TAXATION OF PROFITS FROM THE SALE OF PERSONAL PROPERTY

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Under section 65(2)(e) of the Income Tax Act 1976 the term "income" is deemed to include:

> All profits or gains derived from the sale or other disposition of any personal property or any interest therein (not being property or any interest therein which consists of land within the meaning of section 67 of this Act), if the business of the taxpayer comprises dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit.

The purpose of this article is to examine the way in which the section is interpreted by the courts. The section has three limbs. Under the first limb, assessable income is deemed to include "[a]ll profits or gains derived from the sale or other disposition of any personal property or any interest therein . . . if the business of the taxpayer comprises dealing in such property". Under the second limb assessable income is deemed to include "[a]ll profits or gains derived from the sale or other disposition of any personal property or any interest therein . . . if the property was acquired for the purpose of selling or otherwise disposing of it". Under the third limb assessable income is deemed to include "all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit." The first and second limbs apply only to personal property, but the third is more general. The taxation of profits from isolated sales of land, which will not be considered in this article, is primarily governed by section 67.

The predecessor of both these sections is section 88(1)(c) of the Land and Income Tax Act 1954 which applied to sales of both land and personal property and which still applies in respect of dispositions before 10 August 1973. Its direct applicability is of diminishing importance. However, as its terms correspond closely with the current section (65(2)(e)) on personal property, the cases decided under it—whether they be in respect of personal property or land—have a present relevance in the interpretation of section 65(2)(e). The section provides that the assessable income of any person shall for the purpose of the Act (Land and Income Tax Act 1954) be deemed to include:

> All profits or gains derived from the sale or other disposition of any real or personal property or any interest therein, if the business of the taxpayer comprises dealing in such property, or if the property was acquired for the purpose of selling or otherwise disposing of it, and all profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit.

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Also of particular relevance in the interpretation of section 65(2)(e) are cases on the similar Australian provision—section 26(a) of the Income Tax Assessment Act 1936—which provides that the assessable income of a taxpayer shall include:

> Profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit-making by sale, or from the carrying on or carrying out of any profit-making undertaking or scheme.

I Concepts Used in the Legislation

1 *The Common Factor — "All Profits or Gains"*

The term "profits or gains" is used in both paragraphs (a) and (e) of section 65(2). However, it is not used in the same sense. In paragraph (a) it is used in accordance with Fletcher Moulton LJ's definition in *Re the Spanish Prospecting Co Ltd*:[1]

> The word "profits"[2] has in my opinion a well-defined legal meaning. . . . "Profits" implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates.

In paragraph (e) any profits or gains are often in respect of isolated transactions and are calculated without reference to other aspects of taxpayers' incomes and without reference to any particular tax year. Thus, they are calculated by subtracting from the amount realised on sale or other disposition, the original costs and any expenses.[3] In this case, it is possible that the events which give rise to these amounts will occur in different tax years. In the other situation—under section 65(2)(a)—the relevant times will all be in the one tax year.

Whether or not there has been a profit is not always easy to determine. In *FCT* v *Becker*[4] Kitto J said of section 26(a) of the Income Tax Assessment Act 1936 that it:[5]

> [U]ses the language of everyday affairs without artificial restriction or enlargement. . . . Whether a given amount is to be characterized as a profit within the meaning of the provision is a question of the application of a business conception to the facts of the case.

Becker itself illustrates that the courts will consider a transaction in its entirety rather than just the part which involves the acquisition and the sale of the property. The taxpayer owned land which he had acquired for purposes other than profit-making by resale. He wanted to sell part of the land but was restricted by legislation which required government consent to the sale. He was aware that he would not have received this consent if he put a price on the land in excess of £8,000, in the terms of the legislation, "a fair and reasonable value". To avoid the effect of this restriction, he formed a private company and sold the land to it for the

1 [1911] 1 Ch 92, 98 per Fletcher Moulton LJ.
2 The terms "profits" and "profits and gains" seem to be interchangeable: *London County Council* v *Att-Gen* [1901] AC 26 (HL).
3 *Bedford Investments, Ltd* v *CIR* [1955] NZLR 978, 982 per McGregor J.
4 (1952) 87 CLR 456.
5 Ibid at 467.

approved price of £8,000. This price was satisfied by the issue to the taxpayer of 8,000 fully paid £1 shares. He then sold these shares for £12,000. The Commissioner assessed the taxpayer on a profit of £4,000 saying that he had carried on a profit-making undertaking or scheme or, alternatively, that the shares were acquired for the purpose of profit-making by sale. In the High Court of Australia[6] Fullagar J upheld the taxpayer's appeal and this decision was affirmed by the Full Court of the High Court.[7]

It is apparent that even if there had been a profit, the decision would have been the same. However, one of the reasons for the decision was that the taxpayer had not made a profit:[8]

> A profit can only be ascertained by comparing one sum of money with another. We have the price of £12,000 ultimately realised for the land. What sum is to be compared with this in order to ascertain the taxpayer's profit? There is no sum which we can so compare. The who'e of the evidence suggests, and suggests only, that the value of the land at all material times was £12,000.

Another case where the taxing authority selected the wrong sum of money for comparison, thereby ascertaining an artificial profit, is *Holden and Meneer* v *CIR*.[9] Here both taxpayers wished to convert sterling funds in the United Kingdom to New Zealand currency in New Zealand. This could legitimately be done by (1) remitting the sterling funds through the New Zealand banking system at the official rate of exchange; (2) selling the sterling funds to another New Zealand resident at the current official rate of exchange;[10] or (3) using the sterling funds to purchase foreign assets, usually sterling area securities, which would then be resold in New Zealand for New Zealand currency. Both taxpayers chose the third method and the Commissioner assessed them under section 88(1)(c) of the Land and Income Tax Act 1954 on the difference between the amount of New Zealand currency received on selling and the purchase price of the stock calculated at the prevailing official buying rate in New Zealand currency of sterling. This assessment was upheld in the Supreme Court by Haslam J[11] and in the Court of Appeal (Wild CJ and Richmond J, Turner P dissenting).[12] However, on appeal to the Privy Council, the taxpayer was successful and the decision was reversed.[13]

In essence, the problem before the Courts was to ascertain the value of the purchase price. A profit on a sale only arises if the sale proceeds exceed the purchase price. The sale proceeds in both cases were known: the amount of New Zealand currency which the taxpayer obtained. The purchase price, however, could be one of two amounts.

First, the purchase price could be the amount ascertained by converting it at the official rate. Thus each £100 sterling was worth £NZ100.7.6.

6 *Becker* v *FCT* (1951) 87 CLR 456.
7 Supra n 4.
8 Supra n 6 at 460 per Fullagar J.
9 [1973] 2 NZLR 523 (CA); [1974] 2 NZLR 52 (PC).
10 To convert sterling funds into New Zealand currency by this method at any other rate was illegal.
11 Unreported, Wellington, 7 March 1972.
12 [1973] 2 NZLR 523.
13 [1974] 2 NZLR 52.

Since on the sale the taxpayers received for each £100 sterling £NZ112.3, the difference may be said to represent the profit. This was the argument accepted by the majority of the Court of Appeal.

The alternative purchase price was the amount ascertained by valuing it for what it was worth in the "better market", in fact that market which was used. This was the argument accepted by the Privy Council which expressly approved the opinion of Turner P in the Court of Appeal where he said:[14]

> Where there are two markets and the question is what is the value, the economists tell us that the question is begged by selecting arbitrarily one of the available markets rather than the other. In such a case the value is the value in the market *actually used,* or, if neither is yet used, the value is the higher of them.

Apart from the problem of ascertaining whether or not there is a profit there is a problem of valuing the profit. In most cases under the second limb this simply involves the subtraction from the total sale price of the original cost, capital improvements and expenses of acquisition and sale. Difficulties have arisen in a number of cases where part only of the property is disposed of. All these cases are in respect of the subdivision of land and, since the enactment of section 65(2)(e), which deals with personal property only, are more appropriately considered in the context of section 67 of the Income Tax Act 1976.

Under the third limb the property used in the undertaking or scheme is brought into account not at its original cost, but at its value when the undertaking or scheme was commenced and in its existing form as at that time.[15]

2 *"Sale or Other Disposition"*

Under both the first and second limbs of section 65(2)(e) the profit or gain must be derived from the "sale or other disposition" of personal property. It seems that the words "or other disposition" add nothing to the word "sale". There do not seem to be any dispositions under the section that are not sales.

Possibly the words were added to cover the situation where property is involuntarily alienated with a resulting profit to the alienee. In the context of the old section 88(1)(c) this might have occurred where land was purchased by a taxpayer with the purpose of selling it but, before he could do so, it was compulsorily acquired by a government body at a price in excess of the original purchase price. There are several cases on compulsory acquisition in respect of section 88(1)(c) and section 26(a) of the Income Tax Assessment Act 1936[16] but there are none in respect of section 65(2)(e) which deals only with personal property, the compulsory acquisition of which is unlikely. However, there are two other situations involving involuntary alienation of property both personal and real, where the cases on compulsory acquisition may be instructive and where the words "or other disposition" may be of particular relevance.

14 Supra n 12 at 529; approved by the Privy Council supra n 13 at 57-58.
15 *Eunson* v *CIR* [1963] NZLR 278, 281 per Henry J.
16 See eg *Coburg Investment Co Pty Ltd* v *FCT* (1960) 104 CLR 650; *Steinberg* v *FCT* (1975) 134 CLR 640; *Gauci* v *FCT* (1975) 135 CLR 81; *Public Trustee* v *CIR* [1961] NZLR 1034; *Railway Timber Co Ltd* v *CIR* [1977] 1 NZLR 655; *Duff* v *CIR* (1979) 3 TRNZ 158.

The first situation is where a taxpayer purchases property with the purpose of selling it but before he can do so it is lost, destroyed or stolen and he is compensated by way of insurance at a current market value which happens to be in excess of the purchase price. Here the property has not been sold but has it been disposed of? There is some basis for saying that it has. First, the ordinary meaning of the word comprehends a parting with property in circumstances in which it does not necessarily pass from one party to another:[17]

> To dispose of — to make over or part with by way of sa'e or bargain,
> — to put or get (anything) off one's hands . . . to put into a settled state or position, to deal with anything (definitely), to get rid of, to get done with.

