JOSHUA WILLIAMS MEMORIAL ESSAY 1983

Sir Joshua Strange Williams, who was resident Judge of the Supreme Court in Dunedin from 1875 to 1913, left a portion of his estate upon trust for the advancement of legal education. The trustees of his estate, the Council of the Otago District Law Society, have therefrom provided an annual prize for the essay written by a student enrolled in law at the University of Otago which in the opinion of the Council makes the most significant contribution to legal knowledge and meets all requirements of sound legal scholarship.

We publish below the winning entry for 1983. It should be noted that the Budget delivered by the Honourable R O Douglas on 8 November 1984 considerably alters the position with respect to fringe benefits in New Zealand. For the proposed new legislation see clause 34 of the Income Tax Amendment Bill (No 2) 1984.

FRINGE BENEFITS: THE DEFINITION OF "ALLOWANCES" IN SECTION 65(2)(b) OF THE INCOME TAX ACT 1976

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"Of all the debts men are least willing to pay taxes.
What a satire is this on Government!"[1]

I FRINGE BENEFITS

The term "fringe benefits" is usually taken to mean any benefits or advantages, other than the payment of wages and salaries, passing from employer to employee and arising out of the employment.[2] Therefore the term "fringe benefits" envisages both monetary and non-monetry benefits.

Lord Radcliffe in *Abbott* v *Philbin*[3] described the problems with the taxation of benefits in kind:

> It is obvious that this conception raises many attendant uncertainties which are not so far as I know, cleared up except where some particular class of benefit in kind has offended the eye of the legislature and has been dealt with by special legislation

I submit this statement is relevant to New Zealand's current taxation climate. Special sections have "picked off" specific fringe benefits that Parliament felt compelled to tax.[4] Yet the scope for tax avoidance throug

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1 Emerson, *Politics* (1841).
2 Richardson and Congreve, *Tax Free Fringe Benefits* (1974) 3.
3 [1961] AC 352 at 378.
4 The sections referred to in this paper are contained in the Income Tax Act 1976 unle otherwise stated: board, lodging and house allowances, s 72; travelling allowance, s 7 share option schemes, s 69; lump sum retirement schemes, s 68.

inge benefits is still extensive. An employee may have his telephone, motor ar and low interest housing loan provided by his employer. This employer ıay also pay school fees, clothing costs, annual holidays and child care osts. Under present tax legislation, none of these disbursements are taxable n the hands of the employee, nor are they treated as non-deductible xpenses to the employer.[5]

The Task Force on Tax Reform concluded that there was a very strong case for taxing fringe benefits.[6] First, it is said that if the underlying principle of income tax is a taxation of gain, then the receipt of a fringe benefit is as much a gain as cash in hand. Secondly (and perhaps most mportantly), the Task Force considered that the ". . . inequity which results rom the non-taxation of fringe benefits has reached serious proportions".[7] t is unfair to treat two persons differently in terms of taxation when their ncomes are the same. The difference may arise when one receives fringe benefits while the other receives all salary. The Task Force pointed to this perceived unfairness" as a significant factor in creating attitudes of voidance and even evasion of the payment of tax.[8]

And yet the Government has made no move towards taxing these benefits. he Government may consider that there is too great a problem in dministering such a taxing system effectively. Or, politically, Government ıay be acting in its own best interests by providing some relief to extra- rdinarily high personal income tax levels. The conclusion of the Task Force as strongly worded:[9]

> The Task Force is of the view that unless action is taken to tax these benefits, it may be generally concluded that Government is implicitly accepting the propriety of this form of tax avoidance. The result will be an acceleration of existing widespread moves towards the provision of remuneration in a non-taxable form, with increasingly serious implications for equity and for the ability of the remaining tax base to yield sufficient revenue at acceptable rates of tax.

o further action on fringe benefits has been taken by the Government ter the issue of this report.

THE SCOPE OF THIS PAPER

It is the intention of this paper to examine the definition of "allowances" thin section 65(2)(b) of the Income Tax Act 1976. The problem is whether particular benefit is an "allowance". To solve this problem the court can her devise a test for what is an "allowance" or devise a test for what not an "allowance". The courts' attempts to define what is an "allow- ce" have been, I submit, not at all convincing. As I shall discuss later this paper,[10] there would seem to be much better grounds for adopting est to see whether the particular benefit was not an "allowance". For

Report of the Task Force on Tax Reform (1982) para 6.184.
Ibid at para 6.206: "The Task Force strongly recommends that fringe benefits should be brought within the definition of taxable income immediately."
Ibid at para 6.183.
Idem.
Ibid at para 6.205.
Infra, p 696.

this purpose, one looks to see whether it is a non-monetary bonus, gratuity or emolument. If it is one (or more) of these things, then it is not an "allowance", and not assessable under section 65(2)(b).[11]

III THE STATUTE

". . . [I]t is not what the legislators had in mind, but what the words of the statute must be taken to mean that is the subject of inquiry."[12]

It is significant that so many cases in tax law make reference to the judicial approach to taxing statutes. This approach is little concerned with the doctrine of "the substance of the matter" and instead concentrates upon ascertaining the legal rights and obligations of the parties.[13] The courts have laid emphasis upon applying ordinary legal principles. They have been generally[14] ill disposed to "see through" transactions.

Section 65 of the Income Tax Act 1976 provides a list of the types of items which are deemed to be included in assessable income. This inclusive definition is not intended to be at all restrictive upon what types of income can be taxed. Employment related income becomes clearly defined as assessable income by virtue of section 65(2)(b). The subsection states:

> (2) Without in any way limiting the meaning of the term, the assessable income of any person shall for the purposes of this Act be deemed to include, save so far as express provision is made in this Act to the contrary, —
>
> (a) . . . ;
>
> (b) All salaries, wages or allowances (whether in cash or otherwise), including all sums received or receivable by way of bonus, gratuity, extra salary, compensation for loss of office or employment, or emolument of any kind, in respect of or in relation to the employment or service of the taxpayer; . . .

