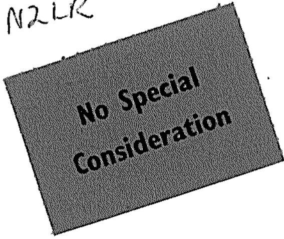
IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

M. No. 377/82

2|3

NZLR



238

IN THE MATTER of the Inland Revenue Department Act 1974

BETWEEN JOHN GEORGE RUSSELL

Appellant

A N D THE COMMISSIONER OF INLAND REVENUE

Respondent

Hearing: 7th December, 1983.

Counsel: P. Woodhouse for Appellant.
C. McGuire for Respondent.

Judgment: 23 March 1984

JUDGMENT OF TOMPKINS, J.

The Appellant appeals by way of Case Stated pursuant to s.43 of the Inland Revenue Department Act, 1974, against the decision of the Taxation Review Authority delivered on the 30th November, 1981, by which the Authority disallowed objections by the Appellant to assessments of income tax made by the Respondent.

The years to which the assessments related were the years ended 31st March, 1975, 1976 and 1977. The Case Stated set out three questions for determination by this court.

THE FIRST QUESTION:

> Whether the Taxation Review Authority was right in determining that the Appellant was not in the business of lending money at relevant times?

In his returns of income for the three years in question, the Appellant had written off as a bad debt $75,460.

It was this writing-off which the Respondent disallowed. The amended assessments issued on the 14th March, 1979, shows what was the position as the result of the Respondent disallowing the writing-off:-

Year Ended 31 March	1975	1976	1977
Income as returned	$40,568.99	$ 8,192.57	$11,544.89
Add: Bad debts disallowed	10,460.00	32,500.00	32,500.00
Amended assessable income	$51,028.99	$40,692.57	$44,044.89
Income Tax	$ 4,948.20	$19,044.75	$22,063.90

It was the Appellant's contention that he was entitled to write off this debt pursuant to s.111 of the Land and Income Tax Act, 1954, being the Act in force during the relevant time. That section reads:-

> " 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. "

The Authority determined the issue on the basis that the Appellant was entitled to rely only on s.111(b). Whether he should also have been allowed to rely on s.111(a) is the issue to which the second question is directed.

It was the Appellant's contention that he was in the business of lending money during the relevant three years, that

that was a business for the purpose of gaining or producing assessable income during those years, and that the loss resulting from the writing off of the debt was a loss incurred in carrying on that business.

During the three years with which the assessments are concerned, the Appellant was the managing director of Securitibank Ltd. He had been appointed to that position in 1973. He was also, during the relevant period, a chartered accountant. The evidence establishes that he undertook some work as a chartered accountant for clients, but the extent and range of this work was not given in evidence.

It was the Appellant's contention that in addition, during the relevant period and for some years previously, he had lent money to a range of persons to a degree and under circumstances that justified a conclusion that he had been and was during the three years in issue in the business of lending money. It is this contention that is the principal matter to be determined in deciding the first question.

There was no difference between counsel on the approach to be adopted in determining this issue, namely, that it was a question of fact to be determined having regard to all the relevant circumstances of the particular case. This accords with the judgment of the Court of Appeal in Best v. Sutcliffe (1965) N.Z.L.R. 750, when McCarthy, J., delivering the judgment of the court, said at p.758:-

> " It is always a question of fact in each case whether a person is carrying on the business of money lending: 27 Halsbury's Laws of England, 3rd Ed., 18; Kirkwood v. Gadd (1910) A.C. 422; 1908 - 10 All E.R. Rep. 768. McCardie, J. in Edgelow v. MacElwee (1918) 1 K.B. 205, put it in a way we would adopt. He said: 'Each case must depend on its own peculiar features. It is ever a question of degree.' (Ibid., 206) Doubtless the number, the nature and the regularity of the transactions under review are all important features and it

> may be competent for a court in some circumstances to decide on those features alone that the proper inference is that a business is being carried on. But that inference is not inevitably a proper one. The loans must be regarded against all the other attendant circumstances - the picture must be seen in its full design. "

I now examine the lending transactions upon which the Appellant relies.

