IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY 11/4/83

M.1409/82

Special Consideration

BETWEEN ANZAMCO LIMITED
(In Liquidation)

Objector

152.

A N D THE COMMISSIONER OF INLAND REVENUE

Commissioner

Hearing : 1st, 2nd March 1983

Counsel : A.P. Molloy for Objector
B.L. Bridger for Commissioner

Judgment : 28th March 1983

JUDGMENT OF BARKER, J.

In this case stated, referred directly to this Court pursuant to Section 33 of the Income Tax Act 1976 ("the Act"), the objector challenges the determination of the Commissioner to assess as liable for income tax, profits derived by the objector upon the sale of a large farm near Taupo.

A comprehensive affidavit with numerous exhibits was filed from Mr F.L. Curtin, a Hamilton solicitor, who has acted as the Secretary of the objector since 1965 and as a director since 1974. This affidavit provided the background facts. Mr Curtin also gave oral evidence; he was cross-examined on that and on his affidavit. In addition, I heard oral evidence from Mr A.J.M. Bowley, the objector's farm manager from 1969 onwards; from Mrs W.S. Mendenhall, the widow of the late Mr Wendell Mendenhall, the principal director in New Zealand of the objector at all material times; and from Mr E.L. Clissold, the sole survivor of the original directors. Despite his considerable age, Mr Clissold travelled from the United States

to the hearing.

The objector was incorporated on 5th July 1956. It was originally formed with the intention of conducting a business based on utilising certain American technology in New Zealand. These initial plans did not bear fruit; it did not trade during its first decade of corporate life.

In 1966, the four principal shareholders and directors in the company were Mr Mendenhall, Mr Clissold, Mr W.C. Olsen and Mr G.R. Beisinger. All were active members of high standing in the Mormon Church; through their missionary activities they had forged strong connections with New Zealand - particularly so in the case of Mr Mendenhall. He had held a roving commission for his church throughout the world to supervise the building of new churches and temples. Having visited New Zealand frequentl in the course of his duties from 1927 onwards, in the words of his widow, he had grown "to love New Zealand".

The four shareholders, whose homes were in Salt Lake City, Utah, U.S.A., were attracted to the idea of purchasing and developing a "ranch" in New Zealand. Each had a different skill to bring to the venture. Mr Clissold (now aged about 85) had been a banker; Mr Beisinger, a contractor; Mr Olsen, a sheep farmer and Mr Mendenhall, a builder, with a knowledge of farming.

They looked for some place where they could take their families for vacations where outdoor sporting activities were available. They hoped to sell the concept to professional people in their own city. With New Zealand's seasons being the opposite from those in the United States they considered that a ranch in this country could have much appeal.

The driving force behind the whole scheme - certainly

in its implementation in New Zealand - was undoubtedly Mr Mendenhall. Most relevant discussions and negotiations at the time the land was acquired were held by him on behalf of the objector.

After inspecting numerous sites, particularly some near to the New Zealand headquarters of the Mormon Church near Hamilton, Mr Mendenhall eventually decided that the objector should buy two contiguous blocks, situated about 25 miles from Taupo on the Napier road.

The first block, with an area of 1,952 acres, was owned by Bio-Lab Developments Limited and the other, some 18,386 acres in area, was owned by the Tuhoe Maori Trust Board.

On 26th February 1966, the objector obtained an option to purchase the Bio-Lab property for £13,500; on 11th March 1966, it obtained an option to purchase for £190,000 the Tuhoe land. (After negotiations, to which it is not necessary to refer, the purchase price for this latter block was reduced to £170,000.)

Under the law then in force, the only formality before purchase was a purchaser's declaration under the Land Settlement Promotion and Land Acquisition Act 1952 in respect of the Bio-Lab land. This declaration was made on behalf of the objector by Mr Earl Mendenhall, a brother of Mr Wendell Mendenhall In his declaration, Mr Earl Mendenhall stated that considerable capital expenditure was anticipated in developing this land and that it would be some years before it was properly productive.

As the law then stood, such a declaration was not required for the Tuhoe land. All that was needed was the consent to the transaction of the Minister of Maori Affairs; this was provided in due course. Together, the two blocks came to be known as "Poronui Station" or, in one promotional brochure, "El Rancho Poronui".

For the objector to raise the necessary funds to complete both purchases, it had either to borrow from its American shareholders or to issue further shares in the United States. Under the Capital Issues (Overseas) Regulations 1965 ("the Regulations"), Regulation 3(1)(a) and (d), such a course was unlawful without the consent of the Minister of Finance.

No reference had been made in the option documents to this consent; the options must be read in the light of this requirement. The respective parties to the options agreed that if the Minister's consent to the raising of further money was not given, then the moneys paid under the options would be refunded.

According to Mr Curtin, Mr Mendenhall was something of an entrepeneur; he was always confident that there would be no difficulty in obtaining the appropriate Ministerial consent under the Regulations. He relied on his friendship with the then Minister of Finance.