At first glance the scope of salaries, wages or allowances (whether in cash or otherwise) would seem to be broad enough to catch every form of remuneration derived by the employee. But the courts' closer examination of the section has provided welcome results to some employees (and employers).

11 Section 65(2)(b) of the Income Tax Act 1976 is the same as section 88(1)(b) of the Land and Income Tax Act 1954, as amended by the Land and Income Tax Amendment Act 1968 and 1973, ss 9(2)(a) and 8(1) respectively.

12 *Edge* v *CIR* [1958] NZLR 42, per Turner J.

13 *IRC* v *Duke of Westminster* [1936] AC 1 at 20, per Lord Tomlin: "This so called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."

14 This statement ought to be qualified by the courts' approach in some of the anti-avoidance cases, eg *Elmiger* v *CIR* [1966] NZLR 683 at 687, per Woodhouse J in discussing the equivalent to the Income Tax Act 1976, s 99: "I think these provisions are intended to forestall deliberate attempts by individuals to obtain tax advantages denied generally to the same class of taxpayer. That the legislature should attempt to anticipate the manoeuvres is not surprising; nor can it be thought unfair to those affected if the method adopted by the legislature should be, as in the case of these sections, the method of general proscription."

It is open to argument that wages and salaries in this definition cover only money sums received or receivable by the employee.[15] Thus the statute catches (as wages and salaries) these monetary forms of remuneration paid to the employee in return for services. Further, cash payments (that are more accurately described as allowances rather than wages or salaries) are assessable, except to the extent where under section 73 they can be demonstrated to be reimbursement of expenses incurred in gaining or producing assessable income.

Non-cash forms of remuneration are left to be included as assessable income if they fall within the definition of "allowances". Those non-cash benefits that fall outside this definition are called "tax free fringe benefits".[16]

IV WHAT IS AN "ALLOWANCE"?

In *Burgess* v *Clark*[17] the English Court of Appeal considered the definition of "allowance" within the Public Health Act of 1875. Brett MR placed a narrow interpretation upon the word when he held:[18]

> I think it would be a disastrous interpretation of the enactments to hold that the payment of rent is an "allowance" within their meaning. The word "allowance" means a payment beyond the agreed salary of the officer for additional services rendered by him to the local board; it does not apply to a contract for letting rooms.

This limited concept of the nature of an "allowance" was introduced to New Zealand by Sim J in *Edwards* v *CT*[19] when delivering a judgment on behalf of himself, Reed, Adams and Ostler JJ. *Edwards'* case concerned the superannuation allowance paid to a retiring judge. The question arose whether this superannuation payment was "earned income" and thus subject to taxation on that basis. Sim J held that the word "allowances" could be construed in the sense given to it in *Burgess* v *Clark*. The retiring judge was entitled to his superannuation as a taxable pension and not as taxable income.

From *Edwards'* case emerge two different ideas about the nature of 'allowances". First, that they ought to be read ejusdem generis[20] with the other items in the section. This lends an "allowance" the character of being concerned with existing employment or service. Secondly, *Edwards'* case introduced the narrow limits of the English cases, viz – extra payment for extra work. This definition is limiting because the word "payment" tends

5 As was argued in *Sixton* v *CIR* (1982) 5 NZTC 61,285 at 6,1286; 5 TRNZ 844 at 845, per Wallace J: "Mr Clews in his submissions on behalf of the objector began by contending that the benefit received by the objector could not be a salary or a wage because the words cover only money sums received or receivable by the taxpayer, and no money sum was ever paid to the objector under the incentive scheme."

6 The other major forms of fringe benefits are deferred benefits in cash.

7 (1884) 14 QBD 735.

8 Ibid at 738.

9 [1925] GLR 247.

0 Ibid at 248, per Stout CJ: ". . . the word 'allowance' as used in paragraph (b) of s 85 is mixed up with other items such as salaries, wages, allowances, bonuses, gratuities, extra salaries, and emoluments of any kind. These are all to be read together as the class which is dealt with under paragraph (b) and, in my opinion, pension could not properly come under that heading."

to suggest that the only form of "allowance" caught will be one paid, ie in cash. It is also limiting because it associates payment with extra work. An employee who receives greater payment for work that is not "extra" will find that this payment is not caught by this definition of "allowance".

An Australian case, *Mutual Acceptance Co Ltd* v *FCT*,[21] also considered the meaning of "allowance" but in a different statutory context. Dixon J in a dissenting judgment said:[22]

> "Allowance" is one of the many words which take their meaning from a context rather than affecting or controlling the meaning of other words of the context in which they occur . . . . The next word "allowances" seems to me naturally to follow as an attempt to make sure that any other kind of gain or reward allowed or conceded by the employer to the employee for his work is brought within the definition.

North P considered these statements in *CIR* v *Parson (No 2)*,[23] but he was doubtful whether Dixon J would have reached the same conclusion if he had been considering ". . . the more limited words of the New Zealand section".[24]

In *Stagg* v *CIR*,[25] Hutchison ACJ bravely[26] set out to describe the characteristics of wages and salaries that would have a bearing on the meaning of "allowances". The facts of *Stagg's* case were these. The Commissioner had included in Stagg's assessable income an amount that represented the cost of airfares to the United Kingdom for both Stagg and his wife. These had been paid for by Stagg's employer. On appeal against the assessment the Magistrate's Court held that Stagg was entitled to have a portion of his own airfare exempt because that was the proportion of time that he had spent on business. The rest of the airfares were held to be part of his assessable income.