The first is lending on mortgage. In his letter to the Respondent of the 7th May, 1978, Exhibit "H", he listed eight mortgages to individuals or companies. With the lack of particularity that characterised the Appellant's evidence in support of his objection, as well as the correspondence with the Respondent that preceded it, the Appellant gave no particulars of these mortgages. In particular he did not state the date upon which the advances were made, the term of each, the amount involved and the rate of interest (if any) applicable. However, he acknowledged in evidence that since there was no interest returned from any mortgages during the relevant three years, then these mortgages must all have been repaid prior to 1975.

The second category is advances to named individuals. There were nine. Three were clients of his chartered accountancy practice. One he described as a business associate. One was his wife. His relationship with the remaining four was not described. Two of the advances, including that to his wife, were free of interest. The others carried interest. In two cases the interest rate was stated (10% and 8%), but in the remainder no rate was given. In three cases he stated the amount involved ($1,070, $600, $2,200) but in the other cases the amounts were not stated - the Appellant gave a general description of $1,300 to $3,000.

In three cases the date of repayment of the advances was stated - in these cases they were all repaid before the relevant period except for one repayment by one debtor of $80 that was made on the 10th November, 1976. In the remaining six cases the dates of advance and dates of repayment were not stated. A witness called by the Respondent produced a schedule of interest that had been returned by the Appellant in which he analysed the details provided in the returns. This schedule shows that for the 1977 tax year the Appellant returned $165.34 interest received from one individual. Other than this there was no interest returned from any individual during the relevant three years.

The next category is advances to four limited liability companies, in each of which the Appellant had an interest. I shall deal with each.

Money Market Securities Ltd. was formed by the Appellant in 1963. The Appellant substantially owns the shares. Since formation the Company was used for money lending activities that had formerly been carried on by the Appellant personally. Again little detail of this Company's activities were provided. The evidence does not show the shareholding, the amount of paid up capital, who are the directors, and what, during the relevant period, was the extent and nature of the Company's lending. The Appellant lent money to that Company to enable it to carry on its operations. No accurate evidence of those advances were given. The Appellant was asked how much he lent the Company over the three relevant years, but was unable to say. He said at one stage that the total amount for the year ended 31st March, 1975, was $223,991.42, but then said that a bit more than half of that amount was advanced to the company. However, the evidence suggests that this was not the net amount lent during the year, but that it included amounts that during the year the Company repaid. When asked about these repayments

the Appellant said:-

> " It is recycling all the time - same old money going round and round. Not a great deal of money but it does a fair mileage. "

During the three years in question the Appellant received no interest from Money Market Seçurities Ltd. for any amounts that may have been owing by that Company to him. He explained that in the early years he had calculated interest on that loan, but ceased doing so since there did not seem to be any point as he owned the shares anyway.

Commercial Management Ltd. is a Company in which the Appellant owned all the share capital but one. That share was owned by Money Market Securities Ltd. The Appellant was a director of Commercial Management Ltd. He thought (but was unsure) that his wife may also have been a director.

On the 9th March, 1977, the Appellant lent Commercial Management Ltd. $1,027. This was to enable the Company to purchase a Fiat Bambina motor car. The debt was repaid on the 8th November, 1977. It carried interest at 18%. The schedule prepared by the Respondent's witness shows that during the 1978 tax year the Appellant declared interest from this Company of $123.58.

The evidence does not disclose what was that Company's business, nor the purpose for which it was purchasing the car.

Amalgamated Properties Ltd. was a Company of 25 shareholders, each holding the same number of shares. The evidence does not disclose what was the share capital, the extent to which the share capital was paid up, nor details of any advances

that may have been made to the Company by other shareholders. The only asset of that Company disclosed from the evidence was two sections with one house at Otahuhu that the Company was renting. At a date not shown by the evidence the Company sold this property to the Housing Corporation.

Between the 16th August, 1973, and the 24th January, 1977, the Appellant made twelve loans to Amalgamated Properties Ltd. of amounts that varied between $7,831 and $205. Some of these advances were repaid relatively soon after they were lent. In a letter to the Department the Appellant said that seven of them carried interest at 10%, and five at 15%. At the 31st March, 1977, the balance outstanding was $5,815. When the house owned by the Company was sold the amount owing to the Appellant was repaid, but he did not receive interest. The amount of unpaid interest is not stated. The schedule of interest prepared on behalf of the Respondent shows that in the year ended 1975 the Appellant received $1,477.02, and in the 1976 year $139.09, by way of interest from Amalgamated Properties Ltd.