With a general election due to be held at the end of 1966, the purchase of large blocks of New Zealand farmland by foreign interests had become a rather sensitive political issue. The Minister's consent could not be assumed. A meeting was held at the office of the Minister on 20th May 1966; it was attended by four Cabinet Ministers, four senior Public Servants and by Mr Mendenhall and a Mr Meyers (both representing the objector). The minutes of this meeting, as sent by the Minister to Mr Mendenhall on 30th June 1966, record an invitation by the Minister to Mr Mendenhall to explain to the meeting the aims and objectives of his company. Counsel did not challenge the accuracy of these minutes.

Mr Mendenhall explained to the meeting his concern to secure the right to remit the profits from any farming

operations, together with the original capital and any capital profits, to the United States. He proposed to the meeting (inter alia) that his company be given the right to develop the properties in blocks and to sell off these blocks (in lots of approximately 1,000 acres each) to New Zealand residents as the company saw fit, with an accompanying right to remit the proceeds of these sales to the United States.

In his letter of 30th June 1966, which accompanied the minutes, the Minister declined his consent; he advised Mr Mendenhall that even since the meeting, there had been criticism of any sale of Poronui to an overseas group; the matter had been raised in the House of Representatives.

There was also produced the minutes of another meeting held on 4th May 1966 in the Minister's office; this involved only the Minister and Messrs Mendenhall and Olsen (all of whom are now deceased). A Mr Lang, a Treasury official, was also in attendance; he recorded Mr Mendenhall's suggestion about selling part of the land differently. His minute reads:

> "If all the above deals go through the company would then have a total of up to 28,000 acres of contiguous farmland which at present is partly developed. They are prepared to undertake that their activity will be confined to developing this land for farming purposes. They propose to develop this land in blocks and to sell off these blocks - it might be 8 to 10 stations - to New Zealanders and to remit the proceeds to the United States."

It should be mentioned, as part of the narrative, that the objector was contemplating the purchase of a further 7,000 odd acres from Sir William Stevenson who owned another contiguous block. This latter purchase never eventuated.

Mr Curtin emphasised that Mr Mendenhall regarded it

as most important (and his evidence was confirmed by Mr Clissold) that he should be able to demonstrate to stockholders in the United States that any money invested by them in the ranch would not be "locked" into New Zealand by restrictive exchange laws.

After the Government had been returned to power in the 1966 elections, the objector, this time through Mr Curtin, renewed its application to the Minister for his consent under the Regulations, to borrow up to £230,000 in New Zealand and in addition to raise up to £700,000 in the United States and bring the money to New Zealand. In a summary of the objector's proposal attached to Mr Curtin's letter dated 6th December 1966, there reappears in identical wording, a reference to a right to develop the properties in blocks as mentioned in the minutes of 20th June 1966 meeting.

Mr Curtin had known nothing about the suggestion to develop the land into blocks for sale within 25 years until he saw the minutes of the meeting of 20th June 1966. When he asked Mr Mendenhall about this suggestion in late 1966, he was told that Mr Mendenhall had no real intention to sell at that stage but he was afraid that if the objector did have to sell, exchange control regulations might be used against them because they had never offered to sell in the first place.

In a follow-up letter dated 15th December 1966, Mr Curtin provided the Minister with requested clarification on the point "when does the company intend to sell off its property or parts of it?" in these words:

> "With respect to the sale of the land the position that my clients take is that the company may not want to sell the land at all or any portion of it; it is being developed

> as a farm or farms, and it is intended that it should be developed in several economic units. However, the company would not wish to have its hands tied on this, and would like it to be understood at this juncture that it wishes to be free to sell off blocks of this land if and when it chooses to do so. It is understood of course, that in the event of any such sale, the land would first be offered to New Zealand residents and would not later be offered to overseas residents on any different terms to that at which it was first offered to New Zealand. With respect to the repatriation of capital and profits which might result from sale or sales, my client company has no wish to embarrass the economy of the country by making a quick demand for repatriation of capital, and in the event of sales of the property or properties, the company would be happy to negotiate the time of repatriation of these funds with the Governor of the Reserve Bank or any other appropriate authority. The company is satisfied that it could give sufficient notice to the Government on the sale of any piece of property to avoid any embarrassment with respect to overseas funds.
>
> The company is of the opinion that it would be unlikely that there would be any sales at all of developed land within the next 10 years, and it may be as much as 20 years before any such land is sought to be sold."

Mr Mendenhall himself wrote another letter dated 22nd December 1966 to the Minister in which he said inter alia:

> "It is expected that we will begin to sell off one half of the property at the end of 25 years, to be offered to New Zealanders first ...".

By a letter dated 5th January 1967 addressed to Mr Curtin, the Minister gave his consent under the Regulations to the objector's bringing into New Zealand, at any time within the next 10 years, between $800,000 and $900,000 for the purpose of purchasing and developing Poronui and acjacent properties for farming. The money was to be raised in the United States at the discretion of the company either by the issue of stocks or shares or by borrowing in the fashion described in Mr Curtin's letters.

The Minister's consent was made subject to the following stated conditions:

> "(a) That no funds are to be borrowed in New Zealand for the purchase and development of the land in question;
>
> (b) The company agrees that in relation to the repatriation of capital and the remission overseas of operating and capital profits it will be bound by the rules in force at the time at which it seeks to repatriate or remit capital or profits;
>
> (c) The company agrees to sell one half of the total area as developed farms to New Zealand residents within twenty five years from the date of this consent;
>
> (d) The company agrees to provide the Forest Service with satisfactory access to the State forests to the south of the proposed development area."