This is reinforced by the impersonal use of the expression "or other disposition of" in the section which does not indicate that property be either disposed of by the taxpayer or that it be disposed of to another person. As pointed out by the High Court of Australia in discussing the similar expression "is disposed of", the words "are wide enough to cover all forms of alienation . . . and they should be understood as meaning no less than 'becomes alienated from the taxpayer', whether it is by him or by another that the act of alienation is done."[18]

The second situation is where a person acquires property for the purpose of selling it and becomes bankrupt with the consequence that the property is then sold by his trustee in bankruptcy. Here the taxpayer is deprived of his property through the process of the law and in this respect the situation resembles the situation where the taxpayer's land is compulsorily acquired by the government.

Some support for the view that the section covers involuntary alienation is given by Australian cases on section 26(a) of the Income Tax Assessment Act 1936 where the word "sale" has been held to cover compulsory acquisition. In *Coburg Investment Co Pty Ltd* v *FCT*[19] Windeyer J held that the word "sale" was not limited to a transaction where mutual assent of vendor and purchaser existed and that section 26(a) applied to profit arising on a compulsory resumption of land, in which the price was arrived at by negotiation.[20]

The New Zealand courts in considering the broader expression "sale or other disposition of" have taken a more restricted approach. They have adopted the view expressed by Viscount Simonds in respect of the words "sale" and "sold" in *Kirkness* v *John Hudson & Co Ltd*:[21]

> To say of a man who has had his property taken from him against his will and has been awarded compensation in the settlement of which he has had no voice, to say of such a man that he has sold his property appears to me to be as far from the truth as to say of a man who has been deprived of his property without compensation that he has given it away. Alike in the ordinary use of language and in its legal concept a sale connotes the mutual assent of two parties.

Windeyer J in considering this view commented that section 26 of the

17 *Oxford English Dictionary* (1961 Reprint) Vol 3.
18 *Henty House Pty Ltd (in voluntary liquidation)* v *FCT* (1953) 88 CLR 141, 151, 152 per Williams ACJ, Webb, Kitto and Taylor JJ.
19 (1960) 104 CLR 650.
20 Ibid at 663. See also *Gauci* v *FCT* supra n 16; *Steinberg* v *FCT* supra n 16.
21 [1955] AC 696, 707 per Viscount Simonds (HL(E)).

Income Tax and Social Services Contribution Assessment Act 1936-1961 (Cth)[22] could not be taken as containing an example of such extended use. However, New Zealand courts have consistently taken the view that the words "sale or other disposition" do not include compulsory acquisition. In *Public Trustee* v *CIR*[23] the Crown compulsorily acquired part of the taxpayer's land under the Public Works Act 1938. The compensation paid represented a profit to the taxpayer. Hutchison J held that this profit was not taxable under section 88(1)(c) of the Land and Income Tax Act 1954. His Honour quoted the above-cited passage from Viscount Simonds' judgment in *Kirkness* v *John Hudson & Co Ltd,* and concluded that "[i]n their ordinary meanings, 'sale' and 'disposition' require intention and activity on the part of the person selling or disposing".[24] He distinguished *Coburg* as being decided on different statutory provisions and on different sets of facts. In his view, section 26(a) was wider than section 88(1)(c) because it was extended to profits from a business which were not separately provided for in the Australian Act.

The decision is unfortunate for two reasons. First, Hutchison J made a false distinction between section 26(a) and section 88(1)(c). Section 26 (a) does not purport to apply to profits from a business. Although these profits are not itemised in the way they are in the New Zealand Act they are specifically mentioned in the definition section (section 6) as "income from personal exertion" or "income derived from personal exertion" and as such they are assessable income under section 25 of the Act.

The second reason for criticising Hutchison J's decision is that he seemed to ignore the words "or other disposition" in section 88(1)(c). Even if Viscount Simonds' restrictive interpretation of the words "sale" and "sold" was correct, his comments and the comments of the other Law Lords in *Kirkness* were confined to those words. Hutchison J applied this interpretation to words which were not contemplated by their Lordships and which seem to be much wider in scope than the words which they were contemplating.

Despite the deficiencies of the case, *Public Trustee* v *CIR* has since been followed in this country without reservation in two Supreme Court decisions: *Duff* v *CIR*[25] and *Railway Timber Co Ltd* v *CIR.*[26]

It may be concluded from the foregoing that:

(i) In New Zealand the words "sale or other disposition" are limited to transactions in which there is intention and activity on the part of the taxpayer.

(ii) Thus, these words do not apply to compulsory acquisition, compensatory parting with property by way of loss, destruction or theft or sale of property acquired for the purpose of resale at profit by the acquirer's trustee in bankruptcy.

(iii) The New Zealand interpretation seems to derive from a narrow construction of the words "sale" and "sold". This construction has been extended to apply to the words "or other disposition".

22 At that time the equivalent of s 26(a) of the Income Tax Assessment Act 1936 (Cth).
23 Supra n 16.
24 Ibid at 1042. See also *Duff* v *CIR* supra n 16; *Railway Timber Co Ltd* v *CIR* supra n 16.
25 Supra n 16.
26 Ibid.

(iv) Under the broader Australian approach the word "sale" has been interpreted to include compulsory acquisition. It would probably also include the sale of property acquired for the purpose of resale at a profit by the acquirer's trustee in bankruptcy. However, as the Australian provision does not provide for "other dispositions" there appears to be no scope for including within it profit arising from compensation for the loss, destruction or theft of property purchased with the purpose of making a profit on resale.

3 *"Of Any Personal Property or Any Interest Therein"*

The first and second limbs of section 65(2)(e) apply only to personal property. Profits from isolated transactions involving the sale or disposition of land are dealt with in section 67 (with the exception of land sold or disposed of before 10 August 1973).

Without embarking on a jurisprudential analysis of the concept, it should be noted that property, both real and personal, has a very wide meaning. In *Jones* v *Skinner*[27] Lord Langdale MR said "property is the most comprehensive of all the terms which can be used, inasmuch as it is indicative and descriptive of every possible interest which the party can have."[28] With this in mind, it seems that the words in section 65(2)(e) "or any interest therein" are superfluous. "Any interest therein" is property.

II THE FIRST LIMB — "IF THE BUSINESS OF THE TAXPAYER COMPRISES DEALING IN SUCH PROPERTY"

At first glance, the first limb of section 65(2)(e) appears to impose a limited capital gains tax. Bearing in mind that section 65(2)(a) imposes a tax on business profits it would be reasonable to assume that this provision relates to profits from isolated transactions that are not part of a dealer's business. Thus, if a car dealer sold his own car any profit which he made would be caught by the provision.

However, it is apparent from the cases that this first impression is not correct and that property held and disposed of as a capital asset does not come within the provision. It applies only to property disposed of as part of the taxpayer's business of dealing in such property.

In *Hazeldine* v *CIR*[29] the taxpayer had purchased land as an investment at a time when he was not dealing in property, but later became a dealer and then sold the land. Wilson J decided that the relevant time to consider the taxpayer's business ie, the time at which the taxpayer must be a dealer in the type of property sold, was at the date of sale of the property. The taxpayer was a dealer at that time. However, Wilson J held that the gain was not taxable because, on the facts, the property had been previously bought as an investment and the sale transaction had the character of a change of investment rather than a sale for profit. Thus he stated:[30]

> Where, as in this case, the property from which the profit sought to be assessed is derived was not bought for resale or in the course of a business

27 (1835) 5 LJ Ch 87.
28 Ibid at 90.
29 [1968] NZLR 747.
30 Ibid at 749.

> of dealing in property of that kind, its disposition at a time when the owner is dealing in such property does not render the resulting profit assessable to tax unless it was disposed of as part of the business. The onus of proving that the property was disposed of otherwise than as part of the business rests, of course, on the taxpayer and, in such circumstances, it will obviously be a heavy one.

Wilson J's judgment was expressly approved by Casey J in the 1974 case of *Cashmere Properties Ltd* v *CIR.*[31] Here, the taxpayer, a company, had been engaged in property dealing and investing in property. Certain properties were bought and sold at a profit and the Commissioner, applying section 88(1)(c) of the Land and Income Tax Act 1954, assessed the taxpayer on the profit. The Commissioner relied on both the first and second limbs of the section. It was contended on behalf of the taxpayer that the properties were not bought for the purpose of resale nor as part of its business of dealing in properties but were purchased as investments and the sales were no more than a realisation of these investments. This argument failed and the assessments were confirmed. In itself, the case adds nothing to the principles expounded in *Hazeldine* but it does illustrate the dependent nature of the first limb of section 88 (1)(c) (and section 65(2)(e)). The Commissioner did not rely on it alone and the decision was not based on it alone.

As mentioned above, the relevant time to consider the taxpayer's business is the date of sale of the property. It is at this time also that the nature of the property must be examined. The property itself must then be part of the taxpayer's business. Thus, if the property had been acquired as part of the business but was not part of the business at the time of the sale, profit on the sale will not be assessable under the first limb.[32] Conversely, if property had been acquired as a capital asset and became part of the trading stock, profit on its sale may be assessable under the first limb.[33]

In addition to ascertaining whether or not the property was sold as part of the taxpayer's business, it is also necessary to determine whether or not the taxpayer was a dealer in the type of property sold. In essence, a dealer is a seller of a specified article.[34] However, the law seems to take a more expanded view of the term or, at least, it gives it a more verbose definition. Thus, in *Raine* v *Police,*[35] a case concerned with sections 2 and 3 of the Motor Vehicle Dealers Act 1958, Woodhouse J said:[36]

> It is my opinion that a dealer is one who buys or sells some form of merchandise, or who trades in some commodity, and to carry on business as a dealer suggests the organisation of some dealing activity into a course of conduct, even if only for a short period in terms of time.

