

Assessability of Receipts from Personal Exertion

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ABSTRACT

This paper explores the gaps that exist with regard to the taxation of receipts from personal exertion. This research examines both the New Zealand legislation and leading cases in New Zealand and other jurisdictions in this area, to arrive at some conclusions about the circumstances in which those receipts will be found to be either gross income or simply a gift. To determine the legal criteria that identify gifts as personal exertion income within the context of s CA 1(1) and s CA 1(2) of the *Income Tax Act 2007* (NZ), the paper sets out and analyses the following propositions:

- (1) Ordinary concepts (s CA 1(2)) includes employment income (s CE 1) and business income (s CB 1); or
- (2) Ordinary concepts (s CA 1(2)), employment income (s CE 1) and business income (s CB 1) are disparate concepts (with different tests to determine each).

The paper shows that sections CA 1(1) and CA 1(2) are not mutually exclusive and s CA 1(2) of the Act supplements specific provisions of the Act defining income.

In the absence of a clear statutory provision in the *Income Tax Act 2007* (NZ), the paper attempts to explain the underlying principles on which such receipts may be taxed within the broader context of the *Income Tax Act 2007* (NZ). The author hopes that this analytical paper will serve as a guide for policymakers to take steps to ensure that unfairness caused by those deficiencies does not ultimately undermine the tax system.

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1 Introduction

There are many ways in which a taxpayer receives payments in a personal capacity which result from a direct or indirect employment relationship. The character of such receipts as either income (revenue) or capital is controversial. As Jeff Waincymer has noted¹, '[t]he income/capital distinction leads to immense problems of factual characterisation'. Items that are clearly gross income are, for example, wages, salaries, commissions and bonuses. Items such as reimbursement of private expenses or expenses incurred by the employee on behalf of the employer and gifts given to employees not as a token of appreciation of their work like a wedding gift are clearly not gross income. There is a distinction between these categories: receipts that are not income because they are capital in nature and receipts that are not income for another reason, such as, gifts.² A present given by a parent to a child is certainly a gain to the recipient but, due to love and affection, it is a gift and not income. Lotto or raffle winnings or a reward by the police or by the owner for finding stolen goods is not income for other reasons such as the one-off nature of the receipt.

The leading cases demonstrate the legal concept of income as a flow and it has been constrained by judicial rules developed over time. Lehman and Coleman³ argue that the view of C J Jordan in *Scott v C of T*⁴ that ordinary concepts and common usage determine the parameters of income is no longer acceptable. They note that income is a concept shaped by the views of experts.⁵ The fundamental question is whether there is any logical distinction between the treatment of receipts from personal exertion and those from gifts. This study attempts to explore the inconsistencies that exist with regard to the taxation of receipts from personal exertion.

The present study examines legislation and leading cases in New Zealand and other jurisdictions relating to the taxation of receipts from personal exertion (PEI).⁶ It looks at the

¹ Jeff Waincymer, 'If at First You Don't Succeed ... Reconceptualising the Income Concept in the Tax Arena' (1994) 19 *Melbourne University Law Review* 977, 1000. Also Stephen Barkoczy, 'Income According to Ordinary Concepts — Part 1: Mere Realisation or Business Operation?' (1997) 3:2 *New Zealand Journal of Taxation Law and Policy* 75 at 96: 'The income/capital tightrope is certainly an awkward one to traverse. Courts need to identify what is the relevant business and what is an ordinary incident of that business in order to determine whether a gain is of an income or capital nature. The outcome of a given case will depend on these crucial findings which in turn depend on whether the Courts choose to adopt broad or narrow approaches in their fact finding mission.'

² R L Deutsch et al, *Australian Tax Handbook 2009* (Australian Tax Practice, Sydney, 2001) 43.

³ Geoffrey Lehman and Cynthia Coleman, *Taxation Law in Australia*, (Australian Tax Practice, 5th ed, 1998) 84. Yet the High Court in *FCT v Stone* adopted the test of the ordinary concepts in common usage in the definition of income. Refer to *FCT v Stone* (2005) ATC 4234 at [8].

⁴ *Scott v Commissioner of Taxation* (1935) 3 ATD 142 at 145; (1935) 35 SR (NSW) 215.

⁵ Lehman and Coleman, above n 3.

⁶ The earning activity is employment or the rendering of services (PEI).

scope, strength and limitations of the law to arrive at a conclusion about the circumstances in which a receipt in return for personal exertion will be found to be either gross income or a mere gift. It also provides an outline of the draft solution to the problem raised.

The *Income Tax Act 1976* (NZ) was rewritten in plain English in 1994 and went through several versions until the current 2007 Act.⁷ The *Income Tax Act 2007* (NZ) (the Act)⁸ taxes net income. Net income is a reference to gross receipts less deductions. When cases referring to earlier New Zealand taxation legislation are discussed in the paper the equivalent 2007 section(s) are referred to.

There is no statutory test of the overall concept neither of ‘income’ nor of personal exertion income. The term income is a judicially created term of art.⁹ To examine the taxation of personal exertion income, the paper considers the application of the key statutory provisions, ss CA 1(2), CE 1 and s CB 1 of the Act. Gifts from personal exertion income may be analysed in two ways:

(1) Ordinary concepts (s CA 1(2)) includes employment income (s CE 1) and business income (s CB 1); *or*

(2) Ordinary concepts (s CA 1(2)), employment income (s CE 1) and business income (s CB 1) are disparate concepts (with different tests to determine each).

Following on from this introduction, Part 2 sets out the economic and statutory concept of income. Part 3 of the paper expands on the analytical framework, specifically related to personal exertion income. Part 4 of the paper develops a conceptual framework and Part 5 outlines concluding comments and observations.

2 Concept of income

To examine the application of the key statutory provisions — sections CA 1 (2), CE 1 and CB 1 of the Act — with regard to personal exertion income, the economic concept of income must be evaluated within the statutory framework of these three sections.

2.1 Economic concept of income

Economists, it seems, cannot agree on a single definition of income. Proposed definitions includes: (a) ideas of capital maintenance, income as a flow and the comprehensive income

⁷ Adrien J Sawyer, ‘New Zealand’s Tax Rewrite Program — In Pursuit of the (Elusive) Goal of Simplicity’ (2007) 4 *British Tax Review* 405.

⁸ The *Income Tax Act 2007* (NZ) and *Tax Administration Act 1994* (NZ) represent the statutory source of taxation law in New Zealand.

⁹ John Prebble, ‘Can Income Tax Law Be Simplified?’ (1996) 2:4 *New Zealand Journal of Taxation Law and Policy* 187 at 190.

concept associated with the work of H C Simons;¹⁰ (b) the power to consume rather than the actual consumption;¹¹ (c) increase in the economic power of the recipient to control goods and services; and (d) an all-encompassing concept recognising all gains as income regardless of the source or the form the gain takes.¹²

In economic terms, 'income' and 'gain' are interchangeable terms that correspond to increases in wealth.¹³ 'Thus, the economist might define the income of a period as the difference between what the taxpayer was worth at the beginning of the period and what he or she was worth at the end of the period, plus the value of his or her consumption during the period.'¹⁴ Simons saw the relationship between the time period and the income concept as being 'fundamental'.¹⁵

Every person's accretion to wealth in any period falls within the tax base. Haig¹⁶ and Simons¹⁷ recognised that the receipt of gifts and windfall gains enhanced the economic power and capacity of the recipient. Simons defined income as follows:¹⁸

personal income may be defined as an arithmetic sum of (1) market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to 'wealth' at the end of the period and then subtracting 'wealth' at the beginning.

However, it has been argued that income should be taxed when earned.¹⁹ Whether or not income is consumed or saved is not material. Every person's accretion to wealth in any period falls within the tax base. Stephen Barkoczy supports the economists in this.²⁰

¹⁰ Phillip Burgess et al, *Income Taxation: Commentary and Materials* (Thomson Reuters, 6th ed, 2009) at 19 cite H C Simons' work 'Personal Income Taxation – The Definition of Income as a Problem of Fiscal Policy' as the best known articulation of the economic concept of income policy (University of Chicago Press, 1938).

¹¹ Robert M Haig (ed), *The Concept of Income: Economic and Legal Aspects* (The Federal Income Tax, Columbia University Press, 1921). At 7 Haig states: 'It [the economic income concept] has the effect of taxing the recipient of income when he receives the power to attain satisfactions rather than when he elects to exercise that power.'

¹² Richard Vann, 'Income as a Tax Base' in Richard Krever (ed), *Australian Taxation: Principles and Practice* (Longman Professional, 1987) 62 at 63.

¹³ Richard Goode, 'The Economic Definition of Income' in J Pechman (ed), *Comprehensive Income Taxation: A Report of a Conference Sponsored by the Fund for Public Policy Research and the Brookings Institution* (Brookings Institution, 1977).

¹⁴ S Ross and P Burgess (ed), *Income Tax: A Critical Analysis* (The Law Book Company, 1996) 31.

¹⁵ Burgess et al, above n 10.

¹⁶ Haig, above n 11.

¹⁷ Henry Simons (ed), *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (University of Chicago Press, 1938) 49.

¹⁸ Simons, above n 17, at 50, as cited in Kevin Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* (IBFD Publications BV, 2001) 66.

¹⁹ Kevin Holmes, 'Should Accountants Determine How Much Tax We Pay?: International Accounting Standards vs Taxable Income and Capital Gains' (2008) 14:3 *New Zealand Journal of Taxation Law and Policy*

2.2 Statutory concept of income

The concept of income is different for tax law and economists.²¹ An Income Tax Act that was drafted on economic concepts would in the author's view be unworkable because increments in wealth would fall within the tax base whether or not they have actually been received by the taxpayer.

In New Zealand core provisions in Part B of the Act set out the key principles and presumptions on which all other parts are based. They are intended to impose a tax liability and to set out procedures that taxpayers must follow to calculate and satisfy their tax liability.

Section YA 1 of the Act refers to s BD 1(1) of the Act for the definition of income. Section BD 1(1) provides that: 'an amount is income of a person if it is their income under a provision in Part C (Income)'. Part C of the Act contains a number of specific provisions outlining what is included in the term income for income tax purposes. It also defines amounts that would be income but by the Act are exempt or excluded from income tax liability. Amounts that are not included as income under Part C are not subject to income tax.

The assessment to tax of income from what is referred to in New Zealand as personal exertion lies primarily upon the inter-relationship of a number of key sections in the Act. The pivotal section is section CA 1.

Section CA 1(1) sets out specific categories of income. These are employment income, business income, income from property (personal property, real property) and accrual income. These categories are not comprehensive because if a receipt is not listed as a specific category it may still be considered income according to ordinary concepts as per s CA 1(2) of the Act. Section CA 1 (2) is the statutory mechanism which to some extent incorporates the economists' view of income.

316 at 318. The broad economics notion of income can be conceptualised as the base of a pyramid and includes unrealised value changes, consumption expenditure and psychic elements.

²⁰ Stephen Barkoczy, 'Income According to Ordinary Concepts — Part 3: Net Profits or Gross Receipts?' (1997) 3:4 *New Zealand Journal of Taxation Law and Policy* 195 at 196: 'Whichever way one looks at the matter, the "thrust" of the economic view is that "income is merely a gain". The source of the gain is irrelevant as is the issue of whether the gain has been realised.'

²¹ The 'income' envisaged by an economist may not be the same 'income' that is liable to tax. The reason for this is that economists, as government advisors (eg in the Treasury Department) on income based concepts, maintain fundamentally different beliefs as to the make-up of 'income' than do lawyers who have the task of interpreting legislation. The result is that on occasion the 'income' envisaged by economists may not be the same 'income' that is liable to tax. Prebble has suggested that the concept of income is 'in some senses an artificial construct, to the extent that it may almost be thought of as a fiction', John Prebble, 'Fictions of Income Tax' (Paper presented at the 14th Annual Australasian Tax Teachers' Association Conference, 2002) at 2, <<http://pandora.nla.gov.au.ezproxy.aut.ac.nz/pan/23524/20020412/c.fong.unsw.edu.au/prebblepaper.doc>>.