On the subject of remission of profits and repatriation of capital, the Minister annexed a statement of his current policy.

Mr Mendenhall sought some variation to these conditions; his representations produced a further letter from the Minister dated 2nd February 1967 in which he refused to remove condition (d) but was prepared to amend condition (c) to read:

> "Agrees to offer for sale to New Zealand residents within 25 years half of the total area as developed farms at valuations to be agreed upon between the Crown and the Company or, failing agreement, at valuations assessed by arbitration under the Arbitration Act."

This wording of condition (c) was far better than that in the letter of 5th January 1967 which can be criticised as vague and possibly unenforceable.

According to Mr Clissold, Mr Mendenhall was most concerned about a "paper road" that went through the property and the requirement to provide access for the Forest Service.

Mr Mendenhall had wanted condition (c) to be amended to read "half the developed land" and not "half the total area". The Minister refused that amendment, saying:

> "The whole tenor of Cabinet's agreement to your proposal was that the whole area should be developed within a period of 25 years. You will appreciate that your suggested amendment could result in a far slower rate of development."

By letter dated 9th February 1967, the company agreed to the conditions as stated in the letter of 5th January 1967 and not as stated in the suggested amendments. There was some further correspondence concerning the exact terms of the condition relating to finance which are not relevant here. The options were duly exercised; formal possession of Poronui Station was taken by the objector on 20th February 1967.

The Department of Lands and Survey was anxious to formalise by deed the conditions subject to which the Minister had consented to the objector's applications under the Regulations. Mr Mendenhall was not anxious to have any such deed executed. Mr Curtin exhibited several years of correspondenc between himself and various Government agencies.

He stated in his evidence that Mr Mendenhall procrastinated for over two years, because he did not wish to be bound to such terms. Eventually, the deed was signed; the objector was engaged in discussions to buy more adjacent land for which it would have needed further Ministerial consents. Mr Mendenhall realised that such consents were unlikely to be forthcoming unless he complied with the conditions of the Poronui consent. The deed was executed in June 1971.

He had told Mr Curtin of his belief that as soon as the station was fully developed, the Government would see the wisdom of keeping it as a single unit. He had a reluctance to "put pen to paper" more than he had because of this belief. Ironically, when the land was sold, according to Mr Curtin, Lands and Survey Department officials considered that it was better farmed in one block. The new owner has sold the Bio-Lab portion only.

Upon taking possession, Mr Mendenhall prepared a report for his stockholders in the United States. He stated in this report:

> "We must keep in mind that in 25 years, half of the property must be offered to the New Zealand market. Our master plan should outline which half is going to remain with us and which half offered for sale."

Over the years, the property was developed constantly and large amounts of money were spent in development. The cost of development was deducted for tax purposes in accordance with various enabling statutes, the provisions of which are now found in Sections 126 to 129 of the Act.

According to Mr Bowley, the manager of the station from 1969 onwards, Mr Mendenhall wanted to farm the property as a whole; it was, under Mr Mendenhall's firm direction, developed in such a way that a subsequent splitting into half would not be feasible. It was a long, narrow property with limited access to public roads. Mr Mendenhall's development was not effected with subdivision either into halves or into 1,000 acre blocks in mind. For example, fencelines were placed on contours as in normal farming practice and not on survey boundaries. Two homesteads were built virtually side by side.

Mr Bowley said that Mr Mendenhall did not favour having to sell at all but had said several times that, if he had to sell half, it would be the southern half which had insufficient roading and greater isolation.

Mr Bowley was not made aware of the sale provision when he was first employed in 1969. He understood from Mr Mendenhall that the station was to be kept for the shareholders and their descendants.

Mr Mendenhall and his wife lived on the property for about 5 months of every year until shortly before his death in 1978. Various stockholders from the United States called for visits of varying lengths. Mr Bowley believed that there were about 100 stockholders in the venture towards the latter stages.

Much of the evidence was devoted to a re-creation of Mr Mendenhall's attitude to the condition of the Minister's consent that the objector was to sell half the property, within 25 years. The actual deed of covenant as eventually signed by the objector reads:

> "The company agrees to sell one half of the total area as developed farms to New Zealand residents within 25 years from the date of this consent."

Mr Clissold and Mr Curtin, whose evidence I accept, both spoke of Mr Mendenhall saying that 25 years was "down the road" or "down the track", meaning that it was so far away that they hoped they would not be called upon to sell; i.e. he hoped to persuade the Government to change its mind.

Mr Clissold was not concerned about the 25 years restriction; he knew that none of the original shareholders

would be alive when the time expired. He said:

> "The desire was to build a ranch which we could be proud of, something which we could visit and have the right kind of recreation and at the same time something which would pay for itself. We did not want to have to invest a lot of capital and have to keep following it with maintenance and it appeared from the surveys that it would be a profitable venture."

It was a profitable venture, especially in the later years when there were annual cash surpluses of over $100,000.

