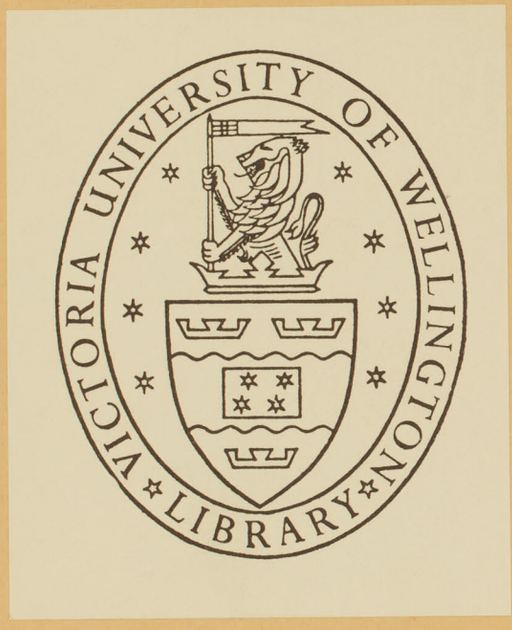
MICHAEL PAUL RIGBY

A COMPARATIVE STUDY OF THE TAXATION OF FRINGE BENEFITS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A COMPARATIVE STUDY OF THE TAXATION OF FRINGE BENEFITS

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I. INTRODUCTION

It is a fundamental principle of nearly every modern state that a large part of the expenses of the government should be met by way of taxation, rather than by way of loans or commercial enterprise. However, despite acceptance of this principle, there has been a traditional reluctance amongst the tax paying public to meet the taxation obligations imposed upon them by their governments. Thus, any study of the history of taxation reveals a basic conflict between, on the one hand, the need of the State to meet its expenditure requirements by means of exactions levied upon its citizens, and on the other, the desire of the citizen to retain as much of his wealth as possible without interference from the state. By way of example, Sabine records that when a poll tax (which is imposed on a per capita basis) was imposed in England in 1380 it appeared from the returns subsequently filed that the population of the country had fallen since the imposition of the previous poll tax in 1377 by nearly one half of a million.[1] Similarly, the preamble to Pitt's Act of 1799[2] whereby income tax was first imposed records that an income tax was being introduced because of widespread evasion of an expenditure-type tax which had been enacted in the previous parliamentary session.[3]

In the past the conflict has often manifested itself in armed confrontation. The struggle between the King and Parliament which ended finally in the execution of Charles I in 1649 and in the complete victory of Parliament over the monarchy in 1688 is attributable as much to the desire of Parliament to exercise and control the taxing power as to any religious differences. Similarly, the American War of Independence may be attributed in large part to onerous taxes imposed on the American colonies by England.[4]

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1. Sabine A History of Income Tax (George Allen & Unwin Ltd, London, 1966) p.12.

2. 39 Geo III C 13.

3. 38 Geo III C 16.

4. For an account of the various taxes levied on the American colonies prior to the War of Independence see J.Coffield A Popular History of Taxation (Longman, London, 1970) pp.82-88.

In the Twentieth Century the conflict between the State and the individual in the field of taxation has manifested itself in the ballot box, rather than on the battlefield. Thus, in the United Kingdom the Thatcher Government was elected in 1979 on the platform of smaller government and lower individual taxes, and in the United States the Republican presidential campaign was successful in 1980 on the same platform.
But at the same time what has been referred to as the "tradition of evasion"[5] has continued unabated. Indeed, that "tradition" has thrived under the stimulus of the high taxes which have characterised many nations during the period since the end of World War II.