In 2004, the Inland Revenue Department published an article titled 'Income Tax Act' (2004), which examined different parts of the *Income Tax Act 2004* (NZ) (the 2004 Act).²² The article stated that Part C contained, 'An exhaustive list of provisions that state the circumstances in which a transaction or other event gives rise to income'.²³ The Inland Revenue noted that section BD 1(1) ITA 2004 'identifies that Part C is a code in relation to its role of determining whether an amount arising from a transaction or event is income'.²⁴ This is arguably incorrect and against this, Clinton Alley and Andrew Maples commented that the Inland Revenue statement does not give the complete picture and there is no actual definition outlined in the 2004 Act and we have to look to the cases for that definition.²⁵

Alley and Maples believe that s CA 1(2) of the 2004 Act served as a catch-all provision, providing that amounts that were not specifically referred to elsewhere in that legislation could still constitute income according to ordinary concepts and be taxed under Part C.²⁶ Section CA 1(2) is the most important provision in the Act.²⁷ Some charging provisions precede it, and (rather more) follow it.²⁸ Other commentators on the scope of Part C have noted that since it: 'includes "income under ordinary concepts", what is (and what is not), income remains to a large extent a matter of common law principle'.²⁹

The Australian *Income Tax Assessment Act 1997* (Cth) (ITAA 1997)³⁰ is of little assistance. Section 6-5 (2), ITAA 1997 brings to tax net 'assessable income' derived by Australian residents. Assessable income consists of 'ordinary income' and 'statutory income' (s 6-1(1) ITAA 1997). Ordinary income consists of income according to ordinary concepts from any source (s 6-5(5) ITAA 1997). Section 6-5(4) ITAA 1997 provides that a taxpayer is taken to have received an amount of ordinary income as soon as it is applied or dealt with in any way on the taxpayer's behalf or as the taxpayer directs. So the ITAA 1997 also does not

²² Inland Revenue Department, 'Income Tax Act' (2004) 16:5 *Tax Information Bulletin* 46. Part C of *Income Tax Act 2004* is equivalent to Part C ITA 2007. The Income Tax Act was rewritten in 2004.

²³ Ibid. The *Tax Information Bulletin* also uses the phrase 'exhaustive list' at 48 and 54.

²⁴ Inland Revenue Department, above n 22, 46 and 51. Section BD 1(1) ITA 2004 is equivalent to ITA 2007, section BD 1(1).

²⁵ Clinton Alley and Andrew Maples, 'An Analysis of the Framework and Terms Used in Determining Assessable Income in the Core Provisions of the Income Tax Act 2004' (2007) 13:3 *New Zealand Journal of Taxation Law and Policy* 462 at 463.

²⁶ Ibid.

²⁷ Committee of Experts on Tax Compliance, Report to the Treasurer and Minister of Revenue *The Rewrite Project* (Chapter 2, 2.159), <<http://www.taxpolicy.ird.govt.nz/publications/files/html/coe/index.html>>.

²⁸ Ibid.

²⁹ Craig Macalister and Therese Turner, *The Income Tax Act 2004: The New Rules* (Brookers Ltd, 2005) 287. If an amount arising from a transaction is not income under Part C, then it would be outside the scope of the Act.

³⁰ Part 3 of the paper undertakes a review and analysis of the leading cases from Australia and the United Kingdom. The United Kingdom *Income Tax Act 1952* is Schedular and there is no provision equivalent to s CA 1(2).

define the concept of income according to ordinary concepts or the concept of derivation. However, section 6-5(4) ITAA 1997 is an umbrella provision.³¹ It ensures that nothing that is income, according to the ordinary meaning of the word, escapes tax.

3. Analytical framework

Before one can arrive at tentative conclusions based upon established tax precedents, it is important to consider statutory and judicial concepts of income. This section develops the analytical framework for the concept of income, considering specifically s CA 1(2), s CE 1 and s CB 1 of the Act.

3.1 Ordinary income

As previously discussed, s CA 1(2) of the Act functions as a catch-all provision, providing that amounts that are not specifically referred to in the legislation constitute income under ordinary concepts.

The Act does not comprehensively define *income* and it was left to courts and commentators to arrive at a sustainable meaning.³² Therefore, taxpayers, their advisors and the Inland Revenue Department have had no choice but to work within the ambits of such an indefinite concept of income.³³ The New Zealand courts have relied on cases from other jurisdictions in order to derive a general concept of income. In the Australian decision of *Scott v Commissioner of Taxation*³⁴ C J Jordan concluded³⁵ that the word *income* was not a term of art. He suggested that the forms of receipt which were comprehended within income and the principles which were to be applied in ascertaining which of these receipts ought to be treated as income must be determined in accordance with the ordinary concepts and usages of humankind. However, the statute must be followed if it states or indicates an intention that receipts which were not income in ordinary parlance were to be treated as income, or the special rules were to be applied in arriving at the taxable amount of such receipts.

³¹ Committee of Experts on Tax Compliance, above n 27, 2.151.

³² The judicial approach to identification of income is different from the economic concept. In *A Taxpayer v CIR* (1997) 18 NZTC 13 350 (CA) when the Inland Revenue Department was relying on American and Canadian courts' economic concept, P Richardson at page 13 556 commented: 'The approach taken to the reach of taxes over income in other jurisdictions with their different economies and with different assumptions as to the influence of property and other concepts in the making of gains is not necessarily a sound basis for determining the scope and application of the New Zealand legislation. Thus, the United Kingdom of 200 years ago when income tax was first introduced was very different from the pioneering, entrepreneurial, less static and more mobile United States of 1913. The American cases on which Mr McKay drew need to be read in their economic and social context.'

³³ Alley and Maples, above n 25, 462.

³⁴ *Scott v Commissioner of Taxation* (1935) 35 SR (NSW) 215.

³⁵ *Scott v Commissioner of Taxation* (1935) 35 SR (NSW) 215 at 219.

Kevin Holmes notes that the courts when determining income for tax purposes ‘refer to adoption of the “ordinary” or “natural” meaning, or the “customary usage” of the word income’.³⁶ He also noted that to constitute income receipts required ‘the presence of: An incoming or inflow; Convertibility into cash; Periodicity or recurrence; A reward from employment or vocation or property; Realisation; Separation from source; A profit-making purpose, and conformity with the “ordinary” meaning of income.’³⁷

In 1985 Professor Ross Parsons³⁸ identified some propositions which provide the hallmarks of income according to ordinary concepts. Parsons noted that the concept of income denotes two components. First, there must be a gain for the taxpayer.³⁹ Second, once a gain has been established there must be something which comes in.⁴⁰ The second component relates to the concept of derivation. So first of all, a gain with an income character must be identified and then a determination needs to be made about whether it has been derived by the relevant taxpayer. Parsons’ definitive text makes a number of assertions, or propositions, which can be used in a general way to identify receipts as income.

The main criterions needed to satisfy the judicial concept of income are as follows.

3.1.1 Realisation — gain must be derived

Holmes observes that a gain must be realised (come in) before it can be treated as income in the legal sense.⁴¹ Parsons suggests that ‘An item is income of a taxpayer, in the amount of its realisable value, if it has been derived by him and the item is a gain derived in circumstances which give it in other respects an income character.’⁴² Conceptually, income derivation is a hard area.⁴³ Writing about the concept of income derivation, Sir Ivor Richardson has noted the fact that the judicial concept of income must work in the real world.⁴⁴

Section BD 3(2) of the Act provides that assessable income must be allocated to the income year in which the amount is derived by the taxpayer and section BC 5 provides that

³⁶ Kevin Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* (IBFD Publications BV, 2001) 233.

³⁷ Holmes, above n 19, 316 at 320.

³⁸ R W Parsons, *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting* (The Law Book Company, 1985).

³⁹ Parsons, above n 38, proposition 4 [2.38] at 36.

⁴⁰ Parsons, above n 38, proposition 1 [2.10] at 27. The second proposition is generally true, but it has been departed from and criticised on two occasions since Parsons’ publication. Refer to the comments of J Hill in *Warner Music Australia Pty Ltd v FCT* 96 ATC 5046 at 5054. Other citations: (1996) 34 ATR 171 (1996) 70 FCR 197.

⁴¹ Holmes, above n 36, 178.

⁴² Parsons, above n 38, [2.6] at 26.

⁴³ J Shewan and P Boyce, ‘Derivation and Deductions Revisited’ (2002) 8:2 *New Zealand Journal of Taxation Law and Policy* 182.

⁴⁴ I L R Richardson, ‘The Impact and Influence of Accounting and Economic Principles on Taxation Law’ (1998) 4 *New Zealand Journal of Taxation Law and Policy* 18.

income tax is imposed on the taxable income derived by the taxpayer during the income year. The term *derived* is not defined in the Act. The Act does not set out any procedures that a taxpayer must follow to determine the amount of income derived by them. The word ‘derived’ is not necessarily equivalent in meaning to ‘earned’.⁴⁵ In *Brent v Federal Commissioner of Taxation* J Gibbs said:⁴⁶

It has become well established that unless the Act makes some specific provision on the point the amount of income derived is to be determined by the application of ordinary business and commercial principles and that the method of accounting to be adopted is that which is calculated to give a substantially correct reflex of the taxpayer’s true income.

Section BD 3(4) of the Act provides that employment income is derived when it is credited in the employee’s bank account.⁴⁷ In *Commissioner of Taxes (SA) v Executor, Trustee and Agency Co of South Australia Ltd (Carden’s Case)* J Dixon noted:⁴⁸ ‘Speaking generally, in the assessment of income the object is to discover what gains have during the period of account come home to the taxpayer in a realised or immediately realisable form.’ Section BD 3(3) of the Act provides that for individuals (except self-employed people) income is derived on a cash/receipt basis.

Where the taxpayer is carrying on a business the most appropriate method to determine derivation may be accruals rather than cash. In *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* the prepayments made for dancing tuition which could extend beyond the current year were held to be income in the year that the lessons were provided and not in the year the fees were paid.⁴⁹ Arthur and Murray was a company (in business) so therefore the accrual basis of accounting was applied.

3.1.2 A gain must be ‘revenue’ in nature

⁴⁵ *Brent v FCT* (1971) 125 CLR 418, 423.

⁴⁶ *Brent v FCT* (1971) 125 CLR 418, 429.

⁴⁷ In *Case D14* (1979) 4 NZTC 60 507, an accountant was paid a salary for services to be performed the following year. The Taxation Review Authority held that the salary was derived by the accountant in the year he received it.

⁴⁸ *Commissioner of Taxes (SA) v Executor, Trustee and Agency Co of South Australia Ltd (Carden’s Case)* (1938) 63 C.L.R.108, 155.

⁴⁹ *Arthur Murray (NSW) Pty Ltd v FCT* (1965) 114 CLR 314 at 318 the court observed: ‘It refers to amounts which have not only been received but have ‘come home’ to the taxpayer; and that must surely involve, if the word ‘income’ is to convey the notion it expresses in the practical affairs of business life, not only that the amounts received are unaffected by legal restrictions, as by reason of a trust or charge in favour of the payer - not only that they have been received beneficially - but that the situation has been reached in which they may properly be counted as gains completely made, so that there is neither legal nor business unsoundness in regarding them without qualification as income derived.’

The Act defines the concept of revenue on the basis of its ordinary meaning. Ultimately it is a matter of commonsense. In ascertaining whether a gain constitutes income, tax law has focused on gains made from services rendered,⁵⁰ the carrying on of a business⁵¹ or from property (personal).⁵² These gains were recognised as being of an income nature and thus taxable. Interest, rents, dividends and royalties are also generally recognised as having the character of income.⁵³

The general concept of net income is based on identification of transactions which give rise to net income.⁵⁴ As the tax law concept of income evolved, the courts identified a number of common elements that were present in established types of income. However, an all-encompassing definition has not yet been developed, partly due to the fact that, as Phillip Burgess et al⁵⁵ state, judicial pronouncements will always be subject to varied interpretations. Holmes⁵⁶ also concludes that the distinction between income and non-income receipts and benefits turns on statutory interpretation.

In *Scott v Commissioner of Taxation*, C J Jordan observed that⁵⁷ the word ‘income’ appears ‘on both sides of the equation’. The definitions adopted in cases, however, did serve to flag the fact that property and personal exertion represented, at the very least, the principal sources from which income may be said to be derived. In *Eisner v Macomber*⁵⁸ the concept of income advocated by Pitney J includes gains from the sale of assets.

New Zealand tax legislation did not develop alongside the United States Supreme Court concept as stated in *Eisner v Macomber*. Unlike in the United States, in New Zealand profits made upon the realisation of an asset do not constitute income for income tax purposes. Intention or purpose of the recipient must be considered.⁵⁹ A receipt may constitute

⁵⁰ ITA 2007, s CA1, s CE 1.

⁵¹ ITA 2007, s CB 1.

⁵² ITA 2007, sections CB 3 to CB 5 (Personal Property) and ss CB 6 to CB 23 (Real Property).

⁵³ Parsons, above n 38, 89 at [2.234].

⁵⁴ *A Taxpayer v CIR* (1997) 18 NZTC 13 350, at 13 355 P Richardson observed: ‘Again, income is a flow of money or money’s worth, a series of periodic receipts arising from the ownership of property or capital, or from labour, or a combination, eg rent, interest and dividends, salary and other personal exertion receipts, annuities and business receipts.’

⁵⁵ Burgess et al, above n 10, 52–3.

⁵⁶ Holmes, above n 36, 192–3.

⁵⁷ *Scott v Commissioner of Taxation* (1935) 3 ATD 142 at 145; (1935) 35 SR (NSW) 215 at 220.

⁵⁸ *Eisner v Macomber* (1919) 252 US 189. The Supreme Court of the United States of America in *Eisner v Macomber* said: ‘The fundamental relation of “capital” to “income” has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop: the former being depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time ...’