After Mr Mendenhall died in 1978, there was some discussion whether his sons would be interested in taking over the ranch; in the event, none of his family nor the families of the other major shareholders were interested in continuing with the property, despite the wish of some of the lesser stockholders that the venture should continue; in the end, the objector decided to sell the property; an agreement for sale with a Mr Howard was executed on 2nd May 1980, selling the land for $3,706,965. The agreement was conditional inter alia on the Government's waiving the requirement of the covenant referred to earlier; this was duly done.

The Commissioner claims, in the objection now before the Court, that half the profits derived by the objector from the sale of the Tuhoe land are assessable income pursuant to Section 67 of the Act.

The Commissioner has since issued another assessment, claiming that the whole of the profit from the sale of both blocks Tuhoe and Bio-Lab, is taxable; because the company is now in liquidation, only sufficient funds to pay the tax in issue in the present proceedings have been retained. The Commissioner's subsequent attempt to recover more tax may be largely academic.

On 19th October 1982, I delivered a judgment which declared invalid a notice issued by the Commissioner, purporting to attach the moneys held by the liquidator of the objector in a bank account. Since that judgment was issued, agreement has been reached between the liquidator and the Commissioner whereby sufficient funds have been retained by the liquidator to cover the amount of tax claimed in the present objection, plus penalty tax plus costs.

If the Commissioner succeeds, there is also non-resident witholding tax involved; the total tax bill on the present assessment is $804,757.

The onus of proving that the Commissioner's tax assessment is incorrect is on the objector; the two matters for decision are:

(a) Whether the objector acquired the land for the purpose or intention or for purposes or intentions including the purpose or intention of selling or otherwise disposing of it; (Section 67(4)(a) of the Act)

(b) Whether the profits derived from the sale of the land are assessable for income tax by reason of Section 67(4)(e) of the Act.

Mr Molloy wished to raise the question of the effect of inflation on the objector's tax liability; this question was determined in favour of the Commissioner in Lowe v. Commissioner of Inland Revenue, (1981) 1 N.Z.L.R. 326. That case is due to be heard by the Privy Council in October of this year. Mr Molloy asks that, if I hold against the objector, nevertheless, the inflation point be reserved until the Privy Council decision is known.

The first issue is whether, on the facts, the objector has satisfied me on the balance of probabilities that it did

acquire the land for the purpose of or with an intention of resale, even though such purpose or intention may have been only one of the purposes or intentions.

Provided it assists the Court to deal effectually with the proceedings, the effect of Section 35(1) of the Inland Revenue Department Act 1974 and Section 33(10) of the Act, enables the Court to receive as evidence, any statement, document, information or other matter, irrespective of whether it would be otherwise admissible. These provisions are particularly useful in the present case, since the person who would be most able to give the relevant evidence, Mr Mendenhall, is now dead.

The appropriate time at which to consider a taxpayer's intention or purpose under this provision is the date of its acquisition of the land. On the facts of this case, this must mean the date when the option was exercised, not the date it was given which may be the appropriate date in other fact situations. The option makes no reference to obtaining of Capital Issues consent; the option could not have been implemented without that consent. I must consider what was in the mind of Mr Mendenhall in particular and the shareholders in general at the time when the option was exercised in 1967.

Having heard the witnesses, in particular Messrs Curtin and Clissold, I am satisfied, on the balance of probabilities, that the directors of the objector did not purchase the land for the purpose or intention of reselling it. Uppermost in their minds was the notion of creating a ranch in New Zealand. They interested many of their friends and acquaintances in Salt Lake City and raised a considerable sum of money from them to purchase and develop the ranch. Mr Mendenhall enjoyed living on the ranch; many of the other stockholders visited for short periods. The evidence of Mr Bowley shows that the ranch was not

developed with subdivision in mind; fencelines not conforming with survey boundaries; the siting of a wool shed and the manager's homestead in the middle of the property are not indications of a desire to subdivide.

The biggest difficulty against the objector in this branch of the case is the covenant in the deed which was derived from Mr Mendenhall's representations to the Minister that half of the land would be offered within 25 years to New Zealand citizens. I conclude that this statement was more of a negotiating posture by Mr Mendenhall; he did not envisage that the covenant would be enforced; his hope was that within 25 years, he would be able to persuade the New Zealand Government to dispense with this condition.

The correspondence and the witnesses show that Mr Mendenhall was an outgoing, assertive, entrepreneurial figure. He was completely taken up with the idea of establishing this ranch in New Zealand. I accept his widow's evidence when she said:

> "We loved Poronui. We didn't want to sell it, that was our home. I sold my home to live in New Zealand. I loved the ranch. I don't think there was ever an attempt to sell it."

Mr Mendenhall seems to have possessed a certain political sense; one can speculate that he may have suggested the notion of selling half the land within 25 years as a "sweetener" when he perceived that there was some opposition to foreign investment in such a large amount of land in New Zealand.

According to Mr Clissold, Mr Mendenhall did not regard this particular condition of consent regarding sale as so much an irritant as he did the condition regarding the

road. Moreover, the fact that Mr Mendenhall delayed for so many years in signing the covenant is an indication to me that he did not want to take it seriously.

