Estate plans and arrangements to avoid income tax

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Whenever a person becomes involved in estate planning there are nearly always income tax implications. A rearrangement of assets will almost inevitably lead to a rearrangement of income. The Income Tax Act 1976 has, in section 99, a general anti-avoidance provision, although there is no similar provision in the Estate and Gift Duties Act 1968. In this paper John Bassett undertakes a comprehensive analysis of the efficacy of a claim by a taxpayer, in response to an income tax assessment by the Commissioner founded upon section 99, that he was "merely engaged in estate planning".

One of the problems foremost in the mind of an estate planner will be the implications that any prospective scheme will bear on the liability to income tax. Whilst the cardinal objective may be the desire to minimise estate duty,[1] that course of action involving the least periodic contribution to the fisc may also be expected to be an important determining factor. The question then to consider is the extent to which the latter consideration may be permitted to influence the course of action taken to fulfil the former objective? Hanging over the intended estate plan, somewhat like the sword of Damocles, is section 99 of the Income Tax Act 1976. This provision, a generic anti-avoidance measure, denies fiscal efficacy to every arrangement that has the purpose or effect of the avoidance of income tax. Hence the issue this paper will examine will be the circumstances in which a taxpayer may rely on the argument of innocence that he was merely implementing an estate plan, when the fall of that sword is imminent and he is called upon to refute an application of section 99. For the sake of brevity, this contention that the alleged arrangement to avoid income tax was but an exercise in estate planning will throughout this paper be referred to as "the estate planning argument".

Part I deals with the New Zealand cases that touch on the estate planning argument. Part II discusses the treatment accorded the issue in relation to

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1 As charged by s. 3 of the Estate and Gift Duties Act 1968.

Australia's legislative analogue; the discussion will draw out the sharply contrasting approach there taken despite the similar ancestry of the two provisions.[2] Part III examines some of the possible arguments that may be made by the hapless estate planner intent upon preventing that sword of Damocles "decapitating" his estate plan.

I. THE NEW ZEALAND APPROACH

A. Introduction

Before proceeding to examine the treatment accorded the estate planning argument itself, it is worthwhile first to refer to some matters of general background. That course will place the estate planning argument in its proper perspective and so render more comprehensible the succeeding analysis of it.

1. Judicial approaches to tax avoidance

Various courts have from time to time stated the proper approach to be taken when dealing with problems of tax avoidance. Some of these comments were alluded to by Woodhouse J. in *Elmiger* v. *C.I.R.*,[3] in a judgment which, though one of our earliest, still stands as one of the most lucid expositions on the question of the proper approach to be taken to the type of problem that falls for consideration under section 99.[4] His Honour noted the conflict between the view expressed by Lord Tomlin in *Duke of Westminster* v. *I.R.C.*[5] — that every person is entitled to organise his affairs so as to pay less tax than he otherwise might — and the point made by Viscount Simon L.C. in *Latilla* v. *I.R.C.*[6] — that to allow one taxpayer to do so is to increase pro tanto the burden of tax on the remaining, more civic-minded citizenry.[7] Matters have not rested at this point however, for Lord Reid took up this whole question in *Greenberg* v. *I.R.C.*,[8] to make the telling observation[9] that

> We seem to have travelled a long way from the general and salutary rule that the subject is not be taxed except by plain words. But I must recognise that plain words are seldom adequate to anticipate and forestall the multiplicity of ingenious schemes which are constantly being devised to evade taxation. Parliament is very properly

2 That ancestry is traced through by North P. in *Elmiger* v. *C.I.R.* [1967] N.Z.L.R. 161 (C.A.), 176-177, and by Privy Council in *Mangin* v. *C.I.R.* [1971] N.Z.L.R. 591, 594-595 and 600. Both s. 99 and s. 260 of the Australian Act are reproduced in full in the Appendix to this paper.

3 [1966] N.Z.L.R. 683, 686-688.

4 For a strong argument in support of an approach contrary to the one in favour of the Revenue eventually taken by Woodhouse J., see the dissenting judgment of Turner J. in *Marx* v. *C.I.R.* [1970] N.Z.L.R. 182, 208-210.

5 [1936] A.C. 1, 19.

6 [1943] 1 All E.R. 265, 266.

7 This proposition has been queried and found to be unconvincing on the ground that in any event governments are inclined to overtax. See Vineberg "The Ethics of Tax Planning" (1969) Brit. Tax Rev. 31, 31-32.

8 [1971] 3 All E.R. 136.

9 Ibid., 149. This view was endorsed by Lord Wilberforce in *I.R.C.* v. *Joiner* [1975] 3 All E.R. 1050, 1055.

determined to prevent this kind of tax evasion and, if the courts find it impossible to give very wide meanings to general phrases, the only alternative may be for Parliament to do as some other countries have done, and introduce legislation of a more sweeping character which will put the ordinary well-intentioned person at much greater risk than is created by a wide interpretation of such provisions as those which we are now considering.

However the last word on the subject belongs to Lord Simon of Glaisdale, who in *Ransom* v. *Higgs*[10] argued for the adoption of a strict approach to the interpretation of taxation statutes on the basis that whilst[11]

It may seem hard that a cunningly advised taxpayer should be able to avoid what appears to be his equitable share of the general fiscal burden and cast it on the shoulders of his fellow citizens. But for the courts to try to stretch the law to meet hard cases . . . is not merely to make bad law but to run the risk of subverting the rule of law itself.

It is against a background of these competing values that the courts approach problems of tax avoidance under section 99. The exercise in essence reduces itself to endeavouring to accord to the subject the freedom to organise his affairs as he sees fit without jeopardising the interests of the fisc. In the estate planning context, the striking of this balance becomes a particularly delicate question, for to allow the subject too much liberty when planning for both these fiscal burdens is to concede to him the best of both worlds.

2. The scope of section 99

Another important matter to elucidate is the judicial perception of the place that section 99 occupies in the scheme of the Income Tax Act 1976. The decision in *McKay* v. *C.I.R.*[12] is the leading one on the point. The particular issue before the Court of Appeal was whether an assignment of income for a term longer than "the prescribed period" (and hence deemed to be income no longer assessable to the assignor) might yet by an application of section 99 remain the assessable income of the assignor. Resolution of this issue entailed a consideration of the relationship between sections 96 and 99. Clearest expression of the view taken by the court may be found in the observation of Speight J.[13] that he agreed

. . . with the President that if the assignment is not within section [96] the matter is at large and falls for decision on the same principles as any other arrangement which is tested against section [99].

It would seem that the courts are willing to accord a wide potential to section 99, and are not prepared to read in the limitation that it is subject to the other provisions of the Act. However, whilst the same notion was later applied by the Court of Appeal in *Wisheart, MacNab and Kidd* v. *C.I.R.*,[14] subsequent remarks by the Privy Council in *Europa Oil (N.Z) Ltd.* v. *C.I.R.*[15] would seem to cast doubt on the position taken in *Wisheart.* This controversy will be returned to, in greater detail, in Part III B.

10 [1974] 3 All E.R. 949.
11 Ibid., 969.
12 [1973] 1 N.Z.L.R. 592.
13 Ibid., 604. The reasoning underlying this view is more fully developed by Turner P. at 600.
14 [1972] N.Z.L.R. 319.
15 [1976] 1 N.Z.L.R. 546, referred to in this paper as *Europa* (No. 2).

3. *The approach to be taken under section 99*

It is commonplace that all of the material case law to date has arisen from a consideration of the legislative forebear of section 99, namely section 108 of the Land and Income Tax Act 1954.[16] It is likewise plain that the genesis of much of that case law is traceable to the landmark decision of the Privy Council in *Newton* v. *F.C.T.*[17] There the Board undertook a thorough review of the law that had developed under section 260 of the Income Tax Assessment Act 1936-1951 (Aus.) and then went on to state the principles to be applied under that provision. The quintessence of that statement was that[18]

> In order to bring the arrangement within the section you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section.

New Zealand courts unhesitatingly accepted the predication test as the correct approach to be followed when considering any purported application of section 108.[19] However, the caveat may be made that in view of the manifest substantial changes effected by the present section 99, it could be said that any principles developed under section 108 may not necessarily be applicable to a resolution of any problem falling for determination under section 99. For example, by section 99's expanding the basis upon which the application of the former section proceeded so that ordinary family or business dealings may now be within the purview of the section, it might be thought that the predication test itself is no longer the correct approach to take in the administration of the section.

Against this contention it may be said that whilst the new section has considerably expanded upon the terms of its precursor, the basic thrust common to both sections — to negate the fiscal effect of tax avoidance arrangements — is the same. The new section has merely contracted the possible range of exceptions that may have been taken to any purported application of the old section. Hence it may be said that whatever principles were established under the former provision should, under the doctrine of precedent but subject to their express statutory reversal, continue to be applied in resolution of cases falling for consideration under its legislative successor. Arbitration between these conflicting schools of thought must await judicial determination. In the meantime, treatment of the issue posed by

16 The Land and Income Tax Act 1954 was repealed by s. 436 of the Income Tax Act 1976, and the latter statute applies in respect of the tax on income derived in the income year commencing 1 April 1977. See s. 1(2) of the 1976 Act. However, the change from what was s. 108 of the 1954 Act into what is now s. 99 of the 1976 Act was effected by s. 9 of the Land and Income Tax Amendment (No. 2) Act 1974.

17 [1958] 2 All E.R. 759.

18 Ibid., 764. The refinements that were subsequently added to the principles laid down in *Newton* were summarised by our Court of Appeal in *C.I.R.* v. *Ashton and Wheelans* [1974] 2 N.Z.L.R. 321, 328.

19 That approach was first followed by the Court of Appeal in *Elmiger* v. *C.I.R.* [1967] N.Z.L.R. 161, and eventually met with the approval of the Privy Council in *Mangin* v. *C.I.R.* [1971] N.Z.L.R. 591.

this article will proceed on the basis that the doctrine of precedent will see the same approach taken under the new section as under the old, subject to the express modification of that approach by the succeeding provision.

B. The Estate Planning Argument

1. Introduction

The courts of New Zealand have found that any matter falling for determination under section 99 comprises two aspects. The first is essentially an evidentiary one, and delineates the proper subject matter to be scrutinised in order to determine whether there is an arrangement of the type about which the section speaks. The second aspect is the substantive one of whether there is as a matter of fact any such arrangement within the ambit of the section. The estate planning argument in relation to both these aspects has attracted some judicial comment, so it is appropriate to divide an analysis of the estate planning argument into a consideration of each of these facets. That course will lead to the remaining relevant issue that must be considered, which is the question of the potential range of application that section 99 bears in the estate planning context.

2. The proper evidentiary source of the estate planning argument

The proceedings in *Ashton and Wheelans* v. *C.I.R.* provide the appropriate starting point under this head. The facts there were that a firm of accountants, upon a change of partners, rearranged their practice so that commission earned from hire purchase agreements actioned in their office came to be income of the family trusts of the firm's principals. One of the prime movers of the arrangement testified that the reorganisation was inspired by the desire to secure for the respective families a source of income in the event of the demise of that partner.

Wilson J., at first instance,[20] found himself able to accept this modified form of the estate planning argument, which in his Honour's view showed the matter to be "a very prudent and reasonable arrangement".[21] The Court of Appeal[22] however was not inclined to such a benevolent construction of the facts, finding the arrangement "highly artificial".[23] The court went on to hold that the oral evidence explaining why the arrangement was adopted was irrelevant, for this merely disclosed what the taxpayer's motive was. But motive, on the authority of *Newton,* is an irrelevant consideration. This reasoning the Privy Council[24] endorsed, their Lordships holding that the problem of ascertaining an arrangement's purpose or effect must be approached on the basis that[25]

> If an arrangement has a particular purpose, then that will be its intended effect. If it has a particular effect, then that will be its purpose and oral evidence to show that it has a different purpose or different effect to that which is shown by the arrangement itself is irrelevant to the determination of the question whether the arrangement has or purports to have the purpose or effect of in any way altering the incidence of income tax or relieving any person from his liability to pay income tax.

20 (1972) 3 A.T.R. 308.
21 Ibid., 310.
22 Supra n. 18.
23 Ibid., 328.
24 [1975] 2 N.Z.L.R. 717.
25 Ibid., 722.

It followed, as their Lordships went on to emphasise, that the material purpose or effect could be determined "only" by reference to the arrangement itself and not by reference to the parties subsequent conduct.[26]

The firmness of the Board in proscribing reference to events subsequent to the initial implementation of the impugned arrangement contrasts with the approach previously taken in the authorities, where no such strict limitation had been placed on the range of material that may be reviewed. In *McKay* for example, the court took into account as "background"[27] two earlier, similar transactions as materially assisting in indicating the purpose or effect of the transaction there under review. Moreover, and particularly in the estate planning context, it can be imagined that this insistence on examining only the arrangement itself may lead to harsh results. There is perhaps no better way to demonstrate sincerity to the estate planning purpose than to subsequently act in fulfilment of it. It would hardly be sensible or fair not to give due weight to subsequent history in these circumstances.[28]

The other material point considered by the Board was the question whether the estate planning argument comprised the taxpayer's "purpose" or was, instead, his "motive". Here the Privy Council was content merely to state its concurrence with the conclusion of the Court of Appeal in favour of the latter alternative,[29] undertaking no searching discussion of the question. However, this same problem was fully considered in the earlier decision in *Loader* v. *C.I.R.*,[30] where the former alternative had been preferred. That latter decision now needs to be examined in order that these contrasting conclusions may highlight the problems encountered with the present issue.

