Privy Council Appeal No. 13 of 1972

Anker Livingstone Wartho Hansen and others – – *Appellants*

v.

Commissioner of Inland Revenue – – – – – *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 23RD OCTOBER 1972

Present at the Hearing:

LORD REID

LORD MORRIS OF BORTH-Y-GEST

VISCOUNT DILHORNE

LORD SIMON OF GLAISDALE

LORD KILBRANDON

[*Delivered by* LORD KILBRANDON]

The appellants were partners carrying on the business of stock farmers at Glen Murray, which they held on a Crown lease. On 1st December 1964 they agreed to sell Glen Murray to a company called Lochiel Cameron Limited as a going concern. Before they could give a title they had to acquire the freehold from the Crown; it was a term of the agreement that if the price they had to pay were to exceed £22,500 the contract was to be subject to re-negotiation at the request of the vendors. In the event the freehold was acquired for £19,500. There was a further condition that the agreement was subject to the purchaser being able to arrange finance by a certain date, which was open to extension; settlement in fact took place and the purchaser took possession on 2nd June 1965.

The appeal arises out of an assessment to Income Tax laid upon the appellants as a partnership in respect of the profits of the partnership arising upon the sale of the farm stock at Glen Murray, and before setting out the nature of the dispute it is necessary to look at the statutory arrangements for assessing the taxable income in undertakings of the kind in question.

The statutory provisions regulating the valuation of trading stock (which includes livestock) for the purpose of calculating taxable income are to be found in s. 98 of the Land and Income Tax Act 1954. The relevant portions are as follows:

> "(2) Where any taxpayer owns or carries on any business, the value of his trading stock at the beginning and at the end of every income year shall be taken into account in ascertaining whether or not he has derived assessable income during that year.
>
> (3) The value of the trading stock of any taxpayer to be taken into account at the beginning of any income year shall be its value as at the end of the last preceding income year:

Provided that where the taxpayer's business is commenced and his trading stock is acquired during the income year the value of the trading stock as at the beginning of the income year shall be deemed to be an amount equal to its cost price.

(4) Subject to the provisions of subsection (9) of this section, the value of the trading stock of any taxpayer to be taken into account at the end of any income year shall be, at the option of the taxpayer, its cost price, its market selling value, or the price at which it can be replaced.

(5) Where the value of the trading stock of any taxpayer at the end of the income year exceeds the value of his trading stock at the beginning of that year the amount of the excess shall be included in his assessable income for that year.

(6) Where the value of the trading stock of any taxpayer at the beginning of any income year exceeds the value of his trading stock at the end of that year the amount of the excess shall be allowed as a deduction in calculating the assessable income of the taxpayer for that year.

(7) Where in any income year the whole or any part of the assets of a business owned or carried on by any taxpayer is sold or otherwise disposed of (whether by way of exchange, or gift, or distribution in terms of a will or on an intestacy, or otherwise howsoever, and whether or not in the ordinary course of the business of the taxpayer or for the purpose of putting an end to that business or any part thereof), and the assets sold or otherwise disposed of consist of or include any trading stock, the consideration received or receivable for the trading stock or, as the case may be, the price which under this Act the trading stock is deemed to have realised shall be taken into account in calculating the taxpayer's assessable income for that year, and the person acquiring the trading stock shall, for the purpose of calculating his assessable income for that year or for any subsequent income year, be deemed to have purchased it at the amount of that consideration or price.

(8) Subject to the provisions of sections 101 and 102 of this Act, the price specified in any contract of sale or arrangement as the price at which any trading stock is sold or otherwise disposed of as aforesaid shall be deemed for the purposes of this section to be the consideration received or receivable for the trading stock.

(9) Notwithstanding anything to the contrary in subsection (4) of this section, any taxpayer who derives income from livestock may with the concurrence of the Commissioner adopt and fix a standard value in respect of that livestock or in respect of any class of such livestock. In any case where a standard value has been so fixed the taxpayer may adopt or the Commissioner may require the adoption of the true value instead of the standard value, or the taxpayer may, with the concurrence of the Commissioner, adopt another standard value instead of the standard value fixed as aforesaid:

Provided that the adoption of a standard value, or the adoption of the true value instead of a standard value, or any alteration in the standard value as herein provided shall first take effect at the end and for the purposes of the income year or other period to which any return of assessable income relates."

It will be seen that, in the case of livestock, provision is made for adopting and fixing a "standard value" in respect of livestock, and

further provisions in that regard are made in sections 99 and 100. Section 101 is crucial in the present case, and reads as follows:

> "101. Income derived from disposal of trading stock—
>
> (1) Where any trading stock is sold together with other assets of a business, the part of the consideration attributable to the trading stock shall, for the purposes of this Act, be determined by the Commissioner, and the part of the consideration so determined shall be deemed to be the price paid for the trading stock by the purchaser.
>
> (2) For the purposes of this section any trading stock which has been disposed of otherwise than by sale shall be deemed to have been sold, and any trading stock so disposed of and any trading stock which has been sold for a consideration other than cash shall be deemed to have realised the market price thereof at the date of the disposition or sale, but, where there is no market price, trading stock shall be deemed to have realised such price as the Commissioner determines.
>
> (3) *Repealed by s. 2 (2) of the Land and Income Tax Amendment Act 1960.*
>
> (4) For the purposes of this section the expression "trading stock" includes anything produced or manufactured, and anything acquired or purchased for purposes of manufacture, sale, or exchange; and also includes livestock; and also includes any other real or personal property sold or disposed of by the taxpayer where the business of the taxpayer comprises dealing in such property or the property was acquired by him for the purpose of sale or other disposal."

