The taxation of fringe benefits

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The recent passage of the Income Tax Amendment Act (No. 2) 1985 which subjects to tax a number of fringe benefits has highlighted the considerable economic value of such benefits. However New Zealand law before the Act held that fringe benefits were in principle not income and thus not assessable. In this article Mike Rigby outlines and criticises the reasons given by the courts for excluding non-convertible benefits from the definition of income. He compares other Commonwealth and American approaches, and concludes that there is no logical reason for such an exclusion.

I. INTRODUCTION

In the 1984 Budget the Minister of Finance, the Hon. R. O. Douglas, announced that a fringe benefits tax would be levied as from 1 April 1985. That statement of intent was given effect to by section 34 of the Income Tax Amendment Act (No. 2) 1985 which inserted into the Income Tax Act 1976 a comprehensive code governing the taxation of fringe benefits. This paper seeks to provide a background to that legislation and to explain why specific legislation was necessary to bring fringe benefits within the charge to tax. That explanation involves an analysis of the concept of income and the operation of the principle that income only comprises such items which are in cash or which are convertible into cash.

A comparison with the concept of income as it is understood in the United States demonstrates that there is no logical reason for excluding fringe benefits from the income tax base. That comparison also illustrates the role played by the courts in the United Kingdom, Australia and New Zealand in excluding fringe benefits from income tax.

In the final part of the paper the problems associated with taxing fringe benefits, and the general scheme of legislation aimed at taxing such benefits, will be discussed. It will be seen that although the New Zealand legislation fell within that general scheme, its ineffectiveness meant that comprehensive legislation was necessary to bring fringe benefits within the tax net.

II. THE NATURE OF FRINGE BENEFITS

To counteract attempts on the part of the taxpaying public to reduce the incidence of taxation legislatures around the world have resorted to increasingly

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complex and sophisticated legislation which has required alteration on a regular basis. However, notwithstanding that phenomenon opportunities invariably remain open for taxpayers to reduce their liability to tax. In some circumstances such a reduction may be effected with the sanction of the statute imposing the tax. Thus, in New Zealand, it is possible to reduce one's liability to tax by assigning an income producing asset to another person provided that the requirements of section 96 of the Income Tax Act 1976 as to the duration of the assignment and the control of the assigned property are met. In other circumstances, such a reduction may occur in the face of the statute: where, for example, a taxpayer conceals income falling within the statutory charge to tax. Therefore whatever method is adopted it generally remains possible, despite the sophistication of modern tax legislation, to avoid the full measure of taxation which the legislature seeks to exact. However, at the same time, without derogating from that general proposition, the scope for some classes of taxpayers to reduce their liability to tax may be narrower than for others. In particular, the salary and wage earner is unable to avail himself of opportunities to reduce the incidence of taxation to the same extent as other taxpayers. Due to the source deduction principle, whereby tax payable by salary and wage earners is required to be deducted by the employer prior to the payment of the salary or wage,[1] such taxpayers must meet their day to day needs and plan for the future out of tax-paid income. Unlike the self-employed businessman, the salary and wage earner cannot easily deal with his income before it is derived by him. Assignment of personal services income is precluded for tax purposes by Henry J.'s holding in *Spratt* v. *C.I.R.*[2] that:[3]

> 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.

And furthermore, as tax is deducted by the employer at source, there is no scope, without the complicity of his employer, for a salary or wage earner to evade tax by concealing his income.

One of the few avenues whereby the incidence of taxation may be reduced for a salary or wage earner is by the provision of what are commonly known by the expression "fringe benefits". Richardson and Congreve define fringe benefits as follows:—[4]

> In its widest sense the term 'fringe benefits' means any benefits or advantages, other than the payment of wages and salary, passing from employer to employee and arising out of the employment. Fringe benefits are usually paid in kind rather than in cash and include a wide range of goods, services, and other employee benefits.

Fringe benefits are provided in a multitude of forms. The use of company property, such as motor vehicles, holiday accommodation and car parking facilities;

1 E.g. s.338 of the Income Tax Act 1976 (N.Z.); s.221C, Income Tax Assessment Act 1936 (Aust.).
2 [1964] N.Z.L.R. 272.
3 Ibid. 277. For a criticism of this holding see McKay "The Arcus and Personal Services Income Principles" (1974) 6 N.Z.U.L.R. 140, 153-156.
4 Richardson and Congreve *Tax Free Fringe Benefits* (Rydge Publications, Sydney, 1975) p.3.

the provision of free or low-rental accommodation and subsidised meals; access to low interest loans and the granting of share options; the payment of club membership and of entertainment expenses; and the provision of superannuation and insurance benefits; to name but a few of the more common forms, all constitute fringe benefits.

Fringe benefits are common at all income levels. They are not solely the prerogative of the highly paid. Thus, the managing director of a large public company may be provided with a company car and a low interest housing loan as well as having his telephone bills and annual holidays paid for. But at the same time an office clerk in the same company may receive fringe benefits commensurate with his or her income levels: for example he or she may be provided with subsidised meals and be entitled to membership of a subsidised superannuation scheme.

To be distinguished from fringe benefits are what may be referred to as conditions of employment. Whereas fringe benefits constitute the provision of a benefit or advantage in lieu of salary or wages, conditions of employment, which include for example luxurious office surroundings, air conditioning, and the provision of secretarial services, confer no economic advantage. This paper is concerned only with the tax status of fringe benefits.

III. FRINGE BENEFITS AND THE INCOME TAX BASE

A. Background

In many jurisdictions fringe benefits have been a valuable tax planning device for the salary or wage earner. In New Zealand, Australia and the United Kingdom, this may be attributed in large part to the means by which income is defined for income tax purposes. In the United States, on the other hand, the statutory definition of income is wide enough to encompass fringe benefits but administrative practice has enabled many such benefits to escape the tax net.

Various statutory provisions have been enacted to ensure that fringe benefits are taxable in the hands of the employee. These provisions are considered briefly in Part IV of the paper. The present part of the paper is concerned more with the reasons why such express statutory provisions have been rendered necessary. To that end, an analysis of the concept of income is undertaken. That analysis is approached in a number of ways. First, income is considered in its economic sense. It will be seen that in this sense income is clearly wide enough to encompass fringe benefits. Secondly, income will be considered in its juristic sense and a brief discussion of the meaning of income as enunciated by the courts will be undertaken. At the same time, an analysis of the various statutory definitions of income, and the historical background to such definitions, will be undertaken. As a result of this second approach, it will be seen that in New Zealand, Australia and the United Kingdom fringe benefits are not taxable as income in the ordinary sense of that word unless they are convertible into cash. It will also be seen that the convertibility principle applies only to income from employment and not to income from other sources. Finally, a comparison will be made with the United States where income in its ordinary sense is wide enough to include fringe benefits.

B. The Concept of "Income"

1. *Income in the economic sense*

An American economist, H. Simons, has defined income as being:[5]

> . . . the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of the property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to 'wealth' at the end of the period and then subtracting 'wealth' at the beginning.

Such a definition is clearly wide enough to encompass not only items such as salaries, wages, rent, interest, dividends and business profits, which are currently taxed as income, but also items such as inheritances, windfall gains and fringe benefits which are not currently so taxed. Thus, in assessing the market value of rights exercised in consumption it would be necessary, for example, to take into account the market value of the use of a company car, or of the right to live in rent free accommodation.

However, economic concepts of income have not played a significant role in the development of income as a legal concept for tax purposes. Neither legislatures nor the courts have availed themselves of economic theories. In a Canadian case, *Oxford Motors Ltd.* v. *Minister of National Revenue*,[6] this neglect of economic theory was explained as follows:[7]

> No one has ever been able to define income in terms sufficiently concrete to be of value for taxation purposes. In deciding upon the meaning of income, the Courts are faced with practical considerations which do not concern the pure theorist seeking to arrive at some definition of that term . . .

And in a similar vein the Supreme Court of the United States, in *Merchants Loan & Trust Co.* v. *Smietanka*,[8] held that:[9]

> In determining the definition of the word 'income' this court has consistently refused to enter into the refinements of lexicographers or economists and has approved what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution.

Thus, for practical reasons, the courts have rejected a broad based definition of income founded upon economic theory. Legislatures appear to have ignored economic theory for similar reasons. In the United Kingdom the *Report of the Royal Commission on the Taxation of Profits and Income*[10] accepted that income could be calculated by comparing the value of total resources at the beginning of the year with total resources at the close and by making adjustments for incomings and

5 H. Simons *Personal Income Taxation* (University of Chicago Press, 1938) p.50-51. Another American economist, R. M. Haig, has defined income in similar terms as "the money value of the net accretion to one's economic power between two points in time" (cited in Curran (ed.) *Tax Philosophers* (University of Wisconsin Press, 1974) p.80).
6 [1959] C.T.C. 195.
7 Ibid. 202, per Abbott J. (S.C).
8 255 U.S. 509 (1921).
9 Ibid. 519.
10 June 1955, Cmnd. 9474.

outgoings. However, that method of calculating income was rejected as being "unworkable for income tax, for by no possibility could a system be operated which involved a fresh determination each year of the current values of all the possessions of the taxpayers of the country."[11]

2. *Income in the juristic sense*

Although each of the countries surveyed in this paper imposes a tax on income, in none of the statutes by which income tax is imposed is there to be found a comprehensive definition of the term "income". The common pattern is to describe a number of receipts which are to be included as income for tax purposes and to conclude with a general provision which brings all classes of income not specifically mentioned within the tax net. In the United Kingdom, for example, Schedules A to E of the Income and Corporation Taxes Act 1970 describe on a source basis a number of receipts which are chargeable to tax. Case VI of Schedule D then operates as a general sweeping up clause by rendering taxable "any annual profits or gains not falling under any other case of Schedule D, and not charged by virtue of Schedule A, B, C, or E."