In the context of the first limb of section 65(2)(e)[37] Henry J in *Bates*

31 (1974) 4 ATR 523.
32 *Corin* v *CIR* 14 ATD 503.
33 *Wellington Steam Ferries Co* v *CT* (1910) 29 NZLR 1025.
34 Cf *Oxford English Dictionary* (1961 Reprint) Vol 3. "Dealer": (a) one who deals; (b) one who deals in merchandise, a trader; "to deal": to carry on commercial transactions, to do business, trade, traffic.
35 [1963] NZLR 702.
36 Ibid at 703.
37 The relevant provision in this case was s 79(1)(c) of the Land and Income Tax Act 1923, and the predecessor of s 88(1)(c) of the Land and Income Tax Act 1954 and s 65(2)(e) of the Income Tax Act 1976.

v *CIR*[38] said that dealing connotes buying and selling or exchanging and to constitute a business of dealing where a person does not hold himself out as carrying on a business he said that "generally speaking, the law requires a reasonable frequency of transactions or some continuity of effort in respect of the buying, selling or exchanging. . . ."[39]

It seems that the first limb of section 65(2)(e) applies only to persons who are dealers in their own right. A sharebroker acting on behalf of his clients is not a dealer for the purposes of the first limb. Nor is an auctioneer acting in that capacity. Both are agents.[40]

As it is apparent that the first limb applies only to property disposed of as part of the taxpayer's business in dealing in such property and that it does not apply to capital gains, there seems to be virtually no scope for the independent operation of the provision. Any profit or gain which would be caught by the first limb would, almost certainly, be caught by section 65(2)(a) which makes assessable profits or gains derived from any business. This view was shared by North J in *CIR* v *Walker*[41] who said of section 88(1)(c):[42]

> No doubt good and sufficient reasons exist why it was thought desirable to single out for special mention businesses which deal either in real or personal property when it could hardly be questioned that any profits made by such businesses would have been taxable in any event under [paragraphs] (a) or (g) of the same section.

III The Second Limb — "If the Property was Acquired for the Purpose of Selling or Otherwise Disposing of It"

The second limb of section 65(2)(e) includes in assessable income profits or gains from the sale or other disposition of personal property where the property was acquired for the purpose of selling or otherwise disposing of it. Unlike section 65(2)(a) and the first limb of section 65(2)(e), it is directly concerned with profits from isolated transactions and may be seen as a limited form of capital gains tax.

There are four main areas of contention in the interpretation of the second limb. First, there is the question of what is comprised in the term "sale or other disposition". Does it include compulsory acquisition, compensation for loss, theft or destruction or resale by trustees in bankruptcy? These are discussed above. Secondly, there is the problem of satisfying the requirement that the property acquired must be the property sold. Thirdly, there is the question of identifying what is comprised in the term "acquired". Fourthly, there is the problem of applying the subjective requirement that the taxpayer had the purpose of selling or otherwise disposing of the property.

1 *The Property Sold Must Be the Same Property That Was Acquired*

This requirement may seem simple but there have been several cases—particularly Australian cases on section 26(a) of the Income Tax Assessment Act 1936—which have shown that in practice the requirement has difficult aspects. In particular, the following situations have created problems.

38 (1955) 6 AITR 283.
39 Ibid at 290.
40 (1969) 4 NZTBR Case 20; *Investment & Merchant Finance Corporation* v *FCT* (1971) 125 CLR 249.
41 [1963] NZLR 339.
42 Ibid at 360.

(a) Where property is purchased, worked on by the taxpayer and then sold.

This situation could arise both with personal property under section 65(2)(e) and land or personal property under the old section 88(1)(c). If a taxpayer purchases a gemstone then cuts and polishes it and sells it, is it the same property? If a taxpayer purchases vacant land then erects a building on it, is it the same property?

In *Moruben Gardens Pty Ltd* v *FCT*[43] the taxpayer, a home unit company, purchased land on which there was a house with the intention of demolishing it and erecting a strata title home unit building and selling the units at a profit. It did so and when it was assessed for income tax on the profit under section 26(a) it claimed, inter alia, that the section did not apply because there was no substantial identity between the property purchased—land with a dwelling-house on it—and the property sold—land with strata title units on it. In the High Court, this claim was rejected by Mason J who said:[44]

> In my opinion when the first part of [section] 26(a) is applied in relation to profit made by selling real estate, the property to which it refers is the estate or interest in land acquired by the taxpayer. The property which the taxpayer acquired in this case was an estate in fee simple in the land known as 21 Moruben Road and that was the estate which it sold. There was therefore no lack of essential identity between what was acquired and what was sold, assuming such an identity to be required by the provision.

Mason J's reasoning would apply to any property. It is not the physical appearance of the property that is relevant but the taxpayer's proprietary interest in it.

(b) Property is purchased with the intention that part be sold. That part is then severed and sold.

This situation involves two interrelated problems. First, is the part sold the same property as the entirety purchased? Secondly, which intention is relevant: the overall intention with regard to the total property purchased or the specific intention with regard to the part sold?

These problems arose in the New Zealand case of *Bedford Investments, Ltd* v *CIR*.[45] The taxpayer company purchased land "with the intention that [it] subdivide the land and sell several of the allotments and raise sufficient finance to enable it to retain at least one allotment as a cheap permanent investment".[46] The company subdivided the land into nine allotments and sold eight of them. The profit on the sale was assessed for income tax under the second limb of section 88(1)(c) of the Land and Income Tax Act 1954. On behalf of the company it was submitted that the property sold was not the same as the property acquired and that the relevant dominant purpose was the intention to retain one lot as an investment, the other intention—the sale of the other lots—merely being an intermediate purpose. In the Supreme Court McGregor J rejected this submission and held that the taxpayer had been correctly assessed. He said:[47]

43 (1972) 3 ATR 225.
44 Ibid at 234.
45 Supra n 3.
46 Minute recorded in the company's books.
47 Supra n 3 at 982.

> I do not think this argument is sound. What, by virtue of [paragraph] (c), is included in assessable income is "profits or gains derived from the sale... of any real . . . property" (here, lots 1-8 inclusive) if the property (again lots 1-8 inclusive) "was acquired for the purpose of selling". "The property" when last used in the passage mentioned must, to my mind, mean the same property as that from which the profit or gain has been derived by means of sale.

Although McGregor J did not specifically consider the point it is necessarily implied in the decision that where property is purchased and part only is sold, the property sold is the same as the property purchased. The most obvious case of this happening is the purchase and subdivision of land—as in *Bedford Investments, Ltd* v *CIR*. However, it could also happen in respect of personal property: for example, where a large gemstone is purchased and cut into a number of small stones, some or all of which are then sold.

(c) Taxpayer has a different proprietary interest in property when it is sold from when it was purchased.

This is the most contentious aspect of the requirement that the property sold must be the same as the property bought. While there are no leading New Zealand decisions on the point, it has been litigated in the High Court of Australia on a number of occasions without being conclusively settled.

In *McClelland* v *FCT*[48] the taxpayer and her brother were residuary beneficiaries under their uncle's will and, as such, they received as tenants in common a large area of land. The taxpayer purchased her brother's interest, thus becoming sole proprietor of the whole land and then sold the entirety. In the High Court, Windeyer J held that the transaction did not come within the first limb of section 26(a) of the Income Tax Assessment Act 1936. He said:[49]

> The first part of [section] 26(a) . . . applies to a transaction whereby a taxpayer sells any property he acquired for the purpose of sale. It applies whether he sells that property as a whole or in parts, and whether when he sells he sells to one buyer or to several buyers as joint tenants or tenants in common. But, as I read it, it does not apply when what is sold is essentially different in kind from the thing acquired It would apply in the case of a taxpayer A who, by purchasing from two tenants in common, B and C, the share of each, acquired Blackacre for the purpose of thereafter selling it at a profit. There the thing acquired for the profit-making purpose was Blackacre. That is not this case. I cannot accept the proposition . . . that when Mrs McClelland sold portion 5 she sold two separate shares in it, hers and her brother's. She did not. She was not selling separate shares. The shares had disappeared into a unity. She sold an entirety.

The case proceeded to the Full Court of the High Court[50] where Windeyer J's decision was reversed (Kitto, Menzies and Owen JJ; Barwick CJ dissenting). It then went to the Privy Council[51] where the appeal was allowed by majority. In the Full Court, Barwick CJ agreed with the conclusion and reasons of Windeyer J. The majority did not consider the

48 (1967) 118 CLR 353 (Windeyer J); (1969) 118 CLR 365 (Full Court); (1970) 120 CLR 487 (PC).
49 Ibid at 359.
50 Supra n 48.
51 Ibid.

first limb. In the Privy Council, both the majority and minority were concerned with the problem of acquisition and did not specifically consider whether the property sold was the same as the property acquired.[52] Thus, despite Windeyer J's clear statement, *McClelland* did not settle the issue.

The next two cases—one in the High Court and the other in the Supreme Court of Victoria—also failed to settle the issue. In *McGuiness* v *FCT*[53] in the High Court, Walsh J resolved the problem before him by applying other aspects of section 26(a) but he expressed the view that he was not bound to hold that the first part of section 26(a) can never apply when what is bought is an undivided share in land and what is sold is the entirety of that land or part of it.[54] Each case depends on matters of fact and degree.[55] In *Cowan* v *FCT*[56] Gowans J, by way of dicta, indicated that he was not bound by what was said on the matter in *McClelland* or by Walsh J in *McGuiness*. However, he expressed a clear preference for Windeyer J's approach:[57] "I think the owners of two undivided half-shares can combine to convey the entirety and therefore can undertake to sell it, but in doing so they do not sell their respective shares or convey them."

The most recent decision on the matter is that of the Full Court of the High Court of Australia in *AL Hamblin Equipment Pty Ltd* v *FCT*; *AL Hamblin Constructions Pty Ltd* v *FCT*.[58] The taxpayers were related companies engaged in earth-moving and construction work. Some of the equipment which they used was leased from a finance company and some was being acquired under a hire-purchase agreement. When the equipment needed to be replaced, the taxpayers did as follows. First, they bought their existing equipment by paying out the lease and hire-purchase contracts. Then they traded this equipment in on the new equipment. The amount required to pay out the lease and hire-purchase contracts was fixed at a low price and the amount received on the sale of the equipment was, because it was by way of trade-in, an inflated price. The Commissioner of Taxation assessed as taxable income under section 26(a) the difference between the two amounts. On appeal to the Full Court of the High Court, it was held[59] that this amount was not taxable.

