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M.91/83

IN THE HIGH COURT OF NEW ZEALAND
PALMERSTON NORTH REGISTRY

BETWEEN JOHN ALEXANDER LOWBRIDGE BENNETT, Solicitor and ALFRED JOSEPH KELLS, Chartered Accountant both of Palmerston North as executors and trustees of the estate of Stanley Roy Nolan, deceased

Objectors

AND THE COMMISSIONER OF INLAND REVENUE

Commissioner

Hearing: 24 February 1984

Counsel: J C A Thomson for Objectors
C J Walshaw for Commissioner

Judgment: 5 JUL 1984

JUDGMENT OF EICHELBAUM J

This is a case stated pursuant to s 92 of the Estate and Death Duties Act 1968. The objectors are the executors of the late S R Nolan. Prior to his death the deceased had accepted a quotation for the painting of his house in the sum of $3105. The Commissioner agrees that at the date of death there was a binding contract. However, at that time work had not commenced. It was carried out after the deceased's death. It is not suggested that there was any obligation on the part of the deceased or his estate to make payment until the work had been performed. The question is whether for purposes of

computation of estate duty, the estate is entitled to allowance for the contract sum.

So far as is relevant the scheme of the legislation can be stated briefly. Estate duty is payable on the "final balance" of the dutiable estate. Broadly speaking the latter comprises all property of the deceased valued as at his date of death. The final balance is the total value of the dutiable estate less certain allowances, including "allowable debts".

The term "debt" is not defined exhaustively but in s 2 is stated to include any pecuniary liability, charge or encumbrance. As to "allowable debts", s 17 provides as follows :

" 17. Allowable debts - (1) Subject to this section, allowable debts shall comprise debts, whether incurred or payable in New Zealand or elsewhere, owing by the deceased at his death.

(2) Allowable debts shall not include -

(a) Any debt incurred by the deceased otherwise than for full consideration in money or money's worth wholly for his own use and benefit:

Provided that a debt shall be deemed to be incurred for full consideration in money or money's worth to the extent that the incurring of the debt

created a gift and the property comprised in the gift is included in the dutiable estate of the deceased:

(b) Any debt in respect of which there is a right of reimbursement except to the extent to which reimbursement cannot be obtained:

(c) Any contingent debt, unless at any time within 8 years after the death of the deceased the debt becomes actually payable:

(d) Any debt the amount of which is, in the opinion of the Commissioner, incapable of estimation, unless at any time within 8 years after the death of the deceased the debt becomes, in the opinion of the Commissioner, capable of estimation:

(e) Any debt in respect of a farm forestry agreement or forestry encouragement agreement under the Forestry Encouragement Act 1962 where the value of the land to which it relates is determined under section 21 of this Act:

(f) If any duty ceasing to be payable pursuant to paragraph (c) of subsection (1) of section 42 of this Act:

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(g) Any debt more than once, whether or not it is charged upon different portions of the dutiable estate:

(h) Any expenses of the administration of the estate of the deceased or commission or other remuneration payable to an administrator. "

I need not set out the balance of the section. Under ss. (4) certain liabilities, of a kind not owing at the date of death, are deemed to be so, for example tax on income derived up to the date of death, and funeral expenses. The first issue is whether the sum in question can be described as an allowable debt within the meaning of s 17(1).

Webb v Stenton 1883 11 QBD 518 was a garnishee case. The judgment debtor was entitled to the income for life arising from a fund vested in trustees, payable half-yearly. At the time of the judgment creditors' application the trustees, having made the last half yearly payment, held no further proceeds of the trust property. In holding that in terms of the Court rule there was no debt "owing or accruing", Lindley LJ said :

" . . .(A) debt legal or equitable can be attached whether it be a debt owing or accruing; but it must be a debt, and a debt is a sum of money which is now payable or will become pay-

able in the future by reason of a present obligation, debitum in presenti, solvendum in futuro. An accruing debt, therefore, is a debt not yet actually payable, but a debt which is represented by an existing obligation. "

