore, it followed that a fundamental breach had to be worse than a merely discharging breach. It also meant that for every fundamental breach there ought to be a corresponding fundamental term. That is why commentators in due course subsequently matched the "main objects" of the contract and the condition as to title under the Sale of Goods Act, as fundamental terms, with total failure of consideration as a fundamental breach. Similarly, the "core of the contract" was matched with "difference in kind". After the Hong Kong Fir case had shown that discharge for breach did not have to be the breach of a condition, but could depend on the scale of the breach, a similar change occurred in relation to fundamental terms and fundamental breaches. Instead of being regarded as the two sides to the one coin, they too came to be seen as two different things, depending on the importance of the term and the scale of the breach.

The basic weaknesses of the substantive doctrine of fundamental breach were that as a rule of law it lacked any previous warrant, and that it was conceived as a unified principle, whereas the threads of authority on which it was based were all really quite distinct. Thus, the courts had long been reluctant to construe general words of exception as excluding the warranty of seaworthiness, but the same was true of important terms generally and even of negligence. Moreover, it was clear on earlier authority that, like promissory conditions, the warranty of seaworthiness could be excluded where the words used were apt to do so. The idea that the condition as to title was unexcludable was not only inconsistent with the emptio spel but was hard to reconcile with the fact that the implied condition as to title was itself only a relatively modern development. The very concept of an unexcludable core of obligation was inconsistent with Rose & Frank v Crompton Bros, in which the House of Lords accepted that, even in a commercial agreement, all obligation whatever could be excluded by the use of an "honour clause." And it was difficult to conceive of a term more fundamental than a condition when a condition was a term so vital that any breach justified a discharge of the contract. Again, to apply to a sale of goods contract, on a fundamental breach, the consequences of a deviation would be to deprive a proferens of the protection of his exceptions, even in respect of those breaches which were not fundamental.

This raises the third and last basic issue regarding the operation of conditions - the possibility of waiver. There are two main questions about waiver: who has the right to waive and when may the right be exercised?

The simple answer to the first is that where the condition is exclusively for the benefit of one party, that party may waive the condition and render the contract fully binding on both parties. The difficulty is to know what is meant by "benefit". That is a necessary first step to knowing when the benefit is exclusively one person's. However, the cases give no clear answer. In some the benefit is seen to be the protection from contractual liability afforded to the person(s) requiring that protection. In others, it is seen to be the right to obtain freedom from legal obligation to perform contractual promises upon the non-fulfilment of the condition. If the former is the correct view, waiver will be available in a much greater number of cases than if the latter is adopted. The latter would restrict waiver to those few cases in which the condition operates in no other way than as precedent to the liability of one party. If it also has potential effects as a condition subsequent to the contract so that, subject to the contract itself restricting the right to avoid to one party, it might give the other party a right to avoid the contract, and thereby in these terms confer a benefit upon him, it would make waiver impossible by the party having the benefit in the first sense given above. There is as yet no judicial resolution of this division of views.

It does seem, however, that where the condition is "inextricably mixed up with other parts of the transaction" from which it cannot be severed, as when the terms of the condition fix the settlement date, waiver is not possible. This may also show that the condition operates partly for the benefit of the other party.
There are also conflicting opinions as to whether evidence of the surrounding circumstances is admissible to show that both parties were intended to benefit. Such evidence has been accepted in New Zealand, but might not be admitted in England.

