INTENTION TO MAKE A PROFIT AND "BUSINESS" IN SECTION 65(2)(a) OF THE INCOME TAX ACT 1976

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"Business" is not an exact word. It is used in a number of provisions of the Income Tax Act 1976, and its meaning has been the subject of dispute between the Commissioner of Inland Revenue and the taxpayer in relation to several of those sections. Perhaps the most important of these is section 65(2)(a) of the Act, which is the charging provision in respect of income derived from business. This section provides that, "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) All profits or gains derived from any business (including any increase in the value of stock in hand at the time of the transfer or sale of the business, or on the reconstruction of a company)."

An issue which remains unresolved, at least in any conclusive way, is whether it is crucial to the existence of a business as the term is used in section 65(2)(a) that the particular undertaking alleged to be a business is carried on with the intention of making a profit. Only a modest illumination of this question is provided by section 2 of the Act, where the word is defined in the following manner: "In this Act, unless the context otherwise requires, . . . 'Business' includes any profession, trade, manufacture or undertaking carried on for pecuniary profit." Prima facie, this inclusive rather than exhaustive definition does not appear to modify the ordinary meaning of "business", and it is with this ordinary meaning that it is appropriate to commence.

Ordinary Meaning of Business

The primary rule for interpreting terms used in statutes is that words should be given their ordinary meaning.[1] This rule is relaxed where a statute relates to some specific trade or activity, and terms in general use within that trade or activity have acquired a particular technical or scientific meaning. In such cases, the technical meaning will prevail.[2] It may be doubted whether the Income Tax Act 1976, which deals with the many and multifarious ways in which a person may gain income, could be described as an Act dealing with a specific, technical subject, at least in the sense in which that expression is used in the present context. Moreover, there is not, in fact, a technical meaning of "business". The primary rule must therefore apply, and the quest is to discover the ordinary meaning of the word.

The legal rules of statutory interpretation are often found to be the same as the commonsense rules of everyday life: to find the meaning of a word used in a statute, it is often quite proper simply to look in a

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1 E.g. *Attorney-General v Winstanley* (1831) 2 Dow & Cl. 302, 310; 6 E.R. 740.
2 E.g. *Mason* v *Bolton's Library* [1913] 1 K.B. 83, 90.

recognised dictionary. Authority may be found for this practice in many cases[3] and, appropriately enough, one of the leading judgments is in *Smith* v *Anderson*[4] where Jessel M.R. consulted several dictionaries to discover the meaning of "business".

The *Shorter Oxford Dictionary*[5] gives nineteen meanings for "business". The first eight are obsolete. Meaning nine is "that about which one is busy" and most of the rest of the meanings are somewhat similar. Only two of the nineteen refer to anything in the nature of a calling or a commercial activity. Meaning ten is "occupation, profession or trade", and meaning nineteen is "a commercial enterprise as a going concern". *Websters,*[6] *Funk and Wagnall*[7] and *Random House*[8] are briefer, but to the same general effect.

Clearly, the dictionary definitions of "business" do not advance the matter very far. The word is used in different senses in different contexts. But it does appear that one can with every confidence and as a preliminary matter distinguish two fairly distinct meanings or groups of meanings. Rowlatt J. said in *Commissioners of Inland Revenue* v *Marine Steam Turbine Co. Ltd.*:[9]

> [T]he word "business" . . . is also a word which has two virtually distinct meanings. It may mean any particular matter or affair of serious importance. This meaning . . . may be illustrated by a few examples. When a private person goes to consult professionally his banker or his solicitor it may properly be said that he goes to see him on business. . . . The word "business", however, is also used in another and a very different sense, as meaning an active occupation or profession continuously carried on, and it is in this sense that the word is used in the Act.[10]

Rowlatt J. went on to hold that within the context of the taxing act with which he was dealing "business" must be interpreted in the second of the two senses that he identified. The same must be true in respect of section 65(2)(a) of the Income Tax Act 1976, if only because the words of the section and the context of the Act require it. Clearly, assessable income does not include some windfall, perhaps a coin found in the street, received by an individual who is on the important "business" of going to see his bank manager. Moreover, Rowlatt J.'s decision is authority on the New Zealand Act. It is an accepted canon of statutory interpretation that judicial decisions in respect of statutes *in pari materia* furnish sound rules of construction in later cases.[11] This may be particularly so where a Commonwealth legislature enacts a statute of similar substance to an

3 See, e.g., Craies, *Statute Law* (7th ed. 1971) 160-161 and cases cited therein.
4 (1880) 15 Ch.D. 247. See also, *G.* v *Commissioner of Inland Revenue* [1961] N.Z.L.R. 994, 998, where in order to determine the meaning of "business" McCarthy J. referred to the *Shorter Oxford Dictionary* and *Funk and Wagnall,* without citing particular editions.
5 3rd ed. 1964 reprint.
6 *Webster's Third New International Dictionary* (1961) gives six meanings for "business", the second of which is "a commercial or industrial enterprise".
7 *Funk and Wagnall's Standard Dictionary, International Edition* (1958) gives six meanings. The first is "a pursuit of occupation; trade; profession; calling." The fifth is "a commercial enterprise or establishment."
8 *Random House Dictionary* (1966) is similar to *Funk and Wagnall,* and *Webster's,* though distinguishing sixteen meanings in all.
9 [1920] 1 K.B. 193, 202-203.
10 Finance (No. 2) Act 1915 (U.K.) ss.38, 39.
11 See e.g., Craies, supra n.3 at 139.

earlier United Kingdom enactment, a principle often illustrated by cases in fiscal matters,[12] the area with which this article is concerned.

Rowlatt J.'s definition of "business" as meaning an active occupation or profession continuously carried on may therefore be taken as a convenient starting point, though with one caveat: there is perhaps room for argument over whether the element of continuity is crucial.[13] However, that is not a matter directly relevant to the present discussion. More to the point, Rowlatt J.'s definition is silent on the question of whether intention to make a profit is essential. Before considering the New Zealand cases on this point, it is convenient to examine a number of English decisions.

The United Kingdom legislation that parallels the New Zealand Income Tax Act 1976 is the Income and Corporation Taxes Act 1970 (U.K.). That statute taxes the proceeds of "trade" rather than "business", and by section 526(5) of the Act "trade" is defined to include "every trade, manufacture, adventure, or concern in the nature of trade". Nevertheless, cases on the meaning of trade are relevant to an examination of the meaning of "business" since, whatever the effect of the definition of "business" in section 2 of the Income Tax Act 1976, it is at least clear from section 2 that "business" includes "trade". In brief, the United Kingdom cases to be discussed below hold that "trade" does not necessarily require an intention to make a profit. It will therefore be submitted that neither should "business". Reasoning thus from United Kingdom cases on "trade" to the interpretation of "business" in section 65(2)(a) has received judicial sanction from McCarthy J. in *G.* v *Commissioner of Inland Revenue,*[14] where his Honour referred to English authority in order to discover the ordinary meaning of the word.

