Commissioner of Inland Revenue v Wattie - [1999] 1 NZLR 529

Judicial Committee
5 May; 29 October 1998
Lord Nolan, Lord Mackay of Clashfern, Lord Jauncey of Tullichettle, Lord Hoffmann and Sir Christopher Staughton

Revenue -- Income tax -- Profit or gain -- Whether any profit element in price received for undertaking to pay inflated rental -- Whether price received assessable income -- Income Tax Act 1976, s 65(2)(a) and (l).

Revenue -- Income tax -- Assessable income -- Premium paid by lessor to lessee for undertaking onerous lease -- Income Tax Act 1976, s 65(2)(a).

Revenue -- Income tax -- Assessable income -- Receipt not attributable to a particular year -- Whether payment could properly be brought into reckoning for a particular year -- Receipt for undertaking obligation for substantial period -- Premium paid by lessor to lessee.

The taxpayer respondents were representatives of the firm of Coopers and Lybrand. The firm negotiated new leases in 1990 and 1991 with a lessor and formal documents were signed on 31 May 1991. The agreement included provision for a 12-year lease of six floors commencing in February 1992 with access from June 1991. The lessor agreed to underwrite the rent for one of the six levels for a period of six years during which the firm would have no rental obligation for that level unless it elected to take over that level instead of allowing a tenant found by the lessor to take possession.

By a collateral deed entered into at the same time the firm was provided with incentives which included a lump sum inducement of $5m. The nominal contract rent was $349.83 per sq metre. The effect of the incentives was to reduce the true rent to $18.97 per sq metre spread across all six floors including the floor underwritten by the lessors. Taking into account operating expenses the effective cost to the firm came to $57.51 per sq metre of floor space.

The firm duly moved to the new premises. The total cost of exit from the previous premises was $2.9m including a forfeiture sum. The balance of the $5m remaining after payment of the exit costs was paid out to the members of the firm.

In the partnership income tax return the exit costs of $2.9m were claimed as a deduction. The monthly rent subsidy was included as assessable income. The $5m inducement payment was shown as a capital receipt, but the annual rent at the full figure of $349.83 per sq metre was claimed as a deduction. The Commissioner of Inland Revenue assessed the $5m inducement payment as income. The firm objected and the objection was disallowed in the High Court, but allowed by a majority in the Court of Appeal. The Commissioner appealed.

Held:

1 The $5m payment was paid by the lessor to the firm for undertaking an onerous lease for a substantial period. Although the $5m was linked to the rental payments due, nevertheless the payment brought into existence an asset or advantage and could not properly be attributed to a particular year. If a payment or a receipt could not properly be brought into the income tax reckoning for a particular year then (apart from special statutory provision) it could not be brought into that reckoning at all (see page 538 line 33, page 539 line 13).

Regent Oil Co Ltd v Strick [1966] AC 295; [1965] 3 All ER 174, *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205 and *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634; [1946] ALR 434 followed. *Commissioner of Inland Revenue v McKenzies (NZ) Ltd* [1988] 2 NZLR 736 (CA) approved.

Commissioner of Inland Revenue v Europa Oil (NZ) Ltd [1971] NZLR 641; [1971] AC 760 (PC) distinguished.

Ikea Ltd v Canada [1994] 1 CTC 2140; (1993) 94 DTC 1112, [1998] 1 SCR 196; (1998) 98 DTC 6092 not followed.

2 The $5m was not a gain arising from a venture entered into in significant part for the purpose of making a profit. The dominant purpose of entering into the transaction with the lessors was to acquire new office accommodation. If the price of $5m received by the firm was the firm's undertaking to pay the above market rental, the undertaking was equal in value to the price received and there could be no profit element in the latter (see page 539 line 30, page 539 line 45).

Commissioner of Taxation of the Commonwealth of Australia v Myer Emporium Ltd (1987) 163 CLR 199; 71 ALR 28 and *Californian Copper Syndicate (Ltd and Reduced) v Harris (Surveyor of Taxes)* (1904) 5 TC 159 referred to.
Appeal dismissed.

Other cases mentioned in judgment

BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia [1966] AC 224; [1965] 3 All ER 209 (PC).

Inland Revenue (Commissioner of) v Thomas Borthwick & Sons (Australasia) Ltd (1992) 16 TRNZ 777 (CA).