In the Supreme Court, Hutchison ACJ considered whether the payment came within the definition of "allowances" contained in section 88(1)(b) of the Land and Income Tax Act 1954. He applied the ejusdem generis rule and attributed the characteristics of "wages" and "salaries" to the meaning of "allowances". He then proceeded to outline four factors that might be characteristics of "allowances". The first characteristic is that the benefit must be in relation to employment or service. This is a requirement of section 65(2)(b). It is an overriding consideration in examining any of the types of employment related income. The second characteristic is that the benefits are payable under a contract of service and not as a gratuity, though this factor is affected by the later part of the paragraph which includes

21 (1944) 69 CLR 389.
22 Ibid at 402-403.
23 [1968] NZLR 574.
24 Ibid at 586.
25 [1959] NZLR 1252.
26 "In *Stagg* v *CIR* . . . Hutchison ACJ attempted to list the criteria of an allowance. I suspect that he found it difficult . . . . In view of the conclusion I have already reached, it is not necessary for me to attempt that task now; but I could say that I doubt whether it is possible to provide an enumeration which will satisfactorily cover all cases. The form in which advantages are bestowed on employees are increasing rapidly and becoming highly complex under the stimulus of high taxation rates" – *CIR* v *Parson (No 2)* [1968] NZLR 574 at 589, per McCarthy J.

at least certain "gratuities" within "salaries, wages or allowances". This is really quite a restrictive definition because it would only catch the contemplated contractual remuneration of the employee. The option to purchase shares in *Parson's* case was clearly outside such a definition.[27] The use of company assets, such as a company car, could easily be effected without bringing it under a contract of employment. The third characteristic is that the benefit is paid in money or it is convertible into cash by the employee. I intend to establish in a later section of this paper that this characteristic is irrelevant to the question of whether a benefit is an "allowance".[28]

Lastly, Hutchison ACJ held that a characteristic of an "allowance" is that it should be paid periodically. Again this is a limiting definition because many forms of remuneration are in a single transaction. For instance, in *Stagg's* case itself, the single purchase of the air travel ticket. In *Parson's* case North P pointed out that there were only two transactions.[29] In *Sixton* v *CIR*[30] a single points cheque was paid out under the employee incentive scheme. It is likely that many forms of non-cash benefits are conveyed in a single transaction. Should the characteristic of periodic payment truly become part of the test of what is an "allowance", employers will increasingly resort to such single transactions as forms of remuneration.

The definition of "allowance" is both restricted and obscured by these cases. There was a consensus that "allowances" must be read ejusdem generis with the preceding words "salaries" and "wages". But beyond that different judges have tended to view the word differently.

Dixon J's view of "allowances" in the *Mutual Acceptance* case[31] was wide enough to encompass any kind of gain or reward from employment — but the Australian statute he was considering was widely worded.[32] Sim J in *Edwards'* case adopted the narrow interpretation that an "allowance" was extra payment for extra work. Hutchison ACJ in *Stagg's* case tried to provide a comprehensive set of characteristics to define an "allowance". With respect, I submit that only one of the four characteristics is valid, and that is that the benefit must be in relation to the employment or service. The other three characteristics he proposed are limiting and unsatisfactory.[33]

Perhaps, though being unable successfully to define what is an "allowance", their Honours have been conscious of the advantage in having a flexible definition. In *Parson's* case, McCarthy J doubted whether it was possible to provide an ". . . enumeration [of the criteria of an "allowance"]

[1968] NZLR 574 at 586, per North P.

Infra, p 703.

[1968] NZLR 574 at 586.

(1982) 5 NZTC 61,285; 5 TRNZ 844.

(1944) 69 CLR 389.

The Pay-roll Tax Assessment Act 1941-1942 (Commonwealth), s 3 provided that "wages" meant "any wages, salary, commission, bonuses, or allowances paid . . .", and included certain other defined benefits.

Unsatisfactory in the sense that they are so related to the characteristics of "salary" and "wages" as not to give "allowances" any real force. They are so limited that virtually any scheme that an employer could think of to provide his employee with a benefit would fail to be caught as an "allowance".

which will satisfactorily cover all cases."[34] He considered that the forms of benefits given to employees were rapidly increasing and becoming more complex.

Although in *Edwards'* and *Stagg's* cases the Courts read "allowances" closely with "wages" and "salaries", they have tended to ignore the later words of the section. It is to these later words that the Court of Appeal has attached a great deal of importance.[35]

V WHAT IS NOT AN "ALLOWANCE"?

1 *Non-monetary Bonuses, Gratuities and Emoluments*

In *CIR* v *Parson (No 2)*[36] the respondent was a senior employee of Woolworths Ltd. Woolworths made an offer to him by which he could purchase Woolworths shares. The purchase was financed in part by the company. Parson was bound to pay for the shares over a five year period but he could not deal with the shares during this time. As a result of Parson's acceptance of the offer of the shares, the Commissioner calculated that he had received assessable income. The basis for the Commissioner's calculations was the difference between the market value of the shares at the date of the allotment, and the cost of the shares.

The majority of the Court of Appeal[37] held that any benefit acquired by the employee was not an "allowance" in terms of section 88(1)(b) of the Land and Income Tax Act 1954, and was therefore not assessable under that section. After a careful consideration of the historical construction of section 88(1)(b), North P held that the legislature, by introducing the enlargement of the term "allowance", had recognised that the natural import of the word "allowance" did not include the meaning that the later enlargement provided for. In the Land and Income Assessment Act 1891 the words "including all sums received or receivable by way of bonus, gratuity, extra salary, compensation for loss of office or employment, or emolument of any kind, . . .", were not used. If the 1954 Act had similarly omitted these words, North P would have found it easier to give a wide meaning to "allowances".[38]

However, the 1954 legislation contained these words, which had been introduced in 1900. North P held that their addition posed an "insuperable difficulty"[39] to the Commissioner, for:[40]

34 [1968] NZLR 574 at 589.