Probably the leading recent English case on whether the existence of a "trade" requires an intention to make a profit, for the purposes of the Income and Corporation Taxes Act 1970 or its predecessors, is *Griffiths* v *J. P. Harrison (Watford) Ltd.,*[15] a case on section 341 of the Income Tax Act 1952 (U.K.). To understand the effect of that section, it is necessary to appreciate that a good deal more income is taxed at source in the United Kingdom than in New Zealand. The result is that often when a taxpayer might qualify to take a deduction against profits from one source of income as a result of losses suffered in respect of another, tax has already been charged on the former income when received by the taxpayer. Consequently the United Kindom tax legislation provides for taxpayers to claim back tax for which it transpires that they have no liability. Section 341 was such a provision. It authorised a refund where the taxpayer had suffered losses in a "trade", which were able to be set off against profits on which tax had been paid.

The taxpayer company was a merchant. It had accumulated losses of £13,585. It purchased all the shares in a company called Claiborne Ltd. Claiborne had accumulated profits of £28,912. Of this sum, £13,011 had been paid as tax deductions at source, and the balance of £15,901 was available to be distributed as a dividend, net of tax. The taxpayer

12 E.g. *Harding* v *Commissioners of Stamps* [1898] A.C. 769; *Lovell & Christmas, Ltd.* v *Commissioner of Taxes* [1908] A.C. 46.
13 See, e.g., A. P. Molloy, *Molloy on Income Tax* (1976) 37, 81.
14 [1961] N.Z.L.R. 994, 998, quoted infra in text accompanying n.81. Section 2 of the Income Tax Act 1976 is quoted supra, p.165.
15 [1962] 1 All E.R. 909 (H.L.).

paid £16,900 for the shares in Claiborne Ltd. It then caused Claiborne Ltd. to pay a dividend of £15,901, the total available, and finally sold the Claiborne shares for £1,000. Thus, the taxpayer had made a loss of £15,900 on the purchase and sale of the shares. Added to its accumulated trading losses of £13,585, this produced a total loss of £29,485. Consequently, if these losses were deductible from the dividends received by the taxpayer from Claiborne, the total dividend, before tax, of £28,912, would be set off and the tax paid thereon, £13,011, liable to be refunded. As previously mentioned, the issue was whether the losses were suffered in a trade carried on by the taxpayer. It was conceded by the Revenue that the accrued trading losses of the taxpayer did so qualify. This left the loss of £15,900, resulting from the purchase and sale of the Claiborne shares. For most taxpayers, losses on the sale of shares are not deductible, being capital rather than income losses. However, a dealer or trader in shares can deduct such losses, just as he is liable for tax on profits on share transactions. Counsel for the Revenue argued that the taxpayer could not correctly be described as trading in respect of its dealings with the Claiborne shares, since there was clearly no intention of making a profit. On the contrary, the purchase and sale were simply part of an undertaking designed to obtain a fiscal benefit. Thus the issue of whether "trading" requires an intention to make a profit was squarely before the House of Lords. Viscount Simonds,[16] Lord Reid[17] (though dissenting on other grounds), Lord Morris of Borth-y-Gest,[18] and Lord Guest[19] held that it was not necessary to the existence of a trade that there should be a profit motive or intention. Lord Denning dissented. Lord Morris said:[20]

> It is doubtless true to say that in general a trader embarks on trade with the intention making a profit: but it cannot be said that if this intention is lacking there is no carrying on of a trade. A trade may be carried on with the knowledge that losses will result. Equally, it seems to me that if on any ordinary examination of them certain transactions must be regarded as trading transactions or adventures in the nature of trade they do not cease to be such because those conducting them have embarked on them with a view to obtaining some fiscal benefit.

Further, although repetition of operations provided stronger evidence, their Lordships accepted that a single transaction can amount to trading. This is particularly so in the case of a company whose constitution gives it power to engage in a particular activity which bears all the indicia of trading.[21] The result was that it was held that the losses had been incurred in trading and an appropriate tax refund was due.

Griffiths v *J. P. Harrison (Watford) Ltd.* is by no means alone as a case on whether trading requires an intention to make a profit. But it is somewhat unusual. Most of the United Kingdom cases on this point involved charitable or similar organisations objecting to tax assessments on surplus money arising from their operations on the ground that their

16 Ibid., 912.
17 Ibid., 913.
18 Ibid., 919.
19 Ibid., 921.
20 Ibid., 919.
21 Ibid., 920, per Lord Guest. The taxpayer company had taken the precaution of changing its constitution by adding a power to trade in shares before embarking on its trading with the Claiborne shares.

activities were not of a trading nature but were carried on without profit motive or intention. An example is *Religious Tract and Book Society* v *Forbes*.[22]

In selling and distributing its wares, the Religious Tract and Book Society operated several bookshops. It also sent out missionary colporteurs with loads of literature to sell, and at the same time to administer religious counsel and teaching. It was conceded by the Crown that the Society's object was not to make a profit.[23] Nevertheless, the bookselling operations taken alone did make a profit. The colportage ran at a loss and, when this was set off against the surplus money from bookselling, there was a loss on the whole of the Society's undertaking. The deficit was made up by donations. There were two issues: were the bookselling profits taxable? If so, could the colportage losses be deducted?

The answer to the first question depended on whether the bookselling amounted to a trade, granted that it was not motivated by profit. There was then in the United Kingdom no general exemption for income of charitable organisations comparable to section 61(25), (26) and (27) of the New Zealand Income Tax 1976. Significantly describing bookselling as a "business", a word of wider meaning than "trade", the Lord President, in finding for the Crown, held that[24] " the business of bookselling cannot be taxable or non-taxable according to the motive of the bookseller."

If the bookselling business was a trade, it became advantageous for the Society to argue that so too was the colportage, since the losses thereon were deductible only if incurred in trading. The Court found against the Society. Although both Lord McLaren[25] and Lord Kinnear[26] evinced no reluctance in describing the colportage as a "business", the Court unanimously held that it could not possibly be described as a "trade". It was more in the nature of a charitable mission, and the Society "could not possibly make any profit out of it."[27] It was not carried on according to commercial principles, and was clearly separable from the Society's bookselling shops.

Grove v *Young Men's Christian Association*[28] was a case involving somewhat similar considerations. The Association owned certain premises where it carried on a restaurant, a gymnasium, and certain publishing and educational activities. The first ran at a profit, the remainder at a loss. The restaurant was run on commercial lines, while the other undertakings were more charitable in nature. Was the restaurant a trade? Ridley J. held:[29]

> The Association would indeed carry it on even without a profit, with a view no doubt of benefiting the other objects of the Association; yet I think it is carried on as a "trade". It is conducted upon the usual commercial principles.