Similarly, section 65(2) of the New Zealand Income Tax Act 1976 provides that the assessable income of any person includes a number of items listed in paragraphs (a) through to (k) and concludes in paragraph (1) that it is also to include "income derived from any other source whatsoever." Moreover, the generality of the section 65(2) definition is emphasised by the opening words of that subsection, "[w]ithout in any way limiting the meaning of the term . . . ." The effect of those words was considered in *Duff* v. *C.I.R.*[12] There, Woodhouse P., discussing the predecessor of section 65(2),[13] said:[14]

> . . . for reasons of logic alone the question as to whether a gain or profit is to be regarded as income should be examined initially by reference to the general considerations which surround that concept before any further step is taken of asking whether use can properly be made of the extended meanings of assessable income that are provided in para (a), (b) or (c) of section 88(1). The subsection itself suggests such an earlier approach; and if it is not done the resulting analysis could well be diverted and restricted to the ambit of the extended definitions with consequential neglect of general principle.

In considering income in its juristic sense it is therefore necessary to go beyond the statutory definition. This principle is well illustrated in the following comments of Jordan C.J. in *Scott* v. *Commissioner of Taxes (N.S.W.)*[15]:

> The word 'income' is not a term of art, and what forms of receipts are comprehended within it, and what principles are to be applied to ascertain how much of these receipts ought to be treated as income, must be determined in accordance with the ordinary concepts and usages of mankind, except in so far as the statute states or indicates an intention that receipts which are not income in ordinary parlance are to be treated as income, or that special rules are to be applied for arriving at the taxable amount of receipts.

11 Ibid. para. 83.
12 [1982] 2 N.Z.L.R. 710.
13 Section 88(1) of the Land and Income Tax Act 1954. That section is in pari materia with section 65(2).
14 [1982] 2 N.Z.L.R. 710, 712-713.
15 (1935) 35 S.R. (N.S.W.) 215, 219.

However, the "ordinary concepts and usages of mankind" test is not entirely satisfactory so the courts have developed a number of criteria for determining whether a particular receipt is income. First, income is something which comes in in money or money's worth. In *Lambe* v. *I.R.C.*[16] Finlay J. said:[17]

> [I]ncome means that which comes in, and . . . it refers to what is actually received. Income may be of various sorts . . . but none the less the tax is a tax on income. It is a tax on what in one form or another goes into a man's pocket.

Secondly, a receipt is more likely to be income if it is received with a degree of periodicity, recurrence or regularity.[18] And finally, whether or not an item is income in nature depends upon its character in the hands of the recipient.[19]

Applying those criteria to fringe benefits it would appear that they are income in nature. Fringe benefits generally come in to the taxpayer in money's worth if not in money. Thus the use of a company car for private use is clearly something which comes into the taxpayer in money's worth. Fringe benefits may also be received with a degree of periodicity, as with the provision of subsidised meals for example. Moreover, in the hands of the employee fringe benefits appear to have the character of income. They are provided in money's worth as a means of reward for services rendered. Therefore, prima facie it appears that fringe benefits are income in the juristic sense, and should be taxed accordingly. Indeed, in the United States that is the case and the Supreme Court has on several occasions held that the statutory concept of income is wide enough to encompass fringe benefits.[20] In other jurisdictions surveyed, however, the courts have consistently held that fringe benefits are not income in the hands of employees unless they are either in the form of cash or are convertible into cash. As it is a relatively simple matter to provide a fringe benefit in a non-convertible form the charge to tax may easily be avoided.

The rationale of the convertibility principle is not immediately apparent. Furthermore, it is not immediately apparent why the convertibility principle applies to employment income but not to other types of income. To understand the rationale and the employment-non-employment distinction, it is necessary to digress briefly into an historical consideration of income tax.

C. The History of Income Tax and the Convertibility Principle

1. *The United Kingdom*

The first income tax was introduced by Pitt in 1799 in order to finance the war with France. The excise duties and land and expenditure taxes which had characterised the English tax system for much of the eighteenth century provided insufficient revenue for that purpose and Pitt was forced to resort to loans. In order to reduce dependence on loans Pitt adopted two fiscal measures. First in

16 [1934] 1 K.B. 178.
17 Ibid. 182.
18 *F.C.T.* v. *Dixon* (1952) 86 C.L.R. 540.
19 *Scott* v. *F.C.T.* (1966) 117 C.L.R. 514,526 per Windeyer J.
20 *C.I.R.* v. *Smith* 324 U.S. 177 (1945) (share options); *Rudolph* v. *U.S.* 370 U.S. 269 (1962) (expenses paid trip).

1798 an expenditure tax on certain luxuries was imposed.[21] However, that tax was widely evaded as a result of which Pitt adopted the second measure in 1799: the imposition of an income tax.[22]

By section 3 of Pitt's Act a tax was imposed upon "all income arising from property in Great Britain . . . or from any kind of personal property . . . or from any profession, office, stipend, pension, employment, trade or vocation . . . " The Act therefore taxed income from certain sources, thereby reflecting the eighteenth century concept of income as being the yield from a productive source. That concept is well illustrated in the following excerpt from the works of Adam Smith:[23]

> Whoever derives his revenue from a fund which is his own must draw it either from his labour, from his stock, or from his land. The revenue derived from labour is called wages. That derived from stock, by the person who manages or employs it, is called profit. That derived from it by the person who does not employ it himself, but lends it to another, is called the interest or the use of money . . . . the revenue which proceeds altogether from land, is called rent, and belongs to the landlord . . . All taxes, and all the revenue which is founded upon them, all salaries, pensions, and annuities of every kind, are ultimately derived from some one or other of those three original sources of revenue, and are paid either immediately or mediately from the wages of labour, the profits of stock, or the rent of land.

It will be seen from the preceding discussion of income that Smith's description of revenue is similar in many respects to current concepts of income.

Pitt's Act was repealed in 1802 but an income tax was reimposed by Addington in 1803 when the was with France resumed.[24] However, Addington's Act was significantly different in form in that it introduced a schedular system whereby income was classified into five schedules according to its source. Pitt's income tax had been unpopular largely because the return required disclosed too much information about the taxpayer's total income. Therefore, to meet the criticism that income tax returns represented an intrusion into taxpayers' private affairs the five schedules were introduced and taxpayers were required to submit a return in respect of income derived from each source.

Addington's Act is significant for a number of reasons. The schedular system it introduced is still part of the income tax regime in the United Kingdom. And for the first time a source deduction system was introduced whereby tax was

21 38 Geo. III c. 16.

22 39 Geo. III c. 13. The preamble to this Act explains the reasons for the introduction of the income tax as follows:

> We your majesty's most dutiful and loyal subjects . . . being desirous to raise an ample contribution for the prosecution of the war; and taking notice that the provisions made for that purpose, by an Act in the last session of Parliament . . . have in sundry instances been greatly evaded, and that many persons are not assessed under the said Act in a just proportion to their means of contributing to the public service; have cheerfully and voluntarily given and granted . . . the . . . duties hereinafter mentioned . . .

23 Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* (Reprint Landem, Nelson & Sons, 1865) Bk 1 ch.VI p.22

24 43 Geo. III c.122.

required to be deducted at the source of the payment subject to tax. However, more important for present purposes, the origins of the convertibility principle may be traced to that Act. Schedule E of Addington's Act brought into charge income from "every public office or employment of profit." The first rule to the Schedule provided:

> The said duties shall be charged on the person or persons respectively having, using, or exercising such offices or employments of profits, or to whom such annuities, pensions or stipends shall be payable, for all salaries, fees, wages, perquisites, or profits whatsoever accruing by reason of such offices, employments or pensions . . .

And perquisites were defined in the fourth rule to the Schedule as:

> . . . such profits of offices and employments as arise from fees or other emoluments, and payable either by the Crown or the Subjects, in the course of executing such offices or employments.

It was from these provisions, carried forward into the Income Tax Act in 1842, that the House of Lords abstracted the convertibility principle in 1892 in the landmark decision of *Tennant* v. *Smith*.[25] There, the House of Lords was concerned with the question of whether an employee of a bank was assessable under Schedules D and E on the value of accommodation provided for him by his employer.[26] Their Lordships recognised that by virtue of his occupation of the rent-free accommodation the taxpayer received an economic benefit. Lord Halsbury L.C. said:[27]

> It may be conceded that if he did not occupy it under his contract with the bank rent free, he would be obliged to hire a house elsewhere, pay rent for it, and pro tanto diminish his income. And if any words could be found in the statute which provided that besides paying income tax on income, people should pay for advantages or emoluments in its widest sense . . . , there is no doubt of Mr. Tennant's possession of a material advantage, which makes his salary of higher value to him than if he did not possess it and upon the hypothesis which I have just indicated would be taxable accordingly.

However, notwithstanding the fact that the taxpayer derived a material benefit that benefit was not one which their Lordships considered to be taxable on a construction of the language of Schedule E. Lord Halsbury L.C. centred on the word "payable" in the fourth rule to Schedule E and concluded that it was "quite impossible to suppose that the mere occupation of a house is reconcilable with the just application of that word."[28] His Lordship considered that the only interpretation consonant with the language used in Schedule E was that that schedule charged only money payments or substantial things of money value capable of being turned into money.

Lord Watson's judgment was in similar terms, being based upon a close analysis of the language of Schedule E. His Lordship said:[29]

25 [1892] A.C. 150.

26 Schedule D levied a tax "upon the annual profits or gains arising or accruing to any person or persons residing in Great Britain from any kind of property whatever . . . or from any profession, trade or vocation."

27 [1892] A.C. 150,155.

28 Ibid. 156.

29 Ibid. 159. The other members of the House agreed with the convertibility principle. Lord Macaghten, for example, held that Schedule E "extends only to money payments or payments convertible into money." Ibid. 163.

> It is clear that the benefit, if any, which a bank agent may derive from his residence in the bank is neither salary, fee, nor wages. Is it then a perquisite or a profit of his office? I do not think that it comes within the category of profits, because that word, in its ordinary acceptation, appears to me to denote something acquired which the acquiror becomes possessed of and can dispose of to his advantage — in other words money — or that which can be turned into pecuniary account. If the context had permitted, it might have been possible to argue that a benefit of that kind was a perquisite. But the fourth rule of Schedule E defines perquisites, for all purposes of the Act, to be "such profits of offices and employments as arise from fees and other emoluments, and *payable either by the Crown or by the subject* in the course of executing such offices or employments." (Lord Watson's emphasis).