(p 527)

Similarly Fry LJ said :

" . . .(T)he word 'indebted' describes the condition of a person when there is a present debt, whether it be payable in presenti or in futuro, and I think that the words "all debts owing or accruing" mean the same thing. They describe all debita in presenti, whether solvenda in futuro, or solvenda in presenti. The material question which has been argued before us is this: does the meaning go further, and does it include debts which may hereafter arise? If they may hereafter arise, it is possible also they may not hereafter arise, and it would require explicit words to include such

future possible debts. "

(p 529)

In Perrott and anor v Newton King Ltd 1933 NZLR 1131 CA the question was the effect of bankruptcy of the principal upon the defendant's liability as guarantor. One issue related to the meaning of the word "owing" in relation to the guarantor's liability. Kennedy J, in whose judgment Myers CJ concurred, said :

> " The word 'owing' applied to money expresses, in such a context, the notion of money which a person is under an obligation to pay either at once or at some future time - money which someone has a right to have paid. It connotes undischarged obligation. "
>
> (pp 1159 - 60)

- a passage which was adopted by Hay J in relation to the then equivalent of the legislation now under consideration in NZ Insurance Co Ltd v Commissioner of Stamp Duties. 1954 NZLR 239, 253.

Applying the approach disclosed by these statements to the language of s 17(1), in my opinion it is not possible to fit the present circumstances within

the meaning of the section. The word "debt", reinforced as it is by the phrase "owing by the deceased at his death", requires an obligation subsisting at that date. It may be solvendum in futuro but there must be a present obligation. The deceased's potential liability, which will ripen into a debt upon the completion of the painting work by the contractor in accordance with the terms of the contract, cannot be so regarded.

Nor, in view of authority, is the extended definition, which brings in the concept of "pecuniary liability", of assistance to the objectors. In Re Marshall (deceased), Commissioner of Inland Revenue v Public Trustee 1965 NZLR 851 the deceased had sold shares to a trust, the purchase money being secured by mortgage. He was entitled to interest upon demand, and similarly to a remuneration as trustee if demanded by a specified date in each year. The Commissioner contended that sums in respect of which the deceased had not made demand were assessable for gift duty. The issue was whether the deceased's failure to exercise his rights amounted to a release, discharge surrender or abandonment of a debt, within the meaning of the legislation. Although the case arose under the predecessor of the present Act, the same definition of "debt" was in issue. The Court of Appeal decided that the provisions in the mortgage and deed of trust did not create any debt owing to the deceased until demand was made. Referring to the definition, North P said :

> " In my opinion short of a demand being made no pecuniary liability existed. I cannot agree that these words include a contingent liability. "
>
> (p 855)

McCarthy J said :

" In my view, when an Act speaks of a pecuniary liability, it means, in the absence of words expressly extending that liability to a contingent one, an existing legal liability, though, of course, the operation of that liability may be postponed. It would, I think, be wrong, unless a contrary interpretation was clearly required, to hold that the section includes a liability which might never arise and which at the moment has no current legal force. "

(p 859)

Finally, I quote from the judgment of McGregor J :

" In considering the first submission of the Commissioner I take the view that, until the requisite demand for interest or remuneration had been made by the deceased, the

> relationship of debtor and creditor did not exist. The Act defines a debt as including any pecuniary liability, but there can be no pecuniary liability in respect of such interest or remuneration on the part of the mortgagor or trustee until demand is made, and consequently there is no debt owing in respect of which action could be brought. . . . . I do not agree with the learned Solicitor-General when he suggests that there is an existing liability from the date of the deed. There may be a contingent liability, as suggested by the Solicitor-General, but such liability does not become absolute until demand has been made. There is a clear distinction between an existing liability to pay a sum at a future date, and a contingent liability to pay a sum on the happening of an event which may or may not happen. "
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> (pp 862-3)

So if one substitutes "pecuniary liability" for "debt" in s17(1), the position remains that at the date of death the deceased could not be said to

be under a pecuniary liability within the meaning of the section. There existed at that date contractual obligations, the deceased's being dependent on due performance by the contractor, but as I read the passages quoted that is not sufficient to constitute an existing pecuniary liability. It is not an existing liability to pay a sum at a future date.

