Privy Council Appeal No. 81 *of* 1931.

Aspro, Limited - - - - - - - *Appellants*

v.

The Commissioner of Taxes - - . - - *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 27TH JULY, 1932.

Present at the Hearing:
LORD TOMLIN.
LORD THANKERTON.
LORD MACMILLAN.
LORD WRIGHT.
SIR JOHN WALLIS.

[*Delivered by* LORD THANKERTON.]

This is an appeal from a judgment of the Court of Appeal of New Zealand dated the 29th August, 1930, dismissing an appeal from a judgment of the Stipendiary Magistrate of the Wellington District dated the 12th December, 1929, dismissing an appeal against the assessment to income tax made on the present appellants by the present respondent in respect of the year to the 31st March, 1929.

The appellants' trading account for the year to the 31st March, 1928, which fell to be treated as the income year for the purpose of the assessment, showed a debit item of £10,000 in respect of directors' fees, which they claimed as a proper deduction. But the respondent disallowed this item to the extent of £8,000, on the ground that, to that extent, it was not exclusively incurred in the production of the assessable income, and he assessed the appellants accordingly ; the appellants challenge the assessment in this respect.

The provisions of the Land and Income Tax Act, 1923, as to deductions, so far as material, are as follows :—

> " 80.—(2) In calculating the assessable income of any person deriving income from one source only, any expenditure or loss exclusively incurred in the production of the assessable income for any income year may be deducted from the total income derived for that year . . . Save as herein provided, no deduction shall be made in respect of any expenditure or loss of any kind for the purpose of calculating the assessable income of any taxpayer."

The statute provides a special code by which a taxpayer, who is dissatisfied with the assessment made by the Commissioner, may appeal against it, but it must first be noted that, under section 14, the taxpayer is made liable to pay the tax as assessed by the Commissioner " save in so far as he establishes on objection that the assessment is excessive or that he is not chargeable with tax." The special procedure for appeal by way of objections to assessments is contained in sections 22 to 38, of which the following provisions are material :—As regards procedure in the Magistrate's Court, section 25 provides—

> " On the hearing and determination of all objections to assessments of land-tax or income-tax the burden of proof shall be on the objector, and the Court may receive such evidence as it thinks fit, whether receivable in accordance with law in other proceedings or not."

Where, as here, the amount in dispute exceeds £200, a right of appeal to the Supreme Court from the determination of the Magistrate is given on both law and fact and, on such appeal being taken, section 30 provides that the Magistrate should state and sign a case setting forth the evidence taken before his Court and the questions of law arising for the determination of the Supreme Court. As the present case only raised a question of law, it was removed, with the consent of parties, from the Supreme Court into the Court of Appeal under the provisions of section 33.

It will thus be seen that in the present appeal the power of review of their Lordships is limited to questions of law, and that the appellants have to discharge the burdens laid upon them by sections 14 and 25.

The material facts may be summarised as follows :—The company was incorporated in 1923 as a private company, and since then has carried on business in Wellington as manufacturers and vendors of a patent medicine which is known as " Aspro," and sold in tabloid form.

The capital of the company consists of 20,000 fully-paid up shares of £1 each, of which Messrs. G. R. Nicholas and A. M. Nicholas each hold 10,000 shares. These shares, along with £50,000 debentures, were given by the company to the Messrs. Nicholas as consideration for an exclusive license to use the trade mark " Aspro," and to deal in the commodity in New Zealand. Throughout the existence of the company, the Messrs. Nicholas have been the sole directors of the company as well as the sole shareholders.

The company's trading year ended on the 31st March in each year, the first year's accounts covering only nine months' trading. The directors' fees were fixed towards, or after, the end of each trading year. The following table shows the amount of the fees in each year, the date when they were fixed and the net profits left to the company after deduction of the fees :—

Year ending.	Date Directors' fees were fixed.	Fee fixed for each Director.	Net profit left to Appellant.
31st March 1924.	27th March 1924.	£1,500.	£1,418 9 10
31st March 1925.	16th March 1925.	£2,500.	£2,616 14 10
31st March 1926.	1st July 1926.	£3,250.	£3,170 11 8
31st March 1927.	21st June 1927.	£5,000.	£4,924 13 7
31st March 1928.	8th June 1928.	£5,000.	£5,145 6 6

These fees were fixed each year by resolution of the company in general meeting. The company having adopted Table "A" of the New Zealand Companies Act, 1908, the remuneration of the directors is provided for by Article 78, which is as follows :— "The directors shall be paid out of the funds of the company, by way of remuneration for their services, such sum or sums as the company may from time to time fix at a general meeting, and such remuneration shall be divided amongst them in such proportions as the directors may determine." Prior to the year ended in March, 1928, their amount so fixed was accepted as a proper deduction for income-tax purposes by the Commissioner.