One of the issues in the case was whether the property sold was the same as that acquired. Barwick CJ took a similar approach to that taken by Windeyer J in *McClelland*.[60] In his view, the taxpayers had possessory rights over the leased equipment and proprietary rights over the equipment under hire-purchase, and on paying out these contracts, they acquired only the rights of the lessor and of the hire-purchase company. They then sold the entire proprietary and possessory rights over the equipment:[61] "In each case . . . that which was got in was not that which was traded in. On that ground alone the appeals in connexion with those transactions should be allowed." Of the other majority judges

52 Ibid at 492-493.
53 (1972) 3 ATR 22.
54 Ibid at 29.
55 Idem.
56 (1972) 3 ATR 474.
57 Ibid at 489. *Cowan* is discussed further infra pp 129-130.
58 (1974) 131 CLR 570.
59 Barwick CJ, McTiernan and Jacobs JJ; Mason J dissenting.
60 Supra n 48.
61 Supra n 58 at 575.

McTiernan J concurred with the Chief Justice[62] and Jacobs J decided on a different basis.[63] The dissenting judge, Mason J agreed with Barwick CJ on this aspect of the case and specifically approved the comments of Windeyer J in *McClelland*.[64]

It seems that the present judicial approach in Australia supports the views first expressed by Windeyer J in *McClelland*. Whether or not this approach should be followed in New Zealand is contentious. Windeyer J's view is consistent with the lawyer's understanding of property as a bundle of rights. In one object there can exist a number of rights each of which is property. Thus in *McClelland* the taxpayer's interest as a tenant in common and her later interest as owner of the entirety were distinct interests or items of property. So too, in *Hamblin* the reversionary interest in the earth-moving equipment purchased by the taxpayer was distinct from the entirety which was subsequently sold.

The advantage of this view is that it is consistent with legal theory. But it leaves open an obvious means of escaping the application of section 65(2)(e). If, instead of purchasing property and selling it at a profit, a taxpayer acquires a lease of it then immediately acquires the reversion and sells the entirety, the property sold would not be the same as the property acquired and the profit would not be taxed under the second limb of section 65(2)(e). Here there are three distinct proprietary interests: the leasehold interest, the reversion and the entirety. Similarly, if the taxpayer acquired an option to purchase property, then exercised the option and sold the property, the property comprising the subject of the acquisition of the option, the property comprising the subject of the exercise of the option and the property sold would be all different. To a layman, these distinctions must seem absurdly legalistic.

There are three alternative approaches which may be adopted by the courts in New Zealand. First, they could accept Windeyer J's approach and, as a result, allow a number of transactions to escape taxation. Secondly, they could take a less legalistic interpretation of the concept of property. Perhaps, for the purposes of the section, they could regard it not as rights in respect of an object but, rather, the object itself.[65] This is a simple approach to the problem and is in accord with the view of Walsh J in *McGuiness*.[66] However, it distorts and confuses traditional concepts of the nature of property. One might ask: does this matter? Thirdly, the courts could accept Windeyer J's approach and not apply the second limb of section 65(2)(e) but still catch the profits by applying the third limb of the section (profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit) or even section 99 (arrangements the purpose or effect of which is tax avoidance).

2 *"The Property Was Acquired" — Meaning of Acquisition*

It has been said, in the context of section 88(1)(c) of the Land and Income Tax Act 1954, that the word "acquired" is a wide term which

62 Ibid at 577.
63 Ibid at 585-591.
64 Ibid at 581.
65 This seems to be implied in *A G Healing & Co Ltd* v *CIR* [1964] NZLR 222. See infra pp 128-129.
66 Supra n 53.

covers a wide variety of methods of acquisition.[67] "Acquire" is commonly understood to mean "receive, come into possession of". In this sense, if a taxpayer receives personal property by way of an inter vivos gift or under a will he may be liable to tax when he subsequently sells it if at the time of receiving the property he had the purpose of selling it.

However, it is apparent that this is not the case. In *McClelland*[68] Windeyer J, in discussing the application of the first limb of section 26(a) of the Income Tax Assessment Act 1936 to an interest in land inherited by the taxpayer, said:[69] "Was there such a profit here? I think there was not. The taxpayer had, by the bounty of the testator, acquired an undivided share in the land. This was given to her. It was not acquired by her for the purpose of profit-making". In the Privy Council, the majority specifically approved this part of Windeyer J's judgment and said that:[70] "[I]t is not inaccurate to describe sister and brother as acquiring the land through the bounty of the testator. On that footing it would be quite inappropriate to say of the appellant that she acquired land through the bounty of the testator for the purpose of profit-making by sale."

It should be noted that the words of section 26(a) quoted in this case—"purpose of profit-making by sale"—do not appear in the New Zealand provision which refers to "the purpose of selling or otherwise disposing of it". In the present context this difference is irrelevant. What is important is the connection between the acquisition and the purpose whether that be of "profit-making" or of "selling".

This aspect of *McClelland* was subsequently considered and approved in the Full High Court of Australia in *FCT* v *Williams.*[71] The taxpayer's husband purchased land with a view to making a profit on resale. When he discovered that he would probably be liable for tax on any such profit, he gave it to the taxpayer. She did not solicit the gift although at the time she intended to sell the land later. This she did on the advice of her husband who attended to all aspects of the disposition. The Commissioner assessed the taxpayer on the profit made on the sale. However, the Full High Court held that the profit was not taxable and that section 26(a) does not apply where property is acquired by way of unsolicited gift. As Gibbs J said:[72]

> If a donee who passively receives property the subject of a gift can be said to acquire that property within [section] 26(a) (which is doubtful), the main or dominant purpose with which he acquires that property . . . is simply to accept the bounty of the donor.

It is not just the fact that property is the subject of a gift that takes the acquisition outside the scope of section 65(2)(e): it is the passive nature of the acquisition. Both section 65(2)(e) and section 26(a) talk of something acquired by a person for some purpose which is specified in the provision. This refers to obtaining property by an act or acts done in the exercise of the taxpayer's own will. In *McClelland* and *Williams* the

67 *Beetham* v *CIR* [1973] 1 NZLR 575, 581 per Henry J.
68 Supra n 48.
69 Ibid at 359.
70 Supra n 48 at 493.
71 (1972) 127 CLR 226.
72 Ibid at 248.

taxpayers did not get property by exercising their own wills. They were merely the passive, though willing recipients of property passed to them at the wills of other people.[73]

The leading New Zealand case is *AG Healing & Co Ltd* v *CIR*.[74] There a testator authorised his trustees to sell certain property and he gave the taxpayer an option to buy it for £20,000 when the trustees decided to sell. The taxpayer exercised the option and the following day sold the property for £47,000. The Commissioner assessed the taxpayer on the profit under section 88(1)(c) of the Land and Income Tax Act 1954.

In the Supreme Court, Wilson J held that the dominant purpose of the taxpayer in exercising the option was the resale of the property. However, he then held that the gain was not taxable under the second limb of section 88(1)(c). As was later held in *McClelland* and *Williams,* he took the view that "acquired" "connotes some positive step by the taxpayer which would be absent from an outright gift."[75] But one might ask, was there not a positive step by the taxpayer in the exercise of the option? According to his Honour, this may have been so but it was not by the exercise of the option that the taxpayer acquired the property:[76]

> I can find no evidence in the words of the Act or in this particular provision that the Legislature intended that a gift otherwise free from income tax should be rendered liable thereto by the mere circumstance that its reduction into possession, its "acquisition",[77] was for the purpose of realisation by resale, or that it was deliberately reduced into possession for the purpose of realisation.

This approach ignores the distinction between different proprietary rights, between different properties. When the taxpayer received the option under the testator's will, he acquired property—the option—but as it was a passive acquisition, it did not attract section 88(1)(c). When the taxpayer exercised the option, he again acquired property but this time it was by a positive act—the type of acquisition that is contemplated by the Act.

However, it does not necessarily follow from this that the money received from the transaction was taxable. In the first place, even if there was a profit from the sale of property, it might be that the property acquired was not the same as the property sold. If property is regarded as a bundle of rights, there are three distinct properties involved on the facts of *Healing.* First, there is the option to purchase; secondly, there is the property acquired when the taxpayer exercised the option; and thirdly, there is the fee simple. When the second property was acquired, the first property was extinguished and when the third property was acquired, the second property was extinguished. Nevertheless, they are all distinct properties with distinct values. Accepting this, it seems that the property sold—the fee simple—was not the same as the property acquired—the fee simple less what he had before (the option).

73 See also *Steinberg* v *FCT* supra n 16 at 695 per Gibbs J.
74 Supra n 65.
75 Ibid at 224.
76 Ibid at 228.
77 Wilson J seems to be using the word "acquisition" in a subsidiary sense. He regards the acquisition by way of exercising the option as an aspect of the acquisition by way of gift under the will.

There is another reason, to which Wilson J referred,[78] for not taxing the profit or gain under section 88(1)(c). It is that there may in fact have been no profit or gain. If the property sold was worth £47,000 and the option given to the taxpayer was worth £27,000, then the exercise of the option at £20,000 plus the option was equal to the sale of the fee simple. Counsel for the taxpayer pointed out that when the taxpayer exercised the option he was merely realising the value of the gift. It would have been unrealistic in calculating the profit or gain not to take this amount into account.

Healing and *Williams* illustrate what might seem to be a possible means of avoiding section 65(2)(e). Consider the case of a taxpayer who buys speculative shares for the purpose of resale. He realises that if he sells the shares himself he will have to pay income tax on the profit. So he gives them to a member of his family who then sells them at a profit. The transaction would not be caught by section 65(2)(a). However, it is likely that it would be caught by section 91(2) which applies to the disposition of trading stock without consideration or for consideration less than the market value or true value of the trading stock. The section makes assessable the difference between the market value or true value and the consideration (if any) actually received. For the purposes of the section "trading stock" is widely defined to include "anything acquired or purchased for purposes of manufacture, sale or exchange. . . ."