⁵⁹ Though in this context there is some overlap between motive and intention. In *Californian Copper Syndicate v Harris* (1904) 5 TC 159 at 166 according to Lord Macdonald the question to be asked was, ‘is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in the

income if it arises from an isolated business operation or commercial transaction entered into otherwise than in the ordinary course of the carrying on of the taxpayer's business, so long as the taxpayer entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction.⁶⁰ However, Justice Edmonds⁶¹ notes that the High Court in *Myer* when referring to a one-off transaction left the door 'half open' when it stated 'in which event the extraordinary character of the transaction may reveal that any gain resulting from it is capital, not income'.⁶²

In *A Taxpayer v Commissioner of Inland Revenue* P Richardson said:⁶³ 'A further underlying notion is the idea of gain from the carrying on of an organised activity — an employment, a business or profession, an adventure in the nature of trade, or a business deal — directed to the making of gain.' In another case the court states that sums which are received annually or periodically are often revenue in nature but that factor is an evidential test not a decisive test in determining the revenue nature of the sums.⁶⁴ In *Sun Newspapers Ltd v Federal Commissioner of Taxation* the Australian High Court stated that it is necessary to look at the primary purpose for which the amount is received.⁶⁵

Tax law has recognised the ability to tax personal exertion receipt as being dependent upon the nature of the receipt. In this case it is the character of the receipt in the hands of the recipient.⁶⁶ In *G v Commissioner of Inland Revenue*⁶⁷ the taxpayer, an evangelist, received gifts regularly and which were a recurrent reward for the performance of services. The gifts were received by the taxpayer in anticipation that they would be a means of support for him and were considered income.⁶⁸ In *Reid v Commissioner of Inland Revenue* when deciding whether the student allowance was assessable to the taxpayer, J Richardson observed:⁶⁹

operation of business in carrying out a scheme for profit making'? Also in *Plimmer v CIR* [1958] NZLR 147 at 150 according to Chief Justice Barrowclough intention and purpose are not one and the same although sometimes purpose may mean intention.

⁶⁰ See, eg, s CB 4 of the Act. In *FCT v The Myer Emporium Ltd* (1987) 163 CLR 199; 87 ATC 4363, 4370 the High Court added the qualification that: 'at least in the context of carrying on a business or carrying out a business operation or commercial transaction'. In *Westfield Ltd v FCT* (1991) 21 ATR 1398, J Hill made it clear that the actual transaction contemplated at the time of entry must be carried out.

⁶¹ Justice R Edmonds, 'A Finding that a Taxpayer Carries on a Business: What is Required, Related Issues and What are the Tax Consequences' (2010) 39 *Australian Tax Review* 71 at 81.

⁶² *FCT v The Myer Emporium Ltd* 87 ATC 4363, 4372; (1987) 163 CLR 199 at 215–16, 209.

⁶³ *A Taxpayer v CIR* (1997) 18 NZTC 13 350 at 13 355.

⁶⁴ *Scott v FCT* (1966) 117 CLR 514; [1967] ALR 561.

⁶⁵ *Sun Newspapers Ltd v FCT* (1939) 61 CLR 337 at 363.

⁶⁶ *Hayes v FCT* (1956) 96 CLR 47; *Scott v FCT* (1966) 117 CLR 514.

⁶⁷ *G[raham] v CIR* [1961] NZLR 994.

⁶⁸ *G[raham] v CIR* [1961] NZLR 994, 999. It was cited by the Australian High Court in *Commissioner of Taxation v Stone* (2005) 215 ALR 61 at [84]. Profit-making intention or purpose was not essential to the carrying on of the business.

⁶⁹ *Reid v CIR* (1985) 7 NZTC 5176 at 5183–4.

If it has that quality of regularity or recurrence then the payments become part of the receipts upon which the recipient may depend for his living expenses, just as in the case of a salary or wage earner, annuitant or welfare beneficiary. But that in itself is not enough and consideration must be given to the relationship between payer and payee and to purpose of the payment, in order to determine the quality of the payment in the hands of the payee.

Therefore it is submitted that to determine whether a receipt from personal exertion would be considered as income, the relevant factors identified by the courts are: a gain is derived by a person for services rendered; periodicity, recurrence or regularity; an expectation of reward; and the intention of the donor and the donee.⁷⁰

3.1.3 Capital gains are excluded

The default rule of New Zealand tax law (s BD 1(1) of the Act) is that capital gains, whether realised or unrealised, are not taxable in the hands of the recipient even though it represents a gain to that person. However, many types of capital gains, which prima facie are not taxable, are being drawn into the tax base by virtue of particular legislative provisions.⁷¹

According to Ivor Richardson⁷² and Phillip Burgess et al⁷³ trust law concepts of income have been influential in shaping the tax law concept of income. Burgess et al⁷⁴ cite an example of the exclusion of capital gains from the tax law concept of income as having its origins in trust law, which recognised a difference between those beneficiaries entitled to receive income from the property and those beneficiaries entitled to receive the property itself. But Professor John Prebble⁷⁵ has argued that it is more likely due to the general concept of income in English law.

The treatment of increases in capital as constituting a profit or gain under the United Kingdom Income Tax Act 1918 was considered in *Ryall v Hoare* where J Rowlatt concluded that⁷⁶ ‘a capital accretion is outside the words “profits or gains”, as used in these Acts’. Therefore, profits made from the isolated buying and selling of an item fell outside the scope of income/gain as per J Rowlatt’s idea of income.

⁷⁰ *G[raham] v CIR* [1961] NZLR 994; *Reid v CIR* (1985) 7 NZTC 5176 at 5183–4; *Moore v Griffiths (Inspector of Taxes)* [1972] 3 All ER 399 at 411.

⁷¹ See, eg, section CB 6 to s CB 23 of ITA 2007, which contains a series of provisions to catch land sales.

⁷² Sir Ivor L M Richardson, ‘The Concept of Income and Tax Policy’ (1990) 4 *Canterbury Law Review* 203.

⁷³ Burgess et al, above n 10, 53.

⁷⁴ *Ibid.* This theory was expounded by Professor Parsons.

⁷⁵ John Prebble, ‘Fictions of Income Tax’ (Paper presented at the Australasian Tax Teachers’ Association 14th Annual Conference, Manukau Institute of Technology, Auckland, 17–19 January 2002) 22 <<http://pandora.nla.gov.au.ezproxy.aut.ac.nz/pan/23524/20020412/c.fong.unsw.edu.au/prebblepaper.doc>>.

⁷⁶ *Ryall v Hoare* [1923] 2KB 447 at 454.

3.1.4 Windfall gains are excluded

Flow chart B2 (calculating and satisfying income tax liabilities) of the Act provides that windfall gains are not income and therefore are not taxed. A state of mind test applies to determine whether a receipt is a windfall gain.⁷⁷ A windfall gain relates neither to the income-earning process nor to the framework which enables the income activity to take place. It is never received with a profit-making purpose.⁷⁸

Alley and Maples⁷⁹ observe that there is an overlap between the terms ‘windfall gain’ and ‘gift’. They believe that windfall gains may not be earned, but arise by virtue of luck and payments made by way of personal esteem or testimonial are gifts.⁸⁰ Ross and Burgess⁸¹ refer to a gift as a windfall payment.

In *G v CIR* the New Zealand Supreme Court adopted the position of English law and observed that:⁸² ‘Though gratuitous payments amount to income in the widest sense of the word — namely something which comes in — it has generally been accepted that they are not part of the taxpayer’s assessable income unless they can be shown to be embraced by some specific provision of the tax law which makes them taxable.’

Ross and Burgess stated:⁸³

[w]hy the courts exclude gifts from income has never been clearly explained in the case law, but perhaps the isolated nature of these receipts, their general unpredictability and lack of control the recipient has over their derivation qualifies gifts for special treatment.

In *FCT v Squatting Investment Co Ltd* J Kitto commented as follows:⁸⁴ ‘the test of whether a “gift” is income in the ordinary sense of the word is whether it is “made in relation to some activity or occupation of the donee of an income-producing character”.’ According to the income and non-income distinction developed by the English courts,⁸⁵ a gift is not a reward for a donee’s labour in an office or employment. Nor is the gift a product of the donee’s property. A gift might also be viewed as a distribution of the donor’s income or property rather than an income receipt of the donee. The value the recipient places on a gift is also significant, as discussed later

⁷⁷ Garth Harris et al, *Income Tax in New Zealand* (Thompson Brookers, 2004) 113 at 3.2.4 (a).

⁷⁸ *Scott v FCT* [1967] ALR 561; (1966) 117 CLR 514 at 527.

⁷⁹ Alley and Maples, above n 25, 462 at 472.

⁸⁰ Ibid.

⁸¹ Ross and Burgess, above n 14, 54.

⁸² *G[raham] v CIR* [1961] NZLR 994 at 997.

⁸³ Ross and Burgess, above n 14, 44.

⁸⁴ *FCT v Squatting Investment Co Ltd* (1953) 86 CLR 570 at 633.

⁸⁵ Ibid and *FCT v Dixon* (1952) 5 AITR 443. Income must come in; Income must be convertible into money or money’s worth; Income must generally comprise a periodic or recurrent flow; Income must be a reward for effort or the produce of property.

Therefore, each gift is considered on its own facts. Only those gifts which are related to the income-producing activities of the taxpayer are assessable and mere personal gifts made purely as a mark of affection, esteem or respect are therefore not assessable.

3.2 Section CE 1 employment income

Payments to an employee constitute payments of salary or wages which are subject to the pay as you go (PAYE) system. For a payment for personal exertion to constitute a payment of salary or wages it must be paid on account of an employment relationship. The term 'employment relationship' is not defined in the Act and relies on general law. However, income from an employment relationship is captured by s CE 1 (amounts derived in connection with employment) of the Act.

The use of the phrase in s CE 1: 'The following amounts derived by a person in connection with the employment or service of the person'⁸⁶ allows the inclusion in income of benefits in money derived in connection with employment.⁸⁷ The words refer to existing employment or service, and cannot be treated as extending to an employment or service which has come to an end. Employment income is an amount which is a reward for services.⁸⁸

Section 15-2 of the *Income Tax Assessment Act 1997* (ITAA) states that an amount is income if it is: 'in respect of, or for, or in relation directly or indirectly to, any employment of or services rendered by you'.⁸⁹ This similarity in wording to the Act allows greater reliance on the Australian cases than the English cases.⁹⁰

To prevent the erosion of the tax base of the country, the sections of the New Zealand Income Tax Act which specifically make employment income assessable have been amended from time to time. For example the word 'emoluments', which appeared in section 88(1) (b)

⁸⁶ ITA 2007, s CE 1. *Naismith v CIR* (1981) 5 NZTC 61 046 is the authority for this proposition.

⁸⁷ The employee is taxed on income derived, employee expenses discharged by the employer and non-cash benefits from the provision of accommodation and share investments.

⁸⁸ *A Taxpayer v CIR* (1997) 18 NZTC 13 350 at 13 368.

⁸⁹ Section 15-2(1) ITAA 1997 states that 'Assessable income includes the value to the taxpayer of all allowances, gratuities, compensation, benefits, bonuses and premiums provided to you in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by the taxpayer (including any service as a member of the Defence Force). It replaces s 26(e) *Income Tax Assessment Act 1936* (AU).

⁹⁰ See A P Molloy, *Molloy on Income Tax* (Butterworths, 1976) 503 and accompanying text for further discussion of the difference in reliance on English and Australian cases. Schedule E to the *Income Tax Act 1952* (UK) states: 'Tax under [Schedule E] shall also be charged in respect of any office, employment or pension, the profits or gains arising or accruing from which would be chargeable to tax under Schedule D but for the proviso to paragraph 1 of that Schedule.' The payments come within Schedule IX, which referred, in respect of an office or employment of profit mentioned in Schedule E, to 'all salaries, fees, wages, prerequisites or profits whatsoever therefrom'.

of the *Land and Income Tax Act 1954* and in the *Income Tax Act 1976* via the definition of ‘monetary remuneration’, was dropped from s CE 1 of the Act.⁹¹

3.3 Section CB 1 business income

Section CB 1 of the Act states that an amount that a person derives from a business is income of the person.⁹² ‘Business’ is defined in s YA 1, inter alia to include any profession, trade or undertaking carried on for profit.⁹³

The concept of a business involves the exercise of an activity in an organised and coherent way to attain the end result of pecuniary profit. The word pecuniary was not defined in the earlier Acts. In *Grieve*, J Richardson noted that⁹⁴ ‘it simply reflects the underlying notion of income as being money or money’s worth. The profit sought must be in money or money’s worth and the business must be carried on for pecuniary profit.’ There are no further statutory criteria set out in the Act to assist in identifying a business. The concept of carrying on a business has been developed through the case law.