From *Tennant* v. *Smith* it may be concluded that the convertibility principle in the United Kingdom is attributable to two main factors. First, it may be attributed to the manner in which income from employment was defined in Addington's income tax Act of 1803.[30] Rather than defining income as being any form of gain, the 1803 Act reflected eighteenth century concepts of income as being the yield from a productive source. And the yield from labour was defined in that Act in terms connoting monetary payments, or payments in kind which are convertible into money. Secondly, the convertibility principle may be attributed to judicial attitudes to the interpretation of tax statutes. This attitude is best illustrated by Lord Halsbury's opening words:[31]

> This is an Income Tax Act and what is intended to be taxed is income. And when I say 'what is intended to be taxed,' I mean what is the intention of the Act expressed in its provisions, because in a taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes . . . Cases, therefore, under the Taxing Acts always resolve themselves into a question whether or not the words of the Act have reached the alleged subject of taxation. Lord Wensleydale said, in *In re Micklehwa t* [11 Ex 456], 'It is a well-established rule, that the subject is not to be taxed without cleear words for that purpose . . .'

This literal approach is clearly illustrated in the dicta of Lord Halsbury L.C. and Lord Watson already quoted.[32] Although their Lordships recognised that the provision of rent-free accommodation provided the taxpayer with a material advantage, a literal interpretation of the charging provisions excluded that advantage from the tax net. By contrast, the Scottish Court of Session, the appeal from whose decision the House of Lords heard in *Tennant* v. *Smith,* took a more pragmatic approach.[33] There, the majority held that the annual value of the occupation of the house was income. The Lord Justice-Clerk's judgment in particular contains a useful contrast to the judgments in the House of Lords. Basically, his Lordship's reasoning consisted of an assertion that it would be "contrary to common sense"[34] to suggest that an employee would not consider a house provided by his employer to be a profit, gain or emolument of his office. Stating the principle to be applied broadly, the Lord Justice-Clerk concluded that "it is what a man

30 The 1842 Act which was considered in *Tennant* v. *Smith* was largely based upon the 1803 Act.
31 [1892] A.C. 150,154.
32 Supra, n.27, n.29 and accompanying text.
33 *Tennant* v. *Inland Revenue* (1891) Session Cases, series 4, vol.18, 428.
34 Ibid. 434.

enjoys . . . upon which he must be assessed for income tax."[35] Had that rationale been accepted by the House of Lords then all manner and form of fringe benefits would have been brought within the charge to tax. However, the convertibility principle subsequently enunciated by the House of Lords successfully excluded the majority of such benefits from the charge.

In the context of Schedule E the convertibility principle has more recently been approved by the House of Lords in two cases concerning fringe benefits: *Abbott* v. *Philbin*,[36] and *Heaton* v. *Bell*.[37] In the latter case the question falling for determination was the assessability of benefits received under a car loan scheme. Under that scheme the taxpayer's employer purchased cars, insured them, paid the road fund tax, and lent them to the members of the scheme. There was then subtracted from the weekly wage of those employees a sum of money which varied according to the type of car on loan. Provision was made for withdrawal from the scheme at two weeks notice, after which time the deduction from the employee's weekly wages would cease. On the grounds that the participants in the scheme were receiving taxable emoluments, the Commissioners assessed the taxpayer — a member of the scheme — on his total wages without making any allowance for the amounts subtracted in respect of the car. The taxpayer disputed that assessment, arguing that as the benefit derived from the use of the car was not convertible into cash, he had derived no emoluments within the terms of Schedule E.

In the House of Lords the taxpayer's argument was rejected on the grounds that the benefit he derived from the scheme was convertible into cash. Once again the convertibility principle was unanimously approved. Lord Reid rationalised that approval as follows:[38]

> Income tax is a tax on income and income means money income. The words profits and gains are used throughout the legislation in reference to sums of money . . . there is no provision for the valuation in money or other kinds of advantages which one might call perquisites. In 1842 income tax was at the rate of a few pence in the pound, 'fringe benefits' were unknown for there was no incentive to create them, and it appears to me to be clear that there was no intention to saddle the commissioners with the difficult and at times unprofitable task of putting money on advantages arising out of the employment which did not sound in money.

Therefore, rather than slavishly following *Tennant* v. *Smith* Lord Reid sought to explain the convertibility principle by reference to the probable intention of Parliament when the 1842 Act was enacted. Lord Diplock also accepted the convertibility principle but at the same time indicated that if it were not for the history of Schedule E, he would be prepared to hold that the use of the car was a perquisite irrespective of whether or not it was convertible into cash. His Lordship said:[39]

> For my part, if it were permissible to confine myself to a consideration in the current Statutes (namely the Income Tax Act 1952 and the Finance Act 1956) by which income tax under Schedule E is currently charged, I should have little hesitation in deciding

35 Idem.
36 [1961] A.C. 352.
37 [1970] A.C. 728.
38 Ibid. 744.
39 Ibid. 763-764.

> that the free use of a car for his own purposes, provided to an employee by an employer by reason of his employment, was a perquisite from that employment . . . I have no doubt that the man in the street would call the benefit of the use of the car if not a 'perquisite' at any rate a perk.

Lord Diplock was therefore of opinion that according to current usage the use of the car was a perquisite. However, His Lordship held that it was too late "to read the relevant words of the current legislation in what I should regard as their current acceptation"[40] as *Tennant* v. *Smith* had confined these words to money payments and payments in kind which were convertible into cash.

2. *New Zealand and Australia*

As in the United Kingdom, fringe benefits are not generally taxable in New Zealand unless they are convertible into cash. The requirement of convertibility has arisen in New Zealand for reasons similar to those for its development in the United Kingdom. Thus, both the method of defining income for tax purposes and judicial attitudes to the interpretation of tax statutes have been influential. At the same time, the convertibility requirement has not arisen as the result of the New Zealand courts blindly following principles enunciated by the House of Lords in *Tennant* v. *Smith*. Rather, it has developed upon an independent construction of the relevant New Zealand legislation, section 65(2) of the Income Tax Act 1976. In relevant part that section provides:

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

Whether the provision of a fringe benefit attracted the operation of that section fell to be considered in *Stagg* v. *I.R.C.*[41] There, the taxpayer's employer paid for a trip to England for the taxpayer and his wife. Considering the cost of those air fares to be an allowance within the terms of section 65(2)(b),[42] the Commissioner included an equivalent amount within the taxpayer's assessable income in the relevant income year. The taxpayer objected, first on the ground that the purpose of the trip was wholly or primarily of a business nature so that in effect the cost of the trip was not an allowance, and secondly on the ground that on the authority of *Tennant* v. *Smith* no benefit to a taxpayer could be assessed as income unless it was convertible into cash.

The taxpayer's first ground of objection was given short shrift by Hutchison A.C.J. The learned judge upheld the finding in the Magistrate's Court that the trip was for both business and personal reasons. However, it is Hutchison A.C.J.'s

40 Ibid. 764.
41 [1959] N.Z.L.R. 1252.
42 In *Stagg* the relevant statutory provision was s.88(1)(b) of the Land and Income Tax Act 1954. However, as that provision is identical to s.65(2)(b) of the 1976 Act the latter provision will be referred to in the text for the sake of convenience.

treatment of the second ground of objection that is of greater significance for present purposes. Although the taxpayer's submissions had been based largely on *Tennant* v. *Smith,* his Honour approached the question by analysing section 65(2)(b). Relying on dicta in *Edwards* v. *Commissioner of Taxes,*[43] the learned judge held that "allowance" must be read ejusdem generis with "salaries" and "wages". Applying that rule, his Honour held that certain characteristics of salaries and wages had a bearing on the meaning of "allowances". These were: first, that they are in relation to an employment or service; secondly, that they are payable under a contract of service and not as a gratuity; thirdly, that they are paid in money, although it was recognised that this factor was affected by the words "(whether in cash or otherwise)"; and fourthly that they are paid periodically. Bearing these factors in mind the learned judge concluded that "allowances" refers generally to sums of money. The words "(whether in cash or otherwise)" were given effect to by the application of the principle that if a taxing provision is reasonably capable of two alternative meanings then the courts will prefer the meaning more favourable to the taxpayer. Thus, the words in parenthesis were given a narrow interpretation:[44]

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

Hutchison A.C.J. derived support for this conclusion from the fact that the legislature felt is necessary to enact what is now section 72. This section deems accommodation benefits to be assessable income. If the word "allowances" encompassed the non-monetary benefits brought to charge by section 72, then, his Honour considered, there would have been no need to enact that provision. Further support was derived from the fact that no machinery was provided in section 65(2)(b) for the valuation of non-monetary benefits which were not convertible into money. Finally, the learned judge pointed out that support for his conclusion could be found in *Tennant* v. *Smith.* At the same time, however, his Honour emphasized that cases decided on English taxing provisions were "[not] necessarily authoritative on an interpretation of our [section 65(2)(b)].[45] Moreover, it is quite clear from the analysis of section 65(2)(b) undertaken by Hutchison A.C.J. that the convertibility principle was arrived at independently of any dicta in *Tennant* v. *Smith.* Therefore, while the approach taken by the House of Lords in *Tennant* v. *Smith* and by Hutchison A.C.J. in *Stagg* v. *I.R.C.* was similar, the holding in *Stagg* was not a mere reiteration of that in *Tennant* v. *Smith.*

That the convertibility principle has been adopted in New Zealand is hardly surprising. As with the United Kingdom legislation the New Zealand Act defines income according to its source. And as with the United Kingdom the definition of income derived from labour is expressed in monetary terms. Furthermore, judicial attitudes as to the proper manner in which taxing statutes should be interpreted are

43 [1925] G.L.R. 247.
44 [1959] N.Z.L.R. 1252, 1257.
45 Idem.

largely the same — hence the reference in *Stagg* to the principle enunciated in *I.R.C.* v. *Ross & Coulter (Blackrock Distillery Co. Ltd.)*[46] that any ambiguity in a tax statute should be resolved in the taxpayer's favour.