22 (1896) 3 T.C. 415. (Ct. of Exchequer, Scotland, 1st Div.).
23 The distinction between motive and intention, drawn by McCarthy J. in *G.* v *Commissioner of Inland Revenue* [1961] N.Z.L.R. 994 (S.C.) was not recognised in *Religious Tract and Book Society* v *Forbes*. *G.* v *Commissioner of Inland Revenue* is discussed infra in text accompanying nn.43-45 and 80-85.
24 (1896) 3 T.C. 415, 418.
25 Ibid., 420.
26 Idem.
27 Ibid., 419 per Lord Adam.
28 (1903) 4 T.C. 613.
29 Ibid., 617.

On the other hand the gymnasium, publishing and education were not "trades", and losses thereon were not deductible from the restaurant profit.

In *Brighton College* v *Marriott*[30] the House of Lords discussed the question whether the provision of education at a public school was a trade, in terms germane to the present examination of the meaning of "business". Pupils' fees at the College produced a surplus after operating expenses were paid. This surplus was applied to improvements to the school. Was the surplus taxable as "profits or gains arising from a trade carried on in the United Kingdom"?[31] The taxpayer argued that where, as here, the whole purpose of an undertaking was charitable, then it ceased to be a trade. The argument was rejected.[32] Viscount Cave L. C., delivering the judgment of himself and Lords Carson and Atkinson, referred to the College as carrying on the "business" of providing education for money. This was, his Lordship held, a "trade".[33] It is not without significance that in using the term "business" to describe the charitable undertaking of Brighton College, Viscount Cave appears to have accepted that, whatever argument there may be in respect of "trade", the term "business" clearly comprehends activities carried on without the objective of making a profit.

In all these cases, there is no suggestion that "trade" is used in any technical sense. Rather, the courts are simply interpreting the word in its ordinary sense, as found in the context of the predecessors to the Income and Corporation Taxes Act 1970 (U.K.). And the courts' conclusion is that an objective of making a profit is not an essential ingredient of carrying on a trade. A fortiori, it is submitted that neither should "business" as used in section 65(2)(a) of the Income Tax Act 1976 be interpreted to require an intention, motive, or purpose to make a profit, since "business" is a word of wider significance than "trade". Moreover, the ordinary meaning of the word does not require this additional gloss. However, there remains the question of the interpretation of the word in section 2 of the Act, and the approach that has been adopted in judgments by New Zealand courts.

The Interpretation Clause

Section 2 of the Income Tax Act 1976 provides that "In this Act unless the context otherwise requires . . . 'Business' includes any profession, trade, manufacture or undertaking carried on for pecuniary profit." Whether the words "carried on for pecuniary profit" apply equally to "profession", "trade" and "manufacture" as to "undertaking" does not seem to have been specifically decided, although McCarthy J. appears to have assumed that they do so apply in *G.* v *Commissioner of Inland Revenue*.[34] Such an assumption is in accordance with authority. Lord Bramwell said in *The Great Western Railway Co.* v *The Swindon and Cheltenham Extension Railway Co.*:[35] "[A]s a matter of ordinary construction, where several words are followed by a general expression . . . which is as much applicable to the first and other words as to the last,

30 [1926] A.C. 192.
31 Income Tax Act 1918, Schedule D.
32 Ibid., 199 per Viscount Cave L. C., 203 per Lord Buckmaster.
33 Ibid., 199.
34 [1961] N.Z.L.R. 994, 998.
35 (1884) 9 App. Cas. 787, 808.

that expression is not limited to the last, but applies to all." It is submitted that this principle should apply in the present context of section 2 of the Income Tax Act 1976.

A more difficult problem is the effect of the word "includes" in the definition section. Where "includes" rather than "means" is used in a statutory definition, the usual interpretation, and indeed the ordinary meaning of "includes", extends rather than restricts the meaning of the word defined. The leading case on the point is, in fact, a New Zealand appeal to the Privy Council, *Dilworth* v *Commissioner of Stamps*.[36] The case turned on the definition of "charitable purposes" in the Charitable Gifts Duties Exemption Act 1883. The definition was an inclusive one. Lord Watson discussed the provision in the following terms:[37]

> It is not said in terms that "charitable bequest" shall mean one or other of the things which are enumerated, but that it shall "include" them. The word "include" is very generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so used these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include. But the word "include" is susceptible of another construction, which may become imperative, if the context of the Act is sufficient to show that it was not merely employed for the purpose of adding to the natural significance of the words or expressions defined. It may be equivalent to "mean and include", and in that case it may afford an exhaustive explanation of the meaning which, for the purposes of the Act, must invariably be attached to these words or expressions.

In *Dilworth* v *Commissioner of Stamps* their Lordships in fact came to the conclusion that it was not necessary for them to determine in which of the two senses "include" was used. For purposes of the case they assumed that the word was meant to introduce an exhaustive definition. It is at first sight somewhat surprising that New Zealand's highest appellate court should have determined that there is some uncertainty about the meaning of "include" and that, depending on the context, it may have either of two meanings which are, in a sense, opposites. Nevertheless, this type of judicial decision is by no means rare in the field of statutory interpretation. Most of the so-called "rules" of statutory interpretation are used by the courts as guidelines which may or may not be appropriate, rather than principles that will necessarily lead to the correct decision. To take but one example, one finds in the chapter on Definition and Construction of Penal Acts in *Craies on Statute Law*,[38] sections headed both "Strict construction to be applied" and "Relaxation of rule of strict construction" and even "Operation of statute not to be narrowed by strict construction". Without difficulty, the learned editor cites authorities for all these propositions. Be that as it may, Lord Watson's words do identify two distinct uses of "includes" and, as will shortly appear, the distinction drawn by his Lordship is of direct relevance to the definition of "business" in section 2 of the Income Tax Act 1976.

Somewhat surprisingly in view of the unambiguous terms in which Lord Watson expressed himself, subsequent authorities have occasionally misinterpreted *Dilworth* v *Commissioner of Stamps,* and the second meaning of "includes" identified by his Lordship, "means and includes",

36 [1899] A.C. 99 (P.C.).
37 Ibid., 105-106.
38 Craies, supra n. 3 at 525-535.

has been ignored. The learned editor of *Maxwell on Interpretation of Statutes*[39] cites the case only in respect of the first and more literal meaning.[40] In *R.* v *Crayden*[41] Lawton L. J. held that *Dilworth* v *Commissioner of Stamps* is authority for the proposition that an interpretation clause commencing with the word "includes" merely enlarges the ordinary meaning of the word to which it applies, but does not alter that meaning.[42]

Dilworth v *Commissioner of Stamps* is of course binding on New Zealand courts. And it would appear that the definition of "business" with which the present article is concerned comes into Lord Watson's second category. It was pointed out by McCarthy J. in *G.* v *Commissioner of Inland Revenue*[43] that the words in section 2 do not in fact add anything to "business" in its ordinary meaning. The word clearly includes any profession, trade, manufacture or undertaking carried on for pecuniary profit. In the words of Lord Watson, one might say that "includes" was "not merely employed for the purpose of adding to the natural significance of the words or expressions defined. It may be equivalent to 'mean and include'." Unfortunately, it seems that *Dilworth* v *Commissioner of Stamps* was not cited to McCarthy J. in *G.* v *Commissioner of Inland Revenue.* Nevertheless, his Honour gave as one of his reasons for holding that "business" did not require an intention to make a profit the fact that the words of the statutory definition did not add anything that was not already comprehended within the ordinary meaning of "business". His Honour in fact gave no authority for this conclusion, but stated in words that felicitously echoed Lord Watson:[44]

> a study of the definition itself forces the view that it does not add anything to the common meaning of the word; does not catch anything which would not otherwise be caught; and so, for myself, I am not prepared to say that the use of the word "business" in section 88, particularly having in mind the taxing nature of the section and bearing in mind, too, the definition in section 2, is intended to embrace a profession, trade, manufacture, or calling, unless there is shown to exist an intention to carry on the particular activity under consideration for pecuniary profit.