The leading decision in New Zealand on the definition of a business is that of the Court of Appeal in *Grieve v Commissioner of Inland Revenue*.⁹⁵ In this case the Court of Appeal applied *G v CIR*⁹⁶ and J Richardson sets out the test of what is a business. The test involves a two-step analysis:⁹⁷

(a) Nature of the activity

‘Business’, in the sense in which it is used in the legislation conveys a notion of imposing a charge for tax in respect of revenue earning activities. The activity undertaken must be capable of being classified as a commercial or mercantile activity customarily engaged in as a means of livelihood and typically involving some independence of judgment and

⁹¹ The effect of the changes in the 2007 Act is to remove a direct reference to ‘emoluments’ from the source rules which existed up until and including the 2004 Act. It was believed by officials that the word used was superfluous and presumably the breadth of s CE 1 ITA 2007 would now catch such personal exertion amounts.

⁹² It is important to note the interpretation of the words ‘derived from any business’. This excludes capital receipts; see, eg, *CIR v City Motor Service Ltd* [1969] NZLR 1010. In terms of the derivation of income in the case of business income, the most appropriate method is the accruals method of tax accounting. The *accruals* method treats income as having been earned when it is legally payable but not yet paid.

⁹³ The words ‘manufacture’ and ‘pecuniary’ have been dropped from the definition of business in the Act. The *Income Tax Act 2004* and prior Acts used the term ‘pecuniary profit’.

⁹⁴ *Grieve v CIR* [1984] 1 NZLR 101 at 110. Following *Grieve* the Inland Revenue Department (IRD) released *Technical Policy Circular* 84/24, March 1984. The circular outlines IRD’s policy for determining whether a person is carrying on a business.

⁹⁵ *Grieve v CIR* [1984] 1 NZLR 101.

⁹⁶ *G[raham] v CIR* [1961] NZLR 994.

⁹⁷ *Grieve v CIR* [1984] 1 NZLR 101 at 110. The term ‘business’ has broad application and any activity meeting the two-step criteria would constitute business.

power of decision. It must be a pursuit or occupation demanding time and attention; a serious employment as distinct from a pastime.

(b) Is the activity carried out with an intention to make profit?

Intention refers to the expectation that income will be derived. It is not the same as purpose which is the reason why the taxpayer does something. An expectation and willingness of profits to arise as a result of activity undertaken is material and not the purpose.⁹⁸

In *Grieve*, J Richardson was of the opinion that the test of whether a business existed turned on the intention of the taxpayer as evidenced by his conduct.⁹⁹ Conduct of the taxpayer is an objective test and the intent of the taxpayer is a subjective test, which is determined by examining external evidence apart from their stated intentions. In *Grieve* J Richardson stated that a commitment to engage in business is not sufficient; rather a profit-making structure must be established and ordinary current business operations begun. In *Calkin*¹⁰⁰ J Richardson held that commencement of a business must involve real transactions and not just exist in the mind of the taxpayer. To decide whether the taxpayer has the necessary intention to make a profit factors to look at are:¹⁰¹ ‘Nature of the activity, the period over which it is engaged in, the scale of operations and the volume of transactions, the commitment of time, money and effort, the pattern of activity, and the financial results.’

Considering the particular facts in a situation, the intention test also determines when a business commences and terminates.¹⁰²

4 The conceptual framework

4.1 Section CE 1 employment income

The difficulty arises in drawing a distinction between gifts which are additional remuneration and are therefore assessable as profits from employment and gifts which are purely personal and have no relation to employment.

⁹⁸ *Grieve v CIR* [1984] 1 NZLR 101 at 106, J Richardson stated: ‘Some organised commercial operations may be embarked on without any motivation of profit-making and it is well settled that such activities may constitute trading.’ The joint judgment in *FCT v Stone* (2005) 215 ALR 61, 222 CLR 289 at [55] also established that activities can constitute a business even in the absence of profit motive.

⁹⁹ *Grieve v CIR* [1984] 1 NZLR 101 at 107. In *G v CIR* [1961] NZLR 994 at 999 J McCarthy stated that the essential test as to whether a business existed was the intention of the taxpayer as evidenced by his or her conduct, and other factors such as recurrence were tests to ascertain the existence of that intention.

¹⁰⁰ *Calkin v CIR* (1984) 6 NZTC 61 781 at 61 787.

¹⁰¹ *Grieve v CIR* [1984] 1 NZLR 101 at 110.

¹⁰² *Amalgamated Zinc (De Bavay's) Ltd v FCT* (1935) 54 CLR 295 at 309; *Inglis v FCT* 80 ATC 4001 at 4005.

A critical element is the nature of the employment relationship: whether it is direct or indirect. The existence of a direct employment relationship with the donor strongly increases the likelihood of a receipt being found to be gross income. In *Smith* the allowance was paid ‘in consequence of’ the employment, and thus was paid ‘in respect of ... or in relation ... to’ the employment.¹⁰³ The benefit was indirect, but the fact that Smith was still employed by the bank was crucial in finding the receipt to be gross income. In *Naismith* the key factor in finding the receipt of salvage money to be gross income was that the taxpayer performed services beyond his contractual obligations *during* paid employment.¹⁰⁴ A direct relationship also existed in *Shell*,¹⁰⁵ *Clayton v Gothorp*,¹⁰⁶ *FCT v Holmes*,¹⁰⁷ *Mudd v Collins*¹⁰⁸ and *Laidler v Perry*¹⁰⁹ and the receipts in question were found to be taxable.¹¹⁰ In *Hochstrasser v Mayes*,¹¹¹ Mayes was employed by ICIL, and a direct employment relationship existed. However, the payment to Mayes was during his employment but it did not proceed out of employment and was not a reward for services rendered. He was being compensated for a loss in his capacity as a householder rather than in his capacity as an employee and was not therefore deriving income. In addition the amount was not income as there was no gain.

If there is an indirect employment relationship and a sufficient nexus can be found between the receipt and the employment relationship, then the receipt will be gross income. In

¹⁰³ *Smith v FCT* (1987) 19 ATR 274 at 280 J Brennan. The case was decided under section 15-2 of the ITAA 1997 (formerly s 26(e) of ITAA 1936). In this case a bank had an ‘encouragement to study’ scheme under which payments were made to employees who successfully completed approved courses of study. Smith was an employee of the bank who successfully completed an appropriate course and was accordingly awarded \$570 by the bank.

¹⁰⁴ *Naismith v CIR* (1981) 5 NZTC 61 046 at 61 052. In this case Naismith was the captain of a tug boat and was employed by the Northland Harbour Board. The tug boat rescued a vessel which had foundered off the Northland coast. The Board realised the vessel and its stores and subsequently distributed salvage moneys to the crew, including Naismith, for performing services beyond contractual obligations.

¹⁰⁵ *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11 303. In this case at 11 306 the court stated that: ‘... the words “emolument (of whatever kind), or other benefit in money, in respect of or in relation to the employment or service of the taxpayer” are words of the widest possible scope.’

¹⁰⁶ *Clayton v Gothorp* [1971] 47 TC 168.

¹⁰⁷ *FCT v Holmes* 95 ATC 4476. In this case Holmes, a tug worker, was also taxed on a salvage payment, even though he was not acting in the course of employment at the time. The court relied on section 15-2 of the ITAA 1997 (formerly s 26(e) of ITAA 1936), which is a catch-all for employment benefits generally.

¹⁰⁸ *Mudd v Collins (HM Inspector of Taxes)* (1925) 9 TC 297.

¹⁰⁹ *Laidler v Perry* [1965] Ch 192 (CA).

¹¹⁰ Earlier cases such as *Barson v Airey* (1925) 10 TC 609 reinforce this point. In this case employees received bonuses for exceptional work. The taxpayers argued that the receipts were not in consideration for carrying out the work for which they were employed. But the nexus between the receipts and the employment was too close for the finding to be anything else but income. Such payments are clearly captured in New Zealand by the s CE 1 of the Act (amounts derived in connection with employment).

¹¹¹ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376. In this case Mayes was an employee of ICIL. He was required by the company to often move from one part of the country to the other. Under the company housing scheme the company agreed that it would make up any loss on the sale of a house by an employee when the employee was required to relocate. Mayes did make such a loss of £350 and it was reimbursed by the company.

many cases there was not a direct employment relationship with the donor. The receipts may have been donated by the public,¹¹² or by a former employer.¹¹³ In some cases the donor was even more remote.¹¹⁴ Often the court has found as in *Dixon*¹¹⁵ that '[t]he fact of the respondent's employment explains the selection of him as a recipient, but in no degree characterises the payment.'¹¹⁶ In many of the cases the receipt was found not to be gross income as a result of insufficient causal nexus between the receipt and the employment relationship. However, in *Blakiston*¹¹⁷ the receipt was found to be gross income, partly because of the letter written by the bishop. The letter clearly linked the receipt to Blakiston's office of clergyman so there was sufficient nexus. In *Wright v Boyce*¹¹⁸ the payments were made in pursuance of a custom every year which clearly linked the receipt to Wright's office of huntsman and therefore there was the sufficient nexus present for the receipt to be income. In *Dooland*,¹¹⁹ Dooland's contract entitled him to the collections so again the sufficient nexus was present.

In *Seymour*¹²⁰ the taxpayer was a cricketer who would not have received the benefit in question 'but for' his employment relationship with the cricket club yet the receipt was not income. Was *Seymour* therefore wrongly decided? Even though an employment relationship existed, the benefit received was found to be 'a mere gift or present ... made to [Seymour] on personal grounds and not by way of payment for his services'.¹²¹ It was a special mark of esteem for the career of the cricketer.

A close reading of the cases shows that it is possible that, even if an employment relationship exists, a receipt which can be explained by this employment relationship may still not be gross income. For the receipt to be gross income, a receipt must be a product or consequence of employment and benefits must be received for being or acting as an

¹¹² *Blakiston v Cooper (Surveyor of Taxes)* [1909] AC 104; *Seymour v Reed* [1927] AC 554; *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284; *Wright v Boyce* [1958] 1 WLR 832 (CA).

¹¹³ *Louison v Commissioner of Taxes* [1942] GLR 477; *FCT v Dixon* (1952) 5 AITR 443; *Hayes v FCT* (1956) 96 CLR 47; *FCT v Harris* (1980) ATC 4238; *FCT v Blake* (1984) ATC 4661.

¹¹⁴ *Moore v Griffiths* [1972] 3 All ER 399 at 411; *Kelly v FCT* (1985) ATC 4283; *Reid v CIR* (1985) 7 NZTC 5176.

¹¹⁵ *FCT v Dixon* (1952) 5 AITR 443.

¹¹⁶ *FCT v Dixon* (1952) 5 AITR 443 at 453.

¹¹⁷ *Blakiston v Cooper (Surveyor of Taxes)* [1909] AC 104.

¹¹⁸ *Wright v Boyce* [1958] 1 WLR 832 (CA).

¹¹⁹ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284.

¹²⁰ *Seymour v Reed* [1927] AC 554.

¹²¹ *Seymour v Reed* [1927] AC 554 at 559.

employee. The nexus between employment and receipt in *Seymour v Reed*¹²² is not as obvious as in *Dooland*¹²³ where there was an actual contract. But the rules of the club in *Seymour*¹²⁴ allowed members to have a benefit match and Seymour knew of these rules and would surely have had the hope or expectation of being rewarded by a benefit match as long as he performed his duties well.¹²⁵ If the match had been an ordinary match and not a benefit match, the gate takings would have been gross income to the club. The nexus is stronger than that present in *Kelly*¹²⁶ where the \$20 000 was given to Kelly by a television station. However, Kelly earned it because he performed his normal contractual duties so well over the season.

In *Moore v Griffiths*,¹²⁷ an English case, the receipt was found not to be gross income but the connection was more remote between the donor(s) and the employment than in *Seymour*.¹²⁸ Other distinguishing factors were also present. Moore was not aware that the prize money was available when he played in the World Cup, and the money was given to all the players in the England squad, irrespective of whether they had actually played. In *Case VI35*¹²⁹ while on Special Studies Program Leave the taxpayer was entitled to her usual salary in addition to the fellowship awarded by an overseas university. The decision in *Case VI35* must be open to some doubt because such a receipt is likely to be an ordinary incident of an academic's employment. It is submitted that if *Seymour v Reed*¹³⁰ came before a court today the benefit receipt would be found to be gross income.¹³¹

If the receipt is a result of a systematic scheme under which payments are made to a group of recipients, not just the taxpayer, the receipt is more likely to be gross income. The converse also appears to be true: if a receipt is motivated by the personal qualities of the taxpayer it is

¹²² *Seymour v Reed* [1927] AC 554.

¹²³ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284. In this case Dooland was a professional cricketer. Under his contract of employment he received a salary and other allowances but was also entitled to have collections on the field if he performed well. (There were strict guidelines as to when a player was entitled to a collection.)

¹²⁴ *Seymour v Reed* [1927] AC 554.

¹²⁵ *Seymour v Reed* [1927] AC 554 at 563 L J Atkinson.