In *Loader* the taxpayer had for several years carried on in his own behalf a successful earthmoving contractor's business. But then, determined to reorganise his affairs, the taxpayer first established a family trust and incorporated a company (the shareholding in which was held by two family trusts, each of which benefited the family of the taxpayer and that of his financial adviser). The taxpayer next sold most of his plant and equipment to the family trust and the rest to the company. In each case, the purchase price was interest-free and repayable on demand. The family trust then bailed its assets to the company, which then employed the taxpayer to utilise them in the same enterprise that he had previously conducted. Cooke J. found, for business and familial reasons, that the taxpayer would have adopted this "wholesale reorganisation"[31] of his affairs regardless of the taxation advantages obtained.[32] Therefore, his Honour concluded, a sole or principal purpose of the arrangement was not to escape liability to income tax and thus the section did not apply.

Cooke J. found himself able to introduce the estate planning argument so as to entertain the taxpayer's contention based upon it because[33]

> The documents themselves *naturally suggest* that the principal purposes were the twin

26 Idem.

27 [1973] 1 N.Z.L.R. 592, 598 per Turner P.

28 One case will be instanced later where subsequent events had a decisive influence on the conclusion reached by the court. See Part I B.3 infra. The problems inherent in the approach mandated by the Board are discussed in the pages that follow.

29 [1975] 2 N.Z.L.R. 717, 721.

30 [1974] 2 N.Z.L.R. 472.

31 Ibid., 479.

32 Ibid., 477.

33 Ibid., 477; emphasis added.

advantages of incorporation and of providing some capital and income security for members of the objector's family by permanently transferring assets for their benefit.

From that premise, it was but a short step to conclude[34] that "from the documents it may be inferred that estate duty and tax savings may well have each been included in the purpose of the arrangement".

The reasoning of Cooke J. may be said to be that the estate planning argument may be accepted when it speaks from the terms of the arrangement, because then the argument will thereby demonstrate what the material purpose or effect of the arrangement was. Furthermore, oral testimony in support of the argument is not to be completely ignored, because it may "fortify"[35] the conclusion reached by a scrutiny of the arrangement itself. This reasoning stands in contrast to the view taken by the Privy Council in *Ashton,* where testimony of a similar nature was excluded on the ground that it was within the irrelevant category of "motive". On this state of the authorities, some criticisms readily come to mind.

First, there is the failure to elucidate the notion of "motive" in order that it may be distinguished from the concept of "purpose". It is for example difficult to grasp the reasoning that holds that to provide some "capital and income for members of the objector's family"[36] is a matter of purpose, whilst the fulfilment of the "wish to provide for the welfare of their families"[37] is a case of motive. Secondly, the suspicion lingers that at least in the type of situation dealt with by Cooke J. the court is doing a little more than using the extraneous evidence to "fortify" a conclusion reached by an examination of the arrangement itself. Here the estate planning argument is only implicitly suggested by the terms of the arrangement, so it is difficult to see how a court can accurately surmise that this was the relevant purpose or effect without actually embracing the independent evidence which explains that that was the case. Thirdly, it is perhaps too subjective an approach to hold that "only" the arrangement itself be examined by the court. It has just been observed that the estate planning argument will often only be impliedly suggested upon a scrutiny of the arrangement. This leads to the possibility that on the same set of facts, different courts may come to opposite conclusions merely because to one court the argument may not speak forcefully enough from the terms of the arrangement itself.[38]

For each of these three reasons, it may be expected that the question of the precise relevance of evidence extraneous to the terms of the arrangement will at some time in the future receive further judicial scrutiny. In the meantime, the common sense approach followed by Cooke J. may be acknowledged. Where the estate planning argument speaks from the arrangement itself, this will transform the taxpayer's erstwhile motive into a "purpose or effect" of that arrangement.

3. *The merits of the estate planning argument*

Once the estate planning argument has been led from the proper evidentiary source, the task remaining is to convince the court of the cogency of the argument.

34 Ibid., 477. 35 Idem. 36 Idem.

37 *Ashton,* in the Court of Appeal, supra n. 18, 327.

38 As indeed occurred in the proceedings in *Ashton,* between the first two courts. See Part I B.2 supra.

In terms of the predication test,[39] the estate planning argument was made under the aspect of contending that the arrangement was but an instance of "an ordinary family dealing without necessarily being labelled as a means to avoid tax".[40] Upon application of the predication test, no dispute would arise in the case where the estate planning argument is found to amount to the arrangement's only purpose or effect. However in the situation where it may also be inferred that the desire to avoid income tax was one of the purposes of the arrangement too, original questions arise. In this situation, the balancing of the competing values spoken of earlier[41] — the autonomy of the individual and the need to safeguard the interests of the fisc — is thrown into sharp relief and thus the court is called upon to determine which shall prevail. Precisely this situation arose in the recent case of *Tayles* v. *C.I.R.*,[42] which decision may now be referred to so as to elicit how the judicial mind perceives the force of the estate planning argument.

In *Tayles,* the transaction under review concerned a thorough-going exercise in estate planning, carried out by two brothers in relation to each of their farming enterprises.[43] The essence of the scheme was to create and utilise the medium of a unit partnership, in which the taxpayer and a recently formed family trust joined to carry on the farming business. The capital of the partnership, divided into three classes, comprised a total of 50,600 units, of which the taxpayer held all but 2,000.[44] The actual farm property, although it remained registered in his name, was declared to be held in trust for the benefit of the partnership, which was declared to be for a period of twenty-three years unless sooner determined.[45] The taxpayer then proceeded to gift $2,000 and bail his livestock and equipment to the family trust, which then comprised the trust's contribution to the partnership. It only remained to employ the taxpayer as a salaried manager of the farming enterprise. By these means, the scheme rather artfully comprised all the essential ingredients of a desirable estate plan. The taxpayer had a secure and hopefully adequate source of income,[46] yet his equity in the venture was frozen in such a way that it could be readily diminished by a progressive gifting programme. Unfortunately for the taxpayer, the scheme was not viewed in such a kindly light during the subsequent litigation.

The Taxation Board of Review was unimpressed with counsel's contention that this admittedly novel scheme bore all the hallmarks of a traditional estate plan and

39 Stated in Part I.A.3 supra.

40 *Newton,* supra n. 17, 764. The position obtaining under the new section is stated Part 1 B.3 infra.

41 In Part I A.2 supra.

42 [1977] 1 N.Z.L.R. 668.

43 The plans in both cases were identical apart from minor adjustments to suit the individual case, so reference to one plan may for convenience be taken as including reference to the other.

44 His 100 A units gave him ultimate control of the partnership whilst his 48,500 B units (which figure represented the equity he had until then held in the farm) secured the right to a 5% fixed cumulative preferential dividend. The units held by the family trust enabled it to enjoy the surplus income and receive the surplus capital after repayment of all other units on a winding up.

45 The taxpayer, with the specified proportions of unit holdings, could have achieved a winding up at any time.

46 Comprising income from his salary, the bailment agreement, and the 5% cumulative preference dividend.

so ought to be treated as such. On the contrary, the Board of Review thought that the scheme was a "highly artificial structure"[47] imposed on this farming venture, making no practical difference in the manner by which the farm was operated. Secondly, the Board of Review was inclined to doubt the taxpayer's sincerity in the avowed purpose, for the members noted that not only was the taxpayer largely ignorant of the "mechanics"[48] of the scheme, but also no change in the unit holding had occurred in the succeeding nine years. It was for these two reasons that the Board of Review concluded that the section applied.

On appeal to the Supreme Court, Jeffries J. agreed with that conclusion. The principal feature of the plan which persuaded his Honour to this view was the use of the five percent cumulative preferential dividend. Jeffries J. thought that this was "an artificial device so that a superflow of income was received by the trust".[49] Hence it could "be predicated that the manner in which the [scheme was] implemented was to avoid tax, at least, as one central purpose". For much the same reason, Jeffries J. then went on to hold that this acknowledged exercise in estate planning could not be accepted as a matter of ordinary family dealing. The essence of his Honour's reasoning was in starting from the premise that "The vagueness of the term 'ordinary business or family dealing' cannot be used as a cover for all or any type of transaction within a family".[50] With that point made, his Honour thought that there will be an ordinary family dealing where there are merely some "elements of generosity, risk and eased application of current commercial practices . . . [But not where there is] abandonment of commercial practice, apparent mercantile foolishness or marked artificiality".[51] With this test in mind, his Honour concluded[52]

> What persuades me the scheme is caught by the section is that both the appellants have passed to the partnerships the single asset of each which is of overwhelming importance as the income earning asset, and at the same time accepted, or probably themselves fixed, a device to the scheme to limit the flow of income in return for the use of that asset.

It is apparent that in fulfilment of the balancing exercise that the court was called upon to discharge, a position in favour of protecting the interests of the Revenue was adopted. For the stand taken by the court was that whilst it may perhaps be a matter of ordinary family dealing to reorganise one's affairs in fulfilment of an estate plan, this may not be achieved without violating section 99 if an income tax saving device is expressly embodied as part of that rearrangement. It may be expected that much the same position will continue to prevail under the present section. Section 99 (2) (a) applies the section to the case where the (only) purpose or effect of the arrangement is tax avoidance. Section 99 (2) (b) catches the arrangement that has at least two purposes or effects — one of which is tax avoidance — regardless of whether one of those purposes or effects is a matter of ordinary family dealing. Thus the position established by subsection (2) is that where the estate plan (as a matter of ordinary family dealing) is the only purpose or effect, the section will not apply, whereas, if that estate plan as a matter of ordinary family dealing be a purpose or effect that co-exists along with the more

47 (1974) 5 N.Z.T.B.R. 508, 522.
48 Ibid., 523.
49 [1977] 1 N.Z.L.R. 668, 677.
50 Ibid., 678.
51 Idem.
52 Idem.

than "merely incidental purpose or effect" of tax avoidance, paragraph (b) applies that section. On this analysis, the position now coincides with what was said in one of the earliest cases on section 108.[53] In that case, Woodhouse J. stated the proposition that[54]

> it is my opinion that the family or business dealings will be caught by section [99] despite their characterisation as such, if there is associated with them the additional purpose or effect of tax relief (in the sense contemplated by the section) pursued as a goal in itself and not arising as a natural incident of some other purpose.

In terms of that test, *Tayles* may be cited as authority for the proposition that relief from tax will be regarded as "pursued as a goal in itself" in the case where a tax saving feature is expressly embodied a some part of the arrangement itself. Of the arrangement reviewed in that case for example, use of the five percent cumulative preferential dividend ineluctably suggests the desire to diminish the tax burden by limiting income. *Loader* by way of contrast may be cited as an example of a case where, because it was shown that the estate plan would have been adopted regardless of its income tax advantages and because the estate plan so adopted did not embody any device for the saving of income tax as an overt feature of the arrangement, the diminution of income tax that occurred could be accepted as "a natural incident of [the fulfilment] of some other purpose". As to the more factual aspect as to whether any particular arrangement is within either limb of the test formulated by Woodhouse J., this will be taken up and more fully considered on the discussion of onus of proof, in Part III A. In the meantime, the outstanding issue of principle — the potential scope of section 99 in the estate planning context — remains to be considered.

4. *The scope of section 99 in the estate planning context*

The decision in *Tayles* provides a convenient lead in to a discussion of the question of what, if any, limitations there are to the range of application of section 99. A closer scrutiny of that decision will draw out how important an answer to the question is to the thoughtful estate planner.

The decision in *Tayles* has attracted the comment from Harley that it "represents a considerable extension of the ambit of the section".[55] This view is based on the contention that, for an arrangement to escape application of section 99, "the courts have required the trusts to gain *an enduring benefit*".[56] It is pointed out that most of the cases, from *Elmiger, Mangin* and *Udy*[56a] through to *Gerard*[56b] and *Ashton,* are characterised by "*short term* transfers of high income producing assets or quickly wasting assets".[57] *Tayles* on the other hand is said to be different,

53 *Elmiger* v. *C.I.R.* [1966] N.Z.L.R. 683.

54 Ibid., 694. His Honour there was following *Newton* and the "one purpose" test. However, in *Mangin,* the requisite purpose was modified to a "sole or principal purpose"; only to be returned to a "one purpose" test in *Ashton;* to be changed back to a "main or one of the main purposes" in *Europa Oil* (No. 2) [1976] 1 N.Z.L.R. 546.