To counteract attempts on the part of the taxpaying public to reduce the incidence of taxation legislatures around the World have resorted to increasingly complex and sophisticated legislation which has required alteration on a regular basis.[6] However, notwithstanding that phenomenon opportunities invariably remain open for taxpayers to reduce their liability to tax. In some circumstances such a reduction may be effected with the sanction of the statute imposing the tax. Thus, in New Zealand, it is possible to reduce one's liability to tax by assigning an income producing asset to another person provided that the requirements of section 96 of the Income Tax Act 1976 as to the duration of the assignment and the control of the assigned property are met. In other circumstances, such a reduction may occur in the face of the statute: where, for example, a taxpayer conceals income falling within the statutory charge to tax. Therefore whatever method is adopted it generally remains possible, despite the sophistication of modern tax legislation,

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5. Sabine, op. cit. p.15.

6. E.g. the New Zealand Income Tax Act 1976 required two amending Acts in 1982 and three in 1983. Many of the provisions contained in those Acts had as their objective the counteraction of measures adopted by taxpayers to reduce their liability to tax.

to avoid the full measure of taxation which the legislature seeks to exact. However, at the same time, without derrogating from that general proposition, the scope for some classes of taxpayers to reduce their liability to tax may be narrower than for others. In particular, the salary and wage earner is unable to avail himself of opportunities to reduce the incidence of taxation to the same extent as other taxpayers. Due to the source deduction principle, whereby tax payable by salary and wage earners is required to be deducted by the employer prior to the payment of the salary or wage,[7] such taxpayers must meet their day to day needs and plan for the future out of tax-paid income. Unlike the self-employed businessman, the salary and wage earner cannot easily deal with his income before it is derived by him. Assignment of personal services income is precluded for tax purposes by Henry J.'s holding in Spratt v C.I.R.[8] that:[9]

> No taxpayer can, by way of assignment, escape assessment of tax on income resulting from his personal activities - such income always remains truly his income and is derived by him irrespective of the method he may adopt to dispose of it.

And furthermore, as tax is deducted by the employer at source, there is no scope, without the complicity of his employer, for a salary or wage earner to evade tax by concealing his income.

One of the few avenues whereby the incidence of taxation may be reduced for a salary or wage earner is by the provision of what are commonly known under the rubric "fringe benefits". Richardson and Congreve define fringe benefits as follows:-[10]

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7. E.g. s.338 of the Income Tax Act 1976 (New Zealand); s.221 C Income Tax Assessment Act 1936 (Australia).

8. [1964] N.Z.L.R. 272.

9. Ibid. 277. For a criticism of this holding see McKay "The Arcus and Personal Services Income Principles" (1974) 6 N.Z.U.L.R. 140, 153-156.

10. Richardson and Congreve Tax Free Fringe Benefits (Rydge Publications, Sydney, 1975) p.3.

> In its widest sense the term 'fringe benefits' means any benefits or advantages, other than the payment of wages and salary, passing from employer to employee and arising out of the employment. Fringe benefits are usually paid in kind rather than in cash and include a wide range of goods, services, and other employee benefits.

To be distinguished from fringe benefits are what may be referred to as conditions of employment. Whereas fringe benefits constitute the provision of a benefit or advantage in lieu of salary or wages, conditions of employment which include for example luxurious office surroundings, air conditioning, and the provision of secretarial services, confer no economic advantage. This paper is concerned only with the tax status of fringe benefits.

Fringe benefits are provided in a multitude of forms. The use of company property, such as motor vehicles, holiday accommodation and car parking facilities; the provision of free or low-rental accommodation and subsidised meals; access to low interest loans and the granting of share options; the payment of club membership and of entertainment expenses; and the provision of superannuation and insurance benefits; to name but a few of the more common forms, all constitute fringe benefits. With the stimulus of high rates of taxation currently enjoyed in many countries, fringe benefits have become a common method of compensating employees. In New Zealand, for example, a perusal of any daily newspaper reveals numerous advertisements with offers of attractive salary packages with benefits provided. To take but a minor example, the business pages of one metropolitan daily newspaper recently surveyed contained advertisements for two accountants offering in one case an "executive salary and benefits and a company car", and in the other a "competitive salary and a company house"; for a training and personnel officer offering "subsidised superannuation and other benefits"; and for a computer sales representative offering "a base salary, car allowance or company vehicle".[11]

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11. The Dominion,, Wellington, New Zealand, 30 June 1984, pp.12-13.