I turn to the next issue : whether the situation falls within the concept of "contingent debt", the term appearing in s 17 (2) (c). I have found considerable difficulty in the proper interpretation to be placed on this provision, and its relationship to s 17 (1). For a start the very expression "contingent debt" seems oxymoronic; as Pollock B said arguendo in Mortimore v Commissioners of Inland Revenue 1864 2 H&C 838, 159 ER 347, a contingent debt is in reality no debt but merely an obligation or promise which in a certain event will become a debt (p 849). But the judgment of the Court in the same case said that the terms contingent debt or debt payable upon a contingency had been long in common use, a reference I think to bankruptcy legislation where there was provision for the proof and valuation of contingent debts. See Hardy v Fothergill 1888, 13 App Cas 351, 355. It seems likely that the concept found its way into revenue statutes from bankruptcy practice.

As a matter of first impression I would say that the present was a contingent debt. If as a minimum requirement one stipulates that there has to be some legal obligation existing at the date of death, as distinct from the mere expectation of one, that is satisfied by the presence of the contractual obligation. The contingent aspect is provided by the feature that the deceased's liability to pay was conditional upon performance by the painting

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contractor. The latter (in this instance, a company) might have gone into liquidation, or simply defaulted. Such an interpretation appears consonant with the purpose of the legislation, namely to permit the estate the benefit of deductibility in the situation where at death there was uncertainty whether the particular obligation would mature, but it in fact did so within a specified time. While to that extent the legislative intent is obvious, in this instance I do not think the intention assists to define more precisely the meaning of the terms which the legislature has used.

I turn then to consider whether my prima facie view is consistent with authority, commencing with N Z Insurance Co Ltd v Commissioner of Stamp Duties (above). The deceased together with his brothers and a sister had entered into a deed binding them to make monthly payments to another sister during her life. There was evidence of the capitalised value of the deceased's share of the annuity, calculated actuarially in accordance with the annuitant's expectation of life; but the Commissioner declined to make allowance for that sum under the then equivalent of s 17 (1), which was in identical terms. The reference to contingent debts was then contained in s 9 (2) (d) of the Death Duties Act 1921 which read :

> " No such allowance shall be made -
> . . . . . (d) for contingent debts or any other debts the amount of which is, in the opinion of the Commissioner, incapable of estimation. "

In dealing with "contingent debts" Fair J said the expression had two meanings. In its strict and most correct sense, it meant a debt that may never become due. By way of example he referred to the guarantee of an overdraft. It was reasonable to exclude such a debt from those deductible, since it might never become payable. Where however there was an existing legal liability, although the amount of it might be uncertain and depend, as in the case before the Court, on the duration of life, there was no justification for refusing to allow its deduction unless it was incapable of reasonable estimation. Fair J derived support from Ex parte Ruffle 1873, LR 8 Ch 997, a decision on the Bankruptcy Act 1869. On the facts before him there was an existing pecuniary obligation, not contingent but vested, although the amount of the liability "may possibly be considered dependent on a contingency" (p 249). Accordingly, in the view of the learned Judge it was not a case of a "contingent debt". The situation fell within the definition of "debt", inasmuch as there was a "pecuniary liability". Stanton J took a similar approach. He too was of opinion that the expression "contingent debts" was confined to the situation where all liability was contingent. By way of example he referred to uncalled liability on shares, or a claim made against the deceased and repudiated by him. Hay J agreed with both judgments.