55 G. Harley "*Tayles* v. *C.I.R.* Section 108 After the Privy Council in *Ashton* and *Europa Oil*" [1977] N.Z.L.J. 141.

56 Idem.

56a *Udy* v. *C.I.R.* [1972] N.Z.L.R. 714.

56b *Gerard* v. *C.I.R.* [1974] 2 N.Z.L.R. 279.

57 Idem.

because the farm would eventually pass to the taxpayer's family. *Ergo* an "enduring benefit" had been obtained. It may be observed that, on the basis of the analysis offered by Harley, the decision in *Tayles* can be seen to strike at one of the essential characteristics of any estate plan and hold that satisfaction of this element is not enough to defeat an application of the section. Inherent in any estate plan, regardless of form, is that some "enduring benefit" moves to the disponor's family. Hence, although *Tayles* occurred in the context of a reorganisation of an entrepreneurial activity, does the view argued for by Harley suggest that the case has wider ramifications for areas outside its particular context? The answer to this question is plainly a matter of vital concern to estate planners.

Before testing this contention by means of eliciting from the jurisprudence the pivotal feature which will move the court to apply the section, some comments may first be made on the coherence of the argument made by Harley. In the first place, it is unfortunate that the commentator did not intimate precisely what he had in mind when speaking of the notion of an "enduring benefit". Does it connote merely the right to a source of income or something more in the form of the acquisition of a permanent asset or an interest therein? In *Loader* for example, whilst the family trust obtained equity in the new family company, its source of income was dependent upon the continued personal exertions of the taxpayer. This is exactly the situation that prevails in the classic paddock trust situation. Only in the former case was the arrangement upheld, yet it would be difficult to hold that the "enduring benefit" in the form of a source of income was different in kind in the two situations.

A second problem is encountered when it is maintained that application of the section depends upon the nature of the assets transferred. Such a view would not, for example, sustain the different results that were reached in the similar cases of *Grierson* v. *C.I.R.*[58] and *Wisheart*. These cases concerned the endeavour by an engineering and legal firm respectively to utilise a service company to provide, inter alia, office equipment to the respective practices. Yet in *Grierson* the court upheld the arrangement.[59]

Thirdly, it may be asked in what cases the courts have expressly "required" an "enduring benefit" to pass in order to defeat application of the section? There is for example only some obiter dicta by the High Court of Australia,[60] that the section could not invalidate an actual disposition of income-producing property, made to reduce the burden of taxation. The nearest our Court of Appeal has come to making the suggested stipulation is merely to observe that the section could not avoid "transactions consisting simply of absolute present gifts of capital".[61] Perhaps the position closest to requiring an "enduring benefit" is that taken by the Inland Revenue Department itself. In "Incidence of Taxation" for example,[62] where the Department sets out the guidelines followed by it in administering the section, the emphasis for an unimpeachable arrangement is upon those transactions that create real and enduring obligations and benefits and which involve permanent transfers without reservations or reversions. In short "an enduring benefit".

58 (1971) 3 A.T.R. 3.

59 For the reasons cited in Part III A infra.

60 *Dep. F.C.T.* v. *Purcell* (1921) 29 C.L.R. 464, 473.

61 *McKay* v. *C.I.R.* [1973] 1 N.Z.L.R. 592, 601.

62 I.R.D. "Incidence of Taxation' '(1971) N.Z. Society of Accountants, Seminar 14.

However it is apparent that the courts do not analyse problems arising under the section either on the basis of the view argued for by Harley or, indeed, on the basis of the approach taken by the Department itself.

The case law suggests that the fundamental basis upon which application of section 99 proceeds is that overriding importance is to be attached to the impact — or lack of it — that the arrangement has on the affairs of the taxpayer. Right from the earliest cases, the court found it significant that "there was no change in the practical operation of the partnership business" or that "the appellants continued their business to all intents and purposes as before".[63] Rather, the only change was found to be an "accounting or procedural"[64] one that enabled income to be "hived off",[65] "siphoned off"[66] or "diverted".[67] Hence the approach taken in the authorities has been that when a survey of the material facts discloses that the "economic incidence"[68] of the disponor's tax burden is all that has been affected by the arrangement, the court will hold that section 99 is to be applied — unless the taxpayer is able to adduce sound commercial or familial reasons which demonstrate that the arrangement was either necessary or desirable.[69]

Plainly this analysis does not postulate the absence of an "enduring benefit" as the pivotal notion upon which application of the section proceeds. Rather it is in the notion that the arrangement merely alters the disponer's tax burden without any noticeable change in the conduct of his affairs that the courts find an unacceptable degree of artificiality in the impugned arrangement. Inexorably then, the court moves to draw the inference that the proscribed purpose or effect was in mind. If this line of reasoning is the fundamental basis upon which the courts move to apply the section, then to attach importance to the notion of "enduring benefit", as both Harley and the Department would do, is to misconceive the potential scope of the section. The section has never been read as subject to any such limitation. Moreover, it may further be pointed out that this analysis of the authorities suggests that it is somewhat inadequate to merely observe, as some commentators have done,[70] that the courts "read down" the word "effect" in the phrase "purpose or effect". It may be conceded that quantification of the effect an impugned arrangement has upon an income tax liability is seldom undertaken.[71] However it is now apparent that the effect which that arrangement has

63 *Elmiger* v. *C.I.R.* [1967] N.Z.L.R. 161, 179 (North P.) and 188 (McCarthy J.) respectively. For reiteration of the same notion see, for example, *Marx* v. *C.I.R.* [1970] N.Z.L.R. 182, 192 and 213; *Udy* v. *C.I.R.* (1972) 3 A.T.R. 14, 17; *Ridley Motors Ltd.* v. *C.I.R.* (1973) 4 A.T.R. 48, 51-52; *Wells* v. *C.I.R.* (1973) 4 A.T.R. 136, 144; *Mangin* v. *C.I.R.* [1970] N.Z.L.R. 222, 234; *Wisheart MacNab and Kidd* v. *C.I.R.* [1972] N.Z.L.R. 319, 321; *McDonald* v. *C.I.R.* (1975) 1 T.R.N.Z. 130, 133; and *Halliwell* v. *C.I.R.* (1977) 2 T.R.N.Z. 186, 189.

64 *Marx*, ibid., 213 per McCarthy J.

65 *Udy*, ibid., 17.

66 *Ridley Motors*, ibid., 52.

67 *O'Kane Construction Co. Ltd.* v. *C.I.R.* (1973) 4 A.T.R. 54, 57.

68 *Mangin* v. *C.I.R.* [1971] N.Z.L.R. 591, 596.

69 As the taxpayer was able to do in *Grierson*. Cp. n. 59.

70 E.g. D. F. Dalton "Avoidance of Taxation: Section 260 of the Income Tax Assessment Act" (1973) 9 Melb. U.L.R. 95, 104; I. L. M. Richardson "And Now The New Section 108" [1974] N.Z.L.J. 560, 565.

71 For a rare example of the court's examining the impugned arrangement's effect, see *Grierson* v. *C.I.R.* (1971) 3 A.T.R. 3, 8-9.

up the conduct of a taxpayer's business affairs is an aspect of crucial significance.[72] It only remains to add that this analysis of the basic concept underlying section 99 would not support the view that *Tayles* "represents a considerable extension of the ambit of the section", novelty of the particular circumstances excepted.

However to discount the importance of the passing of an "enduring benefit" pursuant to an estate plan is not to make a case for despair amongst estate planners. It may be observed that the estate planning argument has arisen in the context of a reorganisation of a taxpayer's entrepreneurial activity. In this type of situation, the court may naturally be inclined to be suspicious of the argument, for the commercial context may well suggest that the desire to reduce income tax could have also been a strong motivating force.[73] Beyond that type of situation, where for example a person proceeds to divest himself of his equity, is a shadow area: one not touched on in depth by any wide-ranging judicial discussion. It has already been noted[74] that the New Zealand Court of Appeal has stated in passing that to "simply" dispose of property is not within the subject matter dealt with by the section. That view may be endorsed on the basis of the predication test to be administered under the section. To "simply" dispose of property would not enable it to be predicated that the transaction was "implemented in that particular way so as to avoid tax".[75] Some authority in support of this view may be drawn from the judgment of Wild C.J. in *Wisheart*,[76] where his Honour applied the predication test to meet the contention that to dispose of the insurance agency was an ordinary family dealing.[77] This suggests that the converse conclusion would be open in the more innocent situation presently in mind. It is on this line of reasoning that it may be speculated that if the Department should seek to reverse its present policy and apply the section to this shadow area, it would probably be unsuccessful.

The discussion of our jurisprudence has taken us to the point of perceiving that section 99 is on its face a far-reaching provision.[78] The only limitation that it would seem to be subject to is an administrative one whereby the section is only applied in a commercial context where a purpose or effect of tax avoidance is thought by the Revenue to be present. Just what a taxpayer must do in this situation to defeat invocation of the section is a matter taken up in Part III A. At this juncture, the appropriate course is to turn to the Australian situation to see the disparate approach taken there despite the close similarity between the New Zealand and Australian provisions.

72 Indeed it was pointed out in Part I.B.3 supra, that one of the reasons expressly relied upon by the Taxation Board of Review was the view just argued for.
73 For reasons that are more fully developed in Part III A, infra.
74 Cp. n. 61 supra.
75 *Newton* v. *F.C.T.* [1958] 2 All E.R. 759, 764.
76 (1969) 1 A.T.R. 434, 442.
77 Although his Honour was overruled on appeal on the ground that an insurance agency was not an "asset" that could be "transferred", this would not detract from the relevance of the reasoning applied by the Chief Justice.
78 Early in the history of the section, the very width of its terms was relied upon as a basis for arguing that there must be some limits to the width of the language used. The argument was met by adoption of the predication test. This aspect is alluded to by McCarthy J. in *Marx* v. *C.I.R.* [1970] N.Z.L.R. 182, 214-215 and 218. Latterly, however, the point has been to some extent revived when the very breadth of s. 108 was said to indicate that the section was nontheless partly limited by the general deductions provision. See *Halliwell* v. *C.I.R.* (1977) 2 T.R.N.Z. 186, 194.

II. THE AUSTRALIAN APPROACH

A. The Conceptual Scope of Section 260

In any endeavour to apply section 260 of the Income Tax Assessment Act 1936 (Aus.) the Federal Commissioner of Taxation faces the task of satisfying two conceptual limitations to the section. One of these limitations has been found to be inherent in the terms of the section itself, whilst the other is said to flow from the judicial perception of the place that the section occupies in the scheme of the Act. These restrictions are independent of the further consideration as to whether the particular fact situation under review is of the type nominally within the terms of the section as it has been interpreted in the cases.[79] Hence the discussion in this Part divides itself broadly into an examination of these three matters.

1. The annihilating character of section 260

The High Court in *Clarke* v. *F.C.T.*[80] first drew attention to the point that section 260 merely "annihilates", for income tax purposes, every arrangement that purports to avoid liability to income tax. The significance of this limitation lies in the point that, even if the section may be applied to such an arrangement and the matters thereby voided are disregarded, an appropriate set of facts must still remain which support the Commissioner's assessment. If that is not the case, the assessment must fall because the section does not authorise the assumption of hypothetical facts.[81] This point may be illustrated by reference to what is one of the most controversial cases decided under section 260, the decision of the Full High Court in *Cecil Bros. Pty Ltd.* v. *F.C.T.*[82] The taxpayer there was a footwear merchant, whose impugned arrangement was simply to purchase his trading stock requirements from a family company instead of from a wholesale outlet directly. By this means, the taxpayer paid A£19,777 more for its trading stock than if it had dealt with the wholesaler direct. By the Commissioner's assessment, the taxpayer's claim for a deduction on account of trading stock was reduced by that amount so that the claim conformed to market value of the stock purchased. The view taken by the Full High Court as to the problems attendant upon annihilation was expressed by Menzies J. in the following terms[83]

> I do not think that section [260] authorises the Commissioner to substitute a different price for that actually paid in accordance with those contracts. Indeed s. 260 does not authorise the Commissioner to do anything; it avoids as against the Commissioner arrangements, etc. as specified and so leaves him to assess taxable income and tax on the facts as they appear when the avoided arrangements, etc. are disregarded. Here, it is not revealed that the taxpayer company's real outgoings for its supplies were

79 The approach taken in this jurisdiction is to also apply the principles laid down in *Newton,* as stated in Part I A.3 supra. For a lucid discussion of their interpretation by the Australian courts, see Dalton, n. 70 supra, particularly at pages 96-109.

80 (1932) 2 A.T.D. 121, 127.

81 Spry "Arrangements For The Avoidance of Taxation" (Sydney, 1972) 90.

82 (1964) 111 C.L.R. 430. That controversy, arising on another aspect of the case, is taken up in Part III B infra.

83 Ibid., 441.

> £19,777 less than the price it paid or that the additional £19,777 was not paid or was a gift to [the family company]. To arrive at any such conclusion would, I think be an unauthorised reconstruction of what occurred. . . .