The two directors in question reside in Melbourne and direct the policy of the New Zealand company from there. The parent company is an Australian company, and there is also a subsidiary English company, and the Messrs. Nicholas are also directors of these two companies. A comparison of the monthly sales of these three companies shows that the volume of the Australian business is about eight times, and the volume of the English business about eleven times, that of the New Zealand business. There is a local manager in Wellington, who acts under the direction of Melbourne ; weekly samples of the mixtures made in Wellington are sent to Melbourne, which are tested by Mr. G. Nicholas, and the result is reported by him to Wellington. The manager stated that about three letters each way would pass between Wellington and Melbourne, and that about one letter in six of those sent by him would be referred to the directors. While it was stated that the directors paid periodical visits to New Zealand, it was admitted that neither of them had been in New Zealand in the year in question. They declined to give the respondent information as to the amount of time spent by them in New Zealand since the inception of the company, and neither of them appeared to give evidence before the Magistrate.

The appellants maintained, in the first place, that the production by them of a resolution fixing the remuneration of the directors for their services in terms of Article 78, and vouchers for payment of the amounts so fixed, when taken along with the

admitted fact that services had been rendered, was sufficient to exclude any further enquiry by the Commissioner and to entitle them to a deduction in terms of section 80 (2) of the Act. But this contention was not seriously pressed, and, in their Lordships' opinion, it is untenable.

The appellants maintained, in the second place, that the Commissioner was not entitled to challenge the amount paid by the company to its servants for their services on the ground of excess or over-generosity in its amount, for that was entirely a matter in the discretion of the company, and that he could only challenge such payments on the ground that it was not a genuine transaction, being in fact fictitious or the sums so paid being, wholly or partly, not truly paid as remuneration for their services. They maintained that, in the present case, there was no evidence to justify any such ground of challenge by the Commissioner and that, accordingly, the Magistrate was bound to sustain the appellants' objections and to hold that the assessment was excessive. The respondent substantially accepted the premises of this contention, but he maintained that the state of the evidence was such that the appellants had failed to establish that the assessment was excessive, as required by section 14, or to discharge the burden of proof laid on them by section 25.

In their Lordships' opinion, there is no material difference between these two aspects of the argument for present purposes, and the true issue is whether there was evidence before the Magistrate on which he was entitled to refuse to hold it proved that the £10,000 had been exclusively incurred in the production of the assessable income and that the assessment was excessive. If the only evidence before him had been the company's resolution fixing the directors' fees and vouchers for payment of the amounts so fixed, it is difficult to see how the Magistrate could reasonably have refused to hold that the assessment was excessive, and the question must be whether there was further evidence which reasonably entitled the Magistrate to decline to hold it proved that the assessment was excessive.

Their Lordships are of opinion that the state of the evidence was not such as to compel the Magistrate to the conclusion that the £10,000 had been exclusively incurred in the production of the assessable income. There was complete identity of the persons interested as shareholders in fixing the amount of the fees to be paid to the directors and of the persons to whom the fees were to be paid, and, except in regard to its bearing on the liability of the company to tax, it made no difference to the destination of the money whether the amount of the fees represented fair remuneration for the directors' services or not. The Messrs. Nicholas, who, as sole shareholders and sole directors, alone knew how the fees came to be fixed, not only declined to allow the respondent to examine them on this matter, but did not come forward to give evidence before the Magistrate, although the burden of proof was upon them. Further, in this situation, it

is not irrelevant to take also into account that in each year the fixing of these fees was made when a fair estimate of the trading results for the year was available and that in each year, of the balance available for directors' fees and for distribution among the shareholders, about two-thirds was apportioned to directors' fees. In their Lordships' opinion, the Magistrate was entitled to hold that the appellants had failed to prove that the £10,000 had been exclusively incurred in the production of the assessable income.

None of the authorities cited appear to have much bearing on the present case, except possibly the case of *Johnson Brothers and Co.* v. *Inland Revenue Comms.* [1919], 2 K.B. 717, in which the sums paid to the owner's sons, who were employed in the business, were disintegrated, on the evidence of the owner himself, into the amount of a fair wage and a balance which " might be considered as paid on account of family feeling " ; but there was nothing equivalent to the resolution of the company in the present case.

For these reasons their Lordships are of opinion that the judgments appealed from were right and that the appeal should be dismissed with costs, and they will humbly advise his Majesty accordingly.

In the Privy Council.

ASPRO, LIMITED,

v.

THE COMMISSIONER OF TAXES.

DELIVERED BY LORD THANKERTON.

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