Taxation (Commissioner of) v Cooling (1990) 94 ALR 121; 22 FCR 42.

Van Den Berghs Ltd v Clark [1935] AC 431.

Appeal

This was an appeal from a decision of the Court of Appeal (reported at (1997) 18 NZTC 13,297) allowing an appeal from the High Court (reported at (1996) 17 NZTC 12,712) dismissing an objection by the taxpayers to the disallowance of their objection to an assessment of income tax.

Lindsay McKay, *Fiona Bolwell* and *James Coleman* for the appellant.

Richard Green and *Geoffrey Harley* for the respondents.

Cur adv vult

The judgment of Their Lordships was delivered by

LORD NOLAN.

This appeal raises the question whether the appellant Commissioner is entitled to claim income tax from the partners in the firm of Coopers and Lybrand upon a sum of $5m received by them in 1991 as part of

an arrangement whereby the firm entered into a lease of premises to house its Auckland branch. The commercial background to the payment of that sum is fully described in the judgment of Fisher J [reported at (1996) 17 NZTC 12,712], and Their Lordships think it helpful to quote that description at some length both because of its interest to those unfamiliar with the property market in New Zealand at the material time and also because of its relevance to the issues raised in the appeal. It reads as follows at pp 12,714 - 12,717:

``*Commercial lease practices in general*

During the 1980s many New Zealand property developers adopted the practice of recording in lease agreements apparent rents which exceeded the real cost of the right to possession. The apparent rent would inflate the apparent capital value of the building

and in turn promote its financing and ultimate sale. Since tenants were not prepared to pay any more than actual market rates the parties would also sign a collateral agreement to compensate the tenant. The collateral agreement contained enough in the way of `inducements' to return the effective rental to actual market rates. These inducements could take a number of forms - lump sum cash payments, rent-free holidays, the underwriting of part of the leased space, rental subsidies, a contribution to the lessee's hard and/or soft fit-out, assistance with the lessee's relocation costs or the underwriting of the lessee's commitment in respect of existing leased premises. By keeping the existence and content of the collateral agreement confidential, the developers could delude financiers, investors and valuers into believing that the consideration provided by lessees, and hence the value of the building as a whole, was higher than it really was. No one seems to have thought of the possibility that in some circumstances this could have amounted to fraud.

Ultimately, the practice was shown to be ineffective. The Court of Appeal stressed the need for valuers to be able to refer to genuine market rents (***Modick** RC Ltd v Mahoney* [1992] 1 NZLR 150) and ruled that attempts to suppress knowledge of collateral agreements offering side benefits is contrary to the public interest (*Re Dickinson* [1992] 2 NZLR 43). Ever since it has been recognised that in order to arrive at the effective or true rent payable by a lessee a valuer must calculate the net present value of all inducements and incentives, amortise that sum over the period of the lease term certain, and deduct it from the contract rent. In the meantime, however, many leases had come into existence based upon the dual documentation practice.

The dual documentation practice had its genesis in the boom period of the mid-1980s following deregulation and associated growth in the New Zealand economy. Mergers in legal and accounting practices created a demand for larger and more elaborate offices. There was rapid growth in financial institutions and a high level of buoyancy in financial and business sectors. Office space in the Auckland Central Business District grew scarce. Low vacancy levels of around 5 per cent encouraged an unprecedented commercial building boom.

The demand came to an abrupt end with the stock market crash of October 1987 and the decision to tax superannuation funds two months later. By this stage developers were committed to partially or completely constructed buildings. A number of investment and development companies failed. Prices and rentals dropped sharply in an attempt to

capture the dwindling residue of buyers and tenants. From 5 per cent the vacancy rate climbed to a high of about 30 per cent by 1991. In consequence financial institutions changed to conservative financing policies with respect to commercial buildings, demanding higher levels of pre-leasing commitments for new developments. The substance and strength of individual lessees became important. Of special importance were major `anchor tenants' whose long term commitment to a given building could be expected to encourage others to follow suit.

Facts in this case

By early 1991 several large commercial developments had been completed in Auckland with little or no pre-commitment by lessees. Of special importance were large new premium quality office blocks. It was critical to the developers and owners of these buildings that they attract tenants, particularly major `anchor tenants'. There were few potential candidates in the latter category.