The effect of the two basic views as to benefit stated above upon the two kinds of condition identified in this paper needs now to be considered. The effect upon a condition subsequent has already been stated: the first view of benefit would permit waiver in a wide range of cases, while the second would restrict the right to waive to a very narrow range of cases. The accepted position with regard to waiver and a condition precedent to contract is that such a condition cannot be waived. Certainly neither of the above views as to benefit stated above would allow the waiver of such a condition. Waiver of a condition operating within a contractual relationship assumes that the parties are contractually bound but that it is a part of the agreement that if a certain situation does not come about, one or either may terminate the contract. If the party who sought that protection decides to forego it, he can do so by waiver. But, in the case of a condition precedent to contract, the parties have agreed that if a certain situation does come about, they will be bound by contract. They have defined the time and the manner of the creation of the contractual relationship, a definition which can be altered only by agreement. The operation of the condition is so different that waiver is no longer logically possible. The second view of a benefit, the right to freedom from legal obligation, clearly does not apply because until there is a contract there is no obligation from which to obtain freedom. Waiver, therefore, applies only to conditions subsequent, and then only according to the view taken of benefit.

As to when the right of waiver may be exercised, again the simple answer is that it must be exercised before the termination of the contract. This reinforces the opinion that waiver has no application to conditions precedent to contract because there is then no contract to terminate. Waiver is available only to save a contract from termination, not to create a contract.
Several explanations have been given for the phenomena associated with deviation. One has been that it derived from marine insurance and refers back to the difficulties of communication in the days of sailing ships. Another, given by Lord Wright in *Rendall v Arcos*, was that the exception clauses have reference only to the risks to be encountered along the contract route and, hence, have no reference to the altered risks of the deviation. The true explanation, it is submitted, lies in the nature of a bailment relationship. Though such relationships tend to be seen as imposing burdens, they are equally a form of protection to the bailee. But the protection lasts only so long as the bailee holds the bailed goods within any limits the bailor has placed on his right to possession. If he steps outside those limits he holds, not as a bailee, but as a mere detainor and as such becomes absolutely liable for loss or damage to the goods so detained. Neither the construction nor the bailment explanation presupposes any termination of the contract.

For present purposes, though, the important point is that if the incidents of deviation and quasi-deviation are taken to be the result of a rescission of the contract, they cannot be explained as flowing from a discharge for breach as it was analysed in *Heyman v Darwins*. On the other hand, in the light of House of Lords decisions like *U.S. Shipping Board v Bunge and Born* and *Hain v Tate & Lyle* itself, it seems too late to suppose that deviation can be seen by the Courts to turn on anything but a rescission. For practical purposes therefore, deviation and quasi-deviation would seem to be best regarded as sui generis.

**Fundamental Breach**

The doctrine of fundamental breach, as it developed before the *Suisse Atlantique*, was a substantive rule of law. It asserted that there were categories of breach and types of contractual term so fundamental that no exception clause, however drawn, could exclude liability for them. It originated in a series of three judgments by Devlin J., in *Chandris v Isbrandt-Moller*, *Alexander v Railway Executive*, and *Smeston Hanscomb v Sassoon I. Setty*. The first two of these cases were contracts for the carriage and bailment of goods, respectively, and the breaches involved were of the "deviation" type. Devlin J. referred to such breaches as "fundamental", which was a word used by them of the House of Lords in *Hain v Tate & Lyle*. So far there was no novelty. The real departure came with the *Smeston Hanscomb* case, where timber sold by description did not comply with specification so that there was a breach of the condition implied by Section 13 of the Sale of Goods Act 1893. But the buyer had failed to take action within a contractual fourteen-day time limit on claims. Devlin J. attempted to generalise a new principle of wider application in words well worth repeating for the light they shed on its incidents and purposes.

When conditions subsequent as described in this paper, are considered, again difficulty arises with the use of the term "precedent" in the New Zealand decisions, and particularly in the majority judgments in *Scott v. Rania*. It has been seen that in those judgments it was found that, having labelled the condition as "precedent", the contract automatically terminated when the condition had not been fulfilled by the specified time. Any waiver of the condition, to be effective, had also, therefore, to occur before that time. But if the analysis suggested in this paper, which basically agrees with the dissenting judgment of Hardie Boys J., is correct, the condition was precedent to performance, not to contract, and was therefore subsequent to contract with non-fulfilment giving rise to a right to avoid the contract. If waiver is effective at any time before the termination of the contract, the statement by the purchaser's solicitor that finance had been arranged and that the contract was unconditional would have constituted a waiver which, on the facts, preceded what could have been construed as the vendor's exercise of the right of avoidance - all of which accords with the judgment of Hardie Boys J.