Section 102 deals with the situation where trading stock is sold for inadequate consideration.

When, therefore, one taxpayer is negotiating the sale of his trading stock to another, the interest of the vendor, looked at purely from the point of view of the incidence of tax, will be (wherever the standard value is less than the realised value) to fix such a price as to give rise to as small a difference as possible between the standard value of the stock—or whatever book value may have been accepted by the Commissioner for the previous assessment period—and the realised value, because upon that difference he will be assessed to tax. Conversely, the interest of the purchaser is that there shall be as small a difference as possible between the purchase price and the value at which the stock will be required to appear in his books, for tax purposes, on the opening of his trading operations. The negotiations in the present case followed the expected course. Both parties understood their respective interests, and a perfectly honest bargain was adjusted between them, at arms' length since their interests were opposed, and there is no suggestion of collusion. The vendors wished to sell at book values, which were "standard values", of 21/- for sheep and £5 for cattle. This was unacceptable to the purchasers, and in the end—disregarding certain negotiations as to wool, which do not affect the present dispute—the value was fixed at 30/- for sheep and £10 for cattle. A document constituting an Agreement for Sale and Purchase was then executed, "WHEREBY the Vendor agree to sell and the Purchaser to purchase ALL THAT piece or parcel of land and live and dead stock more particularly described in the Schedule hereto on the terms and conditions following that is to say:

> 1. The price is TWO HUNDRED THOUSAND POUNDS (£200,000)
>
> . . . .
>
> 17. The said purchase price is apportioned as to the sum of £168,450 for the land and buildings specified in the First Schedule

hereto and to the sum of £31,550 for the live and dead stock chattels and shares specified in the Second Schedule hereto."

The Second Schedule lists 1,265 cattle at £10 each, 6 hacks at £100, and 10,000 sheep at 30/- each, making in total £27,750.

On 14th June 1965, for reasons which were not disclosed, but may well have been the necessary purpose of assessing the purchaser's ultimate liability to tax, the purchasers obtained a valuation of the livestock as running on the property on 10th June, that is, 8 days after possession had been given. This valuation was made by Wright Stevenson & Co. Limited, the agents who drew up the agreement for sale, and brings out a total of £82,645. The controversy between the vendors and the Commissioner arises simply in this way: the former maintain that their tax liability is assessable by reference to the sum of £27,750 apportioned in the agreement applicable to the livestock, the latter maintains that it is assessable by reference to the valuation of £82,645, being the part of the consideration stipulated in the agreement, as determined by him in terms of sec. 101 as being attributable to the trading stock, and accordingly to be deemed to be the price paid for the trading stock by the purchaser. Some subsidiary arguments were directed to the question whether, on the assumption that the Commissioner was entitled to make a determination in terms of sec. 101, his calculation proceeded upon a proper basis, but the main question is, whether the act of allocation between land and stock done as part of an " arms'-length " bargain between vendor and purchaser raises an exception to the apparent generality of the terms of the section, so as to disentitle the Commissioner from relying on its provisions.

Their Lordships are unable to agree with the contentions submitted on behalf of the appellants. The reasoning of Woodhouse J. and of the Court of Appeal of New Zealand appears to them unanswerable, and it is accordingly not necessary to give elaborate reasons for their concurrence. The arguments for the appellants, in their different ways, seemed all to be variations on the same fallacy, namely, that the agreement of sale and purchase is divisible into two bargains, one a sale of land, the other a sale of stock, and that the apportionment operated as a statement of the purchase price in respect of each. Only on some such proposition can the plain words of the section be avoided. This was clearly a transaction where " trading stock was sold together with other assets of a business " ; the " price " was stated at the outset of the agreement as £200,000. A contrasting transaction is seen in *Douglas v. Commissioner of Stamps* (1904) 24 N.Z.L.R. 716. The question there was, whether there had been a sale of the land together with the livestock thereon at the time of the sale. But there were in that case, as Edwards J. points out at p. 724, " in fact two separate purchase-moneys differently ascertained—the purchase-moneys of the lands, ascertained by the agreement of the parties, and the purchase-moneys of the live stock, ascertained by valuers appointed by them under the provisions of the Arbitration Act 1890." As Denniston J. put it at p. 722, " There is, therefore, it seems to me, what may be one transaction, but is not one sale." Another way in which the appellants' submission was made was, that the determination by the Commissioner of " the part of the consideration attributable to the trading stock " cannot come into play when that attribution has already been made by the parties by way of an agreed apportionment. But as soon as it is conceded that " consideration " in this sense means " price ", which concession counsel was naturally constrained to give, and the agreement provides on the face of it for a single price, the terms of the section must prevail against the argument, since it is precisely in those circumstances in which vendor and purchaser have agreed on a price, in the singular, that the Commissioner is given the power to apportion for himself the price of the trading stock out of the total consideration.