One final case should be mentioned in respect of the requirement that the property be acquired. The case is *Cowan* v *FCT*.[79] The taxpayer and another person agreed to sell land to a company. The company made various defaults under the contract of sale and the vendors proceeded to rescind the contract. The taxpayer formed an intention to resell if the rescission was effective. After rescission was effected the taxpayer bought the other vendor's share and sold the entirety at a profit. The Commissioner assessed the taxpayer on the profit under section 26(a).

The case involved a number of points of law, one of which was whether or not the taxpayer had acquired property by virtue of the rescission. In the Supreme Court of Victoria, Gowans J held that the rescission did not constitute an acquisition in terms of section 26(a). In his view, the vendor's position was restored, not by a passing of property, but by the extinguishment of the rights and interests formerly recognised in the purchaser.[80]

Gowans J gave three other reasons for reaching his conclusion. One was based on a question of fact and need not concern us. The other two both relate to the requirement that the property sold must be the same as the property acquired and illustrate the connection between this requirement and the requirement that the property must be acquired.

Gowans J's second reason was that the form of property in the hands of the vendors after the rescission was no longer a separate vendible form of property. They could sell the land but not the interest they had acquired from the purchaser.[81] Gowans J did not expand this point but

78 Supra n 65 at 224.
79 Supra n 56.
80 Ibid at 486.
81 Ibid at 487.

presumably he was making a distinction between the purchaser's interest as equitable owner of the land and the vendor's interest after the rescission as full owner of the land.

Gowans J's third reason was that if any property was returned to the vendors, it was the purchaser's interest in the property as a whole and not two half-shares in such an interest.[82] What was eventually sold by the taxpayer was his own half-share and the half-share he acquired from his co-vendor. This was not the "property acquired" from the defaulting purchaser.

It may be concluded for the purposes of section 65(2)(e):

(i) Property may be acquired by a wide variety of methods.[83] Usually it will be by purchase but it could also be, for example, by exchange or by way of distribution of assets in specie in a liquidation.[84]

(ii) Acquisition must involve a positive step by the taxpayer—an act or acts done in the exercise of his own will. Thus an unsolicited gift (inter vivos[85] or testamentary[86]) is not an acquisition, nor is the issue of bonus shares.[87]

(iii) A vendor does not acquire property from a purchaser when he rescinds the contract of sale.[88]

(iv) The requirements that the property sold must be the same as the property acquired and that the property must be acquired are often interrelated. In many cases, if the Commissioner fails on one he will necessarily fail on the other.[89]

3 *"For the Purpose of Selling or Otherwise Disposing of It"*

Much of the litigation on section 65(2)(e) and other similar provisions has been in respect of the word "purpose". In particular, the following problems have caused difficulties.

(a) Is the test of "purpose" subjective or objective?

Both the New Zealand and Australian authorities take the view that "purpose" in this context is the purpose in fact of the taxpayer ie, they adopt a subjective test. In *Davis* v *CIR*[90] Hutchison J said that "what we are concerned with is the state of mind of the appellant when he acquired the property. . . ."[91] Similarly, in *Pascoe* v *FCT*[92] Fullagar J[93] referred to a taxpayer's "purpose or object or other state of mind" of

82 Idem.
83 *Beetham* v *CIR* supra n 67.
84 *Steinberg* v *FCT* supra n 16.
85 *FCT* v *Williams* supra n 71.
86 *FCT* v *McClelland* supra n 48 (Windeyer J and PC).
87 *FCT* v *Miranda* (1976) 6 ATR 367.
88 *Cowan* v *FCT* supra n 56.
89 Ibid.
90 [1959] NZLR 635.
91 Ibid at 642.
92 (1956) 6 AITR 315.
93 Ibid at 320.

which "the statements of that person in the witness box provide, in a sense, the 'best' evidence, but, for obvious reasons they must . . . 'be tested most closely, and received with the greatest caution'."[94]

In contrast with this subjective approach to the word "purpose", is the objective test adopted by the courts to the same word in tax avoidance provisions. Both the New Zealand[95] and Australian[96] sections refer to arrangements which have the "purpose or effect" of tax avoidance. In the Privy Council case of *Newton* v *FCT*[97] Lord Denning, in discussing the Australian section 260, made it clear that the section is not concerned with the motives of the taxpayer or with his desire to avoid tax.[98] This does not indicate a contradiction within the tax legislation. In one case the word "purpose" is used by itself. In the other it is used in conjunction with the word "effect" which adds an objective flavour to the provision. The real question is which of the two tests is preferable in respect of section 65(2)(e).

First, I suggest that any test that depends on the "purpose" of the taxpayer is a bad test. Purpose should be irrelevant. What is important is that the taxpayer profited from the sale of property. Secondly, accepting that we have a test of "purpose" an objective approach would be preferable. As the United Kingdom Commission on the Taxation of Profits and Income suggested in its *Final Report*,[99] if motive is to be ascertained, it is better ascertained by being imputed as the automatic result of prescribed conditions than by an attempt to search the mind of the taxpayer himself. A subjective approach necessarily involves costly and time-consuming litigation in which taxpayers are investigated as to their actual purpose. It results in "hair-splitting decisions" that are of little use as precedents because each case depends on its own facts. Furthermore, it encourages taxpayers to be dishonest—to express a purpose which will not incur tax liability whether or not that purpose is true.[1]

(b) Whose "purpose"?

The second limb does not specify that the purpose of selling or otherwise disposing of the property must be the purpose of the taxpayer. However, it seems that this is the case. In *Harkness* v *CIR*[2] the taxpayer's father arranged for certain rural land to be purchased in the name of the taxpayer. The son knew very little of the purchase and soon after signing the contract, he went overseas, giving his father a general power of attorney. The son was aware that some of the land might be suitable for farming and that some of it would be sold, presumably for the purpose of financing the transaction. While he was overseas, some of the land was sold and by the time he returned it was decided to use the rest of it for subdivisional purposes. In due course it was all sold. The profits were treated by the Commissioner as assessable income under the second limb of section 88(1)(c) of the Land and Income Tax Act 1954. In the

94 See also *Coburg Investment Co Pty Ltd* v *FCT* supra n 16; *Buckland* v *FCT* (1960) 34 ALJR 60.
95 Income Tax Act 1976, s 99.
96 Income Tax Assessment Act 1936, s 260 (Cth).
97 (1958) 98 CLR 1.
98 Ibid at 8.
99 *Final Report of the Royal Commission on the Taxation of Profits and Income* (1955 Cmd 9474) para 113.
1 These deficiencies are well illustrated in *Steinberg* v *FCT* supra n 16.
2 [1975] 2 NZLR 654.

Supreme Court, before Speight J, one of the questions to be answered was whether the father's purpose of selling could be attributed to the son. His Honour held that it could not:[3]

> Sale implies only the future action of the owner and, therefore, if the objector is the owner it is only he who can sell or refuse to sell. Motives which prompted his father to initiate the purchase are not the purposes of the potential seller so on this analysis of the wording it appears that it is the objector's thought processes and no other's.

His Honour supported this view by reference to two Australian cases[4] on the slightly different wording of section 26(a) of the Income Tax Assessment Act 1936. He did not consider the case where the taxpayer is so closely associated with and so strongly influenced by another person that the purpose of that other person might be regarded as being coalesced with that of the taxpayer.

In *Tilley* v *FCT*,[5] in the Supreme Court of South Australia acting in its federal jurisdiction, Zelling J held that the purpose of the taxpayer's husband could be taken to be the purpose of the taxpayer herself. The case involved the purchase and sale of shares. The taxpayer knew very little about shares and left all such matters to her husband who was a leading chartered accountant. He dealt with her property as if it were his own and without reference to her except where reference was required to sign documents. He made all the decisions and she readily adopted them. Thus Zelling J took the view that it was the husband's intention which had to be first ascertained and then imputed to the taxpayer as her intention.

Accepting that generally it is the taxpayer's purpose only that is relevant, it would follow that where there is more than one taxpayer jointly buying and selling property at a profit the purpose of each taxpayer must be considered separately to ascertain their respective liabilities for taxation. Thus, where two taxpayers in Australia purchased property, one with the purpose of selling at a profit and the other with the purpose of using the property in the conduct of his business, and later resold it at a profit, the profit in the hands of the former was held assessable and the profit in the hands of the latter was held not assessable.[6]

A more difficult problem exists where the taxpayer is a company. In *Coburg Investment Co Pty Ltd* v *FCT*[7] where the taxpayer was a company which was controlled at all levels both formally and in fact by one person, Windeyer J imputed that person's purpose to the company. As he said,[8] "the company appears to have had no mind apart from his. . . ." In many cases a company will have no single controller. Here, a purpose may be gathered from the company's memorandum and articles of association.[9] However, these matters are not decisive and it is necessary to consider all the matters advanced by the company[10]—that is, by the persons who direct its affairs.

3 Ibid at 659.
4 *Hampson* v *FCT* (1964) 9 AITR 445; *FCT* v *Williams* (1972) 127 CLR 226.
5 (1977) 7 ATR 139.
6 *Forward Downs & Co Ltd* v *CT (WA)* (1935) 3 ATD 250; *Ridgeway* v *DFCT* (1938) 5 ATD 51.
7 Supra n 16.
8 Ibid at 655-656.
9 *Shand (James) & Co Ltd* v *CT* [1928] GLR 411.
10 *Ruhamah Property Co Ltd* v *FCT* (1928) 41 CLR 148.

(c) Meaning of "purpose".

It seems that "purpose" is not the same as motive or intention. It is not the "sole" purpose or "any" purpose and it is probably not the "main" purpose. It is the "dominant" purpose of the taxpayer.

In *XCO Pty Ltd* v *FCT*[11] Gibbs J discussed the difference between "purpose" and "motive" and said by way of example that while the motive behind a particular transaction may be to test its tax consequences with a view to undertaking similar transactions in the future, such a transaction may have an immediate "purpose" of profit-making.