*Fundamental Breach*
avoidance. Seen in this way, this is clearly more than an election to affirm the contract for oneself, thereby destroying one's own right of avoidance; it is a waiver which does this and destroys the other party's right of avoidance. It may well be questioned whether a waiver at this point is of a benefit belonging exclusively to the party waiving it - if it is not, then Scott v. Rania may have been right after all.

Lastly with regard to waiver, it must be remembered that it is difficult to distinguish waiver both from variation and from promissory estoppel. In the present context such issues generally arise when there has been an extension of the time for the fulfilment of the condition. Because there is an adequate discussion of these points elsewhere, it is not repeated here.

Conclusion

I believe it is impossible to accept all of the decisions, even in New Zealand since 1958, as correct, because some are basically irreconcilable with others. The only satisfactory way to resolve this is to attempt an analysis from first principles. This I have done with regard, insofar as I have had to use the labels "precedent" and "subsequent" and give them meanings, to what is most useful in practice. I have then examined the decisions and the operational rules in the light of the structure which emerged from the analysis. It is impossible to foresee or to answer all of the questions to which conditions might give rise, but I hope that the foregoing does provide at least the basic structure for their consideration.

breach since then has been of a series of explanations for this phenomenon, each of which tended to take on a life of its own. Several of them involved the idea of "condition" in one form or another, doubtless because, originally, the rights of a party to sue were conditioned on his own prior performance.

Thus developed eventually the Sale of Goods Act division of contract terms into so-called conditions and warranties. The idea became current that the release of the injured party involved the 'rescission' of the contract and that the right to 'rescind' arose on the breach of a condition. In Hirji Mulji v Cheong Foo, Lord Sumner, for the Privy Council, likened discharge for breach to frustration and ascribed it to the failure of a condition subsequent. Then, in Hain v Tate & Lyle, the House of Lords saw discharge for breach as having the same incidents as deviation. By contrast, a few years after that, in Heyman v Darwins, the House assimilated discharge for breach to anticipatory breach. The breach by the wrongdoer was a repudiation which gave the injured party the option of discharging the contract. But that discharge was not a literal rescission. The contract as a whole remained in being for the purpose of assessing damages.

In recent years, the House of Lords has, in Mosch v LEP Air Services, produced yet another analysis. On a discharge for breach, the contract does terminate, in the sense that primary obligations to perform are replaced by secondary obligations to pay damages. But those obligations are to be measured by reference to the contract as a whole.

Deviation

The characteristic feature of deviation in contracts for the carriage of goods by sea is that, from the moment the ship departs from the contract route, it automatically loses the protection, not only of its exception clauses, but also of the common law exceptions of the act of God and the actions of the Queen's enemies. The ship becomes absolutely liable for any loss or damage to the goods carried, the only defence being that that loss or damage would have occurred anyway. Similar incidents occur throughout bailment where they bear the label of "quasi deviation", Lilley v Doubleday being a well-known illustration.

As already mentioned, the House of Lords tried, in Hain v Tate & Lyle, to explain these incidents as being the result of a discharge for breach. That meant, they thought, that a discharge for breach automatically rescinded the contract, at least in futuro, unless it were affirmed. That analysis is, of course, quite inconsistent with the version given in Heyman v Darwins. Under that version, there would be no literal rescission, nor would there be any discharge unless the injured party so elected. Even then the contract as a whole would continue to govern the remedies available to him.
THE SECOND RISE AND FALL OF
FUNDAMENTAL BREACH

INTRODUCTION.