One of the potential candidates was the [professional partnership whose members are the objectors in these proceedings]. The firm had leased offices in towns and cities throughout New Zealand. Since 1973 its Auckland branch had occupied two floors of [a building (building A)] in the central business district of Auckland. As the firm expanded it had progressively taken assignments or sub-leases of further floors in that building. By the end of the 1980s it occupied approximately eight floors as well as another smaller office in another building nearby. The majority of its leases were due to expire in 1993, with one in 1994 and two in 1997.

By the end of the 1980s it became apparent to the Auckland partners that serious consideration would have to be given to moving to new premises. In the preceding few years the firm's major competitors had all upgraded their premises. An improvement was needed to maintain the firm's image. The majority of its leases expired in February 1993 and some earlier than that. The firm would shortly have to commit itself to a renewal for a significant period if it remained in [building A]. These thoughts coincided with a number of unsolicited approaches from property developers seeking to entice the firm into one of the new office buildings planned or under construction.

With these considerations in mind, in July 1990 the firm's managing partner . . . negotiated renewals of the leases in [building A] for a period expiring on 28 February 1993 but on the basis that the firm had the right to withdraw from all its leases in [building A] on payment of defined penalties. At the same time the firm commenced negotiations with property developers, receiving proposals from five in all. Two of the developers were in the particularly difficult situation of having large premium accommodation office buildings without a major tenant to act as a stimulus for other prospective tenants. [The firm's managing partner] became aware that there was only one other major potential tenant which might fulfil that role and even that tenant would require only about half to two thirds of the space which could be taken by his firm. In short the economic conditions, the special situation in the central business district of Auckland, and the desperate situation of these two developers in particular, combined to make it a uniquely strong tenant's market, particularly for an anchor tenant.

Negotiations between the firm and the developers continued until April 1991. [The managing partner] knew that he was in a position to

virtually name his own price. As a minimum, he knew that his partners would not want any increase in rent over the first six years of the new lease nor to be out of pocket in respect of relocation costs. In addition he determined to try for a number of other benefits. These would include naming rights, no ratchet clause and better carparking arrangements. As to relocation costs, he decided to seek reimbursement for the [$1.6m] loss on the firm's partitions, furniture and fittings in [building A] (the actual loss on their disposal ultimately proved to be [$1,242,683]). He also decided to seek the full rental which would have been paid had all the [building A] leases run their full term. Notwithstanding the forfeiture payments which had already been negotiated with [building A's owner] by that stage, [the actual cost would be only $1.398m if the firm left but] he decided to try for the full term rental [of

$3.4m]. He also decided to seek payment of all hard and soft fit-out costs in the new building. [The rent which the firm would have to pay if it stayed on in building A was approximately $200 per square metre although this was a gross rental including operating expenses.]

Of the developers with whom the firm had negotiations, it emerged that the owners of [building B] would offer the best terms. After lengthy negotiations the parties came to an agreement in April 1991 and signed formal documents on 31 May 1991. The documents took the form of an agreement to lease and a collateral deed. They provided for a 12 year lease term of six floors commencing in February 1992 with occupational access from June 1991. The firm was to pay operating expenses and [$100] per week per car for 48 carparks.

On its face the agreement to lease called for [rent of $349.83 per square metre]. The quoted rent was fixed for the initial six years of the lease and was thereafter subject to reviews at three-yearly intervals with a modified ratchet clause [providing for a minimum of $215 per square metre and $85 per week per car]. The lessor undertook to underwrite the rent for one of the six levels for a term of six years during which the firm would have no rental obligation for that level unless it elected to take over that level in preference to allowing possession to pass to any other tenant found by the lessor. The firm was given naming rights without payment for the initial six year term. The hard fit-out was to remain the property of the lessor. The lessor was to provide [$1.8m] for the soft fit-out which would remain the lessor's property subject to a `lease to buy' provision in the firm's favour. [The operating expense levy for the first year was expected to amount to $38.54 per square metre.]