I accept what Mr Clissold said that, when the venture was entered into, it was understood that if it did not work out for any reason, then the land would have to be sold. That finding is not to say that the land was purchased with a purpose or intention of reselling. Anybody who purchases a farm may acknowledge, if pressed, that if, for some good but unforeseen reason, the farming venture becomes impossible (e.g. through a natural disaster or an accident to the farmer) then he would have to sell and would hope for a profit on sale. This is not the same as buying in a speculative way with the intention or purpose of making a profit on the resale.

The legal situation is best summarised in the dictum of Owen, J. in Smithfield Pastoral Co. Pty Ltd. v. Federal Commissioner of Taxation (1966), 10 A.I.T.R. 9.11:

> "I have no doubt that any prudent man who was considering the purchase of land in the Smithfield district, to whatever use he proposed to put it, would have taken into account the possibility or probability that, as time went on and the "satellite" town developed, land values in the surrounding countryside would increase. It would be, however, to take a long step to say that, because a purchaser expects an increase in the value of property which he is thinking of buying, it should be inferred that his purpose in buying is to resell at a profit. The existence of such an expectation is obviously a relevant fact to be considered in determining the purpose for which the land is bought but it is a consideration which, I think, would be in the mind of any sensible person who is considering making a purchase of land whether he intended to farm it, use it as a residence or for business purposes, or resell it. I have no doubt that, in buying land at Smithfield, Becker, Pickering and Haseldine took into consideration the prospect, which eventuated, that land values would increase. It would be surprising if they did not do so."

I consider that the objector has succeeded in discharging the onus of proof in respect of the first ground of objection.

The second point raised is of greater difficulty. It depends not on the evidence but on a narrow point of interpretation. Section 67(4)(e) was first introduced to the legislation in 1973; it declares to be assessable income:

> "(e) All profits or gains derived from the sale or other disposition of land where -
>
> (i) An undertaking or scheme, whether or not an adventure in the nature of trade or business, involving the development or division into lots of that land has been carried on or carried out, and the Commissioner is satisfied that the development or division work, not being work of a minor nature, has been carried on or carried out by or on behalf of the taxpayer, on or in relation to this land; and
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> (ii) That undertaking or scheme was commenced within 10 years of the date on which the land was acquired by the taxpayer."

In Lowe's case, the Court of Appeal rejected a submission that a profit automatically escapes taxation because it was a capital profit and not income in character.

Over the years, the objector has spent a large sum on development - work which by no stretch of the imagination could be called "work of a minor nature". This development was commenced shortly after the land was acquired by the objector - certainly within 10 years from the date when the land was acquired. Moreover, it was an "undertaking" or "scheme" - i.e. "a plan, design or programme of action, hence a plan of action to attain some end; a project, an enterprise". See Vuleta v. Commissioner of Inland Revenue, (1962) N.Z.L.R. 325, 329 and Wellington v. Commissioner of Inland Revenue, (1981) 5 T.R.N.Z. 151.

Mr Bridger's submission was that the development of the farm was an undertaking or scheme not of a minor nature, carried on or carried out in relation to or on behalf of the taxpayer on the land in question, involving the carrying on or carrying out of the development of that land.

Mr Molloy submitted that the word "development" in the legislation must be read together with the words "into lots" so that the only kind of "development" caught by the section is "development into lots"; counsel submitted that it would not be possible to have "development into lots" without "division into lots"; the definite article was not placed before the word "division" nor were there commas after the word "development" and the word "lots".

Mr Molloy next submitted that the Legislature had, in enacting Sections 126 to 129, granted farmers the right to claim deductions for development work on farms with the right of the Commissioner to "claw" back the deductions if the sale of the property were made within 5 years of the date of acquisition. He also referred to the exempting subsections; i.e. Section 67(8) and (9) which are in the following terms:

> "(8) Paragraphs (e) and (f) of subsection (4) of this section shall not apply to the sale or other disposition of any land by any taxpayer where that land is a lot resulting from the division into 2 or more lots of a larger area of land (being an area which before any division by the taxpayer did not exceed 4,500 square metres) which was occupied by that taxpayer primarily and principally as residential land for himself and any member of his family living with him.
>
> (9) Paragraphs (e) and (f) of subsection (4) of this section shall not apply to the sale or other disposition of any land in any case where -

(a) That land is a lot resulting from the division into 2 or more lots of a larger area of land which, immediately before that division, was occupied or used by the taxpayer primarily and principally for the purposes of a farming or agricultural business carried on by the taxpayer; and

(b) The Commissioner is satisfied, after, if he considers it necessary, consultation with the Director-General of Agriculture and Fisheries or any other person, that that land is of such an area and nature that it is then capable of being worked as an economic unit as a farming or agricultural business; and

(c) Having regard to the circumstances of the sale or other disposition of that land (including the value of the consideration for which that land is sold or otherwise disposed of, current prices paid for land in the vicinity of that land, the terms of the sale or other disposition, any zoning or other classification relating to that land, the proximity of that land to any other land used or being developed for uses other than farming or agricultural uses) the Commissioner is satisfied, after, if he considers it necessary, consultation with the Director-General of Agriculture and Fisheries or any other person, that that land was sold or otherwise disposed of primarily and principally for the purposes of the use of that land in any farming or agricultural business."