35 Ibid at 586-587 and 589. In *Parson's* case the words that followed "allowances" were considered very important in influencing the meaning of "allowances". Particularly "including all sums received or receivable by way of bonus, gratuity, extra salary, compensation for loss of office or employment, or emolument of any kind, . . .".

36 [1968] NZLR 574.

37 North P and McCarthy J; Haslam J dissenting.

38 Ibid at 585, his Honour comments: "If s 88(1)(b) had stopped at the words 'all salaries, wages or allowances (whether in cash or otherwise) . . . in respect of or in relation to the employment or service of the taxpayer', it may possibly have been arguable that the word 'allowances' was wide enough to include all benefits whether in cash or otherwise received by a taxpayer in respect of or in relation to his employment . . .".

39 Ibid at 586.

40 Ibid at 587.

> Applying this principle of construction [ie that the word "includes" is used in interpretation clauses to enlarge the natural meaning of words or phrases – *Dilworth* v *CSD* [1899] AC 99, PC] as an aid to the interpretation of s88(1)(b) in its present form, I think it necessarily follows that the legislature, by enlarging the meaning of the words "all salaries, wages or allowances" to include sums received by the taxpayer by way of bonuses, gratuities, or emoluments of any kind has recognised that the first mentioned words in their natural import did not include any of these benefits.

The effect of the addition to the section was twofold. First it illustrated that these specified forms of benefit (bonus, gratuity, extra salary and any emolument) were not in the past within the meaning of "allowance". Secondly it brought these bonuses, gratuities, extra salaries and emoluments within the definition of "allowance", but only if they were in a cash form. Since the section refers only to "*sums* received or receivable . . ." these benefits must be in cash to be caught.

The conclusion that North P drew in deciding on the facts in *Parson's* case was that since the share option scheme was in the nature of a non-cash bonus or emolument, it fell outside the scope of section 88(1)(b).

This decision in *Parson's* case has been closely examined and applied by Wallace J in the recent High Court decision *Sixton* v *CIR.*[41] The objector's employer operated an employee's incentive scheme with a view to promoting increased sales. Employees were awarded "prize points" and ultimately received a points cheque which was not transferable and could not be exchanged for cash, but only for items from a range of goods. The Commissioner considered the value of the goods so obtained to be assessable as an allowance in terms of section 65(2)(b).

Wallace J began by identifying the two issues that he considered stood between the parties: (1) whether the benefit received by the objector was an "allowance" in terms of section 88(1)(b); and (2) whether, if the benefit was an "allowance", it was convertible into money.[42] His Honour held that t was not possible to distinguish *CIR* v *Parson (No 2)* on the facts. It was argued for the Commissioner that the benefit in *Parson's* case had nothing o do with the services that were part of the employee's job. His Honour found this distinction unacceptable. He held that the objects of the share scheme in *Parson's* case were indistinguishable from the objects of the export selling scheme, as "Both schemes were to a real extent concerned with improving the work, service and performance of staff".[43]

Wallace J applied the reasoning of North P in *Parson's* case, which he summarised thus:[44]

> (a) benefits of the type in question were clearly perquisites or emoluments;
> (b) the legislature by enlarging the meaning of "allowance" (by the 1900 amendment) recognised that "allowance" in its natural import did not include any of these benefits in the 1900 amendment;
> (c) that, accordingly, a non-monetary perquisite or emolument is not included in the word "allowances".

41 (1982) 5 NZTC 61,285; 5 TRNZ 844.
42 Ibid at 61,286; 845.
43 Ibid at 61,287; 846.
44 Idem.

Therefore he held that the benefit of the "super tub" that the employe received was not assessable income.

Wallace J introduced a new term into the concept (as developed by North P) of what is not an "allowance". North P looked to the language of th amendment to set the limits of non-assessable remuneration. But in *Sixton's* case, Wallace J held that a non-cash perquisite was also outside the definition of an "allowance".[45] He may have had in mind the House of Lords decision in *Abbott* v *Philbin,*[46] in which the giving of shares in the company to employees was held to be within the meaning of "perquisites or profits whatsoever". However it must be recognised that the word is an extension beyond the Court of Appeal's decision, and that it may be (unintentionally) of consequence.

North P in *Parson's* case referred to the English cases as unhelpful because they considered Schedule E of the Income Tax Act 1952 (UK) which speaks of tax being payable "in respect of all salaries, fees, wages, perquisites or profits whatsoever".[47] North P did not consider it necessary to examine the nature of perquisite in the light of our own legislation. It may be that Wallace J referred to "perquisite or emolument" in the sense that the words were interchangeable. He may have some support for this from the definition in the *Shorter Oxford English Dictionary*[48] which is "any casual emolument in addition to salaries or wages". Another view is that Wallace J may by the use of the words "emolument or perquisite" be substituting "perquisite" for all the other forms of benefit, viz "bonuses, gratuities, extra salaries, . . ." etc. On this view *Sixton* can be totally reconciled with *Parson's* case.[49]

There is evidence that Wallace J did not want to extend the meaning of the test of what is not an "allowance" by including non-monetary perquisites. It becomes clear in *Abbott* v *Philbin* that the House of Lords considered that a perquisite was something that was convertible into cash.[50] To adopt the word "perquisite" along with the other forms of remuneration may have the effect of re-introducing the test of convertibility. Wallace J held that the question of whether the benefit was convertible to money was irrelevant in the test for whether the benefit is an "allowance". It is suggested that his Honour could not have intended to introduce "perquisite" in its *Abbott* v *Philbin* meaning. He must have intended that "perquisite" be interpreted either as a complete synonym for emolument or else as a complement to emolument which encompasses all the other forms of remuneration detailed by the 1900 amendment.

45 Idem.

46 [1961] AC 352.

47 [1968] NZLR 574 at 586.

48 Referred to by North P, idem.

49 Supra n 41 at 61,287; 846: "The reasoning followed by North P leads to the conclusi that those non-monetary benefits which are perquisites or emoluments are not allowanc . . .".