The collateral deed, however, presented a different picture. In combination with the terms of the lease itself, the effect of the deed was to provide the firm with incentives [totalling $15.08m valued] as at the commencement of the lease. The incentives took the form of a lump sum inducement [of $5m], payment for hard and soft fit-outs [to a maximum of $4.7m] and a monthly rent subsidy [of $94,008.86]. Accepted valuing principles required the incentives to be amortised and set off against the nominal contract rent [of $349.83 per square metre] in order to arrive at the true rent. It is not disputed that the effect of that process in the present case was to reduce the true rent to [$18.97 per square metre] spread across all six floors including the floor underwritten by the lessors. [Even with the

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addition of $38.54 per square metre in operating expenses, the effective cost to the firm came to only $57.51 per square metre of floor space.]

The firm duly moved to [building B], wrote off, or disposed of, its partitions, furniture and fittings in [building A], and paid the forfeiture sum to that building's owners. They received from the [building B owners the $4.7m] which was spent in fitting out their new premises. Thereafter the firm received the monthly rent subsidy from the owners of [building B] and on their part paid the contract rent as nominated.

The firm also received the [$5m] `inducement payment' from the owners of [building B]. As between the partners, the inducement receipt [of $5m] was paid into a suspense account. After allowance for losses and costs associated with the move, the balance was paid out to the partners. The effect of [the managing partner's] evidence was that the firm's actual costs in moving came to a [total of a little under $2.9m ($1.398m negotiated forfeiting fee paid to building A owners, $1,242,683 loss on disposal of building A partitions etc, approx $100,000 cost of reinstatement to building A and approx $100,000 for relocation costs)].

In their partnership return for income tax purposes the firm claimed as deductions [the foregoing $2.9m exit costs] together with annual rent at the full [$350 per square metre]. They included the monthly rent subsidy [of $94,008.86] as assessable income but showed the [$5m] inducement payment as a capital receipt. The Commissioner accepted the other items but assessed the [$5m] as income."

The statutory provisions upon which the Commissioner relies are set out in s 65(2) of the Income Tax Act 1976. They read as follows:

(2) Without in any way limiting the meaning of the term, the assessable income of any person shall for the purposes of this Act be deemed to include, save so far as express provision is made in this Act to the contrary, -

(a) All profits or gains derived from any business . . .

. . .

(l) Income derived from any other source whatsoever.

Mr McKay for the Commissioner submitted before this Board that the $5m receipt represented a subsidy or offset against the above-market level of (deductible) rental payable by the partnership pursuant to the lease, and on that basis represented assessable income from the carrying on of the business for the purposes of s 65(2)(a). He submitted, in the alternative, that the receipt was assessable, again on the basis of s 65(2)(a), or alternatively s 65(2)(l), as a gain arising from a venture entered into in part for the purpose of profit-making, a basis of assessability illustrated by the decision of the High Court of Australia in *Commissioner of Taxation of the Commonwealth of Australia v Myer Emporium Ltd* (1987) 163 CLR 199.

It was common ground that, for the purpose of determining the true character of the $5m payment, the collateral deed and the agreement for the lease (to which the lease itself was annexed) should be read as one. They were executed on the same day, 31 May 1991, and formed part of the same bargain. Clause 2 of the collateral deed is headed ``Consideration" and, so far as material, provides as follows:

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``In consideration of C&L entering into the Agreement to Lease and the Lease it is agreed as follows:

2.1. Cash Inducement Sum

2.1.1. Pacific shall pay to C&L an amount of $5,000,000 (`the Cash Inducement Sum').

2.1.2. The Cash Inducement Sum shall be paid to C&L:

(a) As to the sum of $1,000,000 within 14 days of the signing of this deed and the agreement to lease by the party:

(b) As to the balance of the Cash Inducement Sum on the Lease Commencement Date PROVIDED THAT C&L has executed and made available the Lease to Pacific . . .

2.3. Rental Payment

2.3.1. Pacific shall pay to C&L the sum of $94,008.86 (`the Monthly Subsidy') on each monthly rental payment date under the Lease, to occur during the period (`the Rent Subsidy Period') by 72 consecutive monthly payments commencing on the Lease Commencement Date and ending on the date being one calendar month prior to the sixth anniversary of the Lease Commencement Date AND notwithstanding the commencement of the Lease and the obligations of C&L as lessee under the Lease to pay Premises rent monthly in advance from the Lease Commencement Date, Pacific will accept from C&L in full satisfaction of the monthly base rent instalment due by C&L under the Lease an amount equal to the result of the calculation:

X-Y

Where X = the monthly base rent instalment payable under the Lease; and

Y = the Monthly Subsidy"

The lease commencement date was 1 February 1992. The $1m and $4m making up the cash inducement sum of $5m were duly paid in accordance with cl 2.1. The term of the lease was 12 years with rights of renewal. As will be seen from cl 2.3.1 the monthly subsidy was payable during the first six years of the lease. Provision was made for a rent review at the end of the six-year period, with further reviews after nine years and on the occasion of any renewal of the lease.