Mr Molloy's submissions have the benefit of reasonableness; particularly when it is remembered that the objector commenced its "undertaking or scheme" long before the 1973 amendment by which profits of this sort are now sought to be taxed. However, it has been said often that there is no equity in tax. I must interpret the provisions in accordance with the normal criteria of statutory interpretation.

It seems to me clear that the Legislature had in mind in Section 67(4)(e) two different concepts; i.e. division into lots and development. Both can enhance the value of land. It is possible to subdivide bare land without having done any development. Likewise, it is possible to develop land without

doing the necessary surveying, engineering and legal preliminaries necessary for subdivision.

Section 67(4)(e) applies to development of any kind of land - industrial, residential, commercial or farming. Sections 126 onwards relate only to farming land.

A detailed discussion of the forerunner of Section 67(4) is found in the judgments in the Lowe case which concerned a subdivision of land. At p.340 Richardson, J. said:

> "I turn now to (d) (now Section 67(4)(e) of the 1976 Act). The paragraph expressly defines and limits the type of undertaking or scheme to which it applies. It is one "involving the development or division into lots of the land". While it is not clear whether the words "into lots" qualify division only or whether they qualify both alternatives "development or division", it is both necessary and sufficient that the plan or project should involve development or division of the land. This is subject to the qualification that the development or division work involved not be "of a minor nature". Whether the work is of a minor nature must, it seems, depend on an overall assessment of such matters as the time, effort and expense involved, measured both in absolute terms and relative to the nature and value of the land on which the work is done. More importantly for present purposes, division as an alternative to development and the limitation of the exception to work of a minor nature suggest that not a great deal is required by way of activity to constitute a plan or programme of action an undertaking or scheme under the paragraph. That is the first ingredient. And the addition of the phrase "whether or not an adventure in the nature of trade or business" was obviously intended to exclude any argument that to come within the tax net the development or subdivisional activity must also exhibit features which give the transaction the character of a business deal." (Italics mine)

In this case, it is necessary to determine the point left open by Richardson, J. in Lowe's case; i.e. whether the words "into lots" qualify both alternatives "development" or "division".

Mr Molloy submitted that Section 67 (or its predecessor) was held in Lowe's case to be a "code"; I doubt this submission. Cooke, J. said at p.331 of the predecessor: "To describe it as a code on the subject would not be strictly accurate". In my view, the sale of the land is caught by the tax net. As Cooke, J. pointed out also at p.331 of Lowe's case that the provision shows "a clear intention on the part of the New Zealand legislature to make the profits of taxpayers who subdivided or developed land liable to income tax in certain circumstances even if they would not have been taxable under the principles applied in such cases as McClelland and Walker". All the judgments in Lowe's case give a helpful discussion of the history of the provisions and emphasise that capital gains may be taxable as income if the statute so directs.

The meaning of Section 67(4)(e) of the Income Tax Act 1976 is plain without having to insert the definite article before the words "division into lots". The word "or" between the words "development" and "division into lots" is disjunctive. One does not speak of development into lots, especially when the concept of subdivision is adequately covered by the words "division into lots". "Development" and "division" are not synonymous words and it must be assumed that the Legislature meant each to bear a different meaning. While a subdivision into lots may be described broadly as a development of the land, development need not involve any division of the land. "Division into lots" may be a specific instance of development in some circumstances; however, there is no need to restrict the meaning of "development" to a synonym for "division into lots".

The judgments in Lowe v. C.I.R. (1981) N.Z.L.R. 326 contain many passing references to a distinction between "development" and "division":

(a) Per Cooke, J. at p.331:
"Scheme of development or subdivision".

(b) Per Richardson, J. at p.339:
"The development or subdivision work".
P.340:
"Division as an alternative to development".

(c) Per McMullin, J. at p.353, l.30:
"Developmental or subdivisional work".
P.357, ll.29-30:
"I think that s.88AA(1)(d) (i.e. now 67(4)(e)) is to be properly read as requiring that the land which was the subject of the sale must have been the whole or part of a block upon which developmental or subdivisional work had been done".

Ongley, J. stated in Wellington v. Commissioner of Inland Revenue (1981), 5 N.Z.T.C. 151, 155, that "the expressions "development work" and "division work" must be taken to indicate different though possibly overlapping categories of work".

The fact that development work may be in the nature of expenditure deductible under Sections 126 to 128 does not preclude the application of Section 67(4)(e). Assessable income is whatever the Act says it is. "Taxable income is the residue of assessable income after deducting the amount of all special exemptions to which the taxpayer is entitled (Section 2)" (Per Richardson, J., Lowe v. C.I.R. (supra) at p.344).

Where there is an "undertaking or scheme" in terms of Section 67(4)(e), it may be that such undertaking or scheme generates farming income from which may be deducted items referred to in Sections 126 to 128; however, once profit from the sale of land is generated, Section 67(4)(e) comes into play. The only requisites for the operation of this provision are that there be an "undertaking or scheme involving the development (or division into lots) of the land which is not of a minor nature,

and which is commenced within 10 years of acquisition". All those requisites are found in the present case.