50 [1961] AC 352 at 372, per Lord Reid: "If in fact this type of option is a kind of rig which can be turned to pecuniary account, what more is necessary to make it perquisite? . . . . It appears to me that if a right can be turned to pecuniary account th in itself is enough to make it a perquisite."

If Wallace J did mean "perquisite" to be an extension to the scope of *Parson's* case, he surely cannot have meant to contradict himself on the role of the convertibility test. In that case whatever he meant "perquisite" to be, it cannot mean a "kind of right that can be turned to pecuniary account", which was Lord Reid's test in *Abbott* v *Philbin.*[51]

2 *Further Definition of Non-Monetary Benefits*

This section looks at some decisions the courts have reached in assessing different benefits as taxable under section 65(2)(b). The purpose behind this is that it is arguable that if the cash benefit is caught under section 65(2)(b), then the equivalent non-cash benefit will not be assessable.

In 1973 the Land and Income Tax Amendment Act[52] made an addition to the inclusive description of an "allowance" by inserting an extra category "compensation for loss of office or employment". Thus it can be argued, by analogy with *Parson's* case, that the legislature did not intend to assess non-cash income derived from "compensation for loss of office or employment".

A further indication of what "compensation for loss of office or employment" includes is provided by the New Zealand Taxation Review Authority in *Case D29.*[53] The Authority considered the conflict between section 88(1)(b) and section 88B(4).[54] A J Lloyd Martin DCJ held that which section applied depended upon the facts:[55]

> In my opinion therefore to reconcile the provisions of the two subsections of the Act already set out, s88(1)(b) must refer to payments of compensation to a taxpayer for loss of office by reason of unforeseen circumstances the result of accidents (or matters similar thereto) arising.

Non-monetary compensation for loss of office or employment will fall outside section 65(2)(b) through the arguments adopted in *Parson's* case. *Case D29* will be authority for the proposition that they will not be caught by section 68(4) if the nature of the compensation is unpredictable or accidental.

The New Zealand Taxation Board of Review considered the nature of a gratuity in *Case 62.*[56] The Board was considering whether the amount received by the taxpayer, paid as a sickness benefit by the trustee of a staff benefit fund, was assessable income. The Commissioner argued that it was a sum received by way of gratuity in respect or in relation to the employee's employment. The Board upheld the Commissioner's assessment and considered that the amount was a gratuity as contemplated by section 88(1)(b). The Board held that the amount did not represent a payment for services. The word "gratuity" must be read closely with "in respect of or in relation

Idem.
Land and Income Tax Amendment Act 1973, s 8(1).
(1980) 4 NZTC 60,646; reported 3 TRNZ 568.
Now Income Tax Act 1976, s 68(4) — retiring allowances payable to employees on redundancy.
(1980) 4 NZTC 60,646 at 60,653; 3 TRNZ 568 at 575.
1 NZTBR Case 62, 457.

to" the employment of the taxpayer. Thus a gift or present made in return for services may be caught by the definition of "gratuity".[57]

The Board distinguished "gratuity" from those forms of remuneration that are directly related to the employment of the taxpayer. In this category would come the payment of salary, extra salary, bonus and emolument. A "gratuity" is thus a less direct payment, arising by virtue of employment. The nature of a "gratuity" would be such that the employee could not demand the payment in return for his services (however much he might expect it).

Thus a non-monetary benefit given to the taxpayer which could be indirectly attributed to his services, but which perhaps he could not have insisted upon as direct remuneration, would constitute a non-monetary "gratuity". As such, under the *Parson's* test it would be non-assessable.

In *Naismith* v *CIR,*[58] Thorp J was called upon to decide the nature of a salvage payment under the collective terms "bonus, gratuity or emolument". Two tugs manned by volunteers had salvaged the vessel *Capitaine Bougainville* off the Northland coast. This salvage was outside the normal scope of operations but the employees received pay at ordinary overtime rates. In addition to this overtime the Northland Harbour Board paid roughly $70,500 to the crew members of the tugs upon the realisation of the salvage. The matter came before the High Court as a result of the Commissioner assessing Captain Naismith to tax on his share of this money.

Thorp J refused (rather reluctantly) to accept the argument of the objector that the payment was voluntary and not pursuant to his contrac of employment. He held that the payment was to be regarded as a bonus gratuity or emolument received in relation to the taxpayer's employment This was because, although the crew members went beyond the call of dut in undertaking this salvage, they did undertake the work for their employe and received the money as a result of that work. This was in spite of th fact that their entitlement to the money was derived from the rules o salvage rather than from a contract of employment.[59] The material fact that placed the payment within the category of "bonus, gratuity o emolument" would seem to be that (1) the employees undertook the wor for the employer; and (2) that they received the money as a result of tha employment.

It can be argued that a receipt of a non-monetary benefit as a resu of work undertaken for a particular employer may be a non-monetar bonus, gratuity or emolument.

In *Case 12,*[60] the objector was an officer of the Royal New Zealand Nav He received an end of service grant, which was an advance made co ditionally upon satisfactory completion of his service contract. The object argued that the grant was a loan made to him. The Board upheld t Commissioner's assessment, finding that the advance was an emolume received in respect of the objector's naval service:[61]

57 Ibid at 462.
58 *Naismith* v *CIR* (1981) 5 NZTC 61,046; 4 TRNZ 300.
59 Ibid at 61,051; 306.
60 5 NZTBR Case 12, 92.
61 Ibid at 99.

> Whatever views may have been expressed in that regard at the hearing (B suggested for example that the sum in question might well have been a gratuity), the Board's opinion is that such an amount undoubtedly was an emolument (that is to say, a gain from the objector's service) received by him in respect of or in relation to the naval service in which he was engaged.