It must be conceded that McCarthy J.'s words, taken in combination with *Dilworth* v *Commissioner of Stamps,* furnish strong authority for a restrictive interpretation of "includes" in the present context. But it must be borne in mind that Lord Watson limited himself to saying that where "includes" falls into the second category it "may" be equivalent to "means and includes". Other authorities point in a contrary direction. In *Wakefield Local Board of Health* v *West Riding and Grimsby Railway Co.*[45] it was held that statutory definitions that do not add anything to the ordinary meaning of a particular word should be treated as having been inserted as an abundance of caution, and should not be taken as limiting the meaning of the word defined. Unfortunately, this case was not considered by McCarthy J. either. Two further general principles of

39 12th ed. 1969.
40 Ibid., 270.
41 [1978] 2 All E.R. 700.
42 Ibid., 702.
43 [1961] N.Z.L.R. 994, 998.
44 [1961] N.Z.L.R. 994, 998. This passage was quoted with approval by North P. in *Harley* v *Commissioner of Inland Revenue*; *Jenkins* v *Commissioner of Inland Revenue* [1971] N.Z.L.R. 482, 487.
45 (1865) L.R. 1 Q.B. 84.

statutory interpretation also lead to a conclusion that differs from the result obtained by applying *Dilworth* v *Commissioner of Stamps.*

First, it was held as long ago as 1905 in *Haynes* v *McKillop*[46] that where some clauses in an interpretation section use "means" and some use "includes", then "includes" should be read in its literal meaning and not be taken to signify "means and includes". Nevertheless, even this apparently entirely logical and commonsense rule was described in that case as not being of invariable application, and subject to variation as the context might require. Be that as it may, the definition section of the Income Tax Act 1976 and of the Land and Income Tax Act 1954 both differentiate between "includes" and "means". It is submitted that this differentiation should be given due weight.

Secondly, there is a judge-made rule that the words of an interpretation clause are not necessarily intended to apply throughout the statute in which they are found, but may yield to the context: *R.* v *Cambridgeshire JJ.*;[47] and *The School Board for London* v *Jackson.*[48] As far as the Land and Income Tax Act 1954 and the Income Tax Act 1976 are concerned, this judge-made rule has been reduced to statutory form, and in both Acts the definition section commences with the words: "In this Act, unless the context otherwise requires." These opening words were not in fact considered by the courts in the New Zealand cases to be discussed below. It is suggested that, as a result, a somewhat undue emphasis was placed on the words of the definition section.

It has earlier been argued that the ordinary meaning of "business" does not require an intention to make a profit. It is submitted that the foregoing examination of the interpretation clause in section 2 of the Income Tax Act 1976 must lead to the conclusion that the clause in no way limits this ordinary meaning: the clause does not require that for purposes of the Income Tax Act 1976 "business" should be limited to undertakings carried on for pecuniary profit. Be that as it may, the New Zealand cases where the matter has been discussed have reached a contrary conclusion.

The New Zealand Cases

The first of these cases was *Commissioner of Inland Revenue* v *Watson.*[49] The taxpayer was a sheepfarmer who bred horses as a hobby. He decided to put the horse-breeding on to a commercial footing. With the help of his accountant, he prepared a set of books for this purpose and, in a businesslike fashion, recorded the various items of income and expenditure that related to his horse-breeding activities. However, the taxpayer's income from horse-breeding was virtually nil. Therefore, he set off his horse-breeding expenses against his farming profits. The Commissioner disallowed that portion of the taxpayer's expenses that related to horse-breeding on the basis that this activity was not in fact a business. The law then applicable was found in section 111(2) of the Land and Income Tax Act 1954, which read as follows:

> In calculating the assessable income of any person deriving assessable income from two or more sources, any expenditure or loss exclusively incurred

46 (1905) 24 N.Z.L.R. 833.
47 (1838) 7 Ad. & E. 480; 112 E.R. 551.
48 (1881) 7 Q.B.D. 502.
49 [1960] N.Z.L.R. 259 (Henry J.).

> in the production of assessable income for any income year may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer for that year from all such sources as aforesaid.

The various categories of assessable income are listed in section 65 of the Income Tax Act 1976, then section 88 of the Land and Income Tax Act 1954. The only provision under which the taxpayer's activities could possibly be categorised was section 88(a) (numbered 88(1)(a) after 1965). This paragraph has already been quoted with its present number of section 65(2)(a), but for convenience may be repeated here: "the assessable income of any person shall for the purposes of this Act be deemed to include . . . All profits or gains derived from any business."

Henry J. stated that the issue simply amounted to whether the taxpayer's horse-breeding amounted to a business.[50] This analysis appears from the report to have been accepted by counsel for both parties, and the case resolved itself into a question of whether intention to make a profit is necessary to the existence of a business. Henry J. did not refer expressly to section 2 of the Act defining "business", but his Honour presumably had that definition in mind in the following crucial passage taken from his judgment.[51]

> The taxpayer and his accountant have each asserted and books have been opened and kept on the basis that as from 1952 the taxpayer was in business as a horse-breeder. This is not sufficient of itself. "Business" includes any undertaking carried on for pecuniary profit. It is not necessary that such a profit should be made, but it is essential, even if not sufficient, that at least an intention to gain pecuniary profit from the activities should be proved before the undertaking can be termed a business.

On the facts, his Honour held that such an intention was not proven, a business was not established, and consequently the expenses in respect of horse-breeding were disallowed.