¹²⁶ *Kelly v FCT* (1985) ATC 4283.

¹²⁷ *Moore v Griffiths* [1972] 3 All ER 399 at 411.

¹²⁸ *Seymour v Reed* [1927] AC 554.

¹²⁹ *Case VI35* (1988) 88 ATC 855.

¹³⁰ *Seymour v Reed* [1927] AC 554. Section CA 1 ITA 2007 provides that such payments constitute assessable income.

¹³¹ *Kelly v FCT* (1985) ATC 4283; *Commissioner of Taxation v Stone* (2005) 2005 HCA 21 demonstrates that the courts are more prepared to find an amount as income where the payments are made to a professional sportsperson.

less likely to be gross income. In *Blakiston v Cooper*¹³² and *Smith*¹³³ the payments were made to all persons of the same class as the recipients and were found to be gross income. The receipts were not personal testimonials as for example in *Seymour v Reed*.¹³⁴ In cases such as *Hayes*,¹³⁵ *Ball*¹³⁶ and *Case VI35*¹³⁷ the receipts were personal gifts and thus not part of any scheme.

Does the test in *Blakiston v Cooper*¹³⁸ represent an effective test for distinguishing between a mere gift and a gift made to reward services rendered? The test may be worded as: if a receipt is given to a person substantially by virtue of his office or employment,¹³⁹ then the receipt will be gross income. A line must be drawn between receipts which arise substantially by virtue of the employment and those which are either gifts given in a personal capacity (and the employment may be merely background) or for which no services have been rendered. Ultimately the courts have to examine the facts in each case to see on which side of the line a receipt lies. In some of the cases the drawing of the line is very difficult. For example in *Seymour v Reed*¹⁴⁰ and *Case VI35*¹⁴¹ the line was drawn on the side of the receipts not being gross income although there was a reasonable nexus between the payments and Seymour's and the Australian academic's employment. In *Kelly*,¹⁴² on the other hand, the line was drawn on the side of the receipt being gross income although the connection was more remote. In Kelly's case the payment was seen as a usual incident of the practice of professional football.

A wedding gift is not assessable when given by an employer to an employee because 'it amounts to a gift to [the employee] in his personal capacity ... a benefit conferred out of affection'.¹⁴³ If a wedding gift is not assessable, what of an ex gratia payment to a successful athlete by his and her employer? In *Seymour v Reed*¹⁴⁴ there was much discussion about whether the benefit was 'a mere gift or present (such as a testimonial) ... made to (Seymour)

¹³² *Blakiston v Cooper (Surveyor of Taxes)* [1909] AC 104.

¹³³ *Smith v FCT* (1987) 19 ATR 274 at 277.

¹³⁴ *Seymour v Reed* [1927] AC 554.

¹³⁵ *Hayes v FCT* (1956) 96 CLR 47.

¹³⁶ *Ball v Johnson* (1971) 47 TC 155.

¹³⁷ *Case VI35* (1988) 88 ATC 855.

¹³⁸ *Blakiston v Cooper (Surveyor of Taxes)* [1909] AC 104.

¹³⁹ *Laidler v Perry* [1965] Ch 192 (CA).

¹⁴⁰ *Seymour v Reed* [1927] AC 554.

¹⁴¹ *Case VI35* (1988) 88 ATC 855.

¹⁴² *Kelly v FCT* (1985) ATC 4283 at 4286.

¹⁴³ *Hayes v FCT* (1956) 96 CLR 47 at 57.

¹⁴⁴ *Seymour v Reed* [1927] AC 554.

on personal grounds,¹⁴⁵ or whether it was assessable income. The judgments in other cases such as *Moorhouse v Dooland*,¹⁴⁶ *Moore*,¹⁴⁷ *Kelly*¹⁴⁸ covered similar ground. What distinguishes these ‘sports’ cases and the example of a gift given by an employer to a successful athlete is that in the ‘sports’ cases the player performed their normal contractual duties well and earned the reward. Sometimes gifts are taxable if the tie relates to the action of the player, for example batting, that triggered the gift. In *Moorhouse v Dooland*, Sir Raymond Evershed MR said:¹⁴⁹

It follows, in my view, that a gift or present made either upon some special occasion such as a wedding, a century at cricket, a birthday or at a season of the year when it is customary to make presents, does not necessarily cease to be non-taxable merely because the ties that link the recipient and giver are or are substantially those of service and are not or not exclusively those of blood or friendship; and this may still be so, although the present is (for example, whenever another century is made or according to custom at Christmas) repeated.

In other words, the existence of an employment relationship does not mean that all receipts by the employee from the employer are gross income. For example, payments for humiliation, injury to feelings and so on under s 123(c)(i) *Employment Relations Act 2000* (NZ) and s 92M(1)(c) of the *Human Rights Act 1993* (NZ) are not taxable.¹⁵⁰ In order for the gift to be taxable there must either be a causal nexus between the employment and the gift,¹⁵¹ or it could be caught as gross income according to ordinary concepts (very unlikely if the payment was one off).

4.2 Section CB 1 business income

¹⁴⁵ *Seymour v Reed* [1927] AC 554 at 559.

¹⁴⁶ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284.

¹⁴⁷ *Moore v Griffiths* [1972] 3 All ER 399 at 411.

¹⁴⁸ *Kelly v FCT* (1985) ATC 4283 at 4286.

¹⁴⁹ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284 at 297.

¹⁵⁰ Inland Revenue Department public binding ruling BR Pub 06/05 assessability of payments under the *Employment Relations Act 2000* for humiliation, loss of dignity, and injury to feelings and public binding ruling BR pub 05/12 taxability of payments under the *Human Rights Act 1993* for humiliation, loss of dignity, and injury to feelings.

¹⁵¹ *Herbert v McQuade* (1902) 4 TC 489. Richard Collins MR held (at 500) that the test is whether from the standpoint of the person who receives it, it accrues to him in virtue of his office. It was held to be irrelevant whether the payment was voluntary or not. Also refer to *Payne v FCT* (1996) 32 ATR 516; *Scott v FCT* [1967] ALR 561.

How important is the existence of a business relationship in deciding whether a receipt constitutes gross income? Under what circumstances might it be found that a receipt which results from the existence of a business relationship is not gross income?

The difficulty arises in drawing a distinction between gifts which are an ordinary incident of taxpayer's business and are therefore assessable as profits from business and gifts which are purely personal and have no relation to business.

In *G v CIR*¹⁵² the receipts were the result of his ordinary activities of preaching the word of God, the very services he was supplying to support himself. The fact that his motive was not profit making was not essential to the carrying on of a business. His intention to make profit was inferred from the facts of the case. Profit-making purpose or intent is one consideration to be applied in deciding whether there is a business, but it is not crucial.

In *Stone*¹⁵³ a taxpayer received from her javelin activities prize money, government grants, appearance fees and sponsorships amounting to AU\$136 448. Ms Stone had used her athletic talent to earn money and that was held to be carrying on a business since all the rewards of that business were held to be incidental to that business. The judges emphasised the importance of the 'intention' of the taxpayer in relation to identifying a business objective and established the principles underlying the concept of intention from *G v CIR*.¹⁵⁴ The *Stone*¹⁵⁵ case shows that there is a harder attitude today towards the realities of professional sport and what comprises the income of a professional sports person.

It is clear from *Californian Copper Syndicate*¹⁵⁶ that an isolated or one-off transaction is capable of being a trading venture if the taxpayer entered into the transaction with a profit-making purpose or intention. In *Squatting Investment Co*,¹⁵⁷ the Australian government did not have a legal obligation to make the payment to the farmers, but it felt it had a moral obligation. The government passed the law enabling it to distribute the surplus to the farmers. The court held that payment was related to the amount of wool supplied and made in the course of their trade therefore the receipt was a trade receipt. In *McGowan v Brown and*

¹⁵² *G v CIR* [1961] NZLR 994.

¹⁵³ *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61; 222 CLR 289.

¹⁵⁴ *G v CIR* [1961] NZLR 994 at 1000 per J McCarthy: 'I do not suggest that the appellant was motivated by the thought of the money which he expected to flow to him; I accept that his motives were of a higher order, but I think it would be unreal to believe that after some seven or eight years of this activity and these means of livelihood, he did not intend that his work should lead to gifts being made to him, gifts which he knew he would accept and use for his support. This, of course, was not the only purpose or intention of his activity; but intention to make a profit is commonly only one of the intentions of those in business.' The unsolicited donations received by an evangelist were held to be assessable.

¹⁵⁵ *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61; 222 CLR 289.

¹⁵⁶ *Californian Copper Syndicate v Harris* (1904) 5 TC 159.

¹⁵⁷ *FCT v Squatting Investment Co Ltd* (1954) 88 CLR 413.

Cousins,¹⁵⁸ the taxpayers received the payment to compensate for inadequate remuneration for past services provided. The additional payment brought the taxpayers' remuneration up to an adequate level. Therefore even though no business relationship existed at the time of payment, the receipt was part of the business or revenue-producing activity carried on by the taxpayers.

In *Scott*¹⁵⁹ and *Walker v Carnaby Harrower*¹⁶⁰ the receipts were personal gifts and not part of any scheme or part of their income-earning process. In *Scott*,¹⁶¹ the defendant had already been paid for his services as a solicitor. Similarly in *Walker v Carnaby Harrower*¹⁶² the firm of accountants had been paid for the annual audit. In *Simpson v John Reynolds*¹⁶³ the taxpayer company had been paid properly for its services. In the *Carnaby Harrower, Barham & Pykett*,¹⁶⁴ *Scott*,¹⁶⁵ and *John Reynolds & Co*¹⁶⁶ cases the amount was received after the business connection had ceased and therefore it was a gift in recognition of past services rendered to the client company over a long period and not income. Ironically the size of the payment (£10 000) and no business relationship existing at that time in *Scott* probably increased the likelihood that it would be found to be a gift. The amount was so much greater than Scott could have charged for services rendered that it had to be given 'predominantly in recognition of personal qualities.'¹⁶⁷

In *Federal Coke Co*¹⁶⁸ the compensation payment was not a part of Federal Coke's business or the carrying on of a revenue-producing activity. The wholly owned subsidiary company gave no consideration for the payment made for variation of a long-term supply contract and there was no business relationship between the parties. The receipt by a subsidiary was in consideration of the closure of the company's coking works necessitated by the change of supply contract. The relevant income-producing activities and corresponding losses were those of the supplier, Bellambi. If the compensation had been paid to Bellambi itself, it would have been treated as ordinary income in the course of carrying on the business.

¹⁵⁸ *McGowan (Inspector of Taxes) v Brown and Cousins* [1977] 3 All ER 844.

¹⁵⁹ *Scott v FCT* [1967] ALR 561 at 567.

¹⁶⁰ *Walker v Carnaby Harrower, Barham & Pykett* (1969) 46 TC 561, [1970] 1 All ER 502.

¹⁶¹ *Scott v FCT* [1967] ALR 561.

¹⁶² *Walker v Carnaby Harrower, Barham & Pykett* [1970] 1 WLR 276.

¹⁶³ *Simpson (Inspector of Taxes) v John Reynolds & Co (Insurances) Ltd* [1975] 2 All ER 88.

¹⁶⁴ *Walker v Carnaby Harrower, Barham & Pykett* [1970] 1 WLR 276.

¹⁶⁵ *Scott v FCT* [1967] ALR 561.

¹⁶⁶ *Simpson (Inspector of Taxes) v John Reynolds & Co (Insurances) Ltd* [1975] 2 All ER 88.

¹⁶⁷ Parsons, above n 38, 62.

¹⁶⁸ *Federal Coke Co Pty Ltd v FCT* [1977] 34 FLR 375; 77 ATC 4255.

The relationship between payer and recipient and the purpose of the payment determines the character of the receipt. The analysis shows that a gift is taxable when there is a causal nexus between the existence of a business relationship and the gift. A gift is taxable under s CB 1 of the Act if received in the ordinary course of the taxpayer's business or as an ordinary incident of the business.

4.3 Section CA 1 (2) services rendered

How important is the existence of services rendered in deciding whether a receipt is gross income? Under what circumstances will a receipt be found to be gross income under ordinary concepts even if no services have been rendered?

Section 15(2) ITAA 1997 provides for the inclusion in a taxpayer's assessable income of all allowances, gratuities, compensations, benefits, bonuses and premiums allowed, given or granted to the taxpayer which relate directly or indirectly to the taxpayer's employment or to services rendered by the taxpayer. The New Zealand ITA 2007 includes in income amounts received 'in connection with their employment or service',¹⁶⁹ which is fairly close to directly or indirectly services rendered.¹⁷⁰ However, in New Zealand the more likely approach to whether an amount is gross income is to consider the presence of services rendered as an indicator of gross income according to ordinary concepts. This distinction is not crucial because either way the presence of services rendered increases the likelihood of a receipt being found to be gross income. The decision in *Mudd v Collins*¹⁷¹ illustrates this principle. In *Mudd* the test established by the court is that if the receipt is in return for services rendered beyond the scope of the person's duties, it is monetary remuneration and becomes assessable to income tax.