Evaglas Products Ltd. When this Company was formed (the evidence does not disclose the date) the share capital was held as to one-half by a Mr. Allinson and one-half by Safe Custody Nominees Ltd. in trust for Money Market Securities Ltd. The Company was formed in order to develop and manufacture a plastic product in respect of which the Company held a patent. In his letter to the Respondent of the 2nd October, 1978, Exhibit "I", the Appellant listed eight advances that he said he made to that Company between the 4th June, 1974, and the 10th February, 1975. They range in amount between $460 and $33,300. They total $75,460. They were intended to carry interest at 16%. It is the write-off of this debt that has given rise to the issue involved in the first question. At some stage (the evidence does not disclose the date) Money Market Securities Ltd. acquired

Mr. Allinson's shareholding in the Company. Although the Appellant thought that the Company was in a sound financial position when the first advance was made, it obviously became in a precarious financial position. It is still in operation making a small profit of something under $1,000 at the time of the hearing. No interest has ever been paid. The Appellant now considers that repayment of the capital and of the accrued interest is unlikely. Apart from the above rather general evidence, no particulars were given of the Company's operations, its financial position, the extent of its indebtedness, whether or not it is solvent, and the possibility of it recovering sufficiently to make some payment to creditors.

The next category of transactions is money lent to the Northern Building Society, Canterbury Building Society, A.N.Z. Savings Bank, Auckland Savings Bank, National Provident Fund, National Development Bonds and Government Bonds. In his submissions to the Respondent and at the hearing before the Authority, the Appellant maintained that these should be taken into account in considering his money lending activities. No details were given of the dates and amounts held by these various institutions on behalf of the Appellant. At the hearing before this court the Appellant placed less reliance on these investments, accepting that by themselves they could not amount to a money lending business, but submitting they required some consideration in evaluating the range of outlets in which the Appellant sought to place his funds. Even if this be correct (and I am doubtful whether monies placed with these institutions could have even that weight) it is impossible to give them any consideration when the Appellant has failed to give any evidence as to the amount or dates of such advances.

The final category of transaction is advances made to syndicates of which the Appellant was a member. There were two.

Shortland Mutual Investment Club was a share investment club to which the Appellant and about twenty other members made monthly advances. The proceeds were invested in shares and occasionally interest-bearing investments. With regard to the payments made to the Club by the Appellant, no interest was sought or paid. At a date not disclosed by the evidence the Appellant sold his interest in the Club to somebody else.

The second was Pomona Vineyards. The Appellant said that he made some thirty advances to this syndicate, totalling something in the vicinity of $12,000 to $15,000. No details were provided of the amounts or dates of each advance. The syndicate was in the business of growing and selling grapes. There were some 18 to 20 members. The Appellant's share was 4/30th. Although the Appellant said that he received some interest from the syndicate, he gave no details of the date or amount, nor of how the interest was calculated. The vineyard has since been sold (the date was not stated), and at least some of the proceeds invested on mortgage. The schedule of interest submitted on behalf of the Respondent does not show any interest payments received from this syndicate during the relevant three years.

Finally, I refer to some other circumstances that may have some bearing on the issue.

The Appellant at no stage was the holder of a money lender's licence. Its absence probably does not contribute much - although undoubtedly if the converse were so, if the Appellant were the holder of a money lender's licence, this would weigh strongly in favour of a contention that he was carrying on a money lending business.

The Appellant said that occasionally if he had a surplus of money to get rid of he advertised that he was in the business of lending money. He was asked how many times he did so between the 1st April, 1974, and the 31st March, 1977. He was unable to remember. When pressed he said that it was on average probably a couple of times a year. The advertisements were not produced, and no more precise information as to the frequency of advertisements was given. Nor does the evidence make it clear whether it was he personally or Money Market Securities Ltd. (which seems more probable) that was doing the advertising. This circumstance also I regard of minor relevance.

During the relevant three years, as I have already stated, the Appellant was the managing director of Securitibank. That was his day to day workplace. He had no separate office for his money lending transactions - although I note that his correspondence with the Department carries his home address.

I have considered all the above evidence and the submissions made to me on behalf of the Appellant. I have endeavoured to look at the picture in its full design. Having done so, I am left in no doubt that the Appellant has failed to discharge the onus that rested on him to establish that during the relevant three years he was in the business of lending money. The Authority was therefore right in determining that the Appellant was not in that business during the relevant period.