Fringe benefits are common at all income levels. They are not the prerogative of the highly paid. Thus, the managing director of a large public company may be provided with a company car and a low interest housing loan as well as having his telephone bills and annual holidays paid for. But at the same time an office clerk in the same company may receive fringe benefits commensurate with his or her income level: for example he or she may be provided with subsidised meals and be entitled to membership of a subsidised superannuation scheme.

The paper undertakes a comparative study of the taxation of fringe benefits. To that end the tax statuts of fringe benefits in New Zealand, Australia, Canada, the United Kingdom and the United States will be considered. In format, the paper first analyses the reasons why fringe benefits developed as a useful tax avoidance measure for the salary and wage earner. Then, the methods adopted to counteract such avoidance will be discussed. That discussion is divided into two parts. First, a study is made of general anti-avoidance provisions whereby fringe benefits of all types are brought within the charge to tax. And secondly, the tax status of two specific fringe benefits - company cars and rent free or low rent accommodation - is considered in detail.

At the time of writing fringe benefits remain largely outside the tax net in New Zealand. Be that as it may, the purpose of this paper is not to construct an argument advocating a change in that tax-free status, or, on the other hand, advocating a maintenance of the status quo. Nor is it intended to provide a descriptive commentary on the legislation governing fringe benefits in the jurisdictions surveyed. Rather, this paper undertakes an analytical appraisal of the reasons for the exclusion of fringe benefits from the tax net and of the general scheme of legislation adopted in several jurisdictions to ensure that these benefits are brought within that net.

PART II FRINGE BENEFITS AND THE INCOME TAX BASE

II. FRINGE BENEFITS AND THE INCOME TAX BASE

A. Background

In each of the jurisdictions considered fringe benefits have been a valuable tax planning device for the salary or wage earner. In New Zealand, Australia, Canada and the United Kingdom, this may be attributed in large part to the means by which income is defined for income tax purposes. In the United States, on the other hand, the statutory definition of income is wide enough to encompass fringe benefits but administrative practice has enabled many such benefits to escape the tax net.

Various statutory provisions have been enacted to ensure that fringe benefits are taxable in the hands of the employee. These provisions are considered in Parts III and IV of the paper. This part of the paper is concerned more with the reasons why such express statutory provisions have been rendered necessary. To that end, an analysis of the concept of income is undertaken. That analysis is approached from a number of perspectives. First, income is considered in its economic sense. It will be seen that in this sense income is clearly wide enough to encompass fringe benefits. Secondly, income will be considered in its juristic sense and a brief discussion of the meaning of income as enunciated by the courts will be undertaken. At the same time, an analysis of the various statutory definitions of income, and the historical background to such definitions, will be undertaken. As a result of this second approach, it will be seen that in New Zealand, Australia, Canada and the United Kingdom fringe benefits are not taxable as income in the ordinary sense of that word unless they are convertible into cash. It will also be seen that the convertibility principle applies only to income from employment and not to income from other sources. Finally, a comparison will be made with the United States where income in its ordinary sense is wide enough to encompass fringe benefits.

B. The Concept of "Income".

1. Income in the economic sense.

An American economist, H. Simons, has defined income as being :[12]

> ...the algebraeic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of the 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.

Such a definition is clearly wide enough to encompass not only items such as salaries, wages, rent, interest, dividends and business profits, which are currently taxed as income, but also items such as inheritances, windfall gains, capital gains and fringe benefits which are not currently so taxed. Thus, in assessing the market value of rights exercised in consumption it would be necessary, for example, to take into account the market value of the use of a company car, or of the right to live in rent free accommodation.