The significance of this limitation of the section will vary from case to case, yet it does indicate that there is some truth in the observation by Mahoney J., that section 260 "operates after the manner of a blunt axe".[84]

2. The relationship to other sections of the Assessment Act

The nature of the second limitation was summed up by Sir Garfield Barwick when he observed[85]

> . . . there will be no relevant alteration of the incidence of tax if the transaction, being the actual transaction between the parties, conforms to and satisfies a provision of the Act even if it has taken the form in which it was entered into by the parties in order to obtain the benefit of that provision of the Act.

The principle expressed by his Honour is compendiously known as "the choice doctrine", whose origin is usually traced back to another controversial decision of the High Court, the case of *W. P. Keighery Pty Ltd* v. *F.C.T.*[86] The reasoning underlying the doctrine may be found in the following observation of Gibbs J., when recently he had occasion to make some general comments about the office of section 260. His Honour said[87]

> The presence of s. 260 makes it impossible to place upon other provisions of the Act a qualification which they do not express, for the purpose of inhibiting tax avoidance. In other words it is not permissible to make an implication which does what s. 260 fails to do in preventing the avoidance of tax. If it is suggested that a taxpayer has engaged in a device to secure a fiscal advantage, and the relevant provisions of the Act do not expressly deal with the matter, the case depends entirely on section 260.

This explanation places the rationale of the "choice doctrine" on the basis of a determination of which of two statutory provisions is to prevail. If the Act expressly purports to regulate a particular transaction, and the taxpayer "chooses" to bring himself within that specific provision, section 260 cannot be invoked to override the treatment designated by that specific provision.[88] Recently

84 *Polden and Wilson Pty. Ltd.* v. *F.C.T.* (1976) 6 A.T.R. 144, 157. In this case, although it was found that there was an arrangement of which the section speaks, the Commissioner's assessment failed because of annihilation problems.

85 *Mullens v. F.C.T.* (1976) 6 A.T.R. 504, 509. The principle was recently reaffirmed by a full bench of the High Court in *Cridland* v. *F.C.T.* (1977) 8 A.T.R. 169, particularly at 173-174.

86 (1957) 100 C.L.R. 66. However see Dalton, n. 70 supra, at 113 for the suggestion that the origin of the doctrine may be traced back further, to dicta in *Purcell.* Cp. n. 60 supra. The doctrine has recently been extended to apply in respect of a similarly worded provision contained in a land tax statute: *Kaybyb Pty. Ltd.* v. *C.L.T. (N.S.W.)* (1977) 8 A.T.R. 254.

87 *Patcorp Investments Ltd.* v. *F.C.T.* (1976) 6 A.T.R. 420, 429. This decision, together with the other recent Full High Court decisions in *Mullens* and *Slutzkin* v. *F.C.T.* (1977) 7 A.T.R. 166, are the subject of an excellent article by Grbich "Tax Avoidance" *Recent Developments in Taxation Law* (Monash University 1977) Lecture 7.

88 Much the same issue was recently considered in Canada in *R.* v. *Alberta and Southern Gas Co. Ltd.* [1977] C.T.C. 338. The Federal Court of Appeal took a third position, holding that a transaction within "the object and spirit" of an incentive type of provision could not be struck down by the general tax avoidance section.

however this principle was sharply expanded, when in *Slutzkin* v. *F.C.T.*[89] the notion was applied that[90]

> To adopt a course which produces a result outside the scope of the Act is not to alter the incidence of tax, or to defeat any liability to tax or to prevent the operation of the Act, notwithstanding that such a course is adopted with full knowledge of the provisions of the Act and with a conscious intention that the proceeds should not fall within the operation of the Act.

It would seem that now the Act also offers a "choice" whether or not a proposed transaction should be brought within the terms of the Act, and to decline to do so is not to violate section 260.[91] It may be observed that that this view is a perspective quite different from the "choice doctrine" previously developed. The earlier aspect, traceable from *Keighery,* is essentially a matter of construction of the statute, involving arbitration between two provisions that might regulate a particular transaction. It was determined that section 260 was not to prevail over the other specific provision of the Act. The latter aspect, propounded in *Slutzkin,* is essentially rooted in the concept of laissez-faire though it also involves a value judgment as to the perceived extent of the tax base. The taxpayer is considered entitled, section 260 notwithstanding, to organise a particular transaction outside the terms of the Act when the Act contains no express provision purporting to draw that type of transaction within the tax base.

From this probe of the reasoning underlying the "choice doctrine" it is apparent that the High Court currently takes a very narrow view of the scope of section 260.[92] The Federal Commissioner would seem to recognise that this is the case and so has switched the battle against tax avoidance to another front. The enactment of section 31C,[93] the intended amendment to section 103A(2)(d)(vi),[93a] and the proposed introduction of measures to prevent tax avoidance[93b] would seem to foreshadow a campaign that relies upon a legislative armoury that is stocked with specific anti-avoidance weapons. The prescient observation made by Lord Reid[94] would seem to be beginning to be realised.

89 (1977) 7 A.T.R. 166.

90 Ibid., 184.

91 The authority of this view may perhaps be questioned. It rests uneasily beside the view just quoted of Gibbs J. from *Patcorp*. Moreover, it would seem to be opposed to a comment made by Walsh J. in *F.C.T.* v. *Ellers Motor Sales Pty. Ltd.* (1972) 3 A.T.R. 45, 55.

92 E.g. the insistence by Barwick C. J. that before s. 260 can be applied, there must be an antecedent transaction that is recast into its present form in order to avoid the tax liability attracted by that antecedent transaction: cp. *Mullens* at 507 and 510. The similarity between this view and the contention made by his Honour when appearing as counsel before the Privy Council in *Newton* has been noted. See Gzell, Revenue Note (1977) 51 A.L.J. 46, 46.

93 Which provision authorises the Commissioner to apportion purchases of trading stock to reflect its true price where the parties in question are not dealing at arms length — in essence the *Cecil Bros.* type of situation.

93a This will further restrict the ability of an erstwhile private company to attain "public" status merely for tax purposes — in essence the type of situation that arose in *Keighery* and *F.C.T.* v. *Casuarina Pty Ltd.* (1971) 2 A.T.R. 61.

93b Budget Speech 1977-1978, at 22.

94 Predicted in *Greenberg,* and cited supra. n. 9.

B. The Estate Planning Argument

Having traced through the increasingly narrow conceptual range of section 260, it should not come as much of a surprise to find such a development parallelled by a trend of restrictive application in those areas where, nominally at least, the section may be applied. This development will become evident by an examination of the precedents reviewing income splitting arrangements that bear estate planning implications.

1. *Millard* v. *F.C.T.*[95]

This case concerned an arrangement whereby the taxpayer, a registered bookmaker, sold his business to a newly incorporated family company. Thereafter the taxpayer purported to carry on as agent for the company exactly the same business as previously. Perhaps because the taxpayer took the unwise course of acknowledging that his actuating purpose was to "pay less tax and finish up with more capital",[96] Taylor J. had little difficulty in holding that the section applied. It followed that all the income derived from the business could be assessed to the taxpayer personally as if the company did not exist.

2. *Hollyock* v. *F.C.T.*[97]

A similar conclusion was reached in the case of a sale by a chemist of a one-half share in his pharmacy business to his wife. Much of the judgment of Gibbs J. is burdened with a discussion of the different "purpose" tests of *Newton* and *Mangin*,[98] in the course of which his Honour makes out a forceful case for adoption of the former standard. In any event though, Gibbs J. was satisfied that along with the desire to avoid death duty, the avoidance of income tax was an essential purpose. *Ergo* the section applied.[99]

These early decisions show the Australian courts to be sympathetic to the endeavours by the Federal Commissioner to utilise section 260 to strike down income splitting arrangements carried out in a family context. In later cases however there has been a discernible willingness on the part of the courts to uphold similar, familial arrangements. With estate planning considerations often cited as one of the reasons actuating such arrangements, this later trend has accorded a substantial measure of legitimacy to the estate planning argument. The cases in point follow.

3.(a) *Peacock* v. *F.C.T.*[1]

Here Nettleford J. sitting in the Supreme Court of Tasmania considered the case where a registered surveyor admitted his unqualified wife as an active partner in his practice. It was not until some fourteen years later that the Commissioner sought to challenge the arrangement, by assessing to the husband, at that point, the income derived from the practice. The taxpayer, in his argument to defeat an application of section 260, acknowledged that he had had in mind the possible

95 (1962) 108 C.L.R. 336.
96 Ibid., 342.
97 (1971) 2 A.T.R. 601.
98 Mentioned n. 54, supra.
99 Ibid., 607.
1 (1976) 6 A.T.R. 677.

savings in income tax that could be achieved under the arrangement. Nonetheless, the main actuating reason was said[2] to be to enable the sharing of the capital built up during the course of the marriage, which in turn would ensure some spousal independence and, in time, achieve saving in estate duty. Such candour had its reward, for Nettleford J. held that the facts disclosed an ordinary dealing without necessarily being labelled as a means to avoid tax.[3]

Perhaps the most interesting feature of this case is the broad view his Honour took of the concept of an "ordinary dealing" in order to arrive at what might at first blush seem a surprising result — that it is not "unusual" for a non-qualified person to be a principal in a professional practice. The premise underlying his Honour's reasoning was that he regarded the taxpayer's enterprise as not merely a professional practice involving the exercise of a special technical skill, but rather as a "business" whose range of activities necessarily comprehended more than purely professional work. It was that reasoning which enabled the court to justify the otherwise surprising result. In this connection, it may be added that much the same view enabled his Honour to skirt the point made as to the possible illegality of the arrangement. Nettleford J. held, by a literalism, that as the taxpayer's wife in her participation of the work of the firm did not actually hold herself out as a surveyor, then equally she did not "practice" as one in terms of the proscription contained in the relevant professional statute.[4] Thus it is reasonably apparent that the court was inclined to a liberal view of matters of ordinary family dealing, which is to acknowledge the force of, inter alia, the estate planning argument.

(b) *Bayly* v. *F.C.T.*[5] and *Jones* v. *F.C.T.*[6]

The decision in these two similar cases by the Chief Justice of South Australia sitting in that State's Supreme Court may be taken as further evidence of this trend of a tolerant approach. Both cases concerned the employment of a pharmaceutical chemist by his unqualified wife to conduct and manage the pharmacy business which she owned. The basic difference between the two cases was that in *Bayly* the business had been purchased by the wife directly from a third party, whilst in *Jones* the business had for some time been owned by the pharmaceutical chemist before he sold it to his wife. In each case, the Commissioner sought to assess the income derived from the pharmacy business to the husbands, as if they were the proprietors of the businesses.[7]

In their efforts to deny an application of section 260, the taxpayers in both cases were nothing if not resourceful in argument. The actuating reasons were

2 Ibid., 678-679. 3 Ibid., 688-689. 4 Ibid., 686.
5 (1977) 7 A.T.R. 215. 6 (1977) 7 A.T.R. 229.
7 In New Zealand, this type of situation is to some extent regulated by s. 97 of the 1976 Act. The essence of that provision is to allow only "reasonable" remuneration or share of profits where a relative joins in the conduct of the taxpayer's business. Normally, the material ruling rate is taken as the appropriate standard. In practice, this section is quite an effective measure to counter income splits in this type of situation. The analogous provision in the Income Tax Assessment Act 1936 (Aus.) is s. 65. However the Commissioner did not seek to rely on that provision in either *Bayly* or *Jones,* presumably because he regarded the agreement under which the husband was employed by his wife as void *in toto* and not merely to the extent of any "unreasonable" remuneration.

said to be to secure some relief from the two fiscal burdens, together with the desire to obtain equality of ownership of the matrimonial assets.[8] Naturally this latter aspect received the most emphasis, and was said to spring from the wish to secure some measure of the limitation of liability should the business prove unsuccessful (neither business was carried on through the medium of a company), as well as to organise their affairs to reflect the modern notion of a marriage as a partnership of equals in all respects. In *Bayly* Bray C.J. did not feel compelled to make any findings on the cogency of the taxpayer's arguments, for his Honour thought that the Commissioner's assessment entailed some notional reconstruction.[9] Hence it fell on that ground.

In *Jones* though, no such difficulty existed, so the court had to deal squarely with the question as to whether the facts showed a case of ordinary family dealing. This the court answered in the affirmative, despite the several points relied upon by the Commissioner as suggesting a contrary conclusion.

The first matter raised by the Commissioner was that significance was to be attached to the casual, if not suspicious, manner by which the sale transaction was implemented. It transpired[10] that though the contract of sale was made in 1967, the price was not paid until 1975 — and only then out of accumulated profits and upon the imminence of the current proceedings. His Honour met the point by holding that the parties seriously "intended"[11] that the sale should be effected, so that any irregularity in bringing it to fruition could be put to one side.