Although the argument before Their Lordships covered a wide range of decided cases there was much common ground between the parties, and the issue raised by the first of the Commissioner's submissions became clear and relatively narrow. Thus, it was common ground before Their Lordships that the $5m was not a receipt arising from Coopers and Lybrand's ordinary business operations which consist, of course, in the practice of the accountancy profession. Nor, as Fisher J had found, could it be regarded as arising from an ordinary incident of that business, and thus liable to tax under s 65(2)(a) by reference to the principle applied by the Australian Federal Court in *Commissioner of Taxation v Cooling* (1990) 22 FCR 42 (where a payment made to a firm of solicitors as an inducement to them to procure their service company to enter into a lease of premises which the firm was to occupy was held to fall within the Australian taxing provisions corresponding to s 65(2)(a)). The majority of the Court of Appeal upheld the decision of Fisher J on this

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point and expressed the view that the decision in *Cooling* should not be followed in New Zealand [see (1997) 18 NZTC 13,297]. The Commissioner has not sought to argue to the contrary before Their Lordships' Board.

Nor has the Commissioner sought at any stage to challenge the deductibility of the above-market level of rental payable under the lease as a proper debit item in the computation of the firm's profits for the purposes of s 65(2)(a). The Commissioner's primary case before Their Lordships' Board was simply that the sum of $5m was indistinguishable in principle from the monthly rental subsidy payments made under cl 2.3.1 which were agreed by Coopers and Lybrand to form part of the revenue receipts of their business. The respondents, on the other hand, contended that the $5m was of the same nature as a normal premium on a lease, though paid in this instance, because of the unusual state of the property market, by the landlord to the tenant rather than vice versa, and was thus a capital receipt in their hands. The Commis-

sioner's case found favour with Fisher J and with Thomas J who wrote a dissenting judgment in the Court of Appeal, but the majority of the Court of Appeal upheld the contention of the respondents.

It is well settled that in considering whether a particular item of receipt or expenditure is of a capital or revenue nature the approach to be adopted should be that described by Dixon J in *Hallstroms Pty Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 634 at p 648, where he said that the answer to the question:

> ``. . . depends on what the expenditure is calculated to effect from a practical and business point of view, rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process."

That approach was adopted by Their Lordships' Board in *BP Australia Ltd v Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224 and has been followed in many other cases of high authority. The passage from the Board's judgment in the *BP Australia Ltd* case at p 264 in which the approach of Dixon J is adopted was described by Richardson J in *Commissioner of Inland Revenue v Thomas Borthwick & Sons (Australasia) Ltd* (1992) 16 TRNZ 777 at p 779 as exemplifying the ``governing approach" in New Zealand. Dixon J was speaking in terms of expenditure but it is familiar law that within the context of the same business, similar principles will apply to payments and to receipts. This appears from the general discussion of the earlier cases by Lord Macmillan in *Van Den Berghs Ltd v Clark* [1935] AC 431 at pp 438 - 441, and from the *Borthwick* case itself, which was concerned with the character of a receipt.

What, then, was the $5m payment in the present case calculated to effect from a practical and business point of view? The answer must be determined from the particular facts of the present case. In submitting that the $5m was a rental subsidy, Mr McKay relied upon its analysis by Thomas J in the Court of Appeal where the learned Judge said at p 13,316:

> ``The lessor paid Coopers & Lybrand $5m, along with other inducements, to enter into the lease and pay rent at a figure substantially in excess of the market rent or the rent which Coopers & Lybrand would otherwise have been prepared to pay. If that rent had represented or even approximated the market rent the lessor would not have paid Coopers & Lybrand the inducement payment. That is the commercial reality."