However, economic concepts of income have not played a significant role in the development of income as a legal concept for tax purposes. Neither legislatures nor the courts have availed themselves of economic theories. In a Canadian case, Oxford Motors Ltd v Minister of National Revenue,[13] this neglect of economic thoery was explained as follows:[14]

> No one has ever been able to define income in terms sufficiently concrete to be of value for taxation purposes. In deciding upon the meaning of income, the Courts are faced with practical considerations which do not concern the pure theorist seeking to arrive at some definition of that term...

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12. H. Simons, Personal Income Taxation (University of Chicago Press, 1938) p.50-51. Another American economist, R.M.Haig, has defined income in similar terms as "the money value of the net accretion to one's economic power between two points in time" (cited in Curran (ed) Tax Philosophers (University of Wisconsin Press, 1974) p.80).

13. [1959] C.T.C. 195.

14. Ibid. 202, per Abbott J (S.C).

And in a similar vein the Supreme Court of America, in Merchants Loan & Trust Co. v Smietanka,[15] held that:[16]

> In determining the definition of the word 'income' this court has consistently refused to enter into the refinements of lexicographers or economists and has approved what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution.

Thus, for practical reasons, the courts have rejected a broad based definition of income founded upon economic theory. Legislatures appear to have ignored economic theory for similar reasons. In the United Kingdom the Royal Commission on the Taxation of Profits and Income[17] accepted that income could be calculated by comparing the value of total resources at the beginning of the year with total resources at the close and by making adjustments for incomings and outgoings. However, that method of calculating income was rejected as being "unworkable for income tax, for by no possibility could a system be operated which involved a fresh determination each year of the current values of all the possessions of the taxpayers of the country."[18]

2. Income in the juristic sense.

Although each of the countries surveyed in this paper imposes a tax on income in none of the statutes by which income tax is imposed is there to be found a comprehensive definition of the term "income". The common pattern is to describe a number of receipts which are to be included as income for tax purposes and to conclude with a general provision which brings all classes of income not specifically mentioned within the tax net. In the United Kingdom, for example, Schedules A to E of the Income and Corporation Taxes Act 1970 describe on a source basis a number of receipts which are chargeable to tax. Case VI of Schedule D then operates as a general sweeping up clause by rendering taxable "any annual profits or gains not falling under any other case of Schedule D, and not charged by virtue of Schedule A, B, C, or E."

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15. 255 U.S. 509 (1921).

16. Ibid. 519. The significance of the Sixteenth Amendment to the Constitution in the context of income tax in the United States is considered later in the paper.

17. June 1955, Cmnd 9474.

18. Ibid. para 83.

Similarly, section 65(2) of the New Zealand Income Tax Act 1976 provides that the assessable income of any person includes a number of items listed in paragraphs (a) through to (k) and concludes in paragraph (l) that it is also to include "Income derived from any other source whatsoever." Threfore, although a rather detailed list of items are included within the meaning of the term "income" for New Zealand tax purposes, the definition contained in section 65(2) is by no means comprehensive. Furthermore, the generality of the section 65(2) definition is emphasized by the opening words of that subsection, "[w]ithout in any way limiting the meaning of the term..." The effect of those words was considered in Duff v C.I.R.[19] There, Woodhouse P., discussing the predecessor of section 65(2),[20] said:[21]

> ...for reasons of logic alone the question as to whether a gain or profit is to be regarded as income should be examined initially by reference to the general considerations which surround that concept before any further step is taken of asking whether use can properly be made of the extended meanings of assessable income that are provided in para (a), (b) or (c) of section 88(1). The subsection itself suggests such an earlier approach; and if it is not done the resulting analysis could well be diverted and restricted to the ambit of the extended definitions with consequential neglect of general principal.

In Australia and the United States income is defined first by a general provision which includes within the definition income from all sources, and then by a list of specific items which are expressly included within the definition. Thus section 61(a) of the United States Internal Revenue Code 1954 defines "gross income" as "all income from whatever source derived, including

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19. [1982] 2 N.Z.L.R. 710.