The second matter relied on by the Commissioner was the question of illegality. It was found that it was illegal for Mrs Jones to acquire and carry on the pharmacy business.[12] The Chief Justice met the point in two ways. First, his Honour cited[13] the principle that income dishonestly earned was taxable just the same as gains honestly made, and then illustrated the point by giving the unhelpful analogy[14] that it would be ridiculous to no longer tax income earned by a licensed tradesman merely because he had not paid his annual licence fee. Secondly, perhaps the more telling point, Bray C.J. noted that any illegality in the mode of carrying on the business could not be said to convert the income of the wife into that of the husband.[15]

The third matter which the Commissioner relied upon was the decision in *Hollyock* v. *F.C.T.*,[16] which, it may be recalled,[17] concerned the very similar problem of a sale of a one-half interest in a pharmacy business by a husband to his wife. To distinguish that case, his Honour invoked the judgment of the Privy

8 See *Bayly*, ibid., 226 and *Jones*, ibid., 232.

9 Ibid., 227. Essentially the point was that "the facts which remain" upon avoidance of the purchase by the wife would still not leave the husband as owner of the business in order that the income derived therefrom could be assessed to him.

10 (1977) 7 A.T.R. 229, 232.

11 Ibid., 234.

12 Idem.

13 At this juncture, Bray C.J. adopted the discussion on the subject undertaken in *Bayly*. See (1977) 7 A.T.R. 215, 219-220.

14 An unhelpful analogy because it would only be truly in point if it were Mr. Bayly who had been carrying on business in the illegal manner suggested in the analogy.

15 Ibid., 220. This point should not be taken as implying that the aspect of illegality is to be entirely discounted. Obviously if a business, particularly one of a professional nature, is carried on in an illegal manner, it may well be easy to infer that the avoidance of income tax is one reason why this is the case.

16 (1971) 2 A.T.R. 601.

17 Supra. Part II B.2.

Council in *Europa* (No. 2)[17a] as now stating the correct law on the point. Although *Hollyock* followed the "one purpose" test of *Newton,* his Honour felt that this had been superseded by the "main or one of the main purposes" test of *Europa* (No. 2). Curiously enough, Bray C.J. did not mention the "one purpose" test reaffirmed in *Ashton;* it might have had some bearing on the choice of the relevant test to be adopted.[18] Be this as it may, the Chief Justice went on to find[19] that the main purpose of the present transaction was to secure the equalisation of the matrimonial assets, with the savings in income tax to be gained thereby being only a minor and subsidiary purpose and effect.

The final noteworthy aspect of the judgment concerns the expansion by the Chief Justice of the concept of ordinary family dealing. Of that notion, Bray C.J. observed[20]

> . . . a redistribution of family assets including a family business, as between husband and wife is a normal, ordinary, everyday family transaction which would not normally attract s. 260 where there is no professional element in the business. Farmers, shop-keepers, factory owners do it frequently.

It would seem that his Honour was willing to extend the opportunity to engage in matrimonial asset sharing exercises regardless of its vocational context, without considering it necessary to make any such refinement as Nettleford J. did in *Peacock.* In so doing, it would seem that the warning sounded by Menzies J. in *Peate* v. *F.C.T.*[21] will no longer be heeded: "What, outside a profession, might be regarded as an ordinary business tranaction may, within a profession have an altogether different appearance".[22]

It is readily apparent that these three later cases illustrate that the present trend of authority in Australia is to elevate exercises in matrimonial asset sharing, almost as a matter of principle it would seem, into matters of ordinary family dealing and therefore beyond the range of section 260. With the estate planning argument but one facet of such transactions, it may be said that that argument has been judicially acknowledged as potent enough to materially assist in defeating an application of the section.

Finally, reference may be made to one other aspect of matrimonial property sharing that has also been the subject of some judicial consideration. *Everett* v. *F.C.T.*[23] concerned the case where the Commissioner had endeavoured to assess to a partner in a law firm that share of the income from the firm which the partner had purported to assign to his wife. Meares J. upheld the taxpayer's objection, holding that a partner could so assign the beneficial interest in that share of the profits he would otherwise be entitled to.[24] However this view would seem to be

17a [1976] 1 N.Z.L.R. 546.

18 That would have meant that there were two Privy Council (*Newton* and *Ashton*) decisions and one High Court of Australia (*Hollyock*) decision following a "one purpose" test (two of which decisions were binding on his Honour), whilst the other tests of "principal" (*Mangin*) and "main" (*Europa* (No. 2)) purpose were formulated in relation to another jurisdiction and hence were only of persuasive authority.

19 (1977) 7 A.T.R. 229, 238.

20 Ibid., 238.

21 (1964) 111 C.L.R. 443.

22 Ibid., 460. Cited with approval by Gibbs J. in *Hollyock* v. *F.C.T.* (1971) 2 A.T.R. 601, 607.

23 (1978) 8 A.T.R. 1.

24 Ibid., 2-3.

contrary to the law as it is understood in New Zealand. In *Johnstone* v. *C.I.R.*[25] for example, Tompkins J. had reached a contrary conclusion,[26] partly by reliance upon an obiter dictum by Henry J. that[26]

> No taxpayer can, by way of assignment, escape assessment of tax on income resulting from his personal activities — such income always remains truly his income and is derived by him irrespective of the method he may adopt to dispose of it.

It would seem that there is a divergence of judicial opinion in the respective jurisdictions, because Meares J. expressly declined to follow the observation made by Henry J.[27] Hence, although the decision in *Everett* was not concerned with the present context of arrangements to avoid income tax, it may nonetheless be taken as further evidence of the liberal approach currently taken by Australian courts in respect of exercises in matrimonial property sharing as they affect liability to income tax.

4. The situation of service trusts or companies

The use of service trusts or companies in the management or conduct of an enterprise is not a matter that has to date received extensive judicial scrutiny.[28] However it would seem that in the meantime, the Federal Commissioner is taking a hard line and is refusing to acknowledge their efficacy for tax purposes.[29] The issue is currently being litigated, but unfortunately the results to hand do not offer a convincing resolution of the matter.

The case in point is the decision of Waddell J. in *Phillips* v. *F.C.T.*[30] when sitting in the Supreme Court of New South Wales. The matter that arose for consideration concerned the measures taken by a large accountancy firm the essence of which was to establish a unit trust for the purpose of providing the various management and administrative services required by the firm. The Commissioner denied the partnership a deduction for all the amounts paid to the trust on account of the provision of those services,[31] which action members of the firm challenged.

The approach taken by Waddell J. was, in essence, to back-in to the problem. The initial premise of his Honour's reasoning was to hold[32] that the decision of

25 [1966] N.Z.L.R. 833.

26 *Spratt* v. *C.I.R.* [1964] N.Z.L.R. 272, 277. That dictum was also approved by Woodhouse J. in *Kelly* v. *C.I.R.* (1969) 1 A.T.R. 380, 384.

27 (1978) 8 A.T.R. 1, 4. It may be said though that the law dealing with assignments of income is an area of some complexity. Some discussion of the more recent cases in point may be found in L. McKay "Some Aspects of the Alienation of Income for Taxation Purposes" (1974) 6 N.Z.U.L.R. 1.

28 However Canada is one country where the efficacy of the service corporation in the conduct of management of a taxpayer's affairs is an issue that has been the subject of extensive scrutiny by the courts. Some of the leading articles on this subject are D. I. Matheson "Service Corporations" (1976) 24 C.T.J. 329, and H. S. Graschuk "The Professional Corporation in Alberta" (1977) 25 C.T.J. 109. Another useful article is D. Y. Timbrell "Of Shams and Simulacra" (1973) 21 C.T.J. 529, whilst recent trends are charted by M. J. O'Keefe "The Business Purpose Test — Who Needs It?" (1977) 25 C.T.J. 139.

29 See K. Pose "The Deductibility of Payments by Professionals to their Service Trusts and the Impact of *Europa Oil (N.Z.) Ltd. (No. 2)* v. *C.I.R.*" (1977) 51 A.L.J. 15.

30 (1977) 7 A.T.R. 345.

31 Ibid., 346-347.

32 Ibid.,356.

Cecil Bros.[32a] governed the present facts, then to note[33] that that decision had been approved by the Privy Council in *Europa Oil* (No. 1).[33a] Whilst this latter observation is undoubtedly correct, it is nonetheless clear from the advice given by the Board that their Lordships approved of that decision in relation to problems arising from the deductions section of the Act.[34] Hence that endorsement would not be strictly in point when attention is turned to consider any matter under section 260.[35] That point aside, Waddell J. then made a lengthy quotation from the judgment of Menzies J. in *Cecil Bros.*,[36] where his Honour had discussed the difficulties that arose upon annihilation which the Commissioner faced in endeavouring to support his assessment. Those remarks Waddell J. turned to apply to the instant facts. They showed, in his Honour's view, that the Commissioner's assessment entailed notional reconstruction because it involved substituting the firm in the place of the trust in the various service contracts that had been made between the firm and the trust.[37] As a final comment, his Honour added[38] that in any event the establishment of the unit trust (and the companies used to manage the trust) were not, as the Commissioner argued, capable of annihilation because a proscribed purpose could not be inferred from their mere establishment. Thus his Honour concluded that an application of section 260 could not be sustained.

Although not very clearly articulated, Waddell J.'s view that the Commissioner's assessment entailed some reconstruction seemed to rest on the ground that the various substitutions his Honour mentioned would then lead to the situation of the firm being *both* parties to the several contracts and thus making, in effect, payments to itself. If that were the case, the claim for the respective reductions could be denied because there would have been no effective disbursement or outlay. However there was another line of reasoning open to the court, if the whole transaction had been approached in its chronological order.

The initial premise of this alternative line of reasoning is the point that Waddell J. added almost as an afterthought, and which concerns the ability to annihilate the unit trust and management companies. *Millard* has already been cited[39] as an example of the court denying the existence of a company upon an application of the section. Furthermore, the decisions of the Privy Council in *Mangin*[40] and *Ashton*[41] may be cited as authority for similarly treating a trust. Thus contrary to his Honour's view, it would seem to be a proposition firmly entrenched in the authorities that section 260 does authorise the Commissioner to ignore the existence of a trust or company when he comes to make his assessment. The position is

32a 111 C.L.R. 430.

33 (1977) 7 A.T.R. 345, 357.

33a *C.I.R.* v. *Europa Oil (N.Z.) Ltd.* [1971] N.Z.L.R. 641.

34 His Honour should have instead cited *Europa* (No. 2) as mentioned in Part III B.2 infra.

35 It may be added that Waddell J. is not entirely alone in extending quotations beyond their original context. In *Slutzkin* v. *F.C.T.* (1977) 7 A.T.R. 166, Barwick C.J. cited the remarks of the Privy Council in *Europa* (No. 1), made in relation to argument about the general deductions section (and which the Board had expressly refrained from saying applied to s. 108), as extending to matters falling for consideration under s. 260. See *Slutzkin* 168-169.

36 A large part of those remarks has been cited supra n. 83.

37 (1977) 7 A.T.R. 345, 357-358.

38 Ibid., 358.

39 Supra n. 95.

40 [1971]N.Z.L.R. 591, 597.

41 [1975] 2 N.Z.L.R. 717, 724.

usually said[42] to be that upon the avoidance of the trust or company and any agreement that they may have made in prosecution of the proscribed purpose, the status quo ante is notionally restored and the Commissioner is entitled to assess on the basis of the position that obtained prior to the making of the (now voided) arrangement.[43] It is manifest that the essence of this line of reasoning is merely to strike down without any concomitant reconstruction and thus provides a reason for declining to accept that the reasoning of Waddell J. conclusively shows why section 260 could not be relied upon by the Commissioner. Be that as it may, it seems that whilst the Commissioner has lodged an appeal to the Federal Court of Australia from the decision of Waddell J. it is understood that there is to be no further reliance upon section 260.[44]

5. *Conclusion*

The ability of the Australian all-embracing anti-avoidance provision to deny fiscal efficacy to any estate plan is restricted by two considerations. First, there are the two conceptual limitations that the provision is subject to, both of which are illustrated by the proceedings in *Cecil Bros.* That decision illustrates the limitations that not only can there be no invocation of section 260 where there is another provision of the Assessment Act expressly dealing with the transaction under review, but also that the Commissioner's assessment must not entail any notional reconstruction of events. Secondly, and perhaps most importantly, there is the current judicial willingness to hold that the exercises in matrimonial asset sharing — which expressly encompass the estate planning argument — are matters of ordinary family dealing and hence may be undertaken without fear of violating section 260. This willingness may be evidenced by the position that the authorities postulate — that it is not now "unusual" for a professionally qualified taxpayer to be either a partner with or in the employ of his unqualified spouse in the pursuit of his professional calling. Thus it may confidently be asserted that in Australia the force of the estate planning argument has been judicially acknowledged.

III. ARGUMENTS DENYING AN APPLICATION OF SECTION 99

The concept underlying the administration of section 99 is that the provision is said to be "self-executing"[45] and not dependent upon the exercise of a discretion

42 See the summary given by Bray C.J. in *Bayly* (1977) 7 A.T.R. 215, 227.

43 A similar situation occurred in *Wisheart* in relation to the employment of office staff. As the agreement under which the law firm purported to pay for the staff provided by the service company was void, the firm had strictly speaking lost the right to claim a deduction for expenditure on account of it (although the Commissioner allowed the disbursement in any event). See [1972] N.Z.L.R. 319, 322 (North P.) and 331 (Turner J.).