Ex parte Ruffle, the only authority cited on this branch of the case, contains a brief statement that in the context of the particular statute, "contingent debt" refers to a case where there is a doubt whether there will be any debt at all. However, the term had received consideration in earlier bankruptcy cases, see for example Hinton v Acraman 1845, 2 CB 367; 135 E R 987. The relevant provision allowed proof of any debt contracted by the bankrupt payable upon a contingency, and the Court of Common Pleas (Tindal CJ and Coltman, Maule and Erle JJ) said that in the con-

struction of that section a distinction had been taken between contingent liabilities which may never become debts, and debts payable on a contingency, only the latter being provable. See also Ex parte Tindal 1832, 8 Bing. 402; 131 E R 449. There S had covenanted to pay to trustees on behalf of his wife the sum of 4000 pounds on terms that the interest was payable to her for life if she survived; the principal went to their children but if they had none, to the survivor of S and his wife. On S being declared bankrupt Tindal, the wife's trustee, sought to prove on the basis of a debt payable upon a contingency. He succeeded, the Court of Chancery (Tindal CJ, Lord Brougham LC & Littledale J) stating it would be wrong to hold that because the event might never happen, the debt was not to be taken as payable upon a contingency (406;450).

The two cases just discussed were decided under an earlier statute from that applicable in Ex parte Ruffle. The history and development of bankruptcy law in relation to contingent debts is discussed in Hardy v Fothergill (above), see particularly the speech of Lord Selborne at p 359. Each decision must of course be read in the context of the legislation on which it was based. I would not have thought that any of them provided a sure footing for the meaning of the expression "contingent debts" in a modern revenue statute. However, any respectful doubts I might entertain as to the route by which the Court of Appeal reached its conclusion in the N Z Insurance case, are of course subordinated to the fact that I am bound by that decision.

At this stage it is convenient to tabulate the distinction that the N Z Insurance case drew between these situations : (a) a legal obligation, accompanied by present certainty that an amount will be payable, but uncertainty as to quantum; and (b) a legal obligation, but the absence of present certainty that any sum will ever be payable.

According to Ruffle (b) is a contingent debt. In the view of the Court of Appeal, (a) is not.

When the N Z Insurance case reached the Privy Council (see 1956 NZLR 335) the judgment was affirmed on a different ground. The Board referred to the distinction drawn by the Court of Appeal as to the two possible meanings of "contingent debt", describing the issue as a difficult point. Their Lordships decided the case on the basis that the phrase in the then subpara (d), "incapable of estimation", qualified both "contingent debts" and "other debts". Therefore, so long as the debt was capable of estimation, which they thought was so in the case before them, it was not disqualified by (d). Accordingly, in the view taken by their Lordships it did not matter whether the debt was regarded as contingent or not. It fell within the operative provision of the section, that is the equivalent of the present s 17(1), and was not excluded by subs 2(d).

The point upon which the case turned in the Privy Council has since been removed by legislation. The concepts of debts that are contingent, and those incapable of estimation, have been given separate status. However, as I see it the amendment has no bearing on the meaning given to the expression "contingent debts". The views expressed by the Court of Appeal remain applicable.

In the N Z Insurance case the Court did not discuss the possible impact of the inclusion of "pecuniary liabilities" in the definition of "debt" in the statute. If the two are read together, s 17(2)(c) may be taken to refer to "contingent pecuniary liabilities". In Re Marshall, the facts of which I have already stated, there was extensive discussion of the meaning of "liability" in this legislation, although in the context of a different part of the Act. One argument was that if the obligation to pay

interest on demand was not a "debt", at least it constituted a "liability", within the extended definition in s 2, albeit the liability was contingent. But relying particularly on In re Sutherland, Winter v IRC 1963 AC 235, North P and McCarthy J were of the opinion that there was no "liability" in a legal sense until the contingency happened. Of course, in Re Marshall the Court was not concerned with "contingent liability" as a statutory expression; the term was "liability" by itself, and it was merely a submission, in the event not accepted, that that should be construed as including contingent liabilities. In In re Sutherland the phrase "contingent liabilities" was deployed in the statute in question, but in a context different from the present. The case related to the valuation of company shares for death duty purposes. The net value was to be the price the assets would fetch on the open market, less the liabilities, including "contingent liabilities". Among the assets were five ships. The value at date of death, for duty purposes, was a figure much in excess of their book value, by reason of allowances previously received under the Income Tax Acts. Had the ships been sold at the date of death, under a type of claw back provision the company would have become liable to a balancing charge for tax. The question was whether that was a contingent liability for which allowance should be made in valuing the assets at the date of death. The House of Lords by a majority held that it was. Lord Reid said :