Only those deductions allowed by the Act can be claimed by a taxpayer. They are a concession by the Legislature; the "clawback" provisions in Section 129, rather than categorising Sections 126 to 128 as a "code", represent a qualification of these particular concessions.

I find no help in subsections (8) and (9) of Section 67 quoted above and relied upon by Mr Molloy in a submission to the effect that the word "development" in Section 67(4)(e) must relate to the words "into lots". True, subsections (8) and (9 relate to subdivision of the land into either homestead lots (subsection 8) or economic farming units (subsection 9). However, I think subsection (11) is of greater help. It provides:

> "This section shall apply where the land sold or otherwise disposed of constitutes the whole or part of any land to which this section applies or the whole or part of any such land together with any other land." (Italics mine)

Clearly in this subsection, the Legislature did not see any part of Section 67 (including Section 67(4)(e)) as being restricted to sales of part of the land, but specifically mentioned sales of all the land.

Therefore, whilst the objector succeeds on the first ground, it fails on the second and the Commissioner's assessment is upheld. Since each party has succeeded on one branch of the argument, I make no order as to costs.

The validity of Mr Molloy's "inflation argument" awaits determination by the Privy Council later this year. Consequently, I do not dismiss the objection meantime, but

reserve liberty to apply to both parties in respect of that matter only.

R. D. Barton J.

SOLICITORS:

F.L. Curtin, Hamilton, for Objector.

Crown Law Office, Wellington, for Commissioner.

28/4

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

M.1409/82

No Special Consideration

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BETWEEN ANZAMCO LIMITED
(In Liquidation)

Objector

A N D THE COMMISSIONER OF INLAND REVENUE

Commissioner

Further Hearing : 15th April 1983 (In Chambers)

Counsel : A.P. Molloy for Objector
B.L. Bridger for Commissioner

Judgment : 20th April 1983

SUPPLEMENTARY JUDGMENT OF BARKER, J.

In my principal judgment delivered on 23rd March 1983, I did not dismiss the objection; I reserved liberty to apply to both parties because of Mr Molloy's submission relating to the effect of inflation on the objector's tax liability. An appeal in Lowe v. Commissioner of Inland Revenue, (1981) 1 N.Z.L.R. 326 is awaiting hearing before the Privy Council; the decision in that appeal will determine Mr Molloy's submission on inflation in this present case.

Since the delivery of judgment, counsel have seen me in Chambers. Mr Molloy claimed that my judgment did not deal fully with a submission advanced at the hearing; i.e. if Section 67(4)(e) of the Income Tax Act 1976 ("the Act") applied and the profit derived by the objector from the sale of its land was accordingly taxable (as I have held), then the accumulated costs of the development of the farm to the point at which it was

able to command the price obtained for it must be deducted from the purchase price received by the objector. These accumulated costs amounted to $1,068,157, being the aggregate sum of the deductions from gross income allowed by the Commissioner to the objector over the period from 1967 to 1980; Sections 126 and 127 of the 1976 Act and corresponding earlier enactments permitted these deductions.

I had thought that, in my earlier judgment, I had made it clear that:

(a) Lowe's case held, in relation to the predecessor of Section 67, that a profit does not automatically escape the purview of the section merely because it is a capital profit; and

(b) The fact that the objector may have claimed a deduction under Sections 126 to 129 of the Act, or corresponding earlier enactments, is of no relevance in determining liability for income tax under Section 67(4)(e).

It is clear law that a Judge is not required, when giving his reasons for judgment, to traverse every argument submitted; see R v. Nahkla (No. 2), (1974) 1 N.Z.L.R. 453, 456 and Hardwick Game Farm v. Suffolk Agricultural Poultry Producers Association Limited, (1966) 1 All E.R. 309, 338; however, I am advised by Mr Molloy that my decision on Section 67(4) is likely to be taken further; it therefore seems appropriate to provide further comment on this particular submission. This rather unusual course is made easier because the objection has not yet been formally determined by the Court. I record the consent of counsel to my issuing this supplementary judgment.

The submission referred to above does not change the view expressed in my earlier judgment. Counsel submitted, as he did in Lowe's case in respect of the same section of the Act,

that profit is, by definition, a net figure. Mr Molloy referred to the comments of Mason, J. in Federal Commissioner of Taxation v. Whitford's Beach Pty Limited (1982), 56 A.L.J.R. 240, 246.

This submission overlooks the fact that Section 67, in some of its provisions (including Section 67(4)(e)), imposes a de facto capital gains tax.

Richardson, J. pointed out in Lowe's case at p.344 that the scheme of New Zealand income tax statutes is to tax income, which is the residue of "assessable income", after deducting from gross income the special exemptions or deductions to which the taxpayer may be entitled. Expenses may not be deducted except insofar as they are expressly provided for in the Act (see Section 101); any expenditure or loss to the extent to which it is incurred in gaining or producing assessable income for any income year, or is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income in any income year, may, except as otherwise provided in the Act, be deducted from the total income derived by the taxpayer in the income year in which the expenditure or loss is incurred (Section 104).