In Australia the convertibility principle is more closely associated with the holding in *Tennant* v. *Smith* than in New Zealand. Upon an analysis of the Australian legislation, this difference is difficult to explain. Income tax is imposed by the Income Tax Assessment Act 1936. By section 25(1) of that Act, a person's assessable income includes that person's "gross income". This is complimented by section 26 which provides a list of specific items which are to be included in assessable income. Finally, "income from personal exertion" is defined in section 6(1) as meaning:

> Income consisting of earnings, salaries, wages, commissions, fees, bonuses, pensions, superannuation allowances, retiring allowances . . . the proceeds of any business carried on by the taxpayer . . . any profit arising from the sale by thet taxpayer of any property acquired by him for the purpose of profit making by sale . . .

However, the section 6(1) definition does not define income. As Jordan C.J. stated in *Scott* v. *C. of T.*:[47]

> The definition section, where it deals with income, does not define it . . . Nor does it define 'income from personal exertion'. It merely enumerates, by way of illustrations, various forms of income which are to be treated as derived from personal exertion.

Thus whether a particular item is income in nature falls to be determined according to ordinary concepts, rather than by the statutory provisions. It follows, therefore, that the convertibility principle in Australia has arisen due to the courts' perception of what constitutes income according to ordinary usage, rather than to a close analysis of the statute. This is well illustrated by *F.C.T.* v. *Cooke and Sherden*.[48] There, a soft-drink manufacturing company ran a scheme whereby free holidays were made available to certain retailers of its products. Under the terms of the scheme if the offer of the holiday was not accepted, the retailers would not be entitled to alternative compensation. The holidays were therefore not convertible into cash. However, the Commissioner assessed the taxpayers on the basis that the hoidays were income according to ordinary concepts and that therefore their value constituted assessable income by virtue of section 25(1).

The Federal Court, comprising Brennan, Deane and Toohy JJ., allowed the taxpayers' appeal. First, their Honours held that the scheme of the legislation required income to be expressed as a pecuniary amount:[49]

> An item of income which could not be reckoned as money could not find its way into taxable income so as to be subjected to tax at a rate declared by the Parliament. And s.20 requires that income wherever derived and expenses wherever incurred be expressed in terms of Australian currency. So the Act sufficiently shows that the items of income are to be reckoned as money. Consistently with this notion, the Act makes particular provision for some non-pecuniary receipts by including within assessable income the value of these receipts (see s.26(e) and s.26(ea)), and this brings a pecuniary

46 [1948] 1 All. E.R. 616.
47 (1935) 35 S.R. (N.S.W.) 215, 220.
48 (1980) 10 A.T.R. 696.
49 Ibid. 703.

> amount to tax. The notion that the items of income are money or are to be reckoned as money accords with the ordinary concepts of income as 'what comes into [the] pocket' to adapt Lord Macnaghten's phrase in *Tennant* v. *Smith* . . . that is not to say that the income must be received as money; it is sufficient if what he receives is in the form of money's worth.

The court's holding that according to ordinary concepts income must be in the form of money or money's worth has long been recognised as a correct statement of the law.[50] Applying that test it would be expected that the holidays under consideration were income as constituting money's worth even though they were not actually convertible into money. However, the Federal Court took the matter one step further and held that not only must the particular item be money's worth, but it must also be convertible into money. Their Honours said:[51]

> If a taxpayer receives a benefit which cannot be turned to pecuniary account, he has not received income as that is understood according to ordinary concepts and usages.

Furthermore:[52]

> If the receipt of an item saves a taxpayer from incurring expenditure, the saving is not income: income is what comes in, it is not what is saved from going out. A non-pecuniary receipt can be income if it can be converted into money, but if it be inconvertible, it does not become income merely because it saves expenditure.

In arriving at that conclusion, the Federal Court placed heavy reliance upon *Tennant* v. *Smith*. Although the learned members of the Court recognised that the legislation under consideration in that case differed from the Australian legislation, they considered that the dicta as to convertibility were of general application and were not limited to the terms of the legislation under consideration.

The correctness of the decision in *Cooke & Sherden* will be considered in the next section of this paper. Suffice it to say for present purposes that in Australia the convertibility principle has been adopted for reasons quite distinct from those which marked its adoption in New Zealand. Whereas in New Zealand the convertibility principle is attributable to the terms of the statute, in Australia it is due to the implementation of the *Tennant* v. *Smith* rationale.

3. *Employment v. non-employment income: is the convertibility principle universal?*

The provision of fringe benefits is traditionally associated only with the employment relationship. This is due not to the fact that for the self-employed opportunities for tax planning are so great that recourse to non-monetary benefits is not necessary, but rather to the fact that the convertibility principle applies only to income from employment. By way of example, if a company provided trips to Hawaii for partners in a law firm which had acted on its behalf then these partners would be assessable on the value of the trips provided. According to ordinary concepts of income, as opposed to those applying to employment income, a receipt is income if provided in money or money's worth. So long as payment in kind is in money's worth, it is not a prerequisite to the treatment of such payment as

50 *Scottish & Canadian General Investment Co. Ltd.* v. *Easson* 1922 S.C. 242; *Cross* v. *London & Provincial Trust* [1968] 1 All E.R. 428, 430.
51 (1980) 10 A.T.R. 696, 704.
52 Ibid. 705.

income that it be convertible into money. Although on the face of it *Tennant* v. *Smith* may appear to contradict that proposition, a close analysis of their Lordship's judgments in that case indicates that the convertibility principle was arrived at on a construction of Schedule E of the 1842 Act rather than on an analysis of general concepts of income. Thus, in discussing Schedule E, the first rule of which brought into charge certain items, including "perquisites" which were "payable", and the fourth rule of which defined "perquisites" as meaning "profits" of employment arising from fees or other "emoluments", Lord Halsbury L.C. said:[53]

> . . . none of the words, either 'perquisites,' 'profits,' or 'emoluments,' are properly applicable, inasmuch as by the rule in which these words are used or explained, the word 'payable' as applied to them renders it quite impossible to suppose that the mere occupation of a house is reconcilable with the just application of that word.

His Lordship then went on to say that things of money value capable of being turned into money could fall within Schedule E. However, quite clearly his Lordship's conclusion was based upon the fact that non-convertible benefits could not be "payable". Lord Watson's judgment was in similar terms, although his Lordship thought that the convertibility principle extended to Schedule D.[54]

Lord Hannen also arrived at the convertibility principle on similar grounds to Lord Halsbury L.C., His Lordship said:[55]

> . . . I am of opinion that the occupation of this house does not fall within the description of '. salaries, fees, wages, perquisites, profits or emoluments' in the sense in which these words are used in the Act.

In *Cooke and Sherden,* however, the *Tennant* v. *Smith* rationale was given wider application. Their Honours held:[56]

> Although *Tennant* v. *Smith* . . . was concerned with the operation of legislation different in structure from the Income Tax Assessment Act, some parts of their Lordships' speeches applied ordinary conceptions to the construction of the terms of the Act there under consideration. Thus Lord Halsbury said (at 157):—
>
> 'I came to the conclusion that the Act refers to money payments made to the person who receives them, though, of course, I do not deny that if substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable.'
>
> . . . And Lord Watson (at 165) held that:—
>
> 'profits in its ordinary acceptation, appears to me to denote something acquired which the acquirer becomes possessed of and can dispose of to his advantage — in other words money — or that which can be turned to pecuniary account.'

With respect, the dicta from *Tennant* v. *Smith* cited in *Cook and Sherden* are not illustrations of "ordinary conceptions" being applied to the Act as their Honours suggest. Rather, they are merely illustrative of the conclusions reached in the House of Lords upon a close construction of Schedule E. The comments of Lord Halsbury which are quoted were made after his Lordship had analysed the language of Schedule E and concluded that the mere occupation of a house was not reconcilable with the use of the word "payable" in that Schedule. And the quotation from Lord

53 [1892] A.C. 150, 155.
54 Reproduced in relevant parts supra n.26.
55 [1892] A.C. 150, 165.
56 (1980) 10 A.T.R. 696, 703-704.

Watson's judgment has been extracted from his Lordship's discussion of the word "profits" as used in Schedule E. In the context of that quotation Lord Watson was not discussing ordinary concepts of income. Therefore, it follows that the quotations from *Tennant* v. *Smith* are not authority for the propositions for which they were cited in *Cook and Sherden.*

The approach adopted by the Federal Court in *Cooke and Sherden* was also adopted by McMullin J. in *Dawson* v. *C.I.R.*[57] There the taxpayer subscribed to debenture stock in a television rental company under a debentureholders colour television plan. Under that plan subscribers would receive the use of a television free of charge for five years in lieu of interest. The Commissioner assessed the taxpayer under section 65(2)(1) on the basis that he had received "income from any other source whatsoever". Relying on *Cross* v. *London and Provincial Trust Ltd.*,[58] where it was held that income includes money or money's worth, the Commissioner argued that the use of the television rent free represented money's worth upon which an assessment could properly be made. McMullin J. rejected that argument, preferring instead the taxpayer's submission that as the use of the television was not convertible into cash the benefit thereby derived was not income. In reaching that conclusion the learned Judge placed reliance upon both *Tennant* v. *Smith* and *Stagg* v. *I.R.C.* However, as has already been indicated in the discussion of *Cooke and Sherden,* the holding in *Tennant* v. *Smith* was based on a construction of Schedule E of the 1842 Act which brought to charge certain receipts associated with employment. With respect, McMullin J. was incorrect in extracting from *Tennant* v. *Smith* the proposition that the convertibility principle is of general application. The better view is that *Tennant* v. *Smith* is only authority for the proposition that non-monetary benefits which are not convertible into cash are not perquisites under Schedule E of the United Kingdom Act. McMullin J.'s reliance upon *Stagg* is also open to criticism. As indicated in the discussion of that case in the preceding section of this paper, *Stagg* was decided upon a close construction of section 65(2)(b). It is quite clear from that case that in holding that "allowances" included only monetary allowances, or those convertible into money, Hutchison A.C.J. was not enunciating a principle of general application to all forms of income.