44 CCH "Australian Federal Tax Reporter"10 June 1977, No. 255, 5.

45 *Bailey* v. *F.C.T.* (1977) 7 A.T.R. 251, 258. This is assuming that the same conception would be said to underlie s. 99. There seems no reason to doubt that it would. In *Reckitt and Colman (N.Z.) Ltd.* v. *T.B.R.* [1966] N.Z.L.R. 1032, McCarthy J. propounded much the same notion when he observed at 1045: "The Commissioner acts in the quantification of the amount [of income tax] due, but it is the Act itself which imposes, independently, the obligation to pay." These remarks also seem to import the notion that the provisions of the Act are "self-executing".

by the Commissioner. Its application to an arrangement of the type within its terms thereby exposes a set of "taxable facts".[46] The Commissioner then sets in motion the process to make the appropriate assessment. Should the taxpayer wish to challenge the assessment duly issued, he can have the matter determined by way of proceedings on objection as provided for in Part III of the Act. Once before the selected forum,[47] the objector is limited[48] only by his imagination in the range of arguments he may adduce as denying vindication of the Commissioner's assessment. It is anticipated that those arguments may possibly be the four now to be discussed.

A. No Proscribed Purpose or Effect — Onus of Proof

Quite clearly the most obvious contention that the objector will seek to make is the factual one that the only purpose or effect of the impugned arrangement was to implement an estate plan. Alternatively, in the case where the estate plan is implemented also to further some other purpose or effect, it will be contended that the avoidance of income tax was "a merely incidental purpose or effect" and not one "pursued as a goal in itself . . . [but] arising as a natural incident as some other purpose".[49] The thrust of the objector's argument will be to persuade the court, as the taxpayer was able to do in *Loader,* that an examination of the impugned arrangement discloses that it was an estate plan. Hence the arrangement was for that reason compelling or desirable and would have been adopted irrespective of its income tax ramifications. The cogency of this argument will of course depend upon the evidence before the court in each case, yet it is nonetheless a vital exercise to elucidate the onus of proof set by the court when determining such issues.

The initial point to make is that by statute the objector bears the onus of proof in objection proceedings.[50] However there is surprisingly little discussion in the authorities as to what onerous implications, if any, this may hold for an objector. There is for example only passing reference to the point in *Wisheart*[51] and *Loader,*[52] which seems to suggest that our courts do not attach any particular significance to the statutory placement of the onus of proof. In this regard, the recent remarks of Bray C.J. in *Jones* have important implications for setting the onerous nature of the standard confronting any disputant estate planner.

It may be recalled that section 190 of the Income Tax Assessment Act 1936 requires the taxpayer to show in any proceedings challenging it that the assessment is excessive. The effect of that section was recently considered by the High Court in *Gauci and Masi* v. *F.C.T.*[53] in connection with the purposive resale provisions of

46 *Bailey,* ibid., 253.
47 Which will be either the Taxation Review Authority or the Supreme Court.
48 Provided that the arguments were stated in the grounds of objection: section 36(1) of the Inland Revenue Department Act 1974.
49 See the discussion in Part I B.3 supra, where the suggestion is made that it is likely that this will be taken to be the test posed by s. 99.
50 Section 33(10) of the Income Tax Act 1976 and s. 36 of the Inland Revenue Department Act 1974.
51 [1972] N.Z.L.R. 319, 339 per Haslam J.
52 [1974] 2 N.Z.L.R. 472, 475.
53 (1975) 5 A.T.R. 672.

section 26(a).[54] Chief Justice Bray considered the test laid down by Sir Garfield Barwick in *Gauci*[55] and then extended that proposition to encompass arrangements reviewed under section 260. Hence the burden of proof under section 260 is said to be that[56]

> Section 190 does not require the taxpayer to show positively that the transactions cannot possibly be labelled as a means to avoid tax, or that they are only explicable by reference to ordinary business or family dealing.

This formulation would seem to contain an important concession for an objector. In a borderline case for example, where the court may entertain some lingering doubts as to the cogency of the objector's account of the actuating reasons, there may yet be a determination in favour of that objector. This is because it is not incumbent upon the objector to go to the lengths of "show[ing] positively" that the proscribed purpose or effect "cannot possibly" have been in mind before there may be a determination in his favour. This subtle but perceptible loosening of the burden of proof would aid an objector in his rebuttal of a purported application of section 99. However present indications are that the lead shown by Chief Justice Bray would not be followed in this country.

In *Williams Property Developments Ltd* v. *C.I.R.*,[57] Jeffries J. had occasion to review the subject of burden of proof in relation to the question of property acquired for the purpose of resale.[58] His Honour's judgment traced through the view of Barwick C.J. as to the effect of section 190, firstly when a dissentient in *Steinberg* v. *F.C.T.*[59] and later when in a majority in *Gauci.* Although not noting any material differences between the respective legislative analogues, Jeffries J. expressly refused to follow the test proposed by Sir Garfield Barwick, finding that that test moved the emphasis of the burden of proof away from the plain wording of the statute.[60] Instead, Jeffries J. preferred the reasoning of Mason J., who in a forceful dissent in *Gauci* endeavoured to apply the view[61] taken by the majority in *Steinberg.* That being the position, it may be expected that with this disapproval of the source of the remarks from which the test propounded in *Jones* was drawn, any local court considering the problem of onus of proof under section 99 would probably decline to accept the test formulated by Chief Justice Bray in relation to section 260.[62]

With the obligation to discharge the onus of proof now firmly in mind, the degree of severity of that task is the next matter that calls for scrutiny. The first point to note is that the standard against which an arrangement is tested under

54 Which provision corresponds approximately to s. 65(2)(e) of the New Zealand Act.
55 Ibid., 675.
56 (1977) 7 A.T.R. 229, 237.
57 (1977) 2 T.R.N.Z. 138.
58 Under s. 91, in relation to the definition of "trading stock" as defined in that provision.
59 (1975) 5 A.T.R. 565.
60 (1977) 2 T.R.N.Z. 138, 141.
61 Which in essence was that s. 190 did not place any onus on the Commissioner to show that the assessment is correct.
62 That is only a tentative conclusion, because an appeal has been lodged against the decision of Jeffries J. However, some support for the approach taken by his Honour may be drawn from the judgment of Woodward J. in *Cooper Brookes (Woollongong) Pty. Ltd.* v. *F.C.T.* (1977) 8 A.T.R. 5. There Woodward J. was likewise wary of interpreting *Gauci* to the effect of " . . . transferring the onus from the appellant to the Commissioner". (Ibid., 28). However that decision also is under appeal, to the Federal Court of Australia.

section 99 is an objective one.[63] The significance of this stipulation is that it is not enough for an objector merely to aver what his actuating purposes were. He must in addition convince the court of their veracity. For a clear example of an application of this standard, reference may be made to the judgment of Casey J. in *McDonald* v. *C.I.R.*[64] There, the approach taken by his Honour was to examine[65] critically each of the explanations of the arrangement offered by the objector, and, finding them wanting, to draw the inference of the existence of the proscribed purpose or effect.

The second aspect of the matter of onus of proof concerns the apparently rigorous standard that our courts apply under section 99. It is readily apparent that our jurisprudence on section 99 is permeated by the notion that some commercial or business efficacy for the impugned arrangement is necessary before application of the section may be defeated.[66] This assertion may be established by reference to two points.

First, the view argued for above[67] as to the fundamental basis upon which application of the section proceeds. In the notion that application of the section proceeds where the court finds "no change" effected by the arrangement in the conduct of the taxpayer's affairs, it is implicit that some sound business motivation must then be adduced if invocation of the section is to be defeated. Otherwise that will leave as the only possible explanation of the arrangement, the fiscal purpose of the desire to relieve the burden of income tax. An instance of the line of reasoning in mind is afforded by the decision in *Grierson* v. *C.I.R.*[68] There the court found that whilst the impact of the arrangement was only a "paper"[69] one, the arrangement could yet be sustained because it furthered the business purposes of "facilitat[ing] changes in partnership personnel and ensur[ing] better and more economical control and use of equipment . . . ".[70]

Secondly, this point may be illustrated by noting some of the express references the courts have made from time to time. The view of the courts of paddock trust arrangements was said to be that they "smack[ed] of business unreality"[71] whilst the use of a service company by a law firm was said not to fall within "the ambit of current business dealing and conform with general legal practice in New Zealand".[72] Furthermore, the test propounded by Jeffries J. in *Tayles*[73] as to what

63 *Ashton and Wheelans* v. *C.I.R.* [1975] 2 N.Z.L.R. 717, 721.

64 (1975) 1 T.R.N.Z. 130.

65 Ibid., 163.

66 It may be noted that in the United States, a "business purpose" doctrine has been firmly established as a basic principle of revenue law, ever since the landmark decision in *Gregory* v. *Helvering* (1935) 293 U.S. 465. Furthermore, recent indications in Canada are that the jurisprudence there is developing in a similar direction. E.g. *M.N.R.* v. *A. T. Leon et al.* (1976) C.T.C. 532 albeit that a dissenting opinion was expressed obiter in *Massey-Ferguson Limited* v. *The Queen* (1977) C.T.C. 6. This trend is discussed by D. I. Matheson, supra n. 28; O'Keefe, supra n. 28; and J. G. Ware "The Business Purpose Test and Sham Transactions" (1976) C.M.R. 602.

67 Supra Part I B.4.

68 (1971) 3 A.T.R. 3.

69 Ibid., 5.

70 Ibid., 9.

71 *Mangin* v. *C.I.R.* [1971] N.Z.L.R. 591, 597, where the Privy Council quoted from the judgment of Turner J. in the Court of Appeal.

72 *Wisheart McNabb and Kidd* v. *C.I.R.* [1972] N.Z.L.R. 319, 339.

73 [1977] 1 N.Z.L.R. 668, 678.

constitutes an ordinary family dealing is, as his Honour expressly acknowledges, only a slight relaxation of a commercial standard.

The third aspect of the onus of proof concerns the relevance to the estate planning context of the pivotal feature[74] upon which application of the section proceeds. It may perhaps be surmised that when a taxpayer reorganises his business affairs in fulfilment of an estate plan, the desire to retain control of affairs to much the same degree as previously will probably lead to little change, in practical terms, in the conduct of his affairs. Moreover, if other legal persons (such as a family trust or company) are interposed in order to reduce the capital holding of the taxpayer, this will compound the judicial suspicion naturally aroused by that other feature of the plan. Hence, in the estate planning situation — because it necessarily bears no commercial rationale — the court may reflexively incline to perceive artificiality in the arrangement because all it may amount to is an "accounting or procedural" change whose only noticeable effect appears to be to diminish the burden of income tax.

To pass now from the general to the specific, the fourth matter to point out is that the estate planning argument will probably be discounted in the situation where it occurs in the context of the reorganisation of an enterprise that depends almost entirely upon the specialised, personal exertions of the taxpayer himself. The reasoning in such a case is that as the demise of the taxpayer would leave little or nothing to pass to his family, it is unlikely that he would be planning for the posthumous conduct of his business. This point was made by the court in both *Wells*[75] and *McDonald*,[76] concerning the reorganisation of the affairs of a chiropractor and commission agent respectively, allegedly for estate planning reasons.

The fifth point to make is that it may sometimes be inferred that in view of the different nature of the liabilities allegedly sought to be avoided, a taxpayer would be more likely to be concerned with the immediate and pressing desire to relieve the burden of income tax than he would be to diminish the more remote and more impersonal obligation of estate duty. In *Ashton* for example, the Court of Appeal alluded to this point, McCarthy P. observing that[77]

> . . . it must have been seen by the [taxpayers] that [the arrangement] was more likely to have effect upon charges received during their joint lives than upon those received after the death of one of them.

The significance of this point would seem to be that, as in *Ashton*, it provides reinforcement for a court already sceptical of the taxpayer's explanation of the arrangement's actuating purposes.

The cumulative effect of the foregoing is clearly to demonstrate the rigorous nature of the onus of proof confronting any estate planner called upon to deny application of the section to his erstwhile estate plan. As a final illustration of the severe nature of the burden of proof, reference may once again be made to the decision of Jeffries J. in *Tayles*. In that case, it will be recalled[78] that the most offensive aspect of the arrangement was found to be the use of the five percent cumulative preference dividend. To the casual observer this one feature would not

74 Identified in Part I B.4 supra.
75 (1973) 4 A.T.R. 136, 143.
76 (1975) 1 T.R.N.Z. 130, 133.
77 [1974] 2 N.Z.L.R. 321, 328.
78 See Part I B.3. supra.

seem to be sufficiently fundamental to the scheme as a whole to disclose that the avoidance of income tax was "one *central purpose*".[79] To seize on this one minor aspect as revealing a culpable purpose is to apply a rigorous standard indeed.