On the basis of section 111(2) it was at least arguable that not only should these expenses be disallowed, but also any expenses partly for sheepfarming and partly for horse-breeding should have been treated the same way, and, indeed, the bulk of the horse-breeding expenses fell into this category. For example, the taxpayer employed his sons about the farm, and he simply paid their wages from his farming account, although they worked partly on sheepfarming and partly on horse-breeding. Section 111(2) did not provide for an apportionment between business and non-business expenses. On the contrary, it emphatically permitted deductions only in respect of expenditure exclusively incurred in the production of assessable income. However, the Commissioner did not argue that all expenditure that was at all related to horse-breeding should be disallowed, and was content for an apportionment to take place. It is not clear from the report just how the apportionment was effected, but on the basis of *Omihi Lime Co. Ltd.* v *Commisioner of Inland Revenue,*[52] counsel for the Commissioner could possibly have taken a somewhat firmer line. In that case it was held that, despite the use of the word "exclusively", expenses may be apportioned between assessable and non-assessable items so long as at least reasonable estimates can be made. However, where expenses are common to both assessable and non-assessable sums, they cannot be described as "exclu-

50 Ibid., 259.
51 Ibid., 262.
52 [1964] N.Z.L.R. 731 (Wilson J.).

sively incurred in the production of assessable income". It might be thought that in the *Watson* case expenditure on, for example, fencing, fertiliser and seed should have been brought into this latter category.[53]

Three cases involving somewhat similar considerations followed *Watson* v *Commissioner of Inland Revenue*. They were *Harley* v *Commissioner of Inland Revenue*; *Jenkins* v *Commissioner of Inland Revenue*;[54] *Golightly* v *Commissioner of Inland Revenue*;[55] and *Prosser* v *Commissioner of Inland Revenue*.[56]

Harley's case involved a partnership that let out its land for grazing. The land was made available free of charge by the parties to the partnership. The partnership made small profits or losses on its grazing operations. However, the parties individually incurred heavy expenses by way of interest on the capital they had invested in the land that they provided. They claimed to deduct these expenses from other income they received in their personal capacity.

For similar reasons to those obtaining in *Watson's* case it was necessary to determine whether or not the grazing activity was a business. This point was decided in the taxpayers' favour by Wilson J. in the Supreme Court, and the Court of Appeal, reluctant to differ from the lower court on a question essentially of fact, did not upset that finding. However, the Court did find against the taxpayers on other grounds. Nevertheless, the Court discussed the meaning of "business" at some length, particularly in respect of whether an intention to make a profit is essential.

North P.[57] repeated with approval the passage from *Watson* v *Commissioner of Inland Revenue* quoted above,[58] and, as already noted,[59] his Honour also adopted the reasons of McCarthy J. in *G.* v *Commissioner of Inland Revenue* to the effect that, since the words of section 2 of the Land and Income Tax Act 1954 defining "business" did not add anything to the ordinary meaning of the word, it should be inferred that the terms of the definition were intended to restrict that meaning.[60] His Honour concluded that:[61]

> it is at least arguable that the words in the definition clause make it necessary for the taxpayer to establish that he was carrying on his occupation for pecuniary profit and, accordingly, if the enterprise had no prospect of earning a profit, it may be wrong to describe the enterprise as a business.

His Honour's views were shared by Turner J.[62] and Richmond J.[63]

53 See also *Harley* v *Commissioner of Inland Revenue, Jenkins* v *Commissioner of Inland Revenue* [1971] N.Z.L.R. 482 (C.A.). In that case one of the grounds of disallowance of certain expenditure on farm land was that it was not incurred exclusively for producing income but, rather, it related chiefly to costs incurred in holding the land as an investment. The question is no longer important, as apportionment is specifically provided for in section 104 of the Income Tax Act 1976, the successor to section 111. The change was made by section 12 of the Land and Income Tax Amendment Act 1968.
54 [1971] N.Z.L.R. 482 (C.A.).
55 (1972) 1 T.R.N.Z. 135 (Speight J.).
56 (1972) 3 A.T.R. 371 (Quilliam J.).
57 [1971] N.Z.L.R. 482, 487.
58 Supra, text accompanying n.51.
59 Supra, n.44.
60 [1971] N.Z.L.R. 482, 487.
61 Ibid., 486.
62 Ibid., 492.
63 Ibid., 496.

Golightly v *Commissioner of Inland Revenue*[64] was another farming case. Here, a solicitor claimed to deduct the expenses of a small farm from his income as a solicitor. Although losses had been incurred for several years, it was not until 1971 that the Commissioner advised the taxpayer that the losses would be disallowed, in respect of the years ending March 1970 and 1971. As in the *Watson* and *Harley* cases, whether the expenses should be allowed depended on section 111 of the Land and Income Tax Act 1954. But, in the meantime, this provision had been amended by the Land and Income Tax Amendment Act 1968. Since 1976 it has been section 104 of the Income Tax Act 1976, and reads as follows:

> In calculating the assessable income of any taxpayer, any expenditure or loss to the extent to which it—
> (a) Is incurred in gaining or producing the assessable income for any income year; or
> (b) Is necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year—
> may, except as otherwise provided in this Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred.

In his judgment, Speight J. did not refer to the changes made in 1968, and he agreed with counsel for both parties that the issue was simply whether the taxpayer was carrying on business as a farmer.[65] Following North P. in *Harley* v *Commissioner of Inland Revenue*; *Jenkins* v *Commissioner of Inland Revenue,* his Honour went on to hold that the test of the existence of a business was "whether or not the taxpayer had the intention and prospect of making a profit."[66] The prospect of a profit should be "in the foreseeable future".[67] On the facts, his Honour held that there was such an intention and profit, and found for the taxpayer.

The final case, *Prosser* v *Commissioner of Inland Revenue*,[68] involved similar facts, again in respect of an income year after the 1968 amendment. On the facts of that case, Quilliam J. found against the taxpayer, but his Honour adopted and applied the test stated by Speight J. in *Golightly* v *Commissioner of Inland Revenue.*

Quilliam J. considered the terms of section 111 more closely than had Speight J. in the earlier case, and pointed out that the claim to deduct farming losses might be made under either or both of sections 111(a) and 111(b). If the taxpayer relied on section 111(b), it was necessary to take the further step of a reference to section 88 of the Act, where "assessable income" is defined to include "all profits and gains from any business". Quilliam J. concluded that under whichever limb of section 111 the taxpayer claimed, he had to show that his farming operations were "a business".[69]

The question of what amounted to a business was thus before the court. Quilliam J. considered *Watson's, G.'s, Harley's* and *Golightly's* cases, and concluded that[70] "the expression 'business' involves both the intention of making a profit and also at least the reasonable prospect of doing so."

64 (1972) 1 T.R.N.Z. 135 (Speight J.).
65 Ibid., 137.
66 Idem.
67 Idem.
68 (1972) 3 A.T.R. 371 (Quilliam J.).
69 Ibid., 373.
70 Ibid., 375.