THE SECOND QUESTION:

> Whether the Taxation Review Authority was correct in precluding the Appellant from relying on both legs of s.111 of the Land and Income Tax Act, 1954 (s.104 of the Income Tax Act, 1976)?

This question involves the application of s.36 of

the Inland Revenue Department Act, 1974:-

> " On the hearing and determination of any objection, the objector shall be limited to the grounds stated in his objection, and subject to the provisions of sub-s.(2) of s.234 of the Land and Income Tax Act, 1954, the burden of proof shall be on the objector. "

In response to an invitation from the Respondent to lodge a formal objection to the assessments the Respondent had made, the Appellant wrote to the Respondent a letter dated 15th June, 1979, Exhibit "L". The letter recorded that the main reason for the disallowance of the claim for bad debts was due to the Department taking the attitude that he was not in the business of lending money. It recorded that there had been two reasons stated for disallowance of the claims:-

> " (a) The Department claims that I am not in the business of lending money and the bad debt is not therefore a deductible item.
>
> (b) The Department feels that the advance may be a capital item. "

The letter then recorded the following detailed objection with regard to the 1975 year:-

> " <u>1975 Assessment Notice</u>
>
> I object to this assessment on the grounds as set out below:
>
> (a) My claim amounting to $10,460 in respect of bad debts has been disallowed.
>
> (b) The debt is bad and has been written off by instalments in accordance with Section 106(1)(b) of the Income Tax Act 1976.
>
> (c) It is part of my business to advance money. During the year to 31st March 1975 I made over 50 distinctive and separate advances totalling in excess of $223,000. A Guide to New Zealand Income Tax practice 1977-78 by Charles A. Staples states on page 15 Section 42 as follows:

> "Losses on advances made in the ordinary course of a taxpayers business are allowed as a deduction provided:
>
> (i) They are actually written off in the books of the taxpayer.
>
> (ii) It is part of the taxpayers business to make advances. "

(d) The advances made and now the subject of the claim were made in the ordinary way of business. I have never personally been a shareholder of the company to which the advances were made. The company was 50% owned by Mr. Harry Plummer Allinson at the time the advances were made. The advance was made subsequent to shareholders capital subscriptions and to refinance previous borrowings and is not a capital item. "

The letter then goes on to make identical objections with regard to the 1976 and 1977 assessments, except there were minor consequential alterations to paragraph (c) and the 1976 assessment included two further paragraphs stating other matters objected to that are not relevant to this appeal.

At the hearing before the Taxation Review Authority, the Appellant sought to rely on paragraph (a) of s.111 as well as paragraph (b). The Authority held, after considering the formal objection made by the Appellant, that the Appellant was confined to the provisions of s.111(b) of the Act. He considered that the objection was not wide enough to permit the Appellant to rely on s.111(a).

It is well established that s.36 of the Inland Revenue Department Act, 1974, contains an imperative direction. The court is bound to give effect to it (Molloy v. F. C. L. T. (1938) 59 C.L.R. 608).

An examination of the Appellant's formal objection makes it clear beyond doubt that the substantial ground of objection that he was stating in his objection is that he was

in the business of lending money. He records that this was the basis of the Department's claim that the bad debt was not a deductible item. Then in paragraphs (c) and (d) of the detailed grounds, the assertion that he was in the business of lending money is the only substantial assertion made. Nowhere is it even suggested by way of implication that the Appellant was claiming that the loss was incurred in gaining or producing assessable income for any income year. In my view, therefore, s.36 prevents the court from entertaining an objection on the ground contained in s.111(a).

The answer to the second question is that the Taxation Review Authority was correct in precluding the Appellant from relying on both legs of s.111.

THE THIRD QUESTION:

> Whether the Taxation Review Authority was correct in the decision that the Appellant was not entitled to an allowance with respect to the sum of $8,000 paid to him and contended by the Appellant to have been retrospective pay?

In his return of income for the year ended 31st March, 1976, the Appellant claimed a rebate of $480 under s.78G of the 1954 Act (s.44 of the 1976 Act). This claim arose from a payment of $8,000 that the Appellant received on the 11th May, 1975, from his employer, Securitibank Ltd. This payment was a bonus for the year ended 31st October, 1974.