Like Fisher J, Thomas J was influenced by Canadian decisions in which payments made to lessees as inducements to enter into leases had been held to be of a revenue nature and taxable accordingly. Thus in *Ikea Ltd v Canada* (1993) 94 DTC 1112 Bowman J had held that the inducement receipt constituted assessable income upon the basis that although not arising out of the sale of goods or services in which [the company] dealt, it was ``directly and inextricably bound up with the economics of the operation". It infringed immediately upon the costs that must be satisfied out of the appellant's trading operations.

The judgment of Bowman J was upheld by the Federal Court of Appeal and also by the Supreme Court of Canada, whose judgment was delivered after the judgment of the Court of Appeal in the present case. Giving the judgment of the Supreme Court Iacobucci J after quoting the passage from the judgment of Bowman J to which Their Lordships have referred, said this at (1998) 98 DTC 6092 at p 6098:

> ``[Bowman J] also found that the payment was an `integral element' of the day-to-day costs of Ikea's business operations, and therefore concluded that the receipt was on income account because, in essence, it constituted reimbursement for expenses which were also on income account: either the payment of rent, or the assumption of other obligations incident to carrying on business in the premises, or both.
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> I can find no fault with this reasoning or this conclusion."

Mr McKay submitted that the same reasoning was applicable to the facts of the present case. He pointed out that in *Ikea*, as in the present case, there was no restriction upon the manner in which the inducement payments could be employed by the recipients. They differed from the fit-out payments received by Coopers and Lybrand, which had to be spent on the premises, and which were accepted accordingly as constituting capital receipts.

Mr McKay denied (as had Fisher J and Thomas J) that the approach of the Canadian Courts involved taxation on the basis of economic equivalence. He accepted that, as Their Lordships' Board had declared in *Commissioner of Inland Revenue v Europa Oil (NZ) Ltd* [1971] NZLR 641 at p 648:

> ``It is not legitimate . . . to disregard . . . the nature of the contracts made and to tax Europa on the substantial or economic or business character of what was done."

Mr McKay submitted, however, that the requisite study of what the payment was calculated to effect from a practical and business point of view inevitably involved a review of the factual context in which the payment was made. That review could not properly be precluded by what he described as the ``economic equivalence prohibition", even if the review had regard to the economic or financial impact of the inducement payment upon levels of rental nominally paid.

This appears to Their Lordships to be the crux of the matter. It brings to mind the arguments put forward by the taxpayer in *Regent Oil Co Ltd v Strick* [1966] AC 295 in support of its claim that premiums paid to petrol retailers for the grant of leases as part of an arrangement under which the retailers covenanted to take all their petrol supplies from *Regent* were deductible revenue expenditure. At p 349 of the report, Lord Wilberforce said this:

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> ``The appellants bring forward two arguments at this stage. First, they say (truly enough) that the sums or premia were calculated by reference to the gallonage of petrol expected to be sold at the sites, the suggestion being that this made them resemble, or be, rebates on the price. An effective answer to this was given in the Court of Appeal where Lord Denning MR [[1964] 1 WLR 1166, 1175] said that it confuses the measure of the payment with the payment itself. A more elaborate form of the argument was that the sums were circulating capital because Regent expected to get its money back out of current profits as sales, gallon by gallon, day by day, were made. Of course they did; many traders who lay out capital expect to get both a return on the capital and the amortisation of the capital expenditure out of the profits of the periodical sales and, whether consciously or not, they calculate the amount they are willing to lay out accordingly; but the fact that they have this expectation and so calculate their expenditure does not enable them to claim that the expenditure is of a revenue character."

Lord Wilberforce continued at p 351 of the report:

> ``On behalf of the appellant it was said that [Their Lordships] must look through the transparent form of the lease-sublease to some underlying commercial reality and that, having performed this penetration, we should see that this was merely part of Regent's normal marketing operations, or, alternatively, that the payments were nothing but disguised rebates. I cannot accede to this. Without embarking here upon the question how far it is permissible in taxation matters to go behind the legal forms which the parties have chosen, where these forms are not a mere sham, I am satisfied that in this case form and substance fully coincide."

Lord Wilberforce went on to conclude, at p 354:

> ``Here the nature of the payments - lump sums - the nature of the advantages obtained - security in respect of the placing of orders for a period - the substantial periods involved, the shortest being a period of five years, more than adequately establish the expenditure as made for the acquisition of capital assets."