"Motive" and "purpose" were also distinguished in the New Zealand case of *CIR* v *Hunter*.[12] The taxpayer wanted to transfer her English funds to New Zealand. At the time, English and New Zealand currencies were about par and if she had transmitted her funds through the banking system, she would have been paid pound for pound. Instead, she purchased stock in England and sold it soon after in New Zealand. In this way she obtained £NZ6,117 for £UK5,750. The Commissioner assessed the profit under section 88(1)(c) of the Land and Income Tax Act 1954. The Court of Appeal (North P, Turner and McCarthy JJ) reversed the decision of McGregor J and held that the profit was assessable. Turner J said:[13]

> The motive which inspired these transactions was no doubt that they provided an advantageous method of remitting funds from England to New Zealand; but I think that there can be no doubt but that the words of the section are literally complied with in this case, and that in acquiring the conversion stock the respondent is plainly demonstrated to have done so for the very purpose of selling that stock again, and immediately.

Although this case was overruled by the Privy Council in *Holden* v *CIR*[14] on the ground that in such a transaction there is no assessable profit, this does not invalidate the distinction made by the Court of Appeal between "motive" and "purpose".

In a number of New Zealand cases, a distinction has been drawn between the concepts of "purpose" and "intention". Perhaps the clearest fact situation and the clearest judicial expression of the distinction is to be found in *Plimmer* v *CIR*.[15] The taxpayer wanted to buy all the ordinary shares in a company. The seller would only sell on the condition that the taxpayer would also buy the preference shares. The taxpayer agreed and, to finance the purchase of the preference shares, obtained a bank loan on the understanding that the preference shares would be sold as soon as possible. In due course, the preference shares were sold at a profit and the Commissioner assessed the profit under section 79(1)(c) of the Land and Income Tax Act 1923. In the Supreme Court Barrowclough CJ held that the assessment was erroneous. His Honour thought that although the taxpayer had the "intention" of selling the preference shares he did not have that "purpose". As he said:[16]

> A man's purpose is usually, and more naturally, understood as the object which he has in view or mind. One can scarcely have a purpose of selling

11 (1971) 124 CLR 343.
12 [1970] NZLR 116.
13 Ibid at 125.
14 [1974] 2 NZLR 52.
15 [1958] NZLR 147.
16 Ibid at 151.

> without having also an intention of selling, but, in ordinary language, "purpose" connotes something added to "intention", and the two words are not ordinarily regarded as synonymous.[17]

This distinction between "purpose" and "intention" was approved by the Court of Appeal in *Walker*.[18] The taxpayer purchased sixty-three acres of land with the intention of adding it to an adjoining farm owned by him and thereby extending his farming activities. Three acres of the new block had road frontage and were within the city limits of Invercargill. It was contemplated at the time of the purchase that this could be subdivided and the profit from the sale would assist in financing the farm land acquisition. The taxpayer subdivided the three acre strip and sold some of the subdivisions at a profit.

There is a difference between this case and *Plimmer* which might seem important. In *Plimmer* it was obligatory for the taxpayer to purchase the preference shares in order to achieve the main purpose of purchasing the ordinary shares. In *Walker* the taxpayer made no overtures to purchase the property without the front land and he actively welcomed the opportunity to purchase, subdivide and sell at a profit.

In the Supreme Court Henry J[19] did not consider this to be a significant difference. In his view, it would have been unrealistic for the taxpayer to have taken steps to deprive himself of the road frontage. He held that the profit was not assessable under section 88(1)(c) of the Land and Income Tax Act 1954 and this decision was upheld by the Court of Appeal (North and Turner JJ, Gresson P dissenting). North J said:[20]

> In my opinion, the respondent's avowed intention to subdivide the frontage land into sections and to sell them was but a necessary incidental step in fulfilment of his real or dominant purpose. I agree, with respect, with the conclusion reached by Barrowclough CJ in *Plimmer* . . . that in this provision the word "purpose" is not to be regarded as merely the equivalent of "intention".

The decision in *Walker* is difficult to reconcile with the decision in *Bedford Investments, Ltd* v *CIR*.[21] There the taxpayer purchased nine lots with the intention of subdividing and selling some of them so as to finance the retaining of at least one as a cheap investment. It sold eight lots and kept one. The only apparent difference between the facts of the two cases is the relationship of the amount of the property retained to that sold. In *Bedford* the bulk of the property was sold and a small portion retained. In *Walker* a small portion was sold and the bulk retained. The significance of this seems to be that only one purpose is taken into account: the purpose that is attributable to the bulk of the property. With respect, this is an unrealistic approach. As Gresson P said in his dissenting judgment in *Walker*:[22]

> It may have been a small area of unfenced land on the road boundary having an early or immediate potential as a subdivision, but, with respect, I think it is incompatible with the facts to regard it as no more than the road

17 See also *Land Projects Ltd* v *CIR* [1964] NZLR 723; *Davis* v *CIR* supra n 90.
18 [1963] NZLR 348.
19 [1963] NZLR 339, 346.
20 Supra p 134 n 18 at 362.
21 [1955] NZLR 978.
22 Supra p 134 n 18 at 356.

> frontage of a large piece of land acquired for farming. . . . Though it was an integral part of the farming land in the sense that it was part of it, it had a character of its own, and indeed was within the city, whereas the rest of the land was in the county.

In Australia the courts have adopted a dual purpose test. Thus in *Chapman* v *FCT*[23] the taxpayers purchased a forty-four acre property with the intention of retaining seventeen acres and subdividing and selling the balance to finance the development of the part retained. In the High Court Menzies J regarded the purposes with respect to the two areas as distinct and held that the profit from the sale of the subdivided property was assessable under section 26(a) of the Income Tax Assessment Act 1936.

Chapman and *Walker* were both discussed by Speight J in *Harkness* v *CIR*.[24] He said that the facts in the cases were similar although in *Chapman* they were perhaps even stronger for the taxpayer. Speaking of Menzies J's decision in favour of the Commissioner, he said that[25] "it is apparent that this is contrary to the decision in *Walker* . . . and would not be decided in that way in this country."

His Honour then looked specifically at the following remarks made by Menzies J in *Chapman*:[26]

> There is no doubt, however, that where the purchase is of an entirety it often happens that the purchaser in making the purchase has the purpose of breaking up the entirety and of using part in one way and part in another. . . . In such a case it is in vain I think to search for a dominant purpose for the purchase. There are in truth two purposes, and it cannot be said that one is dominant and the other servient.

Commenting on this passage, Speight J observed[27] that it seems common sense to say that there can be two separate purposes in cases where two separate areas of land (and presumably of other property) of substantially different character are bought at the one time, particularly when one is immediately adapted and available for resale purposes and suitable for no other.

While there are many points in respect of "purpose" about which the cases are uncertain it has at least been clearly established that it is the *dominant* purpose that is relevant. As North J said in *Walker*,[28] "in my opinion, there is no escape from the conclusion that it is the 'dominant' purpose which alone matters."[29] In the Australian case of *Buckland* v *FCT*[30] Windeyer J explained the test as follows:[31]

> In relation to [section] 26(a) it is the main or dominant purpose of the acquisition that is significant. If, a property . . . were bought for the purpose of resale at a profit it would be immaterial that the purchaser also had in mind to take the rents and profits in the meantime or pending selling to use

23 (1968) 117 CLR 167.
24 [1975] 2 NZLR 654, 661-665.
25 Ibid at 664.
26 Supra p 135 n 23 at 171; noted by Speight J in *Harkness* v *CIR*. Supra p 135 n 24 at 665.
27 Supra p 135 n 24 at 665.
28 Supra p 134 n 18 at 361.
29 See also *Evans* v *FCT* (1936) 55 CLR 80; *Pascoe* v *FCT* supra n 92; *Holden* v *CIR* [1974] 2 NZLR 52 (PC).
30 Supra n 94.
31 Ibid at 62.

> it for some purpose of his own. In such a case two purposes, one primary and dominant, the other secondary and subordinate, are not incompatible and could both be accomplished. . . . I do not understand, however, how two inconsistent and incompatible modes of use could both be the purpose for which the property was acquired.

Why the courts have so readily latched on to the "dominant" purpose test is uncertain. Why not the stricter test of "any" purpose or the more lenient test of "sole" purpose? Both would be easier to apply in practice than "dominant" purpose which requires an artificial separation and ranking of purposes.

One problem which derives from Windeyer J's explanation is his use of the term "main or dominant purpose". The main purpose may in many cases also be the dominant purpose but it need not be. Consider a case where there are six purposes, all of about the same quantum but one which is slightly more significant than the others. It might be said to be the main purpose but could it be described as the dominant purpose?

A recent development in the dominant purpose test derives from the Court of Appeal decision in *Williams Property Developments Ltd* v *CIR*.[32] The taxpayer was one of a group of companies concerned with property development. Another company in the group owned a block of land and was interested in acquiring the adjacent block. It was available for sale but the company for various reasons was unable to buy it at the time. The taxpayer purchased the land and later transferred it to the other company at book value. The Commissioner, acting under section 102 of the Land and Income Tax Act 1954, considered that the sale of the property constituted the sale of trading stock for a consideration which was less than the market price or its true value and assessed the taxpayer on the difference between the price paid by the taxpayer when it bought the land and its market value at the time it was transferred to the other company.

Under section 102(3), land is "trading stock" if the business of the transferor comprises dealing in land or the land was acquired for the purpose of sale or other disposal. The parties agreed that the test under the second limb of the section was whether the dominant purpose of the taxpayer in buying the property was one of resale. The taxpayer submitted that its dominant purpose in buying the property was to bring it within the ownership and control of the group and to hold it as an investment until it was decided what to do with it. The Commissioner submitted that the taxpayer had a conditional purpose which amounted to a dominant purpose. This conditional purpose was said to be to dispose of the property to another member of the group in the hope that another adjoining property could be purchased. In the Court of Appeal, as in the High Court and before the Taxation Review Authority, the Commissioner's assessment was upheld. The leading judgment was given by Richmond P who said:[33]

> It seems to me that that is clearly right. If a person buys a piece of land because he believes that it will go up in price and that he will then be able to resell it at a profit then it seems open to regard resale at a profit as his dominant purpose even though his ability to fulfil that purpose depends on the contingency of a rise in value.