The term emolument is probably the widest form of direct "payment" for services or employment. If it is as widely defined as *Case 12* suggests (a gain from service or employment), then it is difficult to understand why the other words "bonus" and "extra salary" are necessary. A "gratuity" would seem to be a gain, but not as directly related to the service performed (more a gain "in respect" of the service performed). Therefore, it may be suggested that the courts have interpreted quite widely the different forms of cash benefits assessable under section 65(2)(b). For example, advances against end of service grants,[62] prizes from selling schemes,[63] and benefits from salvage rules[64] are all emoluments. It is submitted that the availability of these benefits for assessment under section 65(2)(b) will be decided on the question of whether they were in cash.

3 *Pre 1900 Allowances*

In *Parson's* case, North P held that all non-monetary bonuses, gratuities and emoluments were not assessable under section 65(2)(b).[65] Although McCarthy J stated that he was in general agreement with the reasoning of the learned President,[66] he really extended North P's test by giving "allowances" a slightly different meaning. In McCarthy J's view "allowances" had retained the meaning that Schedule E of the 1891 Act had given to it.[67] Thus defined, "allowances" included all the commonly recognised forms of allowances, such as a house allowance, that would have existed in 1900. McCarthy J held that the legislature recognised the limitations of the word in 1900 and added "including all sums received or receivable by way of bonus, extra salary, or emolument of any kind". His Honour described the consequence as follows:[68]

> Basically, the language has not changed since 1900, and I feel unable in these circumstances now to construe it as covering something which though it probably is an emolument, is not received in the form of a sum of money. If that extension is required, the task should be undertaken by the legislature, not by the Courts.

In his view, the position is that any benefit (whether in cash or otherwise) which would have been regarded as an allowance in 1900 is assessable income. Richardson and Congreve[69] consider that the non-cash allowances of 1900 would probably not go beyond the provision of housing and accommodation, board and meals, travel and working clothing.

62 Supra n 50.
63 Supra n 30.
64 Supra n 58.
65 [1968] NZLR 574 at 587.
66 Ibid at 588.
67 Ibid at 589.
68 Idem.
69 Richardson and Congreve, *Tax Free Fringe Benefits* (1975) 19 (para 17).

Must "allowances" include some non-monetary benefits? Wallace J in *Sixton's* case discussed whether the words "(whether in cash or otherwise)" govern only the word "allowances" in section 88(1)(b).[70] He held that the fact that there was no comma after the word "allowances" was persuasive, but noted the contrary view of Haslam J in *Parson's* case. Therefore he concluded that if "(whether in cash or otherwise)" meant in cash or kind, then "allowances" must include some non-monetary benefits.[71] There is some support for this idea in the test proposed by McCarthy J. Non-monetary meal benefits, for example, would be caught by the 1900 definition of "allowances" and thus be assessable.[72]

Is this a valid argument against the test proposed by North P? His Honour's test does not exempt all the non-monetary benefits, just those that are in the form of bonuses, gratuities and emoluments. Therefore in North P's test, "(whether in cash or otherwise)" can be given the meaning that Wallace J considered in *Sixton's* case. It is designed to catch those non-monetary benefits which are not bonuses, gratuities, emoluments or compensation for loss of office.[73]

With respect, I submit that McCarthy J's proposition (that "allowances" are limited to those common in 1900) cannot logically be sustained. Section 72 was introduced into the tax legislation by section 3 of the Land and Income Tax Amendment Act 1932-1933. It contains these words: "Without limiting the meaning of the term 'allowances' . . . it is hereby declared that the said term shall be deemed to include . . . the use of a house or quarters." The Taxation Review Authority in *Case C13*[74] considered the effect of section 72 (or section 89 as it was then) to be that of a deeming section. A J Lloyd Martin SM considered the effect of the "deemed to include" words and he discussed[75] a principle that Cave J had enunciated in *R* v *Norfolk County Council*:[76]

> Generally speaking, when you talk of a thing being deemed to be something, you do not mean to say that it is that which it is deemed to be. It is rather an admission that it is not what it is deemed to be, and that, notwithstanding it is not that particular thing, nevertheless, for the purposes of the Act, it is to be deemed to be that thing.

Perhaps the dictum of Viscount Simonds[77] expresses the proposition more succinctly:

> I bear in mind what Lord Radcliffe said in *St Aubyn's* case about the word "deemed" but, nevertheless, regard its primary function as to bring in something which would otherwise be excluded.

70 (1982) 5 NZTC 61,285 at 61,288; 5 TRNZ 844 at 846-847.
71 Idem.
72 *CIR* v *Parson (No 2)* [1982] NZLR 574 at 589.
73 (1982) 5 NZTC 61,285 at 61,288; 5 TRNZ 844 at 847: "Perhaps it could be suggested that non-monetary benefits which are not a bonus, gratuity, extra salary, or emolument would fall within the ambit of allowances."
74 (1978) 3 NZTC 60,177; reported 2 TRNZ 385.
75 Ibid at 60,126; 395.
76 (1891) 60 LJQB 379 at 380-381.

When this principle is applied to section 72, an "allowance" is deemed to include board, lodging and house allowances. This means that board, lodging and house allowances could not have been originally part of 'allowances". Since all of these allowances would have been the more obvious examples of those "allowances" commonly found in 1900 (as Richardson and Congreve suggest),[78] one must question the validity of McCarthy J's interpretation of legislative intention.

4 *Convertibility into Cash*

In *Dawson* v *CIR,*[79] McMullin J remarked that:

> In *C. of I.R.* v *Parson* . . . the convertibility to money of contractual rights conferred on an employee by his employer seems to have been accepted as the proper test by the Court of Appeal which accepted the approach adopted in *Tennant* v *Smith* and *Abbott* v *Philbin.*

McMullin J's observation represents a commonly held view of the type of non-monetary benefit that could be held to be assessable. It is my contention that this test, although important in determining the *value* of a non-monetary benefit, actually plays no part in determining whether or not the benefit was an "allowance" within section 65(2)(b).