Mutatis mutandis the same reasoning appears to Their Lordships to apply to the facts of the present case. The respondents, through their counsel Mr Green and Mr Harley, do not dispute that the $5m payment is commercially, financially and mathematically linked to the rental payments due from Coopers and Lybrand. The same, they submit, will normally be true of the ordinary premium payable by a lessee to a lessor upon the grant of a lease. But in the absence of special legislation to the contrary a premium has always been recognised, in the law of New Zealand as in the law of the United Kingdom, as capital rather than revenue. The reason has probably never been better expressed than by Viscount Cave LC in the familiar passage from his speech in *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205 at pp 213 - 214 when he said:

> ``But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of
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> special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

This passage, of course, finds its echo in the conclusion reached by Lord Wilberforce in *Strick* which is quoted above.

Viscount Cave's reference to ``an asset *or an advantage*" (emphasis added) is to be noted. A payment may be capital although not made for the acquisition or disposal of a particular asset. The crucial question is whether in all the circumstances the payment or receipt can properly be attributed to a particular year. The question is crucial because income tax is charged annually upon the income or profits of each year. If the payment or receipt cannot properly be brought into the income tax reckoning for a particular year then (apart from special statutory provision) it cannot be brought into that reckoning at all.

In *Commissioner of Inland Revenue v McKenzies (NZ) Ltd* [1988] 2 NZLR 736 the Court of Appeal, applying this principle, held that a lump sum payment made by a lessee to a lessor in order to secure the termination of an onerous lease with a substantial period still to run was of a capital nature. In the present case the $5m was paid by the lessor to the lessee for undertaking an onerous lease for a substantial period. The majority of the Court of Appeal decided that the same principle applied. They described the payment as ``a negative premium" and as ``the mirror image" of the payment in *McKenzies*. Their Lordships are in full agreement with this view of the matter. In this case, as in *Strick*, there is no conflict between the legal nature of the payment and the practical and business effects it was intended to secure.

Their Lordships would accordingly reject the first of the contentions put forward by the Commissioner. Their Lordships would wish to make no comment upon the decision of the Supreme Court of Canada in the *Ikea* case save to observe that the Canadian Courts appear to have adopted a different approach from that of the Courts of New Zealand and the United Kingdom, and of Their Lordships' Board.

In the light of the foregoing Their Lordships can deal more briefly with the Commissioner's alternative contention, that is to say that the $5m is assessable as a gain arising from a venture entered into in significant part for the purpose of making a profit, so as to fall within the charge either under s 65(2)(a) or s 65(2)(l). This contention is based upon the decision of the High Court of Australia in *Myer Emporium Ltd*. Mr McKay was content to accept, in general terms, the Court of Appeal's interpretation of *Myer Emporium* as contemplating a profit arising from what is commonly referred to as an adventure in the nature of trade, of the kind illustrated by the decision in *Californian Copper Syndicate (Ltd and Reduced) v Harris (Surveyor of Taxes)* (1904) 5 TC 159. He also accepted that the dominant purpose of Coopers and Lybrand in entering into the transaction with the lessors was to acquire new office accommodation. But, he submitted, Coopers and Lybrand also had the purpose of securing a profit of $5m. Without that profit they would not have entered into the obligations imposed by the lease.

Like the majority of the Court of Appeal Their Lordships are unable to understand how the $5m can be regarded as a profit. It could only be so regarded if it constituted a benefit or bonus accruing to Coopers and Lybrand quite independently of the other terms of the bargain between the parties. To regard it in this way would be plainly erroneous in principle, as well as being contradictory of the first contention put forward by the Commissioner. In support of that contention Mr McKay had argued, correctly, that the $5m was

inextricably linked to the payment by Coopers and Lybrand of the above-market rental. It might be described as the price received by them in return for their undertaking to pay that rental. Given that, according to the evidence, the undertaking was equal in value to the price then there could be no profit element in the latter.

Their Lordships are accordingly of the opinion that the second contention of the Commissioner must also be rejected. They will humbly advise Her Majesty that the appeal should be dismissed. The appellant must pay the respondents' costs before Their Lordships' Board.Appeal dismissed.

Solicitors for the appellant: *Crown Law Office* (Wellington).

Solicitors for the respondents: *Russell McVeagh McKenzie Bartleet & Co* (Auckland).

Reported by: Chris Corry, *Barrister*