It is not necessary for services to be rendered for a receipt to be gross income as long as other factors which indicate gross income according to ordinary concepts are strongly present. In *Dixon*¹⁷² and *Louisson*¹⁷³ the payments were periodic, were a means of support and were supplementing their army wages (which were clearly gross income). The payments were related to an income-earning process. In *Harris*¹⁷⁴ the taxpayer was not rendering any services to the bank in return for the supplement to his pension. Other factors which indicate gross

¹⁶⁹ ITA 2007, s CE 1.

¹⁷⁰ *Reid v CIR* (1983) 6 NZTC 61 624, at 61 627–8 J Quilliam commented that a person may give service without necessarily being in employment. But his judgment was not final.

¹⁷¹ *Mudd v Collins (HM Inspector of Taxes)* (1925) 9 TC 297 at 300.

¹⁷² *FCT v Dixon* (1952) 5 AITR 443.

¹⁷³ *Louisson v Commissioner of Taxes* [1942] GLR 477.

¹⁷⁴ *FCT v Harris* (1980) ATC 4238. Now supplements to annuities are statutory income under s 27H (1) (b) of ITAA 1936.

income according to ordinary concepts were not strongly present. There was no real periodicity in the payments and Harris did not rely on the payments as a means of support. The receipt was a supplement to his pension, which clearly had the quality of gross income, but the presence of this factor was not enough to lead to a finding that the pension supplements were assessable. In *Hayes*¹⁷⁵ also no services were rendered to his former employer. Likewise in *Ball*¹⁷⁶ the payment was a mark of the personal success of the employee. In *Hochstrasser*¹⁷⁷ a reimbursement amount was paid to the taxpayer in his personal capacity as a home owner and was not gross income.

The courts have distinguished between payments which can be said to have been earned by the recipient and are taxable, and those payments which have been deserved and are not taxable.¹⁷⁸ A significant factor in determining whether a payment is related to the work or the conduct of the recipient is whether the gift was unexpected and unsolicited by its recipient. It would normally follow that if the receipt does not relate to any particular work of the recipient (ie unexpected and unsolicited) then it has been deserved but not earned.¹⁷⁹

In a number of cases, courts have considered the factor of whether the recipient has been properly paid for the services rendered. If it is found that the recipient has been properly paid for services rendered then the receipt is less likely to be gross income. In *Hochstrasser v Mayes*,¹⁸⁰ Mayes' salary was commensurate with others in work similar to his. However, the author believes that this is true in almost every case. The gifts were made because of the personal relationship that had developed and the way services were performed.¹⁸¹ A voluntary payment or gift that is not related in any way to personal exertion is not assessable. The work of the recipient is considered to be the activity upon which the tax is imposed but the conduct of the recipient is merely how the work is performed and is not the activity itself. In *McGowan v Brown and Cousins*¹⁸² taxpayers were inadequately remunerated for their services, therefore receipts from the new owners for those services were held as assessable.

Should the prizes received by a participant in quiz shows be assessed as gross income because services have been rendered? An employment relationship would not exist between

¹⁷⁵ *Hayes v FCT* (1956) 96 CLR 47.

¹⁷⁶ *Ball v Johnson* (1971) 47 TC 155.

¹⁷⁷ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376.

¹⁷⁸ *Ball v Johnson* (1971) 47 TC 155.

¹⁷⁹ *Ball v Johnson* (1971) 47 TC 155; *Hayes v FCT* (1956) 96 CLR 47.

¹⁸⁰ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376.

¹⁸¹ *Ball v Johnson* (1971) 47 TC 155; *Moore v Griffiths* [1972] 3 All ER 399 at 411; *Walker v Carnaby*

Harrower, Barham & Pykett [1970] 1 WLR 276; *Scott v FCT* [1967] ALR 561; *Simpson (Inspector of Taxes) v John Reynolds & Co (Insurances) Ltd* [1975] 2 All ER 88.

¹⁸² *McGowan (Inspector of Taxes) v Brown and Cousins* [1977] 3 All ER 844.

the contestant and the quiz show company. Therefore, for the prizes to be assessed as income there would need to be strong factors indicating gross income according to ordinary concepts. A service rendered is one of these factors and if a reward is a consequence of the provision of a service it is income even if it is one off: *Brent v FCT*¹⁸³ and *FCT v Cooling*.¹⁸⁴ It is arguable that the contestant is rendering services to the quiz show company. The prize given in pursuance of a service should be income in general principles even if the reward is contingent upon successful performance.¹⁸⁵

In the case of Olympic champions, it would be unrealistic nowadays to view these people as anything other than professionals. Any receipts connected with the performance of their sport are in the nature of gross income according to ordinary concepts and thus would be assessable.¹⁸⁶ In *Stone*¹⁸⁷ the taxpayer, Ms Stone, agreed that sponsorship payments were assessable on the basis that the sponsorship amounts were rewards for services rendered. In *G v CIR*¹⁸⁸ the receipts were not the result of a personal relationship; they were for the services an evangelist was supplying.

4.4 Section CA 1 (2) periodicity, recurrence and regularity

How important is the existence of periodicity, recurrence and regularity¹⁸⁹ in deciding if a receipt is gross income according to ordinary concepts? Under what circumstances might it be found that even if receipts are regularly received, the receipts are not gross income?

While the existence of periodicity is often cited as a sign of the presence of income, as submitted by Lehman and Coleman, 'the recurrent nature of a receipt, where it is not an annuity, is a weak indicia of its income nature'.¹⁹⁰ A payer may simply make a series of gifts

¹⁸³ *Brent v FCT* (1971) 125 CLR 418.

¹⁸⁴ *FCT v Cooling* (1990) 21 ATR 13 at 22 J Hill.

¹⁸⁵ *FCT v Holmes* (1995) 95 ATC 4476.

¹⁸⁶ This approach is supported by the New Zealand Inland Revenue Department's publication *The Rule Book* (IR248), which outlines the tax requirements for all sportspeople (professional or amateur) who derive income from their sport. In line with *Seymour v Reed*, however, sportspeople are advised to seek advice if they receive any amounts from testimonials or benefits, <<http://www.ird.govt.nz/forms-guides/keyword/individualincometax/ir248-guide-the-rule-book.html>>. *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61 the judgment also clarifies the approach to testimonials, benefits or prizes given to sportspeople.

¹⁸⁷ *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61.

¹⁸⁸ *G[raham] v CIR* [1961] NZLR 994.

¹⁸⁹ *Parry v CIR* (1984) 6 NZTC 61 820, at 61 824 J Tompkins stated that 'regular' involves recurring at uniform or near uniform intervals. He further said: '[t]he Court must ... consider the number of transactions and the intervals of time between each thereby assessing the degree of uniformity or consistency of occurrence. In the end it will have to determine as a matter of fact and degree whether the events that occurred demonstrate a regular pattern of such transactions.'

¹⁹⁰ Geoffrey Lehman and Cynthia Coleman *Taxation Law in Australia* (Australian Tax Practice, 5th ed, 1998) 115.

to the recipient, ‘conferred out of affection or pity’.¹⁹¹ A mother for example may decide to give her son, a student, \$50 a week to help support him. The decision in *Louisson*¹⁹² illustrates this principle. The court held that the supplements to Louisson’s army wages were gifts given entirely voluntarily. A similar decision might have been reached in *Dixon*,¹⁹³ but the court went on to consider whether other elements which indicated gross income, including periodicity, recurrence and regularity, were also present. In *Moorhouse v Dooland*¹⁹⁴ the fact that the collections were repeated was *one* element in finding they were gross income. L J Jenkins, for example, said ‘the fact that the voluntary payment is of a periodic or recurrent character affords a further, but I should say less cogent, ground ...’¹⁹⁵ for finding that it is assessable. The presence of periodicity in *Moorhouse v Dooland*¹⁹⁶ was an important distinction from *Seymour v Reed*¹⁹⁷. In the *Moorhouse* case, in distinguishing Mr Dooland’s circumstances from those of Mr Seymour, Sir Raymond Evershed MR at the Court of Appeal emphasised that, except in the rarest circumstances, Mr Seymour would have only one benefit towards the end of his professional career, and that the sum subscribed was very large compared with his regular salary. The court held that these factors were not present in *Dooland* and that the collections paid to him were properly treated as taxable income. However, the judge has no objective test to determine what is a large and a small subscription amount in relation to the recipient’s regular salary.

In *Moore v Griffith*¹⁹⁸ and *Scott*¹⁹⁹ lack of periodicity, recurrence and regularity in the payments led to finding that the receipts were not income. In *Reid*²⁰⁰ the presence of periodicity, recurrence and regularity contributed to finding that the student teacher allowance was assessable. In *Harris*,²⁰¹ C J Bowen said that ‘[t]he regularity and periodicity of the payment will be a relevant though generally not decisive consideration’.²⁰² In fact, the element of recurrence in *Harris*²⁰³ was somewhat contrived given that Harris only received a few lump sum annual payments. In *Blake*²⁰⁴ periodicity was much more strongly present

¹⁹¹ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376 at 388.

¹⁹² *Louisson v Commissioner of Taxation* (No 2) [1942] GLR 477.

¹⁹³ *FCT v Dixon* (1952) 5 AITR 443.

¹⁹⁴ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284.

¹⁹⁵ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284 at 304.

¹⁹⁶ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284 at 304.

¹⁹⁷ *Seymour v Reed* [1927] AC 554.

¹⁹⁸ *Moore v Griffiths* [1972] 3 All ER 399.

¹⁹⁹ *Scott v FCT* [1967] ALR 561.

²⁰⁰ *Reid v CIR* (1985) 7 NZTC 5176.

²⁰¹ *FCT v Harris* (1980) ATC 4238.

²⁰² *FCT v Harris* (1980) ATC 4238

²⁰³ *FCT v Harris* (1980) ATC 4238.

²⁰⁴ *FCT v Blake* (1984) ATC 4238.

because Blake received the cost of living supplements fortnightly along with his pension. In *G v CIR*²⁰⁵ and *Stone*²⁰⁶ the presence of periodicity, recurrence and regularity contributed to finding that the particular activities were business.

The general consensus from the cases is that periodicity is an indicator of gross income according to ordinary concepts but is not an essential or even a strong element. Certainly in *Harris*²⁰⁷ its (somewhat weak) presence did not lead to a finding that the supplementary pension paid to Harris was assessable. Other factors indicating gross income according to ordinary concepts must be present in force as in *Dixon*,²⁰⁸ *Reid*,²⁰⁹ *Louisson*,²¹⁰ *Blake*,²¹¹ *G v CIR*²¹² and *Stone*.²¹³

4.5 Section CA 1(2) expectation of reward

How important is the idea of ‘expectation of reward’ in deciding if an action can be characterised as ‘services rendered’? If a person performs an action unaware that another person intends to (or may) reward them for their action, can the action be characterised as ‘services rendered’?

Gifts are precarious in nature; their receipt is unexpected by the recipient. Since there is no legal obligation for the gifts to be made, they cannot be relied on with certainty. However, precarious income refers to earned income as opposed to unearned income²¹⁴ and then although they are unexpected and uncertain, they are not regarded as being earned either, although they are often deserved.

In *Laider v Perry*,²¹⁵ in the context of a £10 gift voucher given to Dr Laider as a Christmas gift by his employer, Lord Denning stated:²¹⁶

[S]uppose it had been £100 a year which had been given to all the staff ... at Christmas.

In that case it would clearly be open to the commissioners to find that it was a reward, remuneration or a return for services rendered. But now suppose that, instead of £100 it

²⁰⁵ *G v CIR* [1961] NZLR 994.

²⁰⁶ *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61; 222 CLR 289.

²⁰⁷ *FCT v Harris* (1980) ATC 4238.

²⁰⁸ *FCT v Dixon* (1952) 5 AITR 443.

²⁰⁹ *Reid v CIR* (1985) 7 NZTC 5176.

²¹⁰ *Louisson v Commissioner of Taxation* (No 2) [1942] GLR 477.

²¹¹ *FCT v Blake* (1984) ATC 4238. It is ironic that if it is shown that a taxpayer relies on a receipt as a means of support it is more likely to be found to be income. This was certainly the situation in *Blake* and *Dixon*.

²¹² *G v CIR* [1961] NZLR 994.

²¹³ *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61; 222 CLR 289. Now in New Zealand under s CF 1(1) of the Act and in Australia under s 27 H of ITAA 1936, a payment made to a taxpayer to supplement a superannuation pension is included in assessable income.

²¹⁴ Kevin Holmes *The Concept of Income: A Multi-Disciplinary Analysis* (IBFD Publications BV, 2001) 218.

²¹⁵ *Laider v Perry* [1965] Ch 192 (CA).