To explain why this idea of a convertibility test arose it is important to trace back into the law of fringe benefits. It is probable that the most singularly influential decision in this area was that of *Tennant* v *Smith.*[80] Tennant was an agent for a bank, and in that capacity he resided in part of the bank's premises. It was significant that he was bound as part of his employment to occupy the bank's house as custodian. He was not entitled to sublet the premises or to use them for other than bank business. Should he cease to work for the bank he was under an obligation to quit the premises immediately. Tennant's application to have an abatement to his level of taxation was disallowed by the Surveyor of Taxes. This sum was to represent the yearly value to the appellant of residing in the house. The House of Lords held that the nature of the benefit was such that it did not come within any of the terms "perquisites", "profits", or "emoluments" contained in the Act.[81] Lord Halsbury said:[82]

> I come to the conclusion that the Act refers to money payments made to the person who receives them, though, of course, I do not deny that if substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable.

Barclays Bank Ltd v *IRC* [1961] AC 509 at 523.
Supra n 69.
(1978) 3 NZTC 61,252 at 61,257-6,258; 2 TRNZ 375 at 382. But note: this dictum is referring to a principle that the Court of Appeal applied to the *valuation* of an "allowance". It was not applied as a test to determine whether the benefit *was* an "allowance" under s 65(2)(b) as McMullin J appears to indicate.
[1892] AC 150.
5 & 6 Vict, c 35, s 146, Schedule E.
[1892] AC 150 at 156.

Tennant v *Smith* was decided upon its own facts and under its own statute and in that respect the actual decision is of limited importance in examining the meaning of "allowance" in section 65(2)(b). As the promulgator of the convertibility test for income it is significant.

And as *Dawson's* case has shown, the test is important in examining what constitutes income under section 65(2)(1).[83]

In *Machon* v *McLoughlin*[84] the respondent was an attendant at an asylum. His remuneration was paid on a cash basis, subject to fixed deductions for board, lodging and washing provided by the institution. Warrington LJ in the Court of Appeal cited with approval the decision of Rowlatt J in the lower Court thus:[85]

> If a person is paid a wage with some advantage thrown in, you cannot add the advantage to the wage for the purposes of taxation unless that advantage can be turned into money. That is one proposition . . . .

The convertibility test was adopted by Hutchison ACJ in *Stagg* v *CIR.*[86] Counsel based his argument largely upon *Tennant* v *Smith,*[87] saying that nothing could be income unless it could be turned into money. Hutchison ACJ applied this "basic principle of income tax law"[88] to a particular setting of employees' assessable income. His Honour outlined four characteristics that "allowances" possessed. This was the third:[89]

> 3 They are paid in money, though this factor is affected by the words "(whether in cash or otherwise)".

Hutchison ACJ's consideration of what "(whether in cash or otherwise)" meant was influenced by the references made in the rest of the section to "sums". Further, he read "allowances" ejusdem generis with "wages" and "salaries". He reconciled the general principle of *Tennant* v *Smith* and the New Zealand statute he was considering in this way:[90]

> Having regard to the strong indications that there are in the paragraph that "allowances" contemplates payment in money, I agree with counsel for the appellant that the words "(whether in cash or otherwise)" must be read so as to include within "allowances" only such provision for an employee as, if it is not in cash, is convertible into cash by him.

83 "The substantial benefit which the objector received from the investment was that he did not have to pay rental for the set. That does not constitute income, not being money or capable of conversion into money" – (1978) 3 NZTC 61,252 at 61,259; 2 TRNZ 375 at 383, per McMullin J. Section 65(2)(1) deems to be assessable: "Income derived from any other source whatsoever."

84 (1926) 11 TC 83.

85 Ibid at 89 and 95 respectively.

86 [1959] NZLR 1252.

87 [1892] AC 150.

88 [1959] NZLR 1252 at 1256, considering the arguments of counsel.

89 Ibid at 1257.

90 Idem.

This was the position after *Stagg*; since the payment by the company of the air fares of the appellant and his wife was not convertible into money, it could not be an "allowance" (whether in cash or otherwise).

The New Zealand Court of Appeal undertook a closer reading of the statute in *CIR* v *Parson (No 2).*[91] It is my contention that the effect of the Court of Appeal's decision is to remove the convertibility test from the inquiry as to whether a benefit is an allowance under section 65(2)(b).

As I have discussed, North P formulated a test (based on the historical and contextual reading of section 88(1)(b) of the 1954 Act) that examined whether the benefit was a non-monetary bonus, gratuity, extra salary or emolument. This is the fundamental question on whether the benefit is an "allowance". No regard was had to whether the benefit was convertible into cash in the ascertainment of whether the benefit was an "allowance". The statement at the beginning of this section[92] that the convertibility test was used in *Parson's* case is true, but only when the majority was considering the value of the benefit.[93] This valuation is carried out after the benefit is ascertained to be an "allowance".

The statement of McMullin J in *Dawson's* case that begins this section s typical of a popularly held view. But, with respect, upon an examination of *Parson's* case such a view cannot be sustained. The test for what s an "allowance" does not consider the question of convertibility into cash.

In *Sixton* v *CIR,*[94] Wallace J made it clear what part the convertibility est had in determining whether a benefit was an "allowance":[95]

> It appears to me that the benefit in the present case was a non-monetary perquisite or emolument similar to the benefit obtained by the employee of *C. of I.R.* v *Parson,* and that the reasoning of North P is directly applicable. On that reasoning also, the fact that the benefit may have been convertible to money is irrelevant to the question of whether or not the benefit is an allowance within the meaning of s88(1)(b).