S.78G of the 1954 Act reads:-

> " (1) In this section the expression "retrospective pay", in relation to a taxpayer and to the income derived by a taxpayer in any income year, means income of any of the kinds referred to in paragraph (b) of subsection (1) of section 88 of this Act which -

(a) Was paid in respect of the employment or service of the taxpayer during any period or periods within any income year or years preceding the income year in which it was derived; and

(b) Resulted from -

(i) A decision, a determination, or an order made by any board, court, person, or body of persons having statutory authority to make decisions, determinations, or orders relating to rates, scales, or amounts of remuneration; or

(ii) The provisions of any Act, regulation, or Order in Council relating to any taxpayer whose remuneration is fixed by that Act, regulation, or Order in Council; or

(iii) The renegotiation of any award by any union registered under the Industrial Conciliation and Arbitration Act 1954 or the Labour Disputes Investigation Act 1913; or

(iv) A decision made by the Government or any Minister of the Crown in respect of any taxpayer in the service of the Crown (being a taxpayer to whom the foregoing subparagraphs do not apply); or

(v) A decision made by the Government or any Minister of the Crown or the University Grants Committee or the Council of any university within the meaning of the Universities Act 1961 in respect of any taxpayer in the service of any such university or of the University Grants Committee.

(1A) Without limiting the generality of subparagraph (i) of paragraph (b) of subsection (1) of this section, each of the following is hereby declared to be a board, court, person, or body of persons for the purposes of that subparagraph:

(a) The Public Service Appeal Board:

(b) The Court of Arbitration:

(c) The Commissioner of Police:

(d) An employing authority within the meaning of the State Services Remuneration and Conditions of Employment Act 1969:

(e) The State Services Tribunal within the meaning of the State Services Remuneration and Conditions of Employment Act 1969:

(f) A Single Service Tribunal within the meaning of the State Services Remuneration and Conditions of Employment Act 1969.

(2) Subject to the provisions of this section, where the income derived by a taxpayer in any income year includes retrospective pay, there shall be allowed from the income tax payable (apart from the provisions of this section) in respect of that income a rebate of 6c. for every complete $1 of either the retrospective pay or the taxable income of the taxpayer for that year, whichever is the less. "

The Appellant's submission is that this sum of $8,000 was paid in respect of the employment of the Appellant during a period within an income year preceding the income year in which it was derived and therefore came within s.78G(1)(a). This submission is undoubtedly correct. It was not contested by the Respondent.

Then it was submitted that the income resulted from a decision made by a board, namely, the Board of Directors of Securitibank Ltd., and that that was a board having statutory authority to make decisions relating to rates, scales or amounts of remuneration. In support the Appellant produced a photocopy of a page of the Articles of Association of Securitibank Ltd. and referred in particular to Article 112:-

" A managing director shall receive such remuneration (whether by way of salary, commission or participation in profits or partly in one way and partly in another) as the directors may determine. "

It was contended that the $8,000 bonus was remuneration determined by the directors and that they did so pursuant to Article 112 which, since the company is incorporated under the Companies Act, 1955, gives the board statutory authority to make the decision it did.

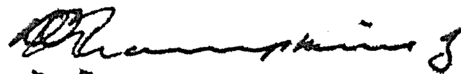
Alternatively, as I understand the Appellant's

submission, it was contended that Securitibank Ltd. was a "person" as defined in s.2 of the 1954 Act, and that, for the same reason, when the company decided to pay the $8,000 bonus to the Appellant it was a person exercising a statutory authority to make decisions relating to the amounts of remuneration.

I do not accept this submission. No doubt Securitibank was a person as defined by the Act. Its Board of Directors is a board. But I can see no proper basis upon which either the board or the company can come within s.78G(1)(b)(i). When the board or the company decides on the rates, scales or amounts of remuneration that it will pay to its employees, it does so in accordance with the contract of service between the company and its employees. It does not do so because of any authority that the board or the company has by statute. Boards or persons who do have such statutory authority are set out in s.78G(1A). Clearly it is intended that this list should not be exhaustive but it illustrates the sort of boards, courts, persons or body of persons to which s.78G(1)(b)(i) is intended to apply. Looking at the section as a whole I can find no reason to consider that it was also intended to embrace any other person simply because that person is incorporated under a statute.

Consequently the Taxation Review Authority was correct in its decision that the Appellant was not entitled to an allowance with respect to the sum of $8,000 paid to him and contended by him to have been retrospective pay.

The appeal is dismissed. I reserve the question of costs.



Solicitors:

Glaister, Ennor & Kiff, Auckland, for Appellant.
Taxation Review Authority, Wellington, for Respondent.