²¹⁶ *Laider v Perry* [1965] Ch 192 (CA) at 199.

was a box of chocolates or a bottle of whisky or £2, it might be merely a gesture of goodwill at Christmas without regard to services at all. So it is a question of degree. It seems to me that in this case when one finds that £10 a year was paid to each of the staff year after year, each of them must have come *to expect* the £10 as a regular payment, which went with their services. It was, I think, open to the commissioners to find that it was made in return for services. It is, therefore, taxable in the hands of the recipient.

The idea of expectation of reward as an indicator of assessable income is discussed in *Moore v Griffiths*.²¹⁷ J Brightman listed the factors which led him to the conclusion that the prize money received by Moore was not assessable. Included in this list was the fact that ‘There was no expectation of reward. The taxpayer was totally unaware of the prospect of the payment prior to the services which he performed. The terms of his contract with his club did not contemplate that gratuitous payments of that or any type would be made.’²¹⁸ In *Case VI35*²¹⁹ the taxpayer was aware of fellowship being awarded but no services were rendered for the fellowship. It was given on personal grounds. In *Ball*,²²⁰ the taxpayer was unaware of any reward. Kelly in *Kelly v FCT*²²¹ on the other hand did know of the existence of the award he eventually won and this knowledge counted against him. Similarly in *FCT v Dixon*,²²² *Louisson*²²³ and *Reid*²²⁴ the taxpayers were aware of the receipts and these receipts were relied upon as a means of support. In *G v CIR*,²²⁵ after every assembly Mr G expected substantial gifts or donations that he then used to live on. The donations were associated with some income-earning process and were earned income.

In *Scott*²²⁶ the taxpayer, a solicitor, was unaware that his client, Mrs Freestone, had any intention of giving him a gift over and above the amounts he charged her for his professional services. This factor helped the court to decide that the gift was not assessable. Similarly in the *Walker v Carnaby Harrower Barham & Pykett*²²⁷ and *Simpson v John Reynolds & Co*²²⁸ cases the gift was unexpected, and therefore held as not being assessable. In *McGowan v Brown and Cousins*,²²⁹ since the taxpayers were inadequately remunerated the gift was

²¹⁷ *Moore v Griffiths* [1972] 3 All ER 399.

²¹⁸ *Moore v Griffiths* [1972] 3 All ER 399 at 411.

²¹⁹ *Case VI35* (1988) 88 ATC 855.

²²⁰ *Ball v Johnson* (1971) 47 TC 155.

²²¹ *Kelly v FCT* (1985) ATC 4283.

²²² *FCT v Dixon* (1952) 5 AITR 443.

²²³ *Louisson v Commissioner of Taxation* (No 2) [1942] GLR 477.

²²⁴ *Reid v CIR* (1985) 7 NZTC 5176.

²²⁵ *G v CIR* [1961] NZLR 994.

²²⁶ *Scott v FCT* [1967] ALR 561.

²²⁷ *Walker v Carnaby Harrower, Barham & Pykett* [1970] 1 WLR 276.

²²⁸ *Simpson (Inspector of Taxes) v John Reynolds & Co (Insurances) Ltd* [1975] 2 All ER 88.

²²⁹ *McGowan (Inspector of Taxes) v Brown and Cousins* [1977] 3 All ER 844.

expected by them, and they were not surprised to receive it. The taxpayers considered that while they had no legal right to the payment, they were morally entitled to it, and therefore it was held to be assessable income.

In conclusion, if a taxpayer acts without expectation of reward this will be a strong factor in finding that a receipt is not gross income. The reward will be received without profit-making purpose or intention and the taxpayer is not relying on it to support them and their dependants. Such payments are not earned but arise spontaneously and are made as a mark of personal esteem and a testimonial.

4.6 Section CA 1 (2) intention of the donor and donee

How important is the intention of the donor in deciding if a receipt is gross income?

In some of the cases the donors clearly intended the payments to be gifts. In *Blakiston v Cooper*,²³⁰ for example, the bishop requested that the parishioners make personal, non-official freewill gifts to the clergy and no doubt the parishioners thought they were making gifts. We can assume in the two ‘cricket’ cases that the fans intended that their donations to Seymour and Dooland were gifts for excellent play. In *Ball*,²³¹ *Case VI35*,²³² *Scott*²³³ and *Hayes*²³⁴ the intention of the donors was quite clearly that the payments were personal gifts. In *Federal Coke Co*²³⁵ the intention of the donor was to compensate the taxpayer for the closure of the coking works. In *McGowan v Brown and Cousins*²³⁶ the intention of the donor was to compensate the taxpayer for underpayment for the work done and therefore is held as assessable. On the other hand, in *Hochstrasser*²³⁷ and in *Shell*,²³⁸ the donors intended that the payments they made to employees to compensate them for the costs of moving were reimbursements. However, in *Hochstrasser v Mayes*²³⁹ the receipt was found not assessable because there was evidence that it was not a reward for services rendered. The source of payment was the housing agreement, but actually it had no purpose other than to advance the interests of the employer.

²³⁰ *Blakiston v Cooper (Surveyor of Taxes)* [1909] AC 104.

²³¹ *Ball v Johnson* (1971) 47 TC 155.

²³² *Case VI35* (1988) 88 ATC 855.

²³³ *Scott v FCT* [1967] ALR 561.

²³⁴ *Hayes v FCT* (1956) 96 CLR 47.

²³⁵ *Federal Coke Co Pty Ltd v FCT* [1977] 34 FLR 375; 77 ATC 4255.

²³⁶ *McGowan (Inspector of Taxes) v Brown and Cousins* [1977] 3 AII ER 844.

²³⁷ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376.

²³⁸ *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11 303.

²³⁹ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376.

In other cases the donors appear to be motivated by different forces. For example, in *Dixon's case*²⁴⁰ the donor was probably motivated by patriotism. In *Harris*²⁴¹ the motivation appears to be a paternalistic desire to assist former employees against the effects of inflation. It was also suggested in *Harris* that the ex gratia inflation increases would be a 'good look' to present employees. In the *Walker v Carnaby Harrower Barham & Pykett*²⁴² and *Simpson v John Reynolds & Co*²⁴³ cases the gift was made as a consolation for the fact the services will no longer be performed by the taxpayer for the donor. In *Reid*²⁴⁴ the motive was clearly that the payment to Mr Reid was for his day to day living expenses. It is submitted that, while the motives of the donors in the cases are diverse and frequently not articulated, there is no discernible relationship between these motives and the decisions reached by the courts as to the assessability of the payments.

The motive of the recipient is also not significant. In *G v CIR*²⁴⁵ the motive of Mr G was preaching and was not profit making, but receipts were held as business income. It is the character of the receipt in the recipient's hands that is significant; the motive of the donor is only significant so far as it bears, if at all on that character.²⁴⁶ In *Reid*, J Richardson stated:²⁴⁷ 'It is accepted ... that the question as to the true character of the payment should be ascertained and judged in relation to the recipient rather than to the payer.' In *Californian Copper Syndicate*²⁴⁸ the taxpayer entered into the transaction with a profit-making purpose or intention, therefore it was deemed a trading venture. In *Squatting Investment Co*²⁴⁹ the receipt was a part of their income-earning process and hence was a trade receipt. In *Dixon*,²⁵⁰ *Louisson*,²⁵¹ *Reid*,²⁵² *Moorhouse*,²⁵³ *Blakiston*,²⁵⁴ *G*²⁵⁵ and *Stone*²⁵⁶ the donees received payments with a profit-making purpose or intent, in anticipation that they will be the means to support them and their dependants. It was this anticipation that gave the receipts the character of income.

²⁴⁰ *FCT v Dixon* (1952) 5 AITR 443.

²⁴¹ *FCT v Harris* (1980) ATC 4238.

²⁴² *Walker v Carnaby Harrower, Barham & Pykett* [1970] 1 WLR 276.

²⁴³ *Simpson (Inspector of Taxes) v John Reynolds & Co (Insurances) Ltd* [1975] 2 AII ER 88.

²⁴⁴ *Reid v CIR* (1985) 7 NZTC 5176.

²⁴⁵ *G v CIR* [1961] NZLR 994.

²⁴⁶ *Murray v Goodhews* [1978] 2 AII ER 40 at 46 per L J Buckley.

²⁴⁷ *Reid v CIR* (1985) 7 NZTC 5176 at 5184.

²⁴⁸ *Californian Copper Syndicate v Harris* (1904) 5 TC 159.

²⁴⁹ *FCT v Squatting Investment Co Ltd* (1954) 88 CLR 413.

²⁵⁰ *FCT v Dixon* (1952) 5 AITR 443.

²⁵¹ *Louisson v Commissioner of Taxation* (No 2) [1942] GLR 477.

²⁵² *Reid v CIR* (1985) 7 NZTC 5176.

²⁵³ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284.

²⁵⁴ *Blakiston v Cooper (Surveyor of Taxes)* [1909] AC 104.

²⁵⁵ *G v CIR* [1961] NZLR 994.

²⁵⁶ *Commissioner of Taxation v Stone* (2005) 2005 HCA 21; 215 ALR 61; 222 CLR 289.

4.7 A matrix summarising the conceptual framework

Factor	Assessable? ML = more likely LL = less likely N = neutral	Cases that support the decision in column 2	Cases that refute the decision in column 2
Direct employment relationship	ML	<i>Smith, Shell Naismith, Clayton Mudd, Wright</i>	<i>H v Mayes</i> — even though Mayes was an employee the receipt was found to be not assessable
Indirect employment relationship	LL — but each case must be determined on its merits	<i>Seymour, Dixon, Harris Hayes, Louisson</i>	<i>Blakiston, Dooland Kelly, Blake</i>
Direct business relationship	ML	<i>Californian Copper, Squatting Investment, Brown and Cousins, Stone</i>	<i>Walker, John Reynolds, Federal Coke, Scott</i>
Systematic scheme — payment to all people of same class	ML — but only just	<i>Blakiston, Dixon, Smith, Dooland, Blake, Wright Laider</i>	<i>Seymour, Harris Moore, Blake</i>
Personal one-off payment	LL	<i>Scott, Hayes, Seymour</i>	<i>Kelly</i>
Voluntary payment	LL	<i>Ball, Harris, Hayes, Federal Coke, John Reynolds, Walker v Carnaby, Scott, Moore</i>	<i>Kelly, Mudd, Brown and Cousins, G v CIR, Dooland</i>
Relied on as a means of support	ML	<i>Dixon, Harris, Blake Reid, G v CIR</i>	<i>Louisson</i>
Presence of services rendered	ML	<i>H v Mayes, Harris, Scott, Walker v Carnaby, John Reynolds, Hayes, Case V135, Ball, Louisson</i> — in these cases no services were shown to be rendered, therefore not assessable	<i>Smith, Dixon</i> — no services were rendered but still found to be assessable
Periodicity	ML — but a weak indicium	<i>Dixon, Reid, Dooland Blakiston, G v CIR, Blake, Reid</i>	<i>Louisson, Harris</i> — periodicity was present but not assessable

Payee has an expectation of reward	ML	<i>Dixon, Dooland, Moore, Kelly, Smith, Blake, Reid, Brown and Cousins, Stone, G v CIR</i>	
Same quality as other receipts which are gross income	ML	<i>Dixon, Brown and Cousins, Blake, Reid, G v CIR, Californian Copper, Squatting Investment</i>	<i>Harris, Ball, Seymour</i>
Intention of donor and donee that the receipt is not gross income	Neutral — not a very relevant factor		

4.8 Results and discussion

In *Dixon, Louisson, Reid, Blake, Moore, Ball, Hayes, Case VI35, Harris* and *Hochstrasser* payments were neither made to the recipient as an employee nor were they related to the recipient's employment and thus were held not to be assessable under s CE 1. However receipts by *Dixon, Reid, Blake* would have been found taxable under equivalent sections of earlier versions of the ITA, under s CA 1 (2). In *Louisson* the New Zealand court did not consider s CA 1(2) of the Act. Like the Australian case *FCT v Dixon, Louisson* has somewhat similar facts, if the New Zealand court would have considered s CA 1(2) of the Act, then extra pay would have been *income*. The presence of periodicity, recurrence and regularity was considered in *Moorhouse* and *Blakiston* but was not decisive. In *Ball, Hayes, Case VI35, Seymour* and *Moore*, payments were made based upon the personal attributes of the recipients and not their employment statuses. The payments were not regular and or periodic. There was no expectation of reward and they were not derived in circumstances which gave them an income character under s CA 1(2). In *Harris* there was no contractual entitlement. The circumstances were exceptional, and unexpected. No regularity or periodicity existed and Harris was not depending on the payments to support himself and his dependants. Therefore the payment did not have an income character under s CA 1(2). In *Shell*,²⁵⁷ the New Zealand Court of Appeal did not follow *Hochstrasser*²⁵⁸ and held that the payment was related to the recipient's employment under the then equivalent of s CE 1 of the Act.

In *Scott, Carnaby Harrower, John Reynolds & Co* and *Federal Coke Co* payments were not related to services provided or the recipient's business activity and thus were not held

²⁵⁷ *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11 303.