The provisions of sec. 101 have formed part of the tax code since a time anterior to the incorporation therein of the present arrangements for the valuation of trading stock, to which reference has been made. But as Woodhouse J. in particular points out, there is an interaction between relative provisions which is of convincing significance. Section 98 (8), in providing that the price for trading stock specified in any contract of sale is to be deemed to be the consideration received therefor, opens with the words " Subject to the provisions of sections 101 and 102 ". That phrase is unintelligible if there is to be excluded from the scope of sec. 101, as the appellants contend, the case where the parties have themselves fixed the price of the trading stock: it is only in that event that sec. 98 (8) can operate at all.

There are no authoritative precedents on the interpretation of sec. 101. Their Lordships were referred, as were the Courts in New Zealand, to the *obiter dictum* of a magistrate in *S's Trustees v. Commissioner of Taxes* (1950) 7 M.C.D. 218 which probably favours the interpretation proposed by the appellants. On the other hand Hutchison J. in *Edge v. Commissioner of Inland Revenue* [1958] N.Z.L.R. 42, although the point was not directly in issue in the case, was of opinion that the power of the Commissioner to determine under sec. 101 was exercisable " even if the price were not a global price, provided always that the stock was sold together with other assets, *e.g.* a sale of land and stock stated to be at £10,000 for the land and £5,000 for the stock, a total of £15,000 " and McCarthy J. described the section as being " wide enough in its terms to cover the case of a sale of livestock along with other assets where the price is apportioned in the terms of sale ". These opinions, which were unanimously concurred in in the present case by the Supreme Court and the Court of Appeal, render the appellants' case on this point unmaintainable. Their Lordships, accordingly, are of opinion that the respondent's interpretation of sec. 101 is correct.

Two subsidiary points, which arise if the appellants are wrong on their main submission, were argued. Firstly, it was said that the Commissioner was wrong inasmuch as his determination was made not on the basis of a sale as a going concern but of a valuation of stock per head. Their Lordships agree with the Court of Appeal that there are no facts upon which it could be shown, as a matter of law, that the Commissioner and the learned trial judge had fallen into error. The second submission was that the determination should have been made as at the date of the agreement, not as at the date of entry. Subject to one observation, their Lordships agree with the Court of Appeal that this point, so far as it has validity, is met by the modification made by Woodhouse J. in order, as North P. puts it, " to take care of any fluctuations in the value of the land or of the trading stock which may have occurred during the interregnum period of 6 months ", albeit Turner J. expresses his doubts as to the propriety of such an allowance being made. What Woodhouse J. did was to accept a " recent " valuation of the land at £147,500; this added to an adjusted stock figure and a figure for other chattels gives a total of £233,745, whereas the total price received was £200,000. He accordingly scaled down the valuation of the livestock by the proportion which the latter total bears to the former. Their Lordships, like the Court of Appeal, are prepared to accept this method of calculation as fair, but there is an additional factor which ought possibly to be taken into account, although, since no argument was presented on the matter, no concluded opinion is expressed. In order to be able to obtain the price of £200,000 the vendors were first obliged to expend £19,500 in purchasing the freehold from the Crown. There might have been a case for saying that the dividend in the " scaling down " fraction should accordingly have been, not £200,000, but £180,500. If, however, there has indeed been an error in the calculation, which their Lordships are

not in a position to assert or to deny, this would now have to be rectified by administrative action on the part of the Commissioner.

Finally, their Lordships would observe that, while the negotiations between the parties leading up to the sale were rightly described as having been conducted " at arms' length ", those negotiations were, so far as the present dispute is concerned, directed only to the respective liabilities of the parties to tax, not to the sum which was eventually to pass from one to the other. There seems to be little doubt, from the course which the negotiations took, as described in the evidence, that the parties themselves were satisfied that those tax liabilities would fall to be regulated in accordance with the agreed apportionment. Why this should have been so, in view of the judicial opinions to be found in *Edge v. Commissioner of Inland Revenue* (*supra*), is not so clear, unless the practice of the revenue authorities had influenced the parties' expectation. But if that were the view held by the parties, then the result is that the respective tax liabilities have turned out to be entirely different from those to which the agreement was expected to give rise, the vendors paying far more, and the purchasers far less. Whatever, however, may now be the legal or moral obligations as between vendor and purchaser, these do not concern the respondent and cannot affect the assessment to tax made by him, if correctly made in terms of the relevant statutory provisions.

Their Lordships will humbly advise Her Majesty that the appeal should be dismissed.

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Printed by HER MAJESTY'S STATIONERY OFFICE
1972