This decision, and thus inferentially those that preceded it, have been strongly criticised by Dr. I. C. F. Spry.[71] Dr. Spry argues that to confine "business" to activities involving the intention of making a profit is contrary to both usage and authority. The question of usage has been discussed at length, and the author respectfully agrees with Dr. Spry.[72] In respect of authority, Dr. Spry is on weaker ground, at least as far as New Zealand cases are concerned. He points out[73] that Quilliam J.'s judgment is contrary to *Griffiths* v *J. P. Harrison (Watford) Ltd.*, which is quite correct.[74] It is also contrary to *Tweddle* v *Federal Commissioner of Taxation.*[75] In that case, Williams J. referred to the difficulty that may ensue from requiring that "business" should be interpreted as requiring an intention to make a profit, in the following terms:[76]

> If a taxpayer is in fact engaged in two businesses, one profitable and the other showing a loss, the Commissioner is not entitled to say he must close down the unprofitable business and cut his losses even if it might be better in his own interests and although it certainly would be better in the interest of the Commissioner if he did so (*Tooheys Ltd.* v. *Commissioner of Taxation N.S.W.*).[77] If the appellant succeeds and makes a profit it will clearly be taxable, and it is difficult to see how his activities could at that point of time be transmogrified from an indulgence in a somewhat unusual form of recreation into the carrying on of a business.

It appears that *Griffiths* v *J. P. Harrison (Watford) Ltd.* was not cited to Quilliam J. His Honour did, however, discuss *Tweddle's* case at some length, but declined to follow it, for the very good reason that it is contrary to the judgments of North P. and Speight J. in *Harley's* and *Golightly's* cases.[78] In the first of these cases, North P.'s discussion of the meaning of "business" was not strictly necessary to the decision. The second case was before a court of concurrent jurisdiction. Nevertheless, the persuasive authority of these cases was perhaps stronger for a New Zealand judge than the English and Australian cases cited by Dr. Spry.[79]

The preceding cases are only indirectly relevant to whether "business" as used in section 65(2)(a) of the Income Tax Act 1954 requires an intention to make a profit. Specifically, they were deduction cases, turning on section 111, and it is only because, and to the extent that, that section refers back to section 65(2)(a) that they furnish authority in respect of the latter. In *G.* v *Commissioner of Inland Revenue,*[80] however, the issue was squarely before the court.

The taxpayer in that case was an evangelist, a member of the Open Brethren. He went from congregation to congregation, teaching and preaching where he was invited. He received no salary, but lived on

71 Spry, "The Carrying on of a Business" (1973) 3 Aust. Tax Rev. 178.
72 Supra, text accompanying nn.15-33.
73 Spry, supra n.71 at 179.
74 Supra, text accompanying nn.15-20.
75 (1962) 2 A.I.T.R. 360.
76 Ibid., 364.
77 (1922) 22 S.R. (N.S.W.) 432, 440-441.
78 (1972) 3 A.T.R. 371, 375.
79 See also Hamilton, "Averaging of Incomes for Primary Producers" (1972) 1 Aust. Tax Rev. 274, discussing *Thomas* v *Federal Commissioner of Taxation* (1972) 46 A.L.J.R. 397 (Walsh J.), where despite the fact that there was no reasonable prospect of a profit for at least ten years the taxpayer was held to be carrying on a business of tree planting and culture.
80 [1961] N.Z.L.R. 994 (McCarthy J.).

gifts from the faithful, relatives and friends. G. argued that these receipts were not income, and therefore not taxable. In reply, counsel for the Commissioner contended that the receipts were "profits or gains derived from any business" and therefore assessable income pursuant to section 88(a) of the Land and Income Tax Act 1954. G. responded that his activities as an evangelist were not prompted by either an intention or a motive of profit, and could not be described as a business. Thus, McCarthy J. was obliged to consider the meaning of the term as used in section 88(a). His Honour determined that in its ordinary usage, "business" does not require an intention to make a profit. He said: [81]

> I doubt whether it can be maintained in these days that, where the word is unaffected by statutory definition, the purpose of producing profits must necessarily be present, though, of course, the existence or otherwise of an intention of that nature must be a material factor in deciding whether any particular undertaking does, in fact, amount to a business. "It is not essential to the carrying on of a trade that the persons engaged in it should make, or desire to make, a profit by it."[82] . . . [This observation, though it refers] specifically to a trade, can also be applied, I consider, to a profession or calling where money is shown to have been received, but I would think that where the activities of the taxpayer may not strictly be described as trading, the inference to be drawn from an absence of a profit motive or intention may be very much stronger in favour of that taxpayer.

However, as already noted,[83] McCarthy J. decided that the statutory definition in section 2 of the Act did affect the meaning of "business" and, although it was an inclusive definition, it required that, for purposes of the Land and Income Tax Act, and in particular section 88(a), there must be an intention of making a profit before a "business" will be held to exist. Despite the somewhat unusual facts of this case, McCarthy J. went on to hold that the taxpayer did have such an intention.[84] Since the taxpayer knew from experience that if he carried on as an evangelist he would receive contributions of money, he must be taken to have intended to receive them, albeit that his motive for working as an evangelist was not to make a profit.[85] Motive is, of course, a different thing from intention.

The author earlier concluded that according to its ordinary meaning, and apart from New Zealand authority, "business" as used in section 65(2)(a) of the Income Tax Act 1976 does not require an intention to make a profit. Be that as it may, the authorities considered above are directly contrary to this view. They have been subject to considerable criticism, and there have been attempts made to distinguish them.[86] The remainder of this article attempts to evaluate that criticism.

Criticism of the New Zealand Cases

Dr. A. P. Molloy has argued strongly that despite the New Zealand cases the law is that "business" in section 65(2)(a) does not require a profit-making intention.[87] While the present author respectfully agrees

81 Ibid., 998.
82 *Re Duty on Estate of Incorporated Council of Law Reporting for England and Wales* (1882) 22 Q.B.D. 279, 293 per Lord Coleridge C. J.
83 Supra, text accompanying nn.43 and 44.
84 [1961] N.Z.L.R. 994, 999.
85 Idem.
86 Molloy, supra n.13 at 30-34, 305-310.
87 Idem.

that such should be taken to be the original intent of the legislature, it is submitted that this argument ignores the effect of the cases. The courts are not free to consider a statutory provision *de novo,* and take a fresh approach with every case. Previous judgments have strong persuasive and, in appropriate circumstances, binding authority. The rules of *stare decisis* apply as well to statutory interpretation as to other judicial decisions, and it is now too late to argue to the contrary. The justification for the rules is often stronger in respect of interpretation of taxing statutes than elsewhere. In *Bourne* v *Keane,*[88] Lord Buckmaster gave three reasons for applying *stare decisis* in statutory interpretation; the third refers specifically to taxing acts. These reasons are: first, that a judicially-accepted interpretation ought not to be changed unless it is positively wrong, and productive of inconvenience; secondly, decisions on which title to property depend or otherwise form the basis of contract ought to receive protection; "Thirdly, decisions that affect the general conduct of affairs, so that their alteration would mean that taxes had been unlawfully imposed, or exemption unlawfully obtained, payments needlessly made, or the position of the public materially affected, ought in the same way to continue."[89]