That convertibility is not a prerequisite to all forms of income is evident from the decision of the House of Lords in *Lady Miller* v. *Commissioners of Inland Revenue.*[59] There, the House of Lords was concerned with whether the occupation of a mansion constituted income under Schedule A of the United Kingdom Act. That Schedule brought to charge "the property in all lands, tenements, hereditaments, and heritages in the United Kingdom, for every 20 shillings of the annual value thereof." By rule 1 of the rules under the Schedule it was provided that "tax under this Schedule shall be charged on and paid by the occupier for the time being". If the right to occupy was income, then by sections 4 and 5 of the Income Tax Act 1918 the value of that right was included within the taxpayer's income for super tax purposes.

57 (1978) 3 N.Z.T.C. 61,252.
58 [1938] 1 All E.R. 428.
59 (1930) 15 T.C. 25.

In the Scottish Court of Session it was held, relying on *Tennant* v. *Smith,* that the right to occupy was not income as it was not convertible into cash.[60] In the House of Lords, however, *Tennant* v. *Smith* was distinguished and the right of occupation was held to be income by virtue of the Schedule A charge. Lord Buckmaster said:[61]

> It is impossible to examine the judgments [in *Tennant* v. *Smith*] closely without realising that they were based upon the fact that, whatever advantage the agent might have enjoyed from his residence, it could not possibly be made the subject of assessment under Schedules D and E . . . To my mind . . . this case in no way governs the present.

Therefore, his Lordship expressly limited *Tennant* v. *Smith* to Schedules D and E. Viscount Dunedin and Lord Warrington reached the same conclusion, the former commenting that "[t]he Bank case . . . has, I think, been only misunderstood."[62] Lord Warrington held that *Tennant* v. *Smith* "is no authority in support of the Respondent's case,"[63] and overruled the Court of Session's decision as follows:[64]

> The majority of the Judges in the Court of Session appear to have based their conclusion on the view that unless the annual value is capable of conversion into money either by letting or otherwise, it cannot be treated as income of the occupier, and further that, in the present case, on the construction of the settlement, it was not capable of such conversion. Thinking as I do that there is no ground in law for their general proposition, I do not think it necessary to decide the point on the construction of the particular settlement . .

It could perhaps be argued that *Lady Miller's* case applies only to Schedule A of the United Kingdom Income Tax Act. Prior to 1963 that schedule included within the charge to tax the right to occupy property.[65] In many cases that right would not be convertible into cash. Therefore, it is not surprising that the House of Lords held that the right of occupation was assessable under Schedule A irrespective of convertibility. But that holding, it could be argued, is limited to Schedule A, which rendered liable to tax not some form of receipt, as with the other schedules, but the right to use an asset. Thus, because of the nature of the charge under that schedule, Schedule A was a special case which in no way affected the convertibility requirement in relation to other forms of income. However, in *London County Council* v. *Attorney-General*[66] the House of Lords made it clear that the schedules merely provided separate methods of assessing various classes of income and that what was brought to charge under each schedule was income in the ordinary sense of that word. Lord Macnaghten said:[67]

> Income tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else. It is one tax, not a collection of taxes essentially distinct. There is no difference in kind between the duties of income tax assessed under Schedule D and those assessed under Schedule A or any of the other schedules of charge. One

60 Reported along with the decision of the House of Lords at (1930) 15 T.C. 25.
61 (1930) 15 T.C. 25,79.
62 Ibid. 83.
63 Ibid. 85.
64 Ibid. 84-85.
65 In 1963 the charge on the beneficial occupation of land was abolished due to widespread criticism from home owners: *Simon's Taxes* (London, Butterworths, 1983) vol.A, para. A4.101.
66 [1901] A.C. 26.
67 Ibid. 35-36.

> man has fixed property, another lives by his wits; each contributes to the tax if above the prescribed limit. The standard of assessment varies according to the nature of the source from which taxable income is derived. *That is all . . . In every case the tax is a tax on income, whatever may be the standard by which the income is measured.* It is a tax on 'profits or gains' in the case of duties chargeable under Schedule A and everything coming under that Schedule . . . just as much as it is in the case of the other schedules of charge (emphasis added).

Therefore the right to occupy property was income in the ordinary sense of that word. Schedule A did not operate as a deeming provision to include within the meaning of income something which otherwise would not be so classified. It follows that income in its ordinary sense is capable of encompassing items which are not convertible into cash and that the convertibility principle enunciated in *Tennant* v. *Smith* may be restricted to the particular provisions under consideration in that case.

The convertibility principle is therefore of limited application. In the United Kingdom it applies to Schedule E and there was some indication from Lord Watson's judgment in *Tennant* v. *Smith* that it may apply to Schedule D.[68] In New Zealand *Stagg* has established that section 65(2)(b) encompasses only "allowances" which are convertible into cash. It is doubtful that the convertibility principle could be extended any further. It could be argued that as it was indicated in *Tennant* v. *Smith* that the convertibility principle applied to Schedule D, which brought to charge "profits or gains arising . . . from any profession, trade or vocation", it also applies to section 65(2)(a) of the Income Tax Act 1976, which includes within assessable income "all profits or gains derived from any business". However, Lord Watson's holding in *Tennant* v. *Smith* that the expression "profits or gains" in Schedule D was not wide enough to encompass "a servant's residence in his master's house, or a meal or a suit of livery supplied by the master"[69] was made by way of obiter dictum. The House of Lords in that case was concerned only with the question of whether the occupation of premises fell within the Schedule E charge. Moreover, Lord MacNagtan's dictum in *London City Council* v. *Attorney-General* that Schedule A applied to "profits or gains"[70] and the conclusion reached in *Lady Miller's* case that Schedule A applies to the right to occupy land whether or not that right is convertible into cash, together indicate that the expression "profits or gains" is wide enough to include items which are not convertible into cash. It may therefore be concluded that the convertibility principle applies only to income from employment. Contrary to the decisions in *Dawson* and *Cooke and Sherden,* the better view is taht the principle does not extend to other forms of income.

D. The United States

1. *Background*

In the United States the taxation of fringe benefits is not restricted by any requirement of convertibility. As in the other jurisdictions surveyed, income is

68 [1892] A.C. 150,161.
69 Idem.
70 Supra n.67 and accompanying text.

defined in section 61(a) of the Internal Revenue Code 1954 on a source basis.[71] However, the courts in the United States have construed the word "income" in a much wider sense than in those other jurisdictions. That wider concept of income is not sufficiently broad as to cover unrealised capital gains. However, it is broad enough to bring fringe benefits within the charge to tax.

The wider concept of income adopted in the United States is due partly to historical and constitutional factors and partly to judicial attitudes to the interpretation of statutes. Both of these factors are considered in this section of the paper.

2. *Historical and constitutional background*

By Article 1, section 8, clause 1 of the United States Constitution, Congress has the power:

> To lay and collect taxes, duties, imposts and exises, to pay the debts and provide for the common defence and general welfare of the United States, but all duties, imposts and excises shall be uniform throughout the United States . . .

Until the Civil War that power was exercised by the levying of customs duties. However those receipts proved insufficient to enable the North to finance its war effort and in 1864 an income tax was enacted. The constitutionally of that Act was upheld in *Springer* v. *U.S.*[72] However, a similar income tax Act of 1894 was struck down by the Supreme Court as being unconstitutional in *Pollock* v. *Farmer's Loan Trust.*[73] As a consequence of that decision the Sixteenth Amendment to the Constitution was promoted. The Amendment provided that "The Congress shall have power to pay and collect taxes on incomes from whatever source derived . . ."

The Sixteenth Amendment had been ratified by February 1913 and was followed soon after by enactment of the Revenue Act 1913. By Part A of that Act a tax was imposed on "the entire net income arising or accruing from all sources" of citizens of the United States. By Part B net income was defined as including:

> gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property . . .

It will be seen that as in the other jurisdictions surveyed "income" itself was not actually defined but was described as being something arising from various sources.

3. *Income tax and the courts*

The ambit of the income tax first fell to be considered by the Supreme Court in *Eisner* v. *Macomber.*[74] There, Mr. Justice Pitney, delivering the majority judgment, adopted the definition enunciated in two cases under the Corporation Tax Act 1908 that "income may be defined as the gain derived from capital, from labour, or from both combined."[75] Therefore, as in other countries, income was seen

71 By section 61(a) of the Code "gross income" is defined as including "income from whatever source."

72 102 U.S. 586 (1880).

73 157 U.S. 429 (1895).

74 252 U.S. 189 (1920).

75 *Stratton's Independence* v. *Howbert* 231 U.S. 399, 415 (1913); *Doyle* v. *Mitchell Bros. Co.* 247 U.S. 179, 185 (1918).

essentially as being the yield of a productive source. The distinction between income and capital was metaphorically described as follows:[76]

> The fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a resevoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time.

However, Mr. Justice Pitney's dictum as to the nature of income has been emasculated by subsequent Supreme Court decisions. In *C.I.R.* v. *Smith*[77] the taxpayer was given by way of compensation for his services an option to purchase shares at their market value when the option was granted. The taxpayer exercised the option in two later years when the market value of the shares was greater than the option price. In the Supreme Court it was held that the taxpayer received taxable income upon the exercise of the option in the amount of the difference between the option price and the then market value of the shares. Chief Justice Stone, delivering the majority judgment, considered that section 22(a) of the 1938 Act[78] "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected."[79] This approach is wider than that taken in *Eisner* v. *Macomber* and clearly brings benefits within the tax net.

The Supreme Court reiterated the broad approach to the definition of income in *C.I.R.* v. *Glenshaw Glass Co.*[80] There, the court was concerned with the assessability of punitive damages received in settlement of an antitrust and fraud action. Although the case was not concerned with a fringe benefit, the following dictum of Chief Justice Warren is of general application:[81]

> This Court has frequently stated that this language [ie section 22(a)] was used by Congress to exert in this field the 'full measure of its taxing power . . .' Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature . . . And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted.