The final comment to make is that this analysis of the New Zealand case law plainly indicates that the tolerant view currently taken in Australia[80] of arrangements with estate planning overtones is not a perspective that may be expected to find favour with New Zealand courts. Indeed, the difference in approach and standard between the two jurisdictions has been judicially acknowledged. In *Halliwell,* Casey J. noted the "more liberal view"[81] taken in Australia of matters of family dealings. Nonetheless, the question may legitimately be asked as to how long this difference in approach will endure. It has been observed that the terms of the Matrimonial Property Act 1976 endeavour to foster the notion of "the status of marriage as a partnership of equals".[82] On this basis, it could be suggested that when those partners enter into arrangements for the purpose of dividing the equity built up through that partnership, the arrangement is to be viewed as merely an attempt to realise this notion and that the aspect of the avoidance of income tax is a "merely incidental" purpose or effect. However until such time as this perspective influences the development of a more liberal approach (such as is witnessed by the decisions in *Bayly* and *Jones*), the current position is that any disputant estate planner faces a rigorous onus of proof when he endeavours to defeat an application of section 99. That onus he will be able to discharge when he is able to completely satisfy the court of his sincerity to only the avowed purpose of estate planning.

B. That the Arrangement is Protected by Another Section of the Act

The essence of this argument is that compliance with the terms of some other section of the Act necessarily protects the arrangement from impeachment under section 99. This contention contrasts with the point drawn out above,[83] that despite fidelity to one provision of the Act, the problem is still "at large" and section 99 may yet be invoked. The decision of *McKay* in relation to section 96 was cited in support. However to further amplify what the Court of Appeal said in that case, it needs to be added that their Honours were careful to make the reservation that "on its own"[84] compliance with section 96 would not be a case for section 99. The position may now be stated to be that compliance with section 96 may normally be expected to be a case not within the scope of section 99,

79 [1977] 1 N.Z.L.R. 668, 677, emphasis added. However it is suggested that such a lack of proportion may well incline the Court of Appeal to take a contrary view of the case when it hears the appeal lodged against the decision of Jeffries J.

80 Noted particularly in Part II B.3 supra.

81 (1977) 2 T.R.N.Z. 186, 197.

82 W. R. Atkin "The New Regime of Family Property" [1977] N.Z.L.J. 81, 86. The concepts reflected in the Matrimonial Property Act 1976 are more fully explored by A. H. Angelo and W. R. Atkin "A Conceptual and Structural Overview of the Matrimonial Property Act 1976" (1977) 7 N.Z.U.L.R. 237.

83 Supra Part I A.2.

84 [1973] 1 N.Z.L.R. 592, 605 per Speight J. Much the same view was taken by Turner P. at 600.

although this will not prevent the court in a proper case moving to apply section 99.[85]

The most likely situation in which the present argument will occur is the case where an estate plan is challenged by the Commissioner by means of applying section 99 to disallow some claim for a deduction (under section 104) that implementation of the plan leads to. This contention in turn reduces itself to arguing for acceptance in New Zealand of the view expressed by Dixon C.J. in *Cecil Bros.,* when he said — "I have great difficulty in seeing how [section 260] could apply to defeat or reduce any deduction otherwise truly allowable under s. 51".[86]

From the volume of judicial comment that this opinion has attracted, it is evident that this view is perhaps one of the most contentious issues of law to arise under both sections 260 and 99. It is necessary now to refer to those comments in order that some resolution of the issue may be suggested.

1. In Australia support for the proposition has been divided

— in *Cecil Bros.* itself, whilst three other judges in the Full High Court — Kitto, Taylor and Windeyer JJ.[87] — concurred in Sir Owen Dixon's judgment, both Owen[88] and Menzies[89] JJ. expressly disagreed with the Chief Justice's view;

— in *Hooker-Rex Pty Ltd* v. *F.C.T.,*[90] McTiernan J. suggested that any claim under section 51 was still subject to the "ordinary business dealing" test propounded under section 260;

— in *Franklin's Selfserve Pty Ltd* v. *F.C.T.,*[91] Menzies J. repeated the position he had taken in *Cecil Bros.;*

—in *Patcorp Investments Ltd* v. *F.C.T.,*[92] Gibbs J., in stating that it was unnecessary for the purposes of the present case to resolve this rift in judicial thinking, may perhaps be taken as thinking that the issue was open to further discussion.

2. In New Zealand there has similarly been a diversity of judicial view as to the correctness of Sir Owen Dixon's observation

— in *Elmiger,* Woodhouse J. discussed the issue and held that section 104 could not override the effect of section 99.[93] On appeal, the contention was abandoned;

— in *Europa* (No. 1) both North P.[94] and Turner J.[95] concurred in Sir Owen Dixon's view. On appeal to the Privy Council, the majority of the Board refrained[96] from expressing an opinion on the applicability of section 99 as the case had

85 It may be added that in the case where an estate plan leads to a violation of the terms of s. 96, the estate planning argument would not be sufficient to defeat an application of that section: *James* v. *C.I.R.* [1973] 2 N.Z.L.R. 119.

86 (1964) 111 C.L.R. 430, 438. Section 51 of the Income Tax Assessment Act corresponds to the New Zealand s. 104.

87 Ibid., 438 and 442.

88 Ibid., 436, sitting at first instance.

89 Ibid., 439, in the Full High Court.

90 (1970) 1 A.T.R. 641, 652.

91 (1970) 1 A.T.R. 673, 689.

92 (1976) 6 A.T.R. 420, 434.

93 [1966] N.Z.L.R. 683, 693.

94 [1970] N.Z.L.R. 321, 389.

95 Ibid., 415.

96 [1971] N.Z.L.R. 641, 653.

already been decided under section 104. The minority of their Lordships however described the Commissioner's contention on section 99 as "hopeless";[97]

— in *Mangin* the Board proceeded to apply section 99 without any discussion of the possible obstacle posed by *Cecil Bros.* This step necessarily implies rejection of the primacy of section 104;[98]

— in *Wisheart* both North P. and Turner J. seemed to resile from their former opinions when their Honours' unequivocally rejected the view of the majority in *Cecil Bros.*[99] However their Honours made no mention at all of their positions formerly taken in *Europa* (No. 1);

— In *Europa* (No. 2) McMullin J. thought it "quite clear"[1] that section 99 may apply to defeat a claim for a deduction under section 104; McCarthy P. in the Court of Appeal[2] adopted the view expressed by the minority of the Board in *Europa* (No. 1); the Privy Council held that allowance of the claim in full under section 104 would be "incompatible"[3] with the claim being liable to avoidance under section 99. Furthermore, their Lordships thought the case before them was on all fours with *Cecil Bros;*

— in *Halliwell* Casey J. undertook what was a rather limited review of the problem and endeavoured to rationalise the authorities by holding that section 99 could only be applied where "the need for such expenditure has been contrived".[4]

It is on these lines that the differing views as to the relationship between section 104 and section 99 are drawn. In view of the diversity of opinion, it is perhaps a matter of conjecture which way the issue will ultimately be resolved. However the better view would seem to be that followed in the *Elmiger, Wisheart, Mangin* line of authority, as being one consistent with the judicial perception of the scope of our section 99. It may be recalled that in *McKay,*[5] the Court of Appeal applied the notion that although an impugned transaction satisfied the terms of another section of the Act, the transaction was still "at large" and then had to face the additional obstacle posed by section 99. In Australia on the other hand, a clear line of authority may be traced through from *Keighery,* to *Casuarina,*[5a] to *Patcorp,* to *Mullens,*[5b] to *Cridland.*[5b] That line of authority holds that once a particular section of the Act is satisfied, section 260 cannot be invoked. Hence the view expressed by Sir Owen Dixon in *Cecil Bros.* can be seen to be consistent with that line of authority, which contrasts with the broader conceptual scope given by our courts to section 99. So it is on the basis of the differing judicial conceptions of

97 Ibid., 659. However the point has been made that their Lordships probably did not have in mind the present question: *Halliwell* v. *C.I.R.* (1977) 2 T.R.N.Z. 186, 192.

98 This is assuming that cases of income splits leading to contrived deductions (as in *Mangin, Elmiger, Wisheart,* for example) can be regarded as of the same nature as cases of inflated deductions for the purchase of trading stock (*Cecil Bros.* for example). There seems no reason why they should not be regarded as analogous. In *Halliwell* for example, Casey J. was not prepared to draw any distinction between the former class of case and those dealing with contrived deductions in general, one genre of which is the "trading stock" type of case. See ibid., 190.

99 [1972] N.Z.L.R. 319, 323 and 328-330 respectively.

1 (1973) 3 A.T.R. 512, 556.

2 (1974) 4 A.T.R. 455, 487.

3 [1976] 1 N.Z.L.R. 546, 556

4 (1977) 2 T.R.N.Z. 186, 195.

5 Supra Part I A.2.

5a See n. 93 supra.

5b See n. 85 (1st series) supra

the ambit of the respective provisions that it is suggested that compliance with section 104 does not preclude the further inquiry as to whether section 99 has been violated.

It remains to deal with the contrary judicial opinion preventing acceptance of this conclusion. The first is the position taken by the Privy Council in *Europa* (No. 2). It is suggested that the way open to interpret the opinion of the Board is to hold that the view of their Lordships was directed to the facts of that particular case. Hence the "incompatability" spoken of by the Board may be said to be occasioned by the present matter being a case of "expenditure genuinely made",[6] in which case that characteristic would make the transaction a matter of ordinary business dealing and therefore necessarily safe from impeachment under section 99.[7] This interpretation would seem to be consistent not only with the situation before the Board, but also one in line with the rather brief treatment of the whole problem by their Lordships. It may be expected — as suggested by Casey J. in *Halliwell*[8] — that if the Privy Council was turning its mind to the broader question of the general relationship between sections 104 and 99, a more detailed exposition of the problem would have been undertaken.

The second precedent to consider is the test formulated by Casey J. in *Halliwell.* Briefly, the facts in that case concerned a classic income split arrangement: sale by a dentist to his family trust of the assets utilised in his practice, followed by their lease back to himself. Thereafter the trust purchased from time to time and from independent sources whatever new equipment was necessary for the conduct of the practice. Casey J. went some way to accepting the majority view in *Cecil Bros.,* when he added to the relationship between the two sections the refinement that section 99 could only apply to defeat a claim under section 104 when "the need for such expenditure has been contrived".[9] Application of this test had the rather curious result that section 99 could only void the hire of those assets originally owned by the taxpayer.[10] Yet the terms of his Honour's judgment did not seek to draw any distinction between the "need" on account of which both categories of assets had been hired. This consideration would seem to suggest that the real basis upon which the different treatment of the two categories of assets rested was whether the assets had originally been owned by the taxpayer.

6 The test propounded by the majority in *Europa* (No. 1), 649.

7 Provided of course that the avoidance of income tax was a "merely incidental" purpose or effect. This interpretation of *Europa (No. 2)* could also explain the view expressed by Sir Owen Dixon. If expenditure was "necessarily incurred in the production of assessable income" and hence was "properly deductible" under s. 51, *a fortiori* it would be a matter of ordinary business dealing and hence not a case for s. 260. However it must be acknowledged that the facts in *Cecil Bros.* do not lend themselves to this interpretation. It is difficult to conceive how the purchase of trading stock at a much inflated price could be described as an "ordinary business dealing without necessarily being labelled as a means to avoid tax". Indeed, Owen J. when sitting at first instance held precisely that: (1964) 111 C.L.R. 430, 435.

8 (1977) 2 T.R.N.Z. 186, 194-195.

9 Ibid., 195.

10 The category of independent purchases could not be said to be "contrived" because the need to hire them was demanded by the needs of the business; so they may as well he hired from the family trust as anywhere. Unfortunately his Honour did not elaborate why the same could not be said of those assets first sold to the trust.

In any event, the obscurity of this part of his Honour's reasoning aside, it would seem, with all due respect, that the test laid down by Casey J. directs attention away from the vital inquiry required by the predication test. It has already been noted[11] that the essence of the predication test is that[12] " . . . you must be able to predicate — by looking at the overt acts by which it was implemented — that it was implemented in that particular way so as to avoid tax".

The question required to be asked under this test is not, as Casey J. held, whether the *need* for an expenditure arising from an arrangement has been contrived so as to avoid tax. Rather the inquiry directed by the test formulated in *Newton* is to the manifestly separate notion as to whether a need that leads to some expenditure has been *satisfied* in a particular way as to disclose a culpable purpose or effect. It is the essence of the predication test that the vital inquiry is to examine the way in which an arrangement is implemented, with any examination of the precedent matter of the need which that expenditure reflects not being to the point. On this analysis, Casey J. ought to have scrutinised the hire agreements in order to determine whether they disclosed a culpable purpose or effect, rather than turn his mind to "the need" of which those agreements were the maturation. The test propounded by Casey J. can be seen then to be inconsistent with the conventional approach mandated by the authorities, which thus deprives that test of compelling force. If this is the case, the view argued for previously may yet be sustained so that section 99 is not to be read subject to section 104 in the manner propounded in *Halliwell*.[13]

C. The New Source Argument

The genesis of this argument may be traced to one of the four unsolicited general propositions that the Privy Council in *Europa* (No. 2) laid down as applying to section 99. The Board stated[14]

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

Unfortunately their Lordships did not proceed to elucidate what they had in mind when pronouncing this enigmatic "new source" limitation to section 99. Some of the questions that readily spring to mind are precisely what is meant by a "source" of income? How drastic a change has to be made to existing revenue in order that subsequent income may be said to be "new"? An instance of the

11 Supra Part I A.

12 *Newton* v. *F.C.T.* [1958] 2 All E.R. 759, 764.