20. Section 88(1) of the Land and Income Tax Act 1954. That section is in pari materia with section 65(2).

21. [1982] 2 N.Z.L.R. 710, 712-713.

(but not limited to) the following items:" whereafter there follows a list of fifteen items. And section 25 of the Australian Income Tax Assessment Act 1936 provides that assessable income includes "the gross income derived directly or indirectly from all sources." Section 26 then lists fifteen items which are expressly included within "assessable income".

In considering income in its juristic sense it is therefore necessary to go beyond the statutory definition. This principle is well illustrated in the following comments of Jordan C.J. in Scott v Commissioner of Taxes (N.S.W.):[21]

> The word 'income' is not a term of art, and what forms of receipts are comprehended within it, and what principles are to be applied to ascertain how much of these receipts ought to be treated as income, must be determined in accordance with the ordinary concepts and usages of mankind, except in so far as the statute states or indicates an intention that receipts which are not income in ordinary parlance are to be treated as income, or that special rules are to be applied for arriving at the taxable amount of receipts.

However, the "ordinary concepts and usages of mankind" test is not entirely satisfactory so the courts have developed a number of criteria for determining whether a particular receipt is income. First, income is something which comes in in money or money's worth. In Lambe v I.R.C.[22] Finlay J. said:[23]

> [I]ncome means that which comes in, and...it refers to what is actually received. Income may be of various sorts...but none the less the tax is a tax on income. It is a tax on what in one form or another goes into a man's pocket.

Secondly, a receipt is more likely to be income if it is received with a degree of periodicity, recurrence or regularity.[24] And finally, whether or not an item is income in nature depends upon its character in the hands of the recipient.[25]

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21. (1935) 35 S.R. (N.S.W.) 215, 219.

22. [1934] 1 K.B. 178.

23. Ibid. 182.

24. F.C.T. v Dixon (1952) 86 C.L.R. 540.

25. Scott v F.C.T. (1966) 117 C.L.R. 514,526 per Windeyer J.

Applying those criteria to fringe benefits it would appear that they are income in nature. Fringe benefits generally come in to the taxpayer in money's worth if not in money. Thus the use of a company car for private use is clearly something which comes into the taxpayer in money's worth. Fringe benefits may also be received with a degree of periodicity, as with the provision of subsidised meals for example. Moreover, in the hands of the employee fringe benefits appear to have the character of income. They are provided in money's worth as a means of reward for services rendered. Therefore, prima facie it appears that fringe benefits are income in the juristic sense, and should be taxed accordingly. Indeed, in the United States that is the case and the Supreme Court has on several occasions held that the statutory concept of income is wide enough to encompass fringe benefits.[26] In the other jurisdictions surveyed, however, the courts have consistently held that fringe benefits are not income in the hands of employees unless they are either in the form of cash or are convertible into cash. As it is a relatively simple matter to provide a fringe benefit in a non-convertible form the charge to tax may easily be avoided.

The rationale of the convertibility principle is not immediately apparent. Morever, it is not immediately apparent why the convertibility principle applies to employment income but not to other types of income. To understand the rationale and the employment-non-employment distinction, it is necessary to digress briefly into an historical consideration of income tax.

C. The History of Income Tax and the Convertibility Princple.

1. The United Kingdom.

The first income tax was introduced by Pitt in 1799 in order to finance the war with France. The excise duties and land and

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26. C.I.R. v Smith 324 U.S. 177 (1945) (share options); Rudolph v U.S. 370 U.S. 269 (1962) (expenses paid trip).

expenditure taxes which had characterised the English tax system for much of the Eighteenth Century provided insufficient revenue for that purpose and Pitt was forced to resort to loans. In order to reduce dependence on loans Pitt adopted two fiscal measures. First in 1798 an expenditure tax on certain luxuries was imposed.[27] However, that tax was widely evaded as a result of which Pitt adopted the second measure in 1799: the imposition of an income tax.[28]