To similar effect are the words of Lord Morton of Henryton in *Close* v *Steel Co. of Wales Ltd.*:[90] "I have always understood that when this House clearly expresses a view upon the construction of an Act of Parliament, and bases its decision on that view, the Act must bear that construction unless and until Parliament alters the Act." This rule is even stronger in cases where Parliament has repealed and re-enacted words that have received considered judicial interpretation,[91] and particularly so in the case of consolidating acts, which the Income Tax Act 1976 is declared by its title to be. Referring to the Supreme Court of Judicature (Consolidation) Act 1925, Evershed M. R. said, in *R.* v *Governor of Brixton Prison Ex Parte De Demko,*[92] "in remembering that this is a consolidation Act one has also to remember that Parliament must be taken to have been aware of the decisions of the courts in the meantime." Admittedly, this rule appears to be losing some of its force in modern times. Dixon C. J. pointed out in *R.* v *Reynhoudt*[93] that "the mechanics of law-making no longer provide it with the foundation in probability which the doctrine was supposed once to have possessed. I note that Lord Radcliffe describes it as 'an almost mystical method of discovering the law.' "[94] Nevertheless, it is submitted that in view of the close agreement among the New Zealand cases that have been discussed, it would be unlikely, and indeed inappropriate, for a New Zealand court to depart from the interpretation of "business" that has been adopted in the cases. McCarthy J. was faced with an argument based on the above dictum of Dixon C. J. in *Re Manson (deceased), Public Trustee* v *Commissioner of Inland Revenue.*[95] Even though the

88 [1919] A.C. 815.
89 Ibid., 874.
90 [1962] A.C. 367, 393-394.
91 *Webb* v *Outrim* [1907] A.C. 81, 89; *McKay* v *Davis* (1904) 1 C.L.R. 483, 491 per Griffiths C.J.
92 [1959] 1 Q.B. 268, 281 (C.A.).
93 (1962) 107 C.L.R. 381, 388.
94 *Galloway* v *Galloway* [1965] A.C. 299, 320.
95 [1964] N.Z.L.R. 257 (C.A.).

statutory provision in question had been judicially interpreted on only two previous occasions, his Honour held that:[96]

> whichever view is preferred, the fact is that the statute was not amended when there was a suitable opportunity to do so, and that circumstance of itself would make this Court reluctant to interfere in a matter which, as we have already observed, is purely a revenue one.

It is in the light of such authority that Dr. Molloy's arguments must be weighed.

Dr. Molloy makes several points. It is convenient first to consider his argument based upon *Land Projects Ltd.* v *Commissioner of Inland Revenue*.[97] That case involved a company that was seeking to purchase land for subdivision and resale as building sections. The company wanted to purchase a portion of a sheep farm for this purpose, but was obliged by the vendors to buy the whole farm, including livestock, as a going concern. It did so, and re-sold the farm land that was surplus to its requirements, and the livestock, making a profit on the sale of the latter. The company owned the livestock for only nine days, during which time it employed three men to take care of it. Pursuant to section 98 of the Land and Income Tax Act 1954, where a taxpayer sells all or some of the trading stock, including livestock, of a business owned or carried on by him, the proceeds of the sale are taken into account in calculating his assessable income. Thus, the issue in the case was whether the company was correctly described as owning or carrying on a business of which the sheep were trading stock. The Court answered this question affirmatively, holding the proceeds to be assessable. Dr. Molloy comments:[98] "It seems that in respect of the nine days during which the company held the sheep station, before passing it on to its purchaser, it had no intention to make a profit. This was no obstacle, however, to a decision that a business was in existence."

Dr. Molloy's conclusion, however, is purely a matter of inference. The issue of whether the taxpayer company intended to make a profit on the sale of the sheep is not mentioned in the judgment of Barrowclough C. J., nor does it appear to have been raised by counsel for either party in argument. In the submission of counsel for the taxpayer, the company did not carry on the farming business; it simply inactively held the assets of the business prior to disposal. Nor did it own the business; it merely owned assets which could be used in a farming business.[99] These submissions were rejected, and the Court held that on the facts the company had both owned and carried on a sheep-farming business.[1]

One must agree with Dr. Molloy that the original motive for the purchase of the sheep was not to make a profit on their resale. The company was simply obliged to buy them in order to obtain the land it needed. Similarly, its motive in selling the sheep was primarily to unburden itself of an asset that was of no use in its ordinary business. But there is nothing in the facts or the judgment of the case to say whether, when it came to a question of actually selling the sheep, the taxpayer intended to sell at a profit, or a loss, or was indifferent, or it simply did not consider the matter. For what it is worth, the inference drawn by

96 Ibid., 272.
97 [1964] N.Z.L.R. 723 (Barrowclough C. J.).
98 Molloy, supra n.13 at 32.
99 [1964] N.Z.L.R. 723, 728.
1 Ibid., 728, 729.

the present author is that faced with the unfamiliar and unwelcome task of buying and selling sheep, the company would probably have decided to conduct the transaction on the most favourable terms it could manage. Any other approach would seem unlikely, in a commercial organisation. One might thus reasonably infer a profit-making intention on the part of the company, an intention that was, albeit, not the dominant motive behind the transaction.

Be that as it may, even if Dr. Molloy is correct in his contrary inference that there was no intention to make a profit when the sheep were sold, it is submitted that the discussion is not thereby much further advanced. The argument and judgment in *Land Projects Limited* v *Commissioner of Inland Revenue* did not touch upon the question of what amounted to a business. That issue was not considered. Rather, the question was whether the taxpayer company had carried on or owned a sheep-farming business. The case is therefore no authority on the meaning of "business".

With respect, Dr. Molloy's second argument has more force. He points out that section 104(b) of the Income Tax Act 1976 in its present form permits the deduction of expenditure which "is necessarily incurred in carrying on a business for the purpose of gaining or producing the assessable income for any income year." Thus, the question to be asked by the courts should be not whether the taxpayer's activities amounted to a "business" but, assuming the existence of a "business", whether the purpose of the business was to gain or produce assessable income.[2] The test is whether the undertaking of the taxpayer has any reasonable prospect of profitability. As Dr. Molloy points out, "since the purpose of section [104(b)] is to enable assessable income, a net figure, to be calculated, there is nothing odd in disallowing expenditure where there is no reasonable prospect of there ever being any income."[3]

Dr. Molloy thus disputes the reasoning, though not the results,[4] in *Golightly* v *Commissioner of Inland Revenue*[5] and *Prosser* v *Commissioner of Inland Revenue,*[6] and with some justice. Nevertheless, the fact remains that the two judgments are consistent with each other, and with earlier authority. It is submitted that they represent what is in fact New Zealand law. This submission is further supported by a closer examination of Quilliam J.'s judgment in *Prosser* v *Commissioner of Inland Revenue,* and by a study of the earlier cases of *Commissioner of Inland Revenue* v *Watson,* and *Harley* v *Commissioner of Inland Revenue*; *Jenkins* v *Commissioner of Inland Revenue.*[8]

In *Prosser's* case, it is significant that Quilliam J. held that the result was the same whether the taxpayer claimed deductions under section 111(a) or section 111(b) of the Land and Income Tax Act 1954, the section being at that time in the same form as the current section 104(a) and (b). While section 111(b) refers to expenses incurred in carrying on a business for the purpose of gaining or producing assessable income, under section 111(a) the taxpayer is required to show that his expenses were simply "incurred in gaining or producing the assessable income".