32 [1980] 1 NZLR 280.
33 Ibid at 288.

This is not to say that the contingent purpose will always be the dominant one. As Cooke J pointed out,[34] a company may buy a property satisfied that it will be a good investment but prepared to sell it if the market rises sharply.

(d) Property bought as a "hedge against inflation".

In recent Australian cases, the question has arisen as to whether a person purchasing property as a hedge against inflation has the necessary dominant purpose of resale (at a profit).[35] In view of recent high inflation rates, this question may be expected to be raised in New Zealand in the context of section 65(2)(e).

In *McClelland*[36] in the majority judgment[37] in the Privy Council it was said that, in the context of the equivalent of the third limb of section 65(2)(e) of the New Zealand Act, the purchase and sale of property bought as a hedge against inflation would not constitute a profit-making undertaking or scheme.

In *Steinberg* v *FCT*[38] Barwick CJ[39] considered the problem in respect of the equivalent of the second limb of section 65(2)(e). He said:[40]

> The presence of [section] 26(a) . . . does not mean that property cannot be acquired as an investment, as a hedge against the loss of value in the currency; or that the only investment advantage of the acquired property which is outside the reach of [section] 26(a) is the income it will produce. The retention of property in the hope or expectation that its value will increase is a justifiable form of investment. That the increased value may only be realised by sale does not deny that the purpose of its acquisition was investment or establish that the purpose of its acquisition was to use it as a subject of trade by reselling it at a profit.

Soon after, the point was again considered by the Full Court of the High Court in *Gauci* v *FCT*[41] where Barwick CJ,[42] Mason J[43] and Jacobs J[44] all said that section 26(a) did not apply to proceeds from property bought as a hedge against inflation.

Whether the New Zealand courts will adopt this view is uncertain. It is open to the criticism that it ignores the distinction between purpose and motive[45] and treats the two as one and the same. Where a taxpayer buys property as a hedge against inflation he most likely has in mind that the property will maintain its "real" value and that in the future he will sell it at a price which corresponds with its value at the time he bought it: a higher price but the same value. His motive is to protect his savings from inflation but his purpose is to sell the property.

On the other hand, it does not always follow that where a taxpayer buys property as a hedge against inflation, he has the purpose of selling

34 Ibid at 290-291.
35 As required by s 26(a) of the Income Tax Assessment Act 1936 (Cth).
36 (1970) 120 CLR 487.
37 Ibid at 494-495.
38 (1975) 134 CLR 640.
39 Barwick CJ dissented on most of the findings of the High Court but none of the other judges took issue with him on this point.
40 Supra p 137 n 38 at 686.
41 (1975) 135 CLR 81.
42 Ibid at 87.
43 Ibid at 90.
44 Idem.
45 Or possibly "intention".

it. Instead, as was pointed out by McInerney J in *FCT* v *Firstenberg*,[46] a taxpayer may decide not to realise his investment during his lifetime but to leave it to those taking under his will. At this point, the distinction between purpose and motive or intention becomes blurred. How the New Zealand courts will deal with the problem remains to be seen but, bearing in mind that in recent times they have generally taken a stricter approach than the Australian courts in taxation matters, it may be expected that they will generally impose the distinction between motive and purpose and say that in these cases the desire to protect savings from inflation is the motive and sale is the purpose. However, this is not to say that, in cases where it is shown that the taxpayer had no intention of selling, the desire to protect savings cannot be regarded not as the motive but as the purpose.

IV The Third Limb — "Any Undertaking or Scheme Entered Into or Devised for the Purpose of Making a Profit"

The third limb of section 65(2)(e) includes in assessable income:

> [A]ll profits or gains derived from the carrying on or carrying out of any undertaking or scheme entered into or devised for the purpose of making a profit.

It is in similar terms to the second limb of section 26(a) of the Income Tax Assessment Act 1936 which includes in assessable income "profit arising . . . from the carrying on or carrying out of any profit-making undertaking or scheme". Like the second limb of section 26(a), the New Zealand provision applies to undertakings or schemes in respect of any type of property whether it be real or personal property.

Unlike the second limb which may well impose a tax on capital gains, the third limb, we are told by the courts,[47] does not do so. Thus in *Eunson* v *CIR*[48] Henry J said:[49]

> I reject any suggestion that the third limb of [section] 88 (1) (c) so departs from the general scheme of income tax that it imposes what is tantamount to a capital gains tax. It does not sweep away the distinction, long recognised by the Courts, between capital gains and income gains. After all, as has been said by high authority, "income tax is a tax on income", per Lord Macnaghten in *London County Council* v *Attorney-General* [1901] AC 26, 35. Assessable income is by [section] 88 deemed to include certain specific items which either define or add to the general meaning of income. Such definition or addition does not limit the natural meaning of income. Nevertheless, the governing concept is something in the nature of income or profits from trading or dealing or the like with a view to profit.

The first part, at least, of this statement seems to be consistent with the views of the majority of the Privy Council in *McClelland*[50] where their Lordships said that an undertaking or scheme, if it is to fall within section 26(a) "must be a scheme producing assessable income, not a capital gain".[51] One might well ask if the third limb, along with the first limb of section 65(2)(e) has any scope of its own. There seems to be

46 (1976) 6 ATR 297.
47 *Eunson* v *CIR* [1963] NZLR 278, 280; *Beetham* v *CIR* [1973] 1 NZLR 575, 582.
48 Supra p 138 n 47 at 278.
49 Ibid at 280.
50 Supra p 137 n 36.
51 Ibid at 495.

nothing caught by it which would not also be caught either by the second limb[52] or by section 65(2)(a). This impression is reinforced by the further comment of the majority in *McClelland* that an undertaking or scheme, to produce assessable income "must—at any rate where the transaction is one of acquisition and resale—exhibit features which give it the character of a business deal".[53] They then went on to say that "the notion of business is implicit in the words undertaking or scheme".[54]

These remarks have resulted in some debate in the High Court and some members have been reluctant to accept them at face value.[55] In New Zealand the courts until recently have taken the view that the concept of business is not an essential aspect of the third limb. Thus in *Eunson* Henry J said[56] that the third limb "catches some residue of methods of earning profits which are neither a business nor the realisation of property bought for the purpose of sale." This case was decided before *McClelland* and on this point might be said to be of doubtful authority in view of the contrary statement by the majority of the Privy Council. However, Henry J reaffirmed his view in *Beetham* v *CIR*,[57] a case which was decided after *McClelland*. In comparing the two provisions, he said:[58]

> Our [section] 88(1)(c) is slightly different from [section] 26(a) . . . in that the first limb of our section does not appear in the Australian Act. This prompted their Lordships in *McClelland* . . . to say that the notion of business is implicit in the words undertaking or scheme. In our legislation business is expressly provided for. In my judgment the subdivision of land is not an undertaking. The argument was that it is a scheme entered into or devised for the purpose of making a profit. It must be a scheme producing assessab'e income and not a capital gain.

There seem to be two aspects to the distinction made by Henry J. The first is that the Australian provision is significantly different because it does not contain an equivalent to the first limb. The second is that the Australian provision is significantly different because the legislation does not expressly provide for taxation of profits from business. As to the first aspect it is hard to imagine the significance of the absence of a provision which is probably superfluous.[59] As to the second aspect, it is an incorrect assumption that the Australian Act does not provide for the taxation of profits from business. Although business profits are not itemised in the way that they are in the New Zealand Act, they are specifically men-

52 Cf*Eunson* v *CIR* supra p 138 n 47 at 280 where Henry J said that the third limb "catches some residue of methods of earning profits which are neither a business nor the realisation of property bought for the purpose of sale." An example of such a method may be a transaction not involving the sale or disposition of an asset but affecting the realisation at a profit as where a company purchases an asset with a resulting increase in the value of its shares and then sells its shares.
53 Supra p 137 n 36 at 495.
54 Idem.
55 Eg Stephen J in *FCT* v *Williams* supra p 132 n 4; Gibbs J on appeal in the same case, (1972) 127 CLR 237. Cf Barwick CJ and McTiernan J in *A L Hamblin Equipment Pty Ltd* v *FCT* (1974) 131 CLR 570.
56 Supra p 138 n 47 at 280.
57 Supra p 138 n 47 at 582.
58 Idem.
59 Supra p 134 n 18 at 360 per North J.

tioned in the definition section (section 6) as "income from personal exertion" or "income derived from personal exertion" and as such they are assessable income under section 25 of the Act.

One has sympathy for Henry J's view that business is not implicit in the words "undertaking or scheme". To say otherwise would be to deny any scope for the independent operation of the third limb. However, his Honour's reasons for saying that the majority view of the Privy Council in *McClelland* does not apply in New Zealand are unconvincing.

More recently, in *Duff* v *CIR*[60] Beattie J in discussing the elements of the third limb cited *McClelland* as authority for the proposition that it is concerned with undertakings or schemes that must be business transactions.[61] His Honour did not refer to *Eunson* on this point.

1 *"Carrying On or Carrying Out"*

There seems to be little controversy over the meaning of these words:[62] "The alternative 'carrying on or carrying out' appears to cover on the one hand, the habitual pursuit of a course of conduct, and, on the other, the carrying into execution of a plan or venture which does not involve repetition or system." In this context it is doubtful whether there is any real significance in this distinction. As Windeyer J pointed out in *IMFC Ltd* v *FCT*[63] "the phrases 'carrying on' or 'carrying out' are not technical expressions. . . . But they are aptly related to undertakings and schemes." Possibly the use of the expression "carrying on or carrying out" in conjunction with the expression "undertakings and schemes" has the effect of rendering the words "carrying on" superfluous. As Barwick CJ said in *IMFC Ltd,*[64] on appeal to the Full Court, "[s]ection 26(a) is intended in my opinion to deal with transactions which are entire in themselves and do not form part of a more extensive business." Such transactions seem to come within Dixon J's definition[65] of "carrying out" and the other transactions—those that form part of a more extensive business and which do not come within the scope of the provision—would ordinarily come within Dixon J's definition of "carrying on".