> " No doubt the words 'liability' and 'contingent liability' are more often used in connection with obligations arising from contract than with statutory obligations. But I cannot doubt

that if a statute says that a person who has done something must pay tax, that tax is a 'liability' of that person. If the amount of tax has been ascertained and it is immediately payable it is clearly a liability; if it is only payable on a certain future date it must be a liability which has 'not matured at the date of death' within the meaning of section 50(1). If it is not yet certain whether or when tax will be payable, or how much will be payable, why should it not be a contingent liability under the same section ?

It is said that where there is a contract there is an existing obligation even if you must await events to see if anything ever becomes payable, but that there is no comparable obligation in a case like the present. But there appears to me to be a close similarity. To take the first stage, if I see a watch in a shop window and think of buying it, I am not under a contingent liability to pay the price: similarly, if an Act says I must pay tax if I trade and make a profit, I am not before I begin trading under a contingent liability to pay tax in the event of my starting trade. In neither case have I committed myself to anything. But if I agree by contract to accept allowances on the footing that I will pay a sum if I later sell something above a certain price I have committed myself and I come under a contingent liability to pay in that event. This company did precisely that, but its obligation to pay arose not from contract but from

statute. I find it difficult to see why that should make all the difference. "

(pp 247-8)

Later, after referring to Scots law, Lord Reid stated :

" I would, therefore, find it impossible to hold that in Scots law a contingent liability is merely a species of existing liability. It is a liability which, by reason of something done by the person bound, will necessarily arise or come into being if one or more of certain events occur or do not occur. If English law is different - as to which I express no opinion - the difference is probably more in terminology than in substance. "

(p 249)

Lord Birkett said :

" The true legal position was that from the moment the appellants accepted capital allowances they were at once under a liability to pay tax in the circumstances provided for in the Income Tax Act 1952. That liability was a contingent liability. "

(p 254)

Thus put the situation has a strong analogy to the present. From the moment the deceased entered into the contract to have his house painted, he was under a liability to pay the contract price in the circumstances provided for in the contract.

Although in the N Z Insurance case the Court confined itself to consideration of the expression "contingent debts", as distinct from contingent liabilities, the approach just stated fits the examples given there, namely the taking up of shares with liability for a call, entering into a guarantee of a bank overdraft, or certain claims made against the deceased in his lifetime, which he had repudiated. It does not conflict with the prerequisite regarded as essential in the same decision, that is the element that the liability may never become due. At the date of death the same could have been said of the painting contract; as I suggested earlier the painter might have ceased business or defaulted.

Returning to Re Marshall, on this aspect the issue was whether for purposes of s 39 of the 1921 Act, the reference to "debts" - which having regard to the extended definition, could be read as "pecuniary liabilities"- was to be construed as covering contingent liabilities. North P, relying on In re Sutherland, held that it did not. I have already quoted the most relevant passage from the judgment of McCarthy J : when the Act speaks of a pecuniary liability, in the absence of words expressly extending that liability to a contingent one (my emphasis) that refers to an existing legal liability. And the learned Judge contrasted s 9(2) and s 39. The former - with whose successor I am now concerned - explicitly brings in the concept of contingency and in turn (by virtue of the definition section) that of contingent liabilities.

McGregor J, in the portion of his judgment set out earlier, drew attention to the distinction between an existing liability to pay a sum at a future date, and a contingent liability to pay a sum on the happening of an event which may or may not occur : "Here liability is contingent and does not arise until demand" (p 863). In other words His Honour too was of the view that pecuniary liability referred to a legal liability; on the facts before him, there was no more than a contingent one. Nothing in Re Marshall, as I see it, is inconsistent with the view that facts such as those arising on the present objection can be regarded as constituting a contingent liability.