2 Molloy, supra n.13 at 309.
3 Idem.
4 Ibid., 310.
5 (1972) 1 T.R.N.Z. 135; see text accompanying nn.64-67.
6 (1972) 3 A.T.R. 371; see text accompanying nn.68-79.
7 [1960] N.Z.L.R. 259; see text accompanying nn.49-51.
8 [1971] N.Z.L.R. 482; see text accompanying nn. 57-63.

The type of income is specified in section 111(b), but section 111(a) inferentially directs the reader to section 88 in order to discover the meaning of "assessable income". In these cases, the only relevant definition is, of course, in section 88(1)(a), defining "assessable income" as including "all profits or gains from any business". Consequently, in the opinion of Quilliam J., under whichever subsection the taxpayer claimed he had to establish that his operations were a "business"[9] and, for purposes of section 111(a), the meaning of "business" as used in section 88(1)(a) was directly relevant. Moreover, his Honour made it clear that in his opinion there was no difference between the meaning of the word as used in section 88(1)(a) and its meaning in section 111(b).[10] As will appear below,[11] the author takes issue with Quilliam J. on his Honour's interpretation of section 88(1)(a). Nevertheless, whether *Prosser* v *Commissioner of Inland Revenue* is regarded as turning on section 111(a), or on section 111(b), or on each provision, the case must be regarded as considered authority directly in point on the subject of this article: whether intention to make a profit is crucial to the existence of a business under section 65(2)(a) of fthe 1976 Act, formerly section 88(1)(a) of the 1954 Act. And, of course, on the authority of that case the answer is affirmative.

Commissioner of Inland Revenue v *Watson*[12] is even more direct authority. The case turned on the old form of section 111(2), which, like the current section 104(a), authorised the deduction of expenditure "incurred in the production of assessable income". Thus, the taxpayer did not have a choice between two statutory provisions, either of which might have authorised the deductions he claimed. He was obliged to refer back to the definition of assessable income contained in section 88, and thus found it essential to his case to argue that his horse-breeding interests amounted to a business. As earlier pointed out, Henry J. in *Watson's* case held that the lack of intention to make a profit from the horse-breeding was fatal to a claim that this activity amounted to a business.[13]

The comments of North P. in *Harley* v *Commissioner of Inland Revenue*; *Jenkins* v *Commissioner of Inland Revenue*[14] must be seen in the same light. The income years under consideration in that case were before the 1968 amendment to section 111. Thus, the meaning of "business" as used in section 88(1)(a) was directly relevant to the question of deductibility of farming expenses.

In consequence, it is respectfully submitted that Dr. Molloy is incorrect in grouping *Watson's, Harley's* and *Prosser's* cases together with *Golightly's* case as all cases turning on the post-1968 form of section 111(b).[15] The first two cases concerned income years before the amendment, and *Prosser's* case turned equally on section 111(a), the post-1968 form of which raises the same issues as the pre-1968 form of section 111(2). From the report, we cannot even be confident that

9 (1972) 3 A.T.R. 371, 373 but see text accompanying n.18 infra.
10 Idem.
11 See concluding observations at pp.183-184.
12 [1960] N.Z.L.R. 259.
13 [1960] N.Z.L.R. 259, 262; see text accompanying n.51; but see also text accompanying n.18 infra.
14 [1971] N.Z.L.R. 482; see text accompanying nn.57-58; but see also text accompanying n.18 infra.
15 Molloy, supra n.2 at 32-33.

Golightly's case, which related to the income years 1970 and 1971, turned on section 111(b) or section 111(a), or on both, like *Prosser's* case. Speight J. simply refers briefly to section 111 without differentiating between the two subsections. However, his Honour does mention that the case depended on the definition of "business" in section 2 of the Act.[16] Logically, this would suggest that his Honour was determining the case on the basis of section 111(a). Under that subsection, with its implied reference to section 88(1)(a), the definition of "business" may be relevant, whereas, as Dr. Molloy so cogently argues,[17] its relevance is not so immediately apparent in respect of section 111(b). Thus, subject to a further argument to be developed immediately below, all these cases, probably even including *Golightly's* case, must be regarded as authority directly in point on the meaning of "business" in section 88 (1)(a), now section 65(2)(a) of the Income Tax Act 1976.

The further argument just mentioned relates to cases turning on the pre-1968 form of section 111(2) and the current section 104(a). These sections both permit the deduction of expenditure incurred in producing "the assessable income for any income year", without specifying any particular source for that income, or defining "assessable income". They thus refer one back to the Act's definition of assessable income in section 88(1)(a) (in respect of section 111) and section 65(2)a) (in respect of section 104(a)). In each case, the definition is, of course, "all profits or gains derived from any business".

It is submitted that the important words here are "profits or gains", whereas the cases that have been discussed have emphasised "business". When one concentrates on "profits or gains" rather than on "business", there becomes apparent an argument based on section 65(2)(a) that is almost identical to Dr. Molloy's argument in respect of section 104(b). There, Dr. Molloy points out that deductible expenditure must be incurred in carrying on a business *for the purpose of gaining or producing* assessable income.[18] Similarly, where the more general words of section 104(a) and the pre-1968 section 111(2) refer one to section 65(2)(a), or section 88(1)(a), it is apparent that, to be deductible, expenditure must be incurred *in order to produce "profits or gains"*. Thus, it is submitted that it is insufficient for a taxpayer claiming under section 104(a) (or, formerly, under section 111(2)) to point to a business that he carries on. His business must produce profits or gains, or at least be reasonably likely to do so. As in respect of section 104(b), the profits or gains need not be in the year of the expenditure, but may be in respect of "any income year".

If this argument is accepted, it is further submitted that Quilliam J. in *Prosser's* case was equally incorrect in his analysis, whether the case turned on section 104(b) or section 104(a), then numbered 111(b) and (a). In either case, the test should have been not whether there was a business, but, assuming a business existed, whether it had a reasonable prospect of profit. Be that as it may, this was not how Quilliam J. approached the case and, more importantly, the judgments in *Watson's, Harleys* and *Golightly's* cases followed the same reasoning as did Quilliam J. *Communis error facit jus.* Despite the arguments of Dr. Molloy

16 (1972) 1 T.R.N.Z. 135, 137.
17 Molloy, supra n.2 at 31-32, 305-310.
18 See text accompanying nn.2-3 supra.

in respect of section 104(b) and of the present author in respect of section 104(a) and the pre-1968 section 111(b), it must be considered as settled law, as far as the Supreme Court is concerned, that an intention to make a profit is an essential ingredient of a "business". Moreover, since the 1976 consolidation Act was passed after the cases referred to above, it is submitted the same conclusion should obtain in the Court of Appeal.[19]

19 Cf. *Re Manson* [1964] N.Z.L.R. 257, 272 per McCarthy J., quoted in text accompanying n.96.