The leading case on Section 104 is Commissioner of Inland Revenue v. Banks, (1978) 2 N.Z.L.R. 472. There, Richardson, J., delivering the judgment of the Court, said at p.476:

> "The deduction is available only where expenditure has the necessary relationship both for the taxpayer concerned and for the gaining or producing of his assessable income... There must be the statutory nexus between the particular expenditure and the assessable income of the taxpayer claiming the deduction."

In the present case, the deductions were claimed by the taxpayer in relation to its farming venture. Substantial amounts of income were generated annually and therefore there was the necessary nexus between the farming income and the farming expenditure. The deductions were therefore properly claimed both under Section 104 and under the special development sections 126 et seq (or their statutory predecessors).

Richardson, J. went on to say in Banks' case at p.477:

> "The statutory requirement is that the expenditure be "incurred" in gaining or producing the assessable income. It is to be judged as at the time that the taxpayer became definitively committed to the expenditure for which deduction is sought."

The question is whether, in computing the profit from the sale of the land, the Commissioner is required to deduct from the price received on sale not only the original purchase price paid by the objector but also its development expenditure. There is no mechanism in the Act to determine the word "profit" in Section 67(4); profit presupposes a net figure and must comprehend at least the subtraction of the cost of the land to obtain a figure; also expenses incurred in acquiring the land such as legal expenses, stamp duty, should also be deducted and possibly items such as rates.

Section 67(9A) may be of some help; it reads:

> "(9A) The Commissioner may, where he considers it necessary for the purposes of paragraphs (a) to (e) of subsection (4) of this section, -
>
> (a) Determine the cost price of any land in such manner as he thinks fit:

(b) Where any land is acquired together with any other real or personal property, apportion the cost price between that land and that other real or personal property in such manner as he thinks fit."

This subsection is deemed by Section 2 of the Income Tax Amendment Act 1980 to apply to tax in respect of income derived in the income year commencing 1st April 1980. Since the agreement for sale and purchase of the objector's land was entered into on 2nd May 1980, this section applies to the "profit" on the sale of the objector's land.

The case stated does not indicate specifically that the Commissioner has exercised his power under Section 67(9A) and determined the cost price of the land. However, there seems to be no argument as to the arithmetic - merely as to what items are to be included on one side of the equation or the other in determining "profit".

There is no express provision in the New Zealand Act as there is in the Australian Income Tax Assessment Act 1936 and the English Capital Gains Tax Act 1979 expressly disallowing double deductions. However, looking at the Act as a whole, there seems no warrant for allowing the taxpayer a double deduction.

There is a pointer to single deductibility in Sections 126(2) and 127(2) of the Act which provide in effect that the special deductions permitted by Sections 126 and 127 - which have been claimed by an objector - are conditional upon those deductions being not otherwise claimable. Also, there are sections in the Act which expressly permit a double deduction; e.g. Section 118(9) dealing with investment allowances are to be in addition to any depreciation allowance permitted by the Act.

Although, as I said in my principal judgment, there is no equity in tax, I do not consider that the result reached is demonstrably unfair; the taxpayer has had the benefit of deductions over the years as did the taxpayer in Lowe's case.

The real difficulty in the present case comes from the apparent mingling within one statute of the concepts of income tax and of capital gains tax. Under well-accepted principles of income taxation, assessable income is derived by subtracting from gross income the costs and expenditure of producing that gross income. It is looked at on a year to year basis. Thus, in the objector's case, over the years, its annual assessable income was determined by deducting from gross farming income normal business expenses plus the special allowances under Sections 126 et seq. or their statutory predecessors.

However, when one comes to consider what is in effect capital gains tax lurking in the interstices of an income tax statute, it is difficult to apply the same simple rationale to the ascertainment of "assessable income". One problem is the normal requirement that both income and authorised deductions therefrom are earned and incurred within a given fiscal year. Such approach is quite inappropriate when one has to consider a scheme or development which must necessarily extend over several years.

A key to solving the dilemma and one which tends to support the view I have taken, is found in Richardson, J.'s judgment in Lowe's case at p.345:

> "Counsel for the Commissioner agreed that the profits or gains derived from the sale of land under s.88AA had to be calculated without reference to the statutory provisions

> for arriving at assessable income which I have been discussing. Because of that concession, and in the absence of any argument on the point, I shall not explore the alternative view that in such a case all assets engaged are held on revenue account with the deduction provisions applying in the ordinary way to the outlays all of which are on revenue account and that until a sale occurs the land involved stands in the books at cost for tax purposes, thus matching the outlays on the acquisition, holding and development of the land in the revenue account as at the particular balance date."

Likewise, McMullin, J. at p.358, acknowledged the difficulty in calculating profits from transactions arising from the subdivision of land where development costs extended beyond a fiscal year. He considered that such difficulties did not preclude the making of an assessment, if the assessment has a basis which is real and sensible.

In my view, the basis on which the Commissioner has acted in assessing the "profit" on the sale of the objector's land has not been shown by the objector to have been wrong. In particular, the refusal by the Commissioner to deduct the development costs from the sale price in arriving at the "profit" under Section 67(4)(e) is correct.

The objection stands adjourned on the basis indicated in my principal judgment.

R D Barker J.

SOLICITORS:

F.L. Curtin, Hamilton, for Objector.

Crown Law Office, Auckland, for Commissioner.