13 This whole question is further debated by G. Harley "The *Europa Oil (No. 2)* Case" [1976] N.Z.L.J. 218, 229. There some sound, more technical reasons in support of just such a conclusion are put forward. Moreover if the suggestion made at n. 7 supra, is correct, it would follow that Sir Owen Dixon's view would not be tenable in relation to s. 99 — at least in the case where the impugned arrangement has two purposes or effects. In Part I B.3 supra, it was pointed out that matters of ordinary business dealing are within the scope of the section, where there is also the purpose or effect of tax avoidance. In which case, the justification for deductibility under s. 104 would not also necessarily vindicate the matter under s. 99.

14 [1976] 1 N.Z.L.R. 546, 556.

type of problem that may be encountered in application of this principle is offered by the recent transaction where preferential shareholders in Europa Oil (N.Z.) Ltd exchanged their current shareholdings for a proportionate amount of convertible notes.[15] Whilst conceptually the nature of the "source" of income would be altered, can it be said that those persons now receive income from a "new" source?

To date, differing judicial views have been expressed as to the meaning of the exception propounded by the Board. First, Casey J. in *Halliwell* undertook a rather brief discussion of the question, and formulated the proposition that[16]

> a new source of income (to which the arrangement under attack relates) depends on a common-sense appraisal of the physical source itself, as well as the taxpayer's interest in it, and of any other relevant circumstances.

That being the case, his Honour went on to hold that the income derived from a professional practice upon its complete take-over by the taxpayer could not be said to be "new" because the taxpayer had previously been a (junior) partner in that practice. This view his Honour noted was consistent with the decision in *Wisheart,* where the impugned arrangement was implemented upon a change of partners. Yet no significance was attached to the impugned reorganisation as to suggest that it led to a transformation of income outside the scope of the section.

By way of contrast to Casey J.'s view, reference may be made to the opinion expressed by Sir Garfield Barwick in *Mullens.*[17] One of the reasons for the insistence by his Honour for an antecedent transaction that is recast in a tax avoiding form before secton 260 can apply, was that "by parity of reasoning" the new source of income limitation may extend to "a new basis for a deduction".[18] The view of his Honour would appear to give a very literal meaning to the principle and hold that without that earlier, analogous transaction, every reorganisation leads to a "new" source of income or a "new" right to a deduction, as the case may be. This view would plainly all but emasculate section 260. However it may be cogently argued that similar reasoning would not be applicable under section 99. First, the origin of his Honour's view has been traced back[19] to the contention made when he appeared as counsel before the Board in *Newton.* However the argument was unambiguously rejected by the Board, it being held that the section did have prospective effect.[20] Secondly, the decision of the Court of Appeal in *Martin* v. *C.I.R.*[21] may be cited as one instance of where section 99 has been applied despite the absence of an antecedent transaction.

Present indications are that New Zealand courts are inclined to treat the "new source" limitation cautiously, holding that some sort of radical transformation to existing revenue is necessary before the exception can be established.[22] In the estate planning context, that view would still leave room for argument in the situation

15 As reported in *National Business Review,* Wellington, N.Z., 14 September 1977, 8.
16 (1977) 2 T.R.N.Z. 186, 196.
17 Noted at n. 92 (1st series) supra.
18 (1976) 6 A.T.R. 504, 510.
19 Noted at n. 19 (1st series) supra.
20 [1958] 2 All E.R. 759, 763. A proposition confirmed by the Board in *Mangin* v. *C.I.R.* [1971] N.Z.L.R. 591, 596.
21 (1973) 3 A.T.R. 707, in order to deny the benefit of carrying forward of accumulated losses, as was provided for under s. 137 of the Land and Income Tax Act 1954.
22 Essentially the view argued for by, for example, Pose n. 29 supra, and Harley n. 13 supra.

where there is a reorganisation of affairs, so that existing income becomes sufficiently altered in character to support the argument that it is now revenue derived from a "new source". It remains to be seen what guidelines future courts establish as applying to the principle. Until that time the view of Sir Garfield Barwick may be noted as offering an indication of the wide potential that the principle holds.

D. *Reconstruction Problems*

If each of the three arguments advanced above fail to persuade the court to overrule the Commissioner's assessment, an objector may still escape an application of section 99 because of the inability to negate the effect of the culpable transaction. Subsection (3) authorises the Commissioner to make an adjustment of the assessable income of any person affected by a tax avoidance arrangement so as to counteract any tax advantage obtained thereby, in which case, subsection (4) deems the income assessed to such persons to be derived by that person and not any other person.[23] Of the problems that may arise under this aspect of the section, it has already been noted that[24]

> the concept of a tax advantage does mean that the taxpayer can argue that if the arrangement had not been entered into he would not have derived as income sums which, under the arrangement, he appears to have avoided.

In other words, there will be no "tax advantage" because if the taxpayer had thought that there was any possibility that the transaction under review was going to be struck down by an application of section 99, then he would not have entered into it. *Ergo* there has been no "advantage" obtained in his fiscal position. It would seem unlikely that a court would accept such reasoning, at least as a general proposition, for to sustain it would plainly be to all but emasculate the section. Moreover, some support for this conclusion may be drawn from the speech of Lord Wilberforce in *I.R.C.* v. *Parker*.[25] There his Lordship made some comments about the definition of "tax advantage" given by what is now the proviso to section 460(5) of the Income and Corporation Taxes Act 1976 (U.K.), in relation to transactions in securities. Of the definition in that provision, his Lordship observed[26]

> . . . [the proviso] presupposes a situation in which an assessment to tax, or increased tax, either is made or may possibly be made, that the taxpayer is in a position to resist the assessment by saying that *the way in which he received what it is sought to tax,* prevents him from taxed on it; and that the Revenue is in a position to reply that if he had received what it is sought to tax *in another way* he would have had to bear tax. In other words, there must be a contrast, as regards the "receipts" between the actual case where these accrue in a non-taxable way with a possible accruer in a taxable way, and, unless this contrast exists, the existence of the advantage is not established.

23 Which deeming provision, curiously enough, does not extend to the transactions of a kind dealt with by subsection (5).

24 R. L. Congreve "The Land and Income Tax Amendment Act (No. 2) 1974" (1974) 6 N.Z.U.L.R. 310, 313.

25 [1966] 1 All E.R. 399.

26 Ibid, 415 — a view later followed by the House in *Cleary* v. *I.R.C.* [1967] 2 All E.R. 48. This formulation may be said to be in point, because the terms of the statutory language upon which it is based are even more narrowly drawn than the criteria expressed in s. 99(3)(a) and (b).

The essence of these remarks by his Lordship is that they postulate that there must be a contrast between the "actual" and the "possible" before there can be said to be a "tax advantage".[27] This proposition would seem to indicate that it would not be necessary for the Commissioner to show that there was an imperative transaction carried out in the most advantageous fiscal manner before there can be said to be a "tax advantage". However it is suggested that this formulation would nonetheless still leave it open for a taxpayer to argue that, in his case, there was no other viable alternative contemplated or available, so that there was no other "possible" transaction from which a tax advantage could be said to have been realised.

The foregoing discussion has been directed to the relatively straight-forward context where there is only one transaction under consideration. Much more difficult questions arise when the conduct of a business is under review, for there the court may be called upon to make suppositions in order that the requisite contrast may be drawn. The type of problems that may arise in this sort of situation are indicated by the facts in *O'Kane Construction Ltd* v. *C.I.R.*[28] Briefly the facts in that case were that the principal shareholder in the taxpayer established a family trust to which he sold and took a lease back of the company's earthmoving equipment. The trust then bought a farm and some eighteen months later purchased a machine (identified as a TD 25) for use in the business of both the taxpayer and on the farm. Henry J. held that whilst the initial sale and lease back transaction could be voided, the purchase of the TD 25 and its hire to the company could not be. One of the reasons was because there was a choice to either buy or hire a machine like the TD 25, and that it was an acceptable business transaction for the trust to choose to buy the machine.[29]

The *O'Kane Construction Ltd.* decision illustrates the point that the Commissioner may have difficulty supporting his assessment in cases where there is some change in the modus operandi of the taxpayer's business subsequent to implementation of the impugned arrangement. For in such a situation, the court may be called upon to speculate or make very hypothetical assumptions as to the course of conduct that might have been followed if the arrangement had not been entered into. And this might draw the court, no doubt reluctantly, into what one judge rather colourfully termed "the world of fiscal fantasy".[30]

27 This proposition comes extremely close to contradicting what the Privy Council stated in *Mangin* v. *C.I.R.* [1971] N.Z.L.R. 591. The Board there repeated at 598 a notion — first put forward by Lord Upjohn in *I.R.C.* v. *Brebner* [1967] 1 All E.R. 779, 784 — to the effect that

> If a bona fide business transaction can be carried through in two ways, one involving less liability to tax than the other, their Lordships do not think s. [99] can properly be invoked to declare the transaction wholly or partly void merely because the way involving less tax is chosen.

From this principle it might have been expected that where a taxpayer followed that alternative involving less liability to tax, there was no resultant tax avoidance or tax advantage though, there was this other "possible" alternative entailing a heavier fiscal burden.

28 (1973) 4 A.T.R. 54.

29 Ibid., 57-58.

30 Wilson J. in *Gerard* v. *C.I.R.* (1972) 3 A.T.R. 271, 281.

Thus the importance of any argument based upon a misconceived reconstruction may be expected to depend very much upon the timing of an application of section 99. The decision in *O'Kane Construction Ltd* indicates that the fruits of a tax avoidance scheme may still be enjoyed where discretionary dealings subject to its implementation occur. This is because those later events do not in such a case readily enable a contrast to be drawn with the possible course of events if the arrangement had not been entered into in order that a "tax advantage" may be hypothesised.

IV. CONCLUSION

The erstwhile licence of a taxpayer to organise his affairs to pay less tax than he otherwise might throws into sharp relief the conflict between this autonomy of the individual and the need to safeguard the interests of the fisc in cases where a taxpayer makes arrangements that purport to diminish both prospective fiscal burdens. In these cases, where the taxpayer may be seen to be arguing for the best of both worlds, it perhaps should not be surprising to find that the courts are wary of the argument that asserts as a justification for a diminution of the perennial burden, the desire to reduce the posthumous levy. This suspicion is manifested firstly in the insistence that the argument may be made only from the proper source — that it be disclosed by an examination of the terms of the plan itself. With that obstacle surmounted, the second problem is to persuade the court of sincerity to the avowed purpose. The current state of our law reveals that this will only be achieved when the saving in income tax is an unsolicited advantage and is seen not to be a feature expressly embodied in the plan itself. This situation contrasts with that obtaining in Australia, where the trend of present authority is to accord exercises in matrimonial asset sharing — which encompass estate planning objectives — a standing outside the range of that jurisdiction's legislative analogue. However, when an estate planner is called upon to deny an application of section 99, it is apparent that he faces a difficult task in discharging the onus of proof that he bears. The emphasis in the authorities is to look for some business or commercial motivation that furnishes a rationale of the arrangement, yet in the estate planning context this is manifestly an onerous requirement to satisfy. Thus of the estate planning argument, the view is offered that our courts do not view the contention as some sacrosanct or inviolable argument whose elucidation necessarily protects an estate plan from impeachment under section 99. Rather its adducement does not preclude the pragmatic approach of a careful scrutiny of the material facts in order to determine the veracity of the contention and an absence of the proscribed purpose or effect. Then and only then may an estate plan escape the thunder of section 99.

APPENDIX

Section 99 of the Income Tax Act 1976

99.(1) For the purposes of this section —

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

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

"Tax avoidance" includes —

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

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

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

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

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

(b) Where it has 2 or more purposes or effects, one of its purposes or effects (not being a merely incidental purpose or effect) is tax avoidance, whether or not any other or others of its purposes or effects relate to, or are referable to, ordinary business or family dealings, —

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

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

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

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

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

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

[(6) Contains bridging provisions in respect of arrangements made or entered into before the section came into force on 1 October 1974.]

Section 260 of the Income Tax Assessment Act 1936-1977 (Aus.)

260. Every contract, agreement, or arrangement made or entered into, orally, or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly —

(a) altering the incidence of any income tax;

(b) relieving any person from liability to pay any income tax or make any return;

(c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or

(d) preventing the operation of this Act in any respect,

be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose.

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