76 252 U.S. 189,206 (1920). The definition of income enunciated in *Eisner* v. *Macomber* has been approved in the United Kingdom in *I.R.C.* v. *Blott* [1921] 2 A.C. 171.

77 324 U.S. 177 (1945).

78 Section 22(a) of the Inland Revenue Code 1938 provided:

> 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever form paid, or from professions, vocations, trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property . . . or gains or profits and income derived from any source whatever.

In the Inland Revenue Code 1904 section 61(a), which replaces section 22(a), provides:

> 'Gross income' includes all income from whatever source derived.

79 324 U.S. 177,181 (1945).

80 348 U.S. 426 (1955).

81 Ibid. 429-430.

Eisner v. *Macomber* was distinguished by the court as applying only to cases where it is necessary to distinguish income from capital. Mr. Justice Warren commented that the test in *Eisner* v. *Macomber* "was not meant to provide a touchstone to all future gross income questions."[82]

In *Glenshaw Glass* the Court held that although the definition of "gross income" contained in the 1954 Code differed considerably from that in the 1938 Code, the wide concept of income formulated in *Smith,* based as it was on section 22(a) of the 1938 Code, applied with equal force to section 61(a) of the 1954 Code. That concept is clearly wide enough to encompass fringe benefits, as *Smith* itself illustrates. Further illustration is provided by *Rudolph* v. *U.S.*[83] There, the Commissioner assessed an insurance agent on the value of an employer-paid trip for the taxpayer and his wife to New York. The trip, ostensibly for a business convention, took one week in total and of the two and a half days spent in New York only one morning was devoted to busineess. The Supreme Court, applying the test laid down in *Smith* that section 61(a) included as income any economic or financial benefit conferred on an employee as compensation, upheld the Commissioner's assessment. As the trip was predominantly for recreational purposes it was considered that its value represented a financial benefit to the taxpayer.

Thus, the distinction enunciated in *Tennant* v. *Smith* between that which comes into the pocket and that which saves the pocket from expenditure is not recognised in the tax jurisprudence of the United States. Accordingly, whether or not a benefit in kind is convertible into cash is irrelevant. The overriding test is whether the benefit confers on the taxpayer an economic or financial gain of some form. At the same time, the courts do not go so far as to approve the concept of income as understood by economists. As was stated by Mr. Justice Holmes in *Weiss* v. *Wiener*:[84] "The income tax laws do not profess to embody perfect economic theory."[85] If income tax laws do not embody economic theory, then it is not surprising that judicial pronouncements on the meaning of income also fail to embody such theory.

4. *The United States and the Commonwealth jurisdictions compared*

The wider concept of income in the United States, and hence the assessability of fringe benefits according to ordinary concepts of income rather than by specific statutory provision, is attributable both to the statutory definition of income and to the manner in which that definition has been interpreted in the courts. Although as in the Commonwealth countries surveyed in this paper income is defined in the United States on a source basis, the statutory definition in the United States is couched in more general terms. Thus, the courts have been willing to hold that income includes all forms of economic or financial benefit. In the United Kingdom, on the other hand, income is more specifically defined. As a result the cases turn more on a close analysis of the statutory language than on general principles. The same is true of the New Zealand legislation.

82 Ibid. 430.
83 370 U.S. 269 (1962).
84 279 U.S. 333 (1979).
85 Ibid. 335.

More important, however, is the different judicial attitudes to the interpretation of statutes. In the Commonwealth countries taxing statutes in particular are narrowly construed, the classic statement being made in *Tennant* v. *Smith* that "in a taxing Act it is impossible . . . to assume any intention" so the court must determine "whether a tax is expressly imposed."[86] In the United States, on the other hand, the approach is markedly different.

There, the courts are prepared to ascertain the intention of Congress by reference to the reports of debates in the House of Representatives and to apply that intention to the statutory provision under consideration.[87] This is well illustrated in *Glenshaw Glass* where by reference to reports of the proceedings in Congress, the court held that the broader wording of the definition of gross income in the 1954 Code as contrasted with the 1938 Code did not alter the meaning of the definition.[88] Similarly, in *Pollock* the meaning of "direct" tax in Article 1 of the Constitution was determined in large part by reference to the debates preceding the ratification of the Constitution in 1789. Thus, the stricture in *Tennant* v. *Smith* against assuming any intention in a taxing Act has no counterpart in the United States. Rather, the courts there adopt a purposive approach. In *Smith* and *Glenshaw Glass,* for example, section 22(a) of the 1938 Code was interpreted on the basis that Congress in enacting that provision intended to exert "the full measure of its taxing power."[89]

It is also noteworthy that in the United States the courts are more willing to distinguish earlier decisions and limit their application to specific factual situations. Thus, in *Glenshaw Glass* the test enunciated in *Eisner* v. *Macomber* as to the nature of income was limited largely to the factual situation then before the court although a reading of the case indicates that the test was intended to be of general application. In the Commonwealth jurisdictions, however, the courts are more reluctant to adopt this approach. Thus, the test as to convertibility laid down in *Tennant* v. *Smith* remains in force even though it was recognised by Lord Diplock in *Heaton* v. *Bell* to be no longer in keeping with ordinary concepts of income.

86 [1892] A.C. 150, 154. This approach was recently reiterated in New Zealand in *Lowe* v. *C.I.R.* [1891] 1 N.Z.L.R. 326, 342 where Richardson J. approved of Rowlatt J.'s statement in *The Cape Brandy Syndicate* v. *Commissioners of Inland Revenue* [1921] 1 K.B. 64, 71 that:

> . . . in taxation you have to look simply at what is clearly said. There is no room for any intendment; there is no equity about a tax: there is no presumption as to a tax, you read nothing in, you imply nothing, but you look fairly at what is said and at what is said clearly and that is the tax.

87 The broad approach preferred by the courts in the United States is illustrated in the following comments of Mr. Justics Holmes in *Johnson* v. *U.S.* 163 F. 30,32 (1908):

> The legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognised and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an adequate discharge of duty for the courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before.

88 348 U.S. 426, 432 (1955)

89 Ibid. 429.

IV. LEGISLATING FOR FRINGE BENEFITS

A. *Background*

It has been seen that in the United Kingdom, Australia and New Zealand the concept of income is not wide enough to encompass fringe benefits. Consequently those jurisdictions have enacted legislation aimed specifically at bringing such benefits within the change to tax.

In this part of the paper the problems associated with legislating for the taxation of fringe benefits will be considered. The general scheme of such legislation will be outlined, and parts of the New Zealand legislation — which falls within that scheme but is largely ineffectual against fringe benefits — will be discussed.

B. *Problems Associated with Taxing Fringe Benefits*

1. *Identification*

In seeking to tax fringe benefits the benefits upon which tax is to be levied must first be identified. In some cases it may be difficult to distinguish between conditions of work and fringe benefits. That difficulty could be resolved by listing certain items which, if provided by the taxpayer's employer, are to be treated as fringe benefits in all cases and taxed accordingly. However, that approach would be intrinsically unfair as the following extract from King and Kaye's book on the British tax system indicates:[90]

> It is difficult to determine any sensible borderline between conditions of work and benefits. The employer who provides a congenial washroom for his employees is presumably simply offering a reasonable working environment, while the one who installs a coloured suite in the bathroom of their homes is providing a fringe benefit; but there is a spectrum of benefits in between . . .

Thus, a blanket taxation of all employer-provided washrooms would prove unfair to those for whom the facility was provided in order to make their working environment more pleasant. The same applies with the more common forms of fringe benefit. Blanket taxation of all employer-provided cars, for example, would prove unfair to those for whom the car was a condition of employment. Travelling salesmen and employee taxi drivers would suffer under any such tax. Clearly, then, if particular benefits are to be singled out for tax treatment rules need to be formulated to ensure that only benefits conferring some form of financial benefit attract the operation of the taxing provisions.

Assuming that particular benefits are to be singled out for tax purposes, questions arise as to which benefits should be chosen. Should employer-subsidised meals and creches be taxed? Should free newspaper and car parking facilities be taxed? Or would the time spent on administering a tax imposed on such items make the tax uneconomic?

In practice the problem of identification is dealt with by taxing certain specific benefits and then providing a general sweeping up clause which catches all

90 King and Kaye *The British Tax System* (Oxford University Press, 1979) p.41.

"other benefits of any kind whatever"[91] or "other benefits and facilities of whatsoever nature."[92] The specific benefits are generally those likely to generate the most revenue: motor cars, accommodation, low interest loans and share options being common examples. The effect of the general sweeping up provision is to confer on the revenue authorities of the country concerned a discretion as to which benefits should be selected for tax treatment. Thus, although free newspapers may fall within the statutory language the revenue authority may, for the purposes of administrative efficacy, treat them as being non-taxable. At the same time, however, more valuable benefits, such as overseas trips and the payment of school fees, which also fall within the terms of the sweeping-up clause, may be treated as taxable.

2. *Valuation*

The major difficulty in taxing fringe benefits lies in valuing them for tax purposes. In many cases fringe benefits perform a dual function. Thus, low interest loans to bank employees serve not only to provide the employee with a benefit but also to provide the bank with long-term employees. Similarly, benefits may be provided with strings attached, so that an executive provided with free accommodation, for example, may be required to use that accommodation to entertain company clients. In other situations, the benefit provided may entail a restriction of choice so an employee provided with a Ford motor car if left to his own choice may have preferred a Toyota. In other cases, the benefit provided may be more extravagant than the employee would himself have provided. Thus, a host of subjective factors affect the value of the benefit to the taxpayer. Whether these subjective factors should be taken into account in valuing the fringe benefit, and if so to what extent, are problems which confront any legislature seeking to tax fringe benefits.

As an alternative to value to the employee, fringe benefits could be taxed according to their cost to the employer. Therefore, if a car cost the taxpayer's employer $20,000 the value of the taxable benefit to the employee could be expressed as a percentage of that cost. The major objection to that approach is that it may operate arbitrarily. Suppose, for example, that two employees, Smith and Jones, are provided with a car by their respective employers. Smith, an executive with a large publicly listed company, has unrestricted use of the car provided by the company. On the other hand Jones, a public servant, is unable to use the car provided for his use for private purposes during weekends. Clearly, in that situation, any calculation of the taxable value of the benefit solely by reference to the cost to the employer would work unfairly in Smith's favour to the detriment of Jones.