²⁵⁸ *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376.

assessable under s CB 1. The payments were made based upon the personal attributes of the recipient or to compensate them for change of supply contract. Since there was no profit-making purpose or intent, no services were provided, payments were not regular or periodic, and there was no expectation of reward. They were not derived in circumstances which gave them an income character under s CA 1(2).

In the cases where gifts received by the taxpayers were held assessable under s CE 1, something has come in,²⁵⁹ has been received with a profit-making purpose or intent, in anticipation that they will be the means to support the recipient and their dependants, the payments were made by the donor for services rendered by the recipient and there was an expectation of reward to catch those receipts under s CA 1 (2). In *Shell, Naismith, Smith, Clayton, Mudd* the payments being instalments of a fixed sum were not periodical or recurrent. However, the general consensus from the cases is that periodicity is only an indicator of gross income according to ordinary concepts but is not an essential or even a strong element.²⁶⁰

In the cases, where gifts received by the taxpayers were held assessable under s CB 1, the payments came in, were received with a profit-making purpose or intent (a trade venture), in anticipation that they will be the means to support recipient, the payments were made by the donor for services rendered or goods supplied by the recipient, and there was an expectation of reward. These factors also capture these receipts under s CA 1(2).

This analysis shows that the receipts which were assessed under s CE 1 and s CB 1 will also have a character of income according to the ordinary meaning of the word income under s CA 1(2). It is submitted that there is support from several important conclusions for the first proposition. This result appears to be consistent with the relationship between s CA 1(2) and specific provisions s CE 1 and s CB 1 defining income. The default rule is that the various characteristics of income under s CA 1(2) apply to all kinds of income. However in practice, since under s CA 1(1) specific categories of income include employment income (s CE 1) and business income (s CB 1) if a receipt (according to its ordinary meaning) is not captured as income as a result of an employment relationship and business activity, usually the courts will explore the possibility that the receipt may be gross income according to ordinary concepts. In

²⁵⁹ A payment in money, or a non-cash benefit, that is convertible into money. *Tennant v Smith* [1892] AC 150.

²⁶⁰ *Moorhouse (Inspector of Taxes) v Dooland* [1955] 1 Ch 284 at 304 ; *FCT v Harris* (1980) ATC 4238 at 4240. *FCT v The Myer Emporium Ltd* 87 ATC 4363 at 4366–67 — one-off payments received with a profit-making purpose or intention may be income.

Reid J Richardson said:²⁶¹ ‘To come within the residual paragraph of s 65(2) [equivalent to s CA 1(2) of the Act] the payments received must be income according to ordinary concepts and be derived from a source not otherwise covered in the earlier paragraphs of the subsection.’²⁶² John Prebble²⁶³ suggested that there are gaps in the formal coverage of an income tax statute and that the statute needs a general, substance-over-form rule to protect the tax base. The manner in which s CA 1(1) and s CA 1(2) have been drafted suggests that when considering different sources of income, the drafters have given examples of income under s CA 1(1) and at the end they thought no omissions existed, so to cover any other income they inserted s CA 1(2) stating that amounts can be income according to ordinary concepts.

5 Conclusion

As tax law does not follow the economic definition, it draws a distinction between income and gains.²⁶⁴ While the economist recognises all accretions to economic or spending power as income, tax law does not. The default rule in New Zealand is that gifts are not taxable in the hands of the recipient notwithstanding they represent a gain to that person.²⁶⁵ However, gains that are income are specifically taxable under s CA 1(1) which includes s CB 1 and s CE1 and s CA 1(2) of the Act.²⁶⁶ Many types of capital gains, which prima facie are not taxable, are being drawn into the tax base by virtue of particular legislative provisions.²⁶⁷ Nevertheless, the existence of the capital/revenue distinction in the Act is perhaps the most striking difference between the legal and economic concepts of income.

In an economic sense, the judicial criteria designed to distinguish gifts from payments for personal exertion are artificial. Under the economic concept of income, receipts constitute an increase in wealth regardless of their label, their source and the circumstances (ordinary or exceptional) under which they are given. Recurrence and expectation criteria reflect deviations from the economic concept of income.²⁶⁸ There are a number of rules in income tax law that relate to the definition of income that exist only for the purposes of income tax law. They do not reflect any other economic reality and have no other purpose.

²⁶¹ *Reid v CIR* (1985) 7 NZTC 5176 at 5182.

²⁶² Earlier paragraphs of the subsection included employment income and other specific provisions.

²⁶³ Prebble, ‘above n 75, at 2 John Prebble stated: ‘Tax law’s concept of income is not the fact of income itself but a legal simulacrum of income.’

²⁶⁴ W Chan, ‘Income – A subjective Concept’ (2001) 7:1 *New Zealand Journal of Taxation Law and Policy* 26.

²⁶⁵ *Ibid.*

²⁶⁶ Sections CB 3 to CB 5 (sales from personal property) are not covered in this paper.

²⁶⁷ Sections CB 6 to CB 23 of ITA 2007 contain a series of provisions to tax land sales.

²⁶⁸ C C Plehn, ‘The Concept of Income, as Recurrent, Consumable Receipts’ (1924) 14 *The American Economic Review* March 1 at 9.

Professor Ross Parsons²⁶⁹ further notes that a ticket received as a payment for services may be income, whereas a prize won by the ticket is something else. Under this thinking the winnings merely constitute the convertibility of income already derived into another form. There is no real dispute between economists and lawyers that gains which are a reward for personal exertion, from employment or from the rendering of services, will be income.²⁷⁰

The courts strive to maintain a balance between the revenue authority and the taxpayer as impartial interpreters of the Legislature's intention. In each of the cases covered in this paper, the courts have had to identify elements which could indicate gross income and then decide whether the combined force of those elements is sufficient to say that a receipt is assessable. In many cases a unanimous decision has not been reached, which indicates a significant level of subjectivity. The facts in *Shell New Zealand*²⁷¹ were somewhat similar to *Hochstrasser*,²⁷² but the court came to a different decision finding that the reimbursement of moving costs was assessable in *Shell New Zealand*.²⁷³ If the gift is no more than an independent voluntary gift made on purely personal grounds, the payment or gift will not be assessable, regardless of the relationship between the donor and the taxpayer.²⁷⁴ Each case is very much decided on a close reading of the facts.²⁷⁵ In the 'business receipts' context, the judges attempt to distinguish between receipts from a taxpayer's ordinary business operations and capital gains from investments.

The Legislature, it is submitted, recognised the limitations of the sections which specifically make income from personal exertion assessable. To prevent the erosion of the tax base and to overcome the deficiency in the legislation in making income from employment or services assessable, the *New Zealand Income Tax Act* had been amended from time to time.²⁷⁶

²⁶⁹ Parsons, above n 38, 68, proposition 9 [2.160].

²⁷⁰ Ibid proposition 13 [2.367].

²⁷¹ *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11 303.

²⁷² *Hochstrasser v Mayes (Inspector of Taxes)* [1960] AC 376.

²⁷³ *Shell New Zealand Limited v CIR* (1994) 16 NZTC 11 303.

²⁷⁴ *Tax Information Bulletin* 'Cash Gifts Received by Voluntary Workers' (1992) 14:5 at 42. Unconditional donations are non-assessable gifts as per *Tax Information Bulletin* 'Distributions Made with Conditions Attached' (1991) 3:1 at 30.

²⁷⁵ Dooland, eg, was described by U Birkett as 'a very fine cricketer', *Moorhouse (Inspector of Taxes) v Dooland* [1955] Ch 284, 308; and all the judges in this case expressed regret at having to find the collections to be gross income. J Brightman in *Moore v Griffiths* [1972] 3 All ER 399 began his judgment (at 403) with the comment: 'In 1966 England won the World Cup for the first, but not, one hopes, the last time.'

²⁷⁶ The *New Zealand Income Tax Act 1994* (NZ) was amended in 2001 to include restrictive covenants and exit inducements paid to employees or contractor as assessable income. Section CHA 1 and s CHA 2 were inserted in the *Income Tax Act 1994* with application to amounts derived on or after 27 March 2001. Section CHA 1 and s CHA 2 are equivalent to s CE 9 and s CE 10 of the *Income Tax Act 2007*. The payments to persuade staff to join (known colloquially as golden hellos) or to encourage bright staff to stay (golden handcuffs) are part of employment income and are assessable income as per *Public Information Bulletin*, 171, March 1988 as well.

Certainly the definition of employment income in the Act is broad enough to capture most disputatious receipts.²⁷⁷

The effect of the other change in the Act is to remove a direct reference to ‘emoluments’ which existed up until and including the 2004 Act. However, the author suspects that rather than being an attempt to change the law, the change in the Act was intended to simplify the language of the source rules while retaining the core concepts. The cross-reference to section CE 1 picks up concepts like allowance, bonus, extra pay and gratuity, and perhaps it is considered these are wide enough to cover emolument. The rewrite process review shows that in the future, while dealing with emoluments payments, the courts will consider that the term ‘extra pay’ is essentially synonymous with the term ‘emolument’. It also explains why the drafters of the Act thought it was unnecessary in s YD 4(4) to specify an emolument. If emoluments are received in respect of or in relation to employment or being an employee they will be taxable under s CE 1 or s CA 1(2) of the Act (which acts as a catch-all provision) as income according to ordinary concepts.

The new legislation does little to remove the difficulties expressed by earlier cases. The analysis from several important decisions also shows that there is support for the first proposition that the receipts which were assessed under s CE 1 and s CB 1 will also have a character of income under s CA 1(2) of the Act, which supplements specific provisions of the Act defining income. Sections CA 1(1) and CA 1(2) are not mutually exclusive and the author believes they were never intended to be. Section CA 1(2) is there to cover any omissions and capture any forms of income which should be caught but are not included in the lists under Part C. Income according to ordinary concepts (section CA 1(2)) acts as an umbrella provision and includes employment income (s CE 1) and business income (s CB 1). Section 5(1) *Interpretation Act 1999* states that the statute meaning must be ascertained ‘in the light of its purpose’. In *Commissioner of Inland Revenue v Alcan*,²⁷⁸ which deals with the approach of the New Zealand Court of Appeal to statutory interpretation, J McKay referred to purposive interpretation. In that case J McKay noted that where words can have more than one meaning and the object of the legislation is clear, in order to ensure the attainment of the object of the Act the words are to be given fair, large and liberal construction. The manner in which legislation has been drafted shows that if there is no better reason to give a technical meaning

²⁷⁷ Section CF 1(1) of the Act now provides that if the pension is payable regardless of whether the death or disability is attributable to service in one of the specified forces, and is in the nature of a normal service pension, it remains assessable income. This means that in a case similar to *FCT v Harris* (1980) ATC 4238 the pension supplements now will be assessable.

²⁷⁸ *CIR v Alcan NZ Ltd* [1994] 3 NZLR 4739.

to a particular receipt then we start off with the ordinary meaning of the word. Hence for receipts from personal exertion we tend first to look at the specific provisions under s CE 1 and s CB 1 and only look later to see if a particular receipt comes within the ordinary meaning if it is not listed separately.

Therefore, the author believes New Zealand needs a conceptually sound Income Tax Legislation. The statutory concept of income creates artificial distinctions about the nature of receipts and is based on judicial interpretation and the presence of selective criteria for a receipt or gain to be treated as income. The judicial concept of income is not compatible with the statutory and economic concept of income. Often being subjective, judicial opinion inevitably varies, which undermines the objective of simplicity, accuracy, tax base protection, and certainty in taxation. These factors should be taken into account and analysed carefully when tax changes or tax reforms are proposed that aim at improving the efficiency, adequacy and equity of the tax system. Kevin Holmes states: ‘Unfortunately legislative reforms that have been designed to enlarge the legal concept of income have been piecemeal. Selected real economic gains have been grafted onto the traditional legal interpretation of income.’²⁷⁹

The author hopes that the current paper will heighten the government’s awareness of these issues and will encourage further policy analysis of the difficulties in defining income. In the author’s view, it is fair to conclude that for a neutral tax base the government should focus on the need for reform by enacting legislation that embodies a provision specifically identifying income based on coherent income tax policy principles or objectives. In the author’s opinion a definition of income should be enacted which provides that a receipt is income where the intention of the donor or payer is that it is a reward which is (i) a consequence of the provision of a service or an incident of activity (even if it is one off), (ii) contingent upon successful performance, (iii) relied on as a means of support and (iv) has the same quality as other receipts which are income. Such an approach would make it easier to see the dividing line between mere gifts and income. The author believes that it would achieve greater neutrality, coherence and theoretical robustness in the tax system, and Income Tax Legislation would be conceptually more sound and rational. A sustainable tax base would make the tax system simpler and fairer for individuals and businesses and thereby reduce taxpayer compliance costs.

²⁷⁹ K Holmes *The Concept of Income - A Multi-Disciplinary Analysis*, IBFD Publications BV, The Netherlands, 2001 573.