2 *"Of Any Undertaking or Scheme"*

The meaning of the words "undertaking" and "scheme" have been considered in a number of cases. It seems that "undertaking" is of limited application. In *Eunson*[66] Henry J said that undertaking[67] "implies some engagement or the like with some other person or persons." More often the courts have been concerned with defining the word "scheme" or the composite expression "undertaking or scheme".

60 (1979) 3 TRNZ 158.
61 Ibid at 164.
62 *Premier Automatic Ticket Issues Ltd* v *FCT* (1933) 50 CLR 268, 298 per Dixon J; *XCO Pty Ltd* v *FCT* supra p 133 n 11 at 349 per Gibbs J.
63 (1970) 1 ATR 425, 432. Windeyer J's judgment was reversed on appeal by the Full Court ((1971) 125 CLR 249) but this does not seem to affect the veracity of his comment.
64 Ibid at 255.
65 See supra p 140 n 62.
66 Supra p 138 n 47.
67 Ibid at 280.

In *Duff*[68] Beattie J referred to some of the more common definitions of the word "scheme":[69]

> As to the meaning of "scheme" in the section, I refer to the passage . . . from *McClelland*'s case.[70] In *Vuleta* v *CIR* [1962] NZLR 325, 329 Henry J refers to the *Shorter Oxford Dictionary* definition of "scheme" in the sense in which it is used in [section] 88(1)(c) as "a plan, design or programme of action, hence a plan of action devised in order to attain some end; a project, an enterprise". See also *Eunson* v *CIR* . . . and *IMFC Ltd* v *FCT* . . . where Windeyer J defined "scheme" as "presupposing some programme of action, a series of steps all directed to an end result".

What does and does not constitute an undertaking or scheme may be ascertained from a consideration of some recent cases. One case where an undertaking or scheme was held to exist is *Steinberg*,[71] a decision of the Full Court of the High Court of Australia (Gibbs and Stephen JJ, Barwick CJ dissenting). Here the taxpayer had acquired shares in a company with the intention of putting the company into liquidation, distributing its assets in specie and subsequently selling them. In *Macmine* v *FCT*[72] Sheppard J held that the acquisition of shares in a company with the intention of thereby acquiring the rights to further shares and then selling those rights for the purpose of obtaining the funds with which to pay for the loan used to acquire the original shares was an undertaking or scheme. In *XCO Pty Ltd* v *FCT*[73] Gibbs J held that the taking of an assignment of debts owed by a loss company with the intention of demanding payment of part of them was an undertaking or scheme by the taxpayer company. It is also apparent from this case that a taxpayer can carry on or carry out an undertaking or scheme notwithstanding that what he does is for the purpose of a larger undertaking or scheme involving other people.

In *Clowes* v *FCT*[74] it was held by the Full Court of the High Court of Australia (Dixon CJ and Kitto J, Taylor and Webb JJ dissenting) that the investment of money in forestry bonds, where the money was simply invested by the taxpayer and all the work was carried out by an independent forestry company with which the taxpayer had no other connection, did not amount to a scheme or undertaking carried on or carried out by the taxpayer. As Kitto J said, if the second limb of section 26(a) (third limb of section 65(2)(e)) was held to catch such an investment it would also catch every bet or contract of life assurance. The short point of *Clowes* is that for the provision to apply it is not enough that the taxpayer derives a receipt from somebody else who has obtained it by carrying out a scheme of profit making.[75] In *Vuleta* v *CIR*[76] Henry J held that a former bookmaker who engaged in heavy betting on horses was not carrying on or carrying out an undertaking or scheme within the

68 Supra p 140 n 60.
69 Ibid at 165.
70 Where the majority of the Privy Council said that an undertaking or scheme must exhibit features which give it the character of a business deal.
71 (1975) 134 CLR 640.
72 (1976) 6 ATR 597.
73 Supra p 133 n 11.
74 (1954) 91 CLR 209.
75 *XCO Pty Ltd* v *FCT* supra p 133 n 11. See also *Milne* v *FCT* (1976) 8 ALR 258.
76 [1962] NZLR 325.

meaning of the third limb. However, he recognised that it was possible for such activity to constitute a business under the provision preceding section 65(2)(a).

One other type of transaction which does not amount to an undertaking or scheme is the realisation of a capital asset. In *Eunson*[77] Henry J held that the owner of farm land who sold surplus land after subdividing it did not carry on or carry out an undertaking or scheme under the third limb.[78] It should be noted that, if the transaction involved something more than the realisation of a capital asset to the taxpayer's advantage the proceeds may be assessable. To use the example suggested by Barwick CJ in *Williams,*[79] profit may be caught either under the third limb or under section 65(2)(a) where houses are built on land originally owned as a capital asset and then sold.

In *Steinberg*[80] the majority of the High Court[81] affirmed the view that it is not necessary for all the details of an undertaking or scheme to be fully worked out at its inception. It is sufficient if at that time there is an intention to turn the relevant asset to profit. The details may be worked out later.[82]

This view was adopted by Hogarth J in *Burnside* v *FCT*[83] where he held that there existed an undertaking or scheme where a taxpayer acquired shares prior to their listing, with the intention of either selling at a profit some of those shares or other shares that he held, or both, so as to pay off a bank loan. His Honour held that it did not matter at the time of acquisition that the taxpayer was uncertain as to which procedure he would follow.[84]

If a taxpayer abandons an undertaking or scheme before completion he will not be assessable under the third limb. In *Kratzmann* v *FCT*[85] the taxpayer purchased a block of land with the intention of erecting a building and selling sufficient units in the building to cover the costs of the scheme. He later abandoned the scheme for financial reasons and sold the property at a profit. In the High Court of Australia Menzies J held that the profit from the sale was not assessable under the second limb of section 26(a) of the Income Tax Assessment Act 1936 because the sale took place after the scheme had been abandoned.[86] *Kratzmann* raised the possibility of a loop-hole in the third limb whereby a taxpayer, having embarked on one scheme the profits from which would have been assessable, changes to another scheme the profits from which would not be assessable because the original scheme had been abandoned. This possibility was commented on by Stephen J in *Steinberg*[87] who said that a taxpayer may be regarded not as having aban-

77 Supra p 138 n 47.
78 See also *Beetham* v *CIR* supra p 138 n 47; *Scottish Australian Mining Co Ltd* v *FCT* (1950) 81 CLR 188.
79 Supra p 132 n 4.
80 Supra p 141 n 71.
81 Ibid at 699-700 per Gibbs J; at 714-715 per Stephen J. Barwick CJ, at 688, dissented on this point.
82 See also *Buckland* v *FCT* (1960) 34 ALJR 60 per Windeyer J.
83 (1976) 6 ATR 406, 418.
84 See also *Macmine* v *FCT* supra p 141 n 72 at 607; *Daish* v *FCT* (1977) 7 ATR 36, 59.
85 (1970) 1 ATR 827.
86 Ibid at 829. See also *Eisner* v *FCT* (1971) 2 ATR 3.
87 Supra p 141 n 71 at 714.

doned the scheme but rather, as having varied some of the details. This would more likely happen where the scheme at the outset is imprecise—where the details are not worked out in advance. Such a scheme will more readily take into its stride unexpected events. Alternatively, where the original scheme is abandoned, subsequent activities may be seen as a new scheme. In such a case the date of inception of the new scheme will be the starting point for the calculation of profit.[88]

Stephen J's first alternative is illustrated in New Zealand by *Duff*.[89] The taxpayers carried on a scheme which involved the development of a subdivision. Before the scheme could be completed, the land was compulsorily acquired by the Crown. Compensation was paid based on the subdivisional value of the land. Beattie J held that the original scheme had been varied and not frustrated by the intervention of the Crown and that the profits were assessable under the third limb. However, it seems that the case depends very much on its facts and that here the difference between the original scheme and the varied scheme was only slight. The scheme at the outset was to buy land for subdivision and sale to builders. In its amended version, the land was bought for subdivision and sold to the Crown at subdivision value. As Beattie J said[90] "a vital and determining factor is that compensation was assessed on the *subdivisional value*. . . ."

Duff is also authority for the proposition that the third limb of section 65(2)(e) applies where property is compulsorily acquired. It is apparent that the second limb does not apply in this circumstance[91] and this was thought to be the case in respect of the third limb by Jeffries J in *Railway Timber Co Ltd* v *CIR*.[92] However, the reason for not applying the second limb to property compulsorily acquired does not exist in respect of the third limb. Where land is compulsorily acquired from a taxpayer there is no "sale or disposition" which is a necessary ingredient of liability under the second limb but not under the third limb.[93]

3 *"For the Purpose of Making a Profit"*

As with the second limb, the "purpose" must be the dominant purpose.[94] However, unlike the second limb, the time at which the purpose of making a profit must be ascertained is the time at which the undertaking or scheme is entered into or devised and not when the property used in the undertaking or scheme is acquired.[95]

88 Idem.
89 Supra p 140 n 60.
90 Ibid at 165.
91 *Public Trustee* v *CIR* [1961] NZLR 1034.
92 [1977] 1 NZLR 655.
93 *Duff* v *CIR* supra p 140 n 60 at 164.
94 *CIR* v *Walker* supra p 134 n 18 at 361 per North J; at 367 per Turner J; *Duff* v *CIR* ibid at 165.
95 *Gilmour* v *CIR* [1968] NZLR 136.

V Conclusion

No clear pattern or philosophy emerges from the decisions on section 65(2)(e). The courts have kept closely to the words of the section, and especially in New Zealand have in a number of instances adopted a fairly restricted construction. As a result, the first limb can have little independent effect; the second limb, while it is more generously applied, is beset by problems associated with the concepts of "motive", "purpose" and "intent"; and although the third limb appears to be more general, it has still been given a limited reading, so that a variety of schemes which result in financial gain have been held to fall outside its ambit.