Where benefits are provided at little or no cost to the employer it will be impractical or impossible to adopt cost to the employer as the basis of valuation. Thus, it would not be practical to value the benefit conferred on airline employees allowed to fill vacant seats on flights run by the airline on the basis of the cost

91 Section 6(1)(a), Income Tax Act 1970 (Can.).
92 Section 61(1), Finance Act 1976 (U.K.).

to the employer providing that benefit. Similarly, where a newspaper company provides free newspapers for its employees, or where a retailer gives produce to his employees which otherwise would deteriorate, the value of the benefit conferred could not be measured by reference to the cost to the employer of providing the benefit.

As a third option, the market value could provide the basis of valuation. Thus, rent free accommodation could be valued according to the prevailing market rentals in the area in which the accommodation is situated. As with cost to the employer, market value could be unfair to the taxpayer in some circumstances. A New Zealand diplomat stationed in Tokyo or Washington, for example, could be faced with a large tax bill if asseessed on the market value of his accommodation.

In practice fringe benefits are valued according to all three methods. Thus, in Australia, for example, in relation to rent free or low rental accommodation, sections 26AAAA and 26AAAB of the Income Tax Assessment Act 1936 contain detailed provisions calculated to ensure that the taxpayer is taxed upon the value to him of the accommodation benefit rather than upon some objective basis. On the other hand, in the United Kingdom the value of fringe benefits is determined by a mixture of cost to the employer, market value and value to the taxpayer.

C. *Anti-Avoidance Legislation*

1. *The general scheme of anti-avoidance legislation*

In jurisdictions where legislation has been enacted to bring fringe benefits within the charge to tax such legislation generally takes the form of a number of provisions aimed at specific benefits, such as motor cars, low interest loans and accommodation, and a general provision which seeks to render taxable all other benefits of whatever nature.

In Australia, for example, section 26(e) of the Income Tax Assessment Act 1936 includes within assessable income:

> [T]he value to the taxpayer of all allowances, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him, whether so allowed, given or granted in money, goods, land, meals, sustenance, the use of premises or quarters or otherwise.

Section 26(e) is complemented by section 26AAC which provides a basis for the valuation of benefits provided by way of share purchase or share option schemes, and by sections 26AAAA and 26AAAB which make provision for the valuation of employee housing.

Similarly, in the United Kingdom legislation has been enacted to render taxable fringe benefits provided by way of accommodation, vouchers and credit tokens, share purchases and options, cars and car fuel, low interest loans and any "other benefits of whatsoever nature."

In New Zealand several provisions of the Income Tax Act 1976 fit within the scheme of fringe benefit anti-avoidance legislation. Section 65(2)(b) is a general provision which includes within assessable income all "allowances (whether in cash

or otherwise)". Specific provision is then made in section 69 for benefits conferred under share option or share purchase schemes and under section 72 for benefits provided by way of board, lodging or house allowances.

Prima facie section 65(2)(b) is wide enough to encompass any form of non-monetary benefit. However, its effect in relation to such benefits has been rendered nugatory by the courts. And although section 72 is wide enough to encompass accommodation benefits administrative practice has meant that many employees do not pay tax on such benefits.

2. *Section 65(2)(b)*

Section 65(2)(b) of the New Zealand Act includes within assessable income:

> All salaries, wages or allowances (whether in cash or otherwise), including all sums received or receivable by way of bonus, gratuity, extra salary or emolument of any kind, in respect or in relation to the employment or service of the taxpayer:

The meaning of the word "allowances" in that provision was considered by the Court of Appeal in *C.I.R.* v. *Parson*.[93] There, the court was concerned with the assessability of amounts derived on the exercise of an option to purchase shares. In the relevant income year the taxpayer had exercised an option to purchase 1500 shares in his employer company, Woolworths Ltd. At the time the option was exercised the market value of 1500 shares was £1008, however the taxpayer paid only £600. The difference of £408 was considered by the Commissioner to be an "allowance" within the terms of section 65(2)(b)[94] and an assessment was issued on that basis.

In the Court of Appeal the majority, comprising North P. and McCarthy J., rejected the Commissioner's argument that the sum in question was an "allowance". Based on an historical analysis of section 65(2)(b) their Honours formulated a very limited test as to what constitutes an "allowance". North P. outlined the history of the provision and considered the effect of that history as follows:[95]

> I have examined the history of the legislation since the enactment of the Land and Income Tax Act 1891. In that year the words 'including all sums received or receivable by way of bonus . . .' did not appear. They first appeared in the Land and Income Tax Assessment Act 1900 and have been carried forward in each succeeding Act with slight amendments in language. Section [65(2)(b)], in its present form, first appeared in the Land and Income Tax Act 1916 (s.85). If [s.65(2)(b)] had stopped at the words 'all salaries, wages or allowances (whether in cash or otherwise), . . . in respect of or in relation to the employment or service of the taxpayer', it may possibly have been arguable that the word 'allowances' was wide enough to include all benefits whether in cash or otherwise . . .

However, as Parliament had added the words "including all sums received or receivable by way of bonus, gratuity, extra salary, or emolument of any kind" North P. considered that "allowances" must be construed narrowly. Applying the

93 [1968] N.Z.L.R. 574.

94 In *Parson* the relevant provision was s.88(1(b) of the Land and Income Tax Act 1954. However, as that provision is identical to s.65(2)(b) of the present Act reference is made to s.65(2)(b) in the present context.

95 [1968] N.Z.L.R. 574, 585.

principle enunciated in *Dilworth* v. *Commissioner of Stamps*[96] that the word "include" is generally used in interpretation clauses to enlarge the meaning of words or phrases, the learned President concluded that by adding the words after "including" "[Parliament] has recognised that the first mentioned words [i.e. salaries, wages or allowances] in their natural import did not include any of these benefits".[97] Accordingly, as Parliament had recognised that the expression "salaries, wages or allowances" had a limited meaning, North P. was not prepared to give it a wide construction so as to include within its ambit a benefit derived on the exercise of a share option.

Although it is clear from North P.'s judgment that the word "allowances" must be narrowly construed, it is not clear what forms of non-monetary benefit, if any, his Honour considered that the word encompassed. Some assistance in that regard may be garnered from McCarthy J.'s judgment. As with North P., McCarthy J. based his judgment on an historical analysis.[98]

> In my view the word 'allowances' in its original context in Schedule E to the 1891 Act had a narrow meaning and was intended to apply only to the then commonly recognised forms of allowances, such as a house allowance, and that it was because Parliament recognised the limitations of the word that it found it necessary in 1900 to add 'including all sums received or receivable by way of bonus, extra salary or emolument of any kind'. That was a plain example of extending a meaning. No one, I imagine, would have contended in 1900 that the word had been enlarged sufficiently to include all benefits even those not received in the form of money . . . Basically, the language has not changed since 1900, and I feel unable in these circumstances now to construe it as covering something which though it probably is an emolument, is not received in a sum of money.

It follows logically from McCarthy J.'s reasoning that the only non-monetary allowances caught by section 65(2)(b) are those which were regarded as being allowances in 1900 when the words succeeding "including" were introduced into the section. This conclusion follows from His Honour's comments that prior to the enactment of the 1900 Act "allowances" applied only to the then recognised forms of allowances; that the limited meaning of "allowances" was recognised by Parliament in 1900 when its meaning was extended to include "sums received or receivable by way of bonus, extra salary, or emolument of any kind"; and that as the language of the section had not significantly changed since 1900 it could not now be construed in a wider sense. Thus "allowances" means things which were regarded as being allowances in 1900 and "sums received or receivable by way of bonus, extra salary or emolument of any kind." If this conclusion is correct then section 65(2)(b) must be regarded as being ineffective as against fringe benefits. It has been suggested that the only non-cash allowances being provided in 1900 were housing and accommodation, board and meals, and travel and work clothing.[99]

By contrast, Haslam J., in a dissenting judgment, concentrated on an analysis of the statutory language of section 65(2)(b) rather than on its historical back-

96 [1899] A.C. 99, P.C.
97 [1968] N.Z.L.R. 574, 587.
98 Ibid. 589.
99 Richardson and Congreve, supra n.4, p.19.

ground. The learned judge considered that in the context of the phrase "salaries, wages or allowances (whether in cash or otherwise)" the word "allowance" was wide enough "to embrace a rent free house for an employee, or by way only of further example, a special discount on the firm's goods given to staff members by virtue of their employment,[100] and that it was "inherently capable of a general application."[101] As for the effect of the words "including all sums received or receivable by way of bonus, gratuity, extra salary, or emolument of any kind" his Honour held that as the word "allowances" in its natural import already covered such payments their express mention could not be read so as to limit the meaning of "allowances." Rather, such payments were given separate expression "solely for the purposes of clarity and of emphasis".[102] Support for this conclusion may be derived from *Wakefield Local Board of Health* v. *West Riding and Grimsby Railway Co.*[103] where it was held that statutory definitions not adding anything to the ordinary meaning of a particular word should be treated as having been inserted in an abundance of caution, and should not be taken as limiting the meaning of the word defined. If Haslam J. is correct, and "allowances" does in its usual sense include the sums referred to expressly in section 65(2)(b), then based on the *Wakefield Local Board of Health* case the expressly mentioned words could in no way limit the meaning of "allowances". Therefore, "allowances" should be interpreted solely in the context of "salaries, wages or allowances (whether in cash or otherwise)" rather than in the more limited context suggested by North P. and McCarthy J. Read in that context "allowances" is wide enough to include non-cash allowances of any type.