Soon after the decision of the House of Lords in the Suisse Atlantique
case,1 and of the High Court of Australia in Council of the City of Sydney
v West,2 I wrote a paper for the 1966 AULSA Conference under the title of
"The Rise and Fall of Fundamental Breach."3 In the light of what followed
that title came to appear at least a little premature! The Suisse Atlantique
did come as an end, but as the end, as it turned out, merely of an episode in
a continuing story. The recent decision of the House of Lords in
Photo
Production Ltd v Securior (Transport) Ltd4 similarly marks an end, but whether
of just another episode or of the story as a whole is still uncertain.
Accordingly, the title of this present paper is more a concession to symmetry
than an attempt to prophesy.

For me, the Securior case draws its meaning and significance from what has
led up to it. That
is
why the first half of the paper deals with the background
to the case, even though this involves some repetition of what I have written
before.5 Then follows a discussion of the main points of the decision, as they
relate to fundamental breach. Finally, some thoughts are offered about the
significance of the decision for the future.

DISCHARGE FOR BREACH AND DEVIATION DISTINGUISHED.6

One of the principal difficulties with the concept of fundamental breach
has been a tendency to confuse it with discharge for breach and deviation. As
a first step, therefore, it would seem desirable to show briefly how the three
differ from each other.

Discharge for Breach

In the sense in which it will be used in this paper, discharge for breach
is concerned with the position of one party to a contract where the other has
so broken his promises that, in a significant way, the injured party is denied
the performance for which he bargained. The concern is not so much with the
right of that party to damages, but with whether he must complete his own
performance as a condition of suing the party in breach. Two hundred years ago,
if the promises were classified as dependent, neither party could sue the other
unless he had first performed his own side of the bargain. This meant that a
party in significant breach was unable to enforce the contract against the
injured party, for the simple reason that he was not qualified to do so. In
this sense, therefore, the breach of the one party automatically meant the release
of the other from the need to continue performing. The history of discharge for

FOOTNOTES

2. Ibid at 267, CA.
3. Idem.
4. A very recent discussion of this distinction may be found in
and 353, para 511.
17. Carruthers v. Whitaker [1975] 2 N.Z.L.R. 667 at 672, CA,
per Richmond J.
18. It might even be only so precedent and so not intended
in any circumstances to have any effect on the contractual
relationship itself, but it is submitted that such is not
the case with any of the New Zealand decisions to date
concerning these kinds of conditions in a vendor and purchaser
context.
per Cooke J.
23. Ibid., at 451, CA, per Cooke J.
25. This approach was adopted in Henning v. Ramsay (1963) 81 W.N. (Pt. 1) (N.S.W.) 71, in which Taylor J., with Walsh J. concurring, regarded the condition as placing the case in the third category identified by the High Court in Masters v. Cameron (1954) 91 C.L.R. 353 at 360: "the intention of the parties is not to make a concluded bargain at all unless and until they execute a form of contract".
An appeal to the Court of Appeal is pending.
29. Hinde, McMorland & Sim, Land Law, 1010, para 10.011, n 1, where the situation when no time is specified is also discussed.
35. This is discussed more fully below.
41. An interpretation of the condition in this way by Barrowclough C.J. at first instance in Scott v. Rania ([1966] N.Z.L.R. 176) caused concern at the time (Fox, "Subject to Finance Again" [1966] N.Z.L.R. 426), because one party would then be held to the contract almost at the pleasure of the other, and so was rejected by the Court of Appeal ([1966] N.Z.L.R. 527) which saw it as a matter of law that
such conditions give a right of avoidance to both parties.


49. Scott v. Rania [1966] N.Z.L.R. 527 at 541, CA, per Hardie Boys J. dissenting; Beauchamp v. Beauchamp (1972) 32 D.L.R. (3d) 693; affd. (1974) 40 D.L.R. (3d) 160. The statement of fulfilment in Gilbert v. Healey Investment Pty Ltd. [1975] 1 N.S.W.L.R. 650 could not be treated as a waiver because the right of termination vested in the other party was seen as a benefit so that the condition was for the benefit of both parties.


52. Hinde, McMorland and Sim, Land Law, 1008, para. 10.010.