Cash or Cash Equivalent

Another possible meaning of the phrase "(whether in cash or otherwise)" that the words mean cash or a cash equivalent. Wallace J put it forward canvassing many alternatives in *Sixton* v *CIR.* His Honour had already ncluded that he was bound to apply the test adopted by North P in *arson's* case. Later, Wallace J noticed McCarthy J's development of North s formulation, but did not comment except to view it as an alternative eaning for "allowances (whether in cash or otherwise)". In discussing hat "(whether in cash or otherwise)" means Wallace J said:[96]

> Or, viewed another way, the words "(in cash or otherwise)" may not mean "in cash or kind", but rather may mean "in cash or cash equivalent" and require an actual payment by the employer on behalf of the employee, e.g., rent paid direct to the

[1968] NZLR 574.
Supra, p 703.
[1968] NZLR 574 at 587-588, per North P; at 589-590, per McCarthy J.
(1982) 5 NZTC 61,285; 5 TRNZ 844.
Ibid at 61,287; 846.
Ibid at 61,288; 847.

employee's landlord or other payments made direct to a third party by the employ on behalf of the employee (as distinct from the present case and the facts in *C. c I.R.* v *Parson* where the employee acquired personal property which could be con verted into money).

This is, however, the very situation that existed in *Stagg's* case.[97] Th employer purchased air travel tickets direct from the airline for the benefi of the employee. Hutchison ACJ held that such a benefit was not a "allowance" within the meaning of section 88(1)(b) of the Land and Incom Tax Act 1954.

The validity of the proposition that the phrase "in cash or otherwise means in cash or cash equivalent may be tested by considering whethe the employer's purchase of property for the employee (*Sixton*) is in fac a payment made direct to a third party by the employer on behalf of th employee (*Stagg*). The difference seems to lie in who actually gives th benefit to the employee; whether the employee does (as in *Sixton*) c whether the third party does (as in *Stagg*). In *Parson's* case the Court c Appeal did not consider that the test for an allowance should be whethe an actual payment was made by the employer for the benefit of th employee. There does not seem, with respect, any reason why Wallace should have discussed it as obiter dicta, except for the understandable reas of attempting to give some meaning to the words "(whether in cash otherwise)".

VI CONCLUSION

It is clear that many difficulties surround the interpretation of the te "allowances" in section 65(2)(b). The New Zealand Court of Appea decision in *CIR* v *Parson (No 2)* seems to provide a test for what is n an "allowance". Whilst the result of *Parson's* case may be considered u satisfactory when viewed against what the legislators may have had in mi the decision in the case is, I submit, historically and contextually logic

It is particularly to the judgment of North P in *Parson's* case that I h referred. He held that the legislation, by introducing an extended mean in 1900, showed that whatever an "allowance" was, it was not a n monetary "bonus, gratuity, extra salary, [compensation for loss of of or employment,][98] or emolument of any kind".

McCarthy J extended this logic to define what constituted an allowa With respect, McCarthy J's embellishment to the logic of North P is supportable because of the existence of specific provisions which show Parliament never intended to have the definition of "allowances" enshri in their amendment of 1900.

It follows, adopting North P's test, that it is open to argument that non-monetary gain from service or employment[99] will not be an "allowa (so long as the benefit is "in respect of or in relation to" his employm

97 [1959] NZLR 1252.

98 The words in brackets were inserted by the Land and Income Tax Amendment Act s 8(1).

99 Being the widest test of what an "emolument" is — as defined by 5 NZTBR Case

It is further open to argument that the fact situations which have resulted in cash benefits being within the inclusive words "bonus, gratuity, extra salary, or emolument", will not be allowances if the benefits are in a non-monetary form.[1]

It can also be argued that the additional test of "convertibility into cash" cannot be sustained alongside the substantive test of whether the benefit is caught by section 65(2)(b). It is on the words of the statute that the test of North P was based and the parallel test of convertibility is immaterial in deciding whether the benefit is an "allowance".

I submit that, in default of legislative intervention, the attraction of fringe benefits will never be greater. As the law in *Parson's* case stands I wonder how many judges will be placed in Wallace J's situation in *Sixton* v *CIR,* where His Honour commented:[2]

> . . . [T]he arguments in favour of the wider interpretation are not unattractive. It is perhaps unfortunate that the opportunity was not taken to resolve the matter when the 1976 Act was introduced: sec. 65(2)(b) of the new Act repeats the former sec. 88(1)(b) in the same terms. Be that as it may, it appears to me that I am bound to follow the interpretation adopted by the majority of the Court of Appeal in *C. of I.R.* v *Parson* and that it is not possible in the present case to reach a different conclusion by reference to the facts or by adopting a pragmatic approach. I cannot see that it is possible to distinguish the present case from *C. of I.R.* v *Parson,* which is binding upon me.

If allowed to persist this situation will find employers and employees alike warming both in a financial and literary way to the words of Lord Sumner:[3]

> It is trite law that His Majesty's subjects are free, if they can, to make their own arrangements, so that their cases may fall outside the scope of the Taxing Acts. They incur no legal penalties, and, strictly speaking, no moral censure if, having considered the lines drawn by the legislature for the imposition of taxes, they make it their business to walk outside them.

1 It is interesting to note that in his dissenting judgment in *Parson's* case Haslan J views the effect of the word "including" in quite a different way to North P. He considered that the "natural import" of "allowances" was wide enough already to cover all the particular forms of remuneration listed, viz bonus, gratuity, extra salary or emolument of any kind. Therefore he considered that the amendment had little significance — [1968] NZLR 574 at 592-593. This view was quite consistent with the passage from the *Dilworth* case to which North P referred to extract his "principle of construction": ". . . and when it is so used these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretations clause declares they shall include" — *Dilworth* v *CSD* [1899] AC 99 at 106, per Lord Watson.

2 (1982) 5 NZTC 61,285 at 61,288; 5 TRNZ 844 at 847.

3 *Levene* v *IRC* [1928] AC 217 at 227.