With respect, it is submitted that Haslam J. is correct. The sums mentioned in the second part of section 65(2)(b) add nothing to the ordinary meaning of "allowances". Therefore, reading "allowances" in the context of "salaries, wages or allowances (whether in cash or otherwise)" it is clearly wide enough to cover non-monetary allowances or benefits. It must be conceded that the learned Judge gave little weight to the legislative history of section 65(2)(b), in particular to the alterations made in 1900. However, an analysis of that history shows that his Honour was correct in taking that approach. Schedule E of the Land and Income Assessment Act 1891 provided that every person was liable to tax in respect of income rerived from employment or emolument. "Income from employment or emolument" was defined as meaning:

> the gains or profits derived or received . . . from the exercise of any profession, employment or vocation of any kind not otherwise liable to taxation under this Act, or *from any salary, wages, allowances, pension, stipend or charge or annuity of any kind* . . . (emphasis added)

Schedule F contained a number of miscellaneous rules relating to assessments. Rule 5 provided:

> Allowances made to any person by way of house-rent, and all *amounts received or receivable by way of extra salary, bonus allowance, or emolument* shall be taken into account as part of the annual income liable to taxation (emphasis added).

100 [1968] N.Z.L.R. 574, 592.
101 Idem.
102 Ibid. 593.
103 (1865) L.R. 1 Q.B. 84.

It will be seen from the italicised parts of Schedule E and rule 5 of Schedule F that those provisions contained the basic ingredients of section 65(2)(b) as it stands today. In 1900 the 1891 Act was repealed and replaced by the Land and Income Assessment Act 1900. The major feature of the new Act was the replacement of the schedular system and the incorporation of the charging provisions previously contained in schedules into sections contained in the body of the Act. Section 58 of the 1900 Act provided, inter alia, that tax was to be levied on "income derived from employment or emolument". That expression was defined in section 60(2) as meaning the profits derived from:

> . . . any salary, wages, allowances, stipend or pension (other than a pension hereinbefore exempt from tax) including all sums received or receivable by way of bonus, extra salary, or emolument of any kind.

It is apparent from the language of section 60(2) that that provision represents a consolidation of the italicised parts of Schedule E and rule 5 of Schedule F; a consolidation that was rendered necessary by the abolition of the schedular system contained in the 1891 Act. The sums described in the second part of the paragraph were therefore included not, as North P. suggested, because Parliament recognised that "salaries, wages or allowances" did not include those sums,[104] but rather in an excess of caution or, as Haslam J. suggests, "for the purpose of clarity and of emphasis."[105] Leaving aside Parliamentary intent, the most plausible explanation is that the draftsman of the 1900 Act was concerned to ensure that the Act he was drafting did not exclude from the charge to tax anything that was taxed under the 1891 Act. To effect that objective, the draftsman simply combined, virtually verbatim, the parts of Schedule E and rule 5 of Schedule F relating to income from employment.

The history of section 65(2)(b) therefore supports the approach adopted by Haslam J. rather than that adopted by the majority. Support for his Honour's approach may also be derived from the fact that by analysing only the language of section 65(2)(b) effect could be given to the words "(whether in cash or otherwise)" which were inserted in 1916. The approach adopted by the majority, on the other hand, virtually rendered those words meaningless.

For practical purposes, it is of little significance that North P. and McCarthy J. may have incorrectly construed section 65(2)(b). As Haslam J. was in the minority his judgment is of academic interest only.

It follows from *Parson* that if a particular fringe benefit is not an "allowance" within the limited meaning given to that term it is immaterial whether or not that benefit is convertible into cash. Therefore, the correct approach in determining whether a fringe benefit is deemed to be assessable income by section 65(2)(b) is first, to ascertain whether it is an "allowance" within the terms of the *Parson* rationale, and secondly, having ascertained that it is an "allowance" to determine whether or not it is convertible into cash. That approach was approved by Wallace J. in *Sixton* v. *C.I.R.*[106] There, the question falling for determination was

104 Supra n.97.
105 Supra n.102.
106 (1982) 5 T.R.N.Z. 844.

whether a prize received by an employee under an incentive scheme in the form of a non-transferable points cheque, and which was subsequently converted into a supertub, was an allowance within the terms of section 65(2)(b). The Commissioner sought to distinguish *Parson* on its facts, arguing that in that case the benefit was unrelated to the services being performed while in the case of the prize granted to Sixton the benefit was so related and accordingly must be regarded as an allowance. However, Wallace J. rejected that argument. His Honour held that *Parson* was indistinguishable: first, on the grounds that the facts in *Parson* and *Sixton* were similar as both related to benefits provided as part of an incentive scheme; and secondly on the grounds that in *Parson* the Court of Appeal regarded the question before them as one of principle turning upon a correct construction of section 65(2)(b). And as *Parson* had been decided on the basis of principle, and not merely on the facts of the particular case, Wallace J. felt constrained to apply the reasoning adopted by North P. and McCarthy J. From North P.'s judgment Wallace J. derived the proposition that "a non-monetary perquisite or emolument is not included in the word 'allowances' ",[107] and from McCarthy J.'s judgment that "non-monetary benefits caught by the term 'allowances' are limited to those existing in 1900."[108] Applying those principles the learned judge held that the points cheque was not an allowance within the terms of section 65(2)(b).

On the question of convertibility, Wallace J. accepted the submission made on behalf of the taxpayer that convertibility was irrelevant to any determination of whether the benefit in question was an allowance and that it became relevant only once it had been established that the benefit was an allowance. Having decided that the points cheque was not an allowance his Honour felt it unnecessary to consider whether or not the cheque was convertible into cash.

The combined effect of *Stagg, Parson* and *Sixton* is to render section 65(2)(b) ineffective as against fringe benefits. However, it would be possible to by-pass that provision by arguing that fringe benefits are income according to ordinary concepts and as such are chargeable to tax by virtue of section 38.[109] In *Duff* v. *C.I.R.*[110] the Court of Appeal held unanimously that in determining whether a profit or gain is income the proper approach is to consider whether it is income according to ordinary principles before having recourse to the extended meanings of income contained in section 65(2). Based on the argument made in Part II C of this paper, it could be argued that fringe benefits are income according to ordinary principles being something provided in money's worth which comes in to the taxpayer. That a particular benefit may not be convertible into cash would be irrelevant as income in its ordinary sense need not necessarily be in cash or in the form of something which is convertible into cash.[111]

107 Ibid. 846.
108 Ibid. 847.
109 Section 38 provides that:
> (2) . . . income shall be payable by every person on all income derived by him during the year for which the tax is payable.

110 [1982] 2 N.Z.L.R. 710.
111 See Part II C under the heading "Employment v. non-employment income: is the convertibility principle universal?".

Richardson and Congreve recognise that an argument could be made to tax fringe benefits under section 38. However, the learned authors state:[112]

> Whatever the arguments which might have been made along those lines, the present position seems clear, namely, that the taxation of fringe benefits is governed exclusively by [section 65(2)(b)] and by other specific provisions. This for two reasons: first, the Commissioner has always approached the problem, and the Courts have dealt with it on that basis, and, second, in a sense as a result of the practice of the Commissioner and the approach of the Courts, fringe benefits falling outside these specific provisions have not in New Zealand been regarded as income according to ordinary concepts.

With respect, those arguments may readily be disposed of. First, although it may previously have been the practice to determine whether a profit or gain is income solely by reference to the provisions of section 65(2), *Duff* established quite clearly that the correct approach is to consider whether the profit or gain is income according to ordinary principles before regard is had to section 65(2). And secondly, fringe benefits falling outside section 65(2)(b) have not previously been regarded as income according to ordinary concepts simply because no argument has previously been made before the courts that they are income in the ordinary sense of that word. In the light of *Duff* and the points made in Part II of this paper as to the nature of income, the failure to raise such an argument is clearly open to reappraisal.

3. *Section 72*

In New Zealand the taxation of accommodation benefits is governed by section 72 of the Income Tax Act 1976. That section provides:

> Without limiting the meaning of the term 'allowances' as used in section 65(2)(b) of this Act, the said term shall be deemed to include (in the case of a taxpayer who in any income year has been provided in respect of any office or position held by him with board or lodging, or the use of a house or quarters, or has been paid an allowance instead of being so provided with board or lodging or with the use of a house or quarters) the value of those benefits; and the value of the benefits shall be determined in case of dispute by the Commissioner.

Although section 72 clearly identifies the benefits which are deemed to be allowances within the terms of section 65(2)(b), it is of little assistance in calculating the value of the benefit. By merely stating that "the value of those benefits" is an allowance section 72 does not indicate whether "value" in that context is value to the taxpayer, market value, or cost to the employer. Consequently the Commissioner has formulated a number of administrative rules of thumb for calculating value for the purposes of section 72.

In relation to hotel keepers and hotel managers specific values are prescribed.[113] The same applies to farm employees.[114] As for shareholder employees and executives in public companies the value of the accommodation benefit is calculated as a function of the cost of the dwelling.[115] Those methods of calculation bear little

112 Supra n.4 p.13.
113 *Staples' Guide to New Zealand Income Tax Practice* (44 ed, Sweet & Maxwell N.Z. Ltd., Auckland, 1984) para. 651.
114 Ibid. para. 601.
115 Ibid. para. 55.

relationship to the actual value of accommodation. It is difficult to see why the value of accommodation to shareholder employees and company executives should be a function of the cost of the occommodation, and the prescribed values for hotel keepers and farm workers have not been updated for many years.[116]

V. CONCLUSION

The discussion of the taxation of fringe benefits in the United States in Part III of this paper demonstrates that there is no logical reason for not treating fringe benefits as income. In New Zealand, even prior to the enactment of the Income Tax Amendment Act (No. 2) 1985, the Income Tax Act 1976 contained provisions which brought fringe benefits within the charge to tax. However, the historical approach of defining income according to its source, judicial attitudes to tax statutes, and administrative practice, combined to exclude most fringe benefits from the tax net. With the stimulus to avoid income tax provided by high marginal tax rates it was inevitable that the New Zealand Parliament would follow the lead given by other legislatures in enacting specific legislation to ensure that fringe benefits are brought within the charge to tax.

116 A comparison of the prescribed values contained in the 44th edition of *Staples* with those contained in the 6th edition, published in 1945, reveals that the values have remained unchanged except for an allowance being made for the conversion to decimal currency in 1967.