The authorities therefore do not cause me to alter my initial view that this is a case of a contingent debt. That conclusion can be reached not only by reference to that expression, but also by the alternative route of resort to the term "pecuniary liabilities" in the definition section. The latter opinion is consonant with In re Sutherland, and not hindered by anything in Re Marshall.

In the present case, the opposite result would not have led to any injustice. The enhanced value of the property, following its painting, will not have been reflected in the valuation placed on it for duty purposes, which would have been carried out as at the date of death. However, as recognised by the learned authors of Adams & Richardson's Law of Estate and Gift Duties 5th Ed (1978) p 136 the result of application of the approach in the N Z Insurance case to the current statute is to confine the present subpara (c), relating to contingent debts, to a narrow meaning. If I strained to exclude the present

case, I would be narrowing the meaning still further, to the detriment of other situations where, on the fair meaning of the statute, the legislature must have intended that an estate should have the benefit of an exemption, if the contingency occurred within the specified time.

In expressing that last opinion I have anticipated the final point requiring consideration. That is whether in any circumstances the provisions of para (c) are to be regarded as enlarging the concept of "allowable debts" in s 17(1). Conflicting opinions have been expressed on the subject, see per McCarthy J in Re Marshall (above) at p 859, Re S M McKenzie 1979 3 TRNZ 167 (Perry J) at p 177 and Adams & Richardson p 130 (in each case favouring an affirmative answer) and cf Hay J in the N Z Insurance case at p 253, and Commissioner of Stamp Duties (NSW) v Permanent Trustee Co of NSW Ltd (Hill's case) 1933, 49 CLR 293 per Rich J at p 299 and Starke and Evatt JJ at p 301. However, with reference to the last mentioned case, Dixon J who was also a member of the Court said the following in a later decision (Commissioner of Stamp Duties (NSW) v Brasch 1937, 57 CLR 69, 84-5) :

> " . . . (I)n the view taken in this Court of the relation of subs 2(d) /a provision identical to s 9(2)(d) of our 1921 Act, excluding contingent debts and those incapable of estimation/ to subs 1 of s 107 /the equivalent of our current s 17(1)/ they provide independent grounds of exclusion (Commissioner of Stamp Duties (NSW) v Permanent Trustee Co of NSW Ltd). If subs 2(d) operates to ex-

> clude a liability, then, although at the time of death the liability may not answer the requirements of subs 1, I think it may afterwards give rise to a claim for a refund of duty under subs 3. "

I have added the explanatory comments in brackets.

If Dixon J were wrong then my initial finding, that the situation was not within s 17(1), would of course be decisive. The point was referred to by their Lordships in delivering the advice of the Privy Council in the N Z Insurance Co Ltd case, see 1956 NZLR at p 339. However, since in that case the debt was held to fall within ss(1), their Lordships did not have to deal with the situation where at the date of death the obligation in question cannot be brought within s 17(1) and additionally is excluded as being a contingent debt in terms of s 17(2)(c), but becomes a debt actually payable within the prescribed period after death. In my opinion, the correct conclusion is as stated by Dixon J, with whose reasoning I respectfully concur. That result appeals to me as consonant with the intention of the legislature as otherwise there is little if any scope for reduction of the dutiable estate by reference to debts or liabilities which, although of a contingent nature at the date of death, in fact become payable within the prescribed period.

For the reasons given the Objection succeeds, and in answer to the question posed in the Case Stated I hold that the Commissioner acted incorrectly in rejecting the Pitcher account as an allowable debt. Pursuant to

s 92(7) I direct that the Commissioner make an assessment in accordance with the Court's findings. I allow the Objectors costs in the sum of $750.

Solicitors :
Cooper Rapley & Co (Palmerston North) for the Objectors
Crown Law Office (Wellington) for the Commissioner