By section 3 of Pitt's Act a tax was imposed upon "all income arising from property in Great Britain...or from any kind of personal property...or from any profession, office, stipend, pension, employment, trade or vocation..." The Act therefore taxed income from certain sources, thereby reflecting the Eighteenth Century concept of income as being the yield from a productive source. That concept is well illustrated in the following excerpt from the works of Adam Smith :[29]

> Whoever derives his revenue from a fund which is his own must draw it either from his labour, from his stock, or from his land. The revenue derived from labour is called wages. That derived from stock, by the person who manages or employs it, is called profit. That derived from it by the person who does not employ it himself, but lends it to another, is called the interest or the use of money....the revenue which proceeds altogether from land, is called rent, and belongs to the landlord...All taxes, and all the revenue which is founded upon them, all salaries, pensions, and annuities of every kind, are ultimately derived from some one or other of those three orginal sources of revenue, and are paid either immediately or mediately from the wages of labour, the profits of stock, or the rent of land.

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27. 38 Geo III. C 16.

28. 39 Geo III. C 13. The preamble to this Act explains the reasons for the introduction of the income tax as follows:
> We your majesty's most dutiful and loyal subjects... being desirous to raise an ample contribution for the prosecution of the war; and taking notice that the provisions made for that purpose, by an Act in the last session of Parliament...have in sundry instances been greatly evaded, and that many persons are not assessed under the said Act in a just proportion to their means of contributing to the public service; have cheerfully and voluntarily given and granted...the ...duties hereinafter mentioned...

29. Smith An Inquiry into the Nature and Causes of the Wealth of Nations (Reprint Landem, Nelson & Sons, 1865) Bk1 Ch.VI p22.

It will be seen from the preceding discussion of income that Smith's description of revenue is similar in many respects to current concepts of income.

Pitt's Act was repealed in 1802 but an income tax was reimposed by Addington in 1803 when the war with France resumed.[30] However, Addington's Act was significantly different in form in that it introduced a schedular system whereby income was classified into five schedules according to its source. Pitt's income tax had been unpopular largely because the return required disclosed too much information about the taxpayer's total income. Therefore, to meet the criticism that income tax returns represented an intrusion into taxpayers' private affairs the five schedules were introduced and taxpayers were required to submit a return in respect of income derived from each source.

Addington's Act is significant for a number of reasons. The schedular system it introduced is still part of the income tax regime in the United Kingdom. And for the first time a source deduction system was introduced whereby tax was required to be deducted at the source of the payment subject to tax. However, more importantly for present purposes, the origins of the convertibility principle may be traced to that Act. Schedule E of the Addington's Act brought into charge income from "every public office or employment of profit." The first rule to the Schedule provided :

> The said duties shall be charged on the person or persons respectively having, using, or exercising such offices or employments of profit, or to whom such annuities, pensions or stipends shall be payable, for all salaries, fees, wages, perquisites, or profits whatsoever accruing by reason of such offices, employments or pensions...

And perquisites were defined in the fourth rule to the Schedule as :

> ...such profits of offices and employments as arise from fees or other emoluments, and payable either by the Crown or the Subjects, in the course of executing such offices or employments.

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30. 43 Geo III C 122.

It was from these provisions, carried forward into the Income Tax Act of 1842, that the House of Lords abstracted the convertibility principle in 1892 in the landmark decision of Tennant v Smith.[31] There, the House of Lords was concerned with the question of whether an employee of a bank was assessable under Schedules D and E on the value of accommodation provided for him by his employer.[32] Their Lordships recognised that by virtue of his occupation of the rent-free accommodation the taxpayer received an economic benefit. Lord Halsbury L.C. said:[33]

> It may be conceded that if he did not occupy it under his contract with the bank rent free, he would be obliged to hire a house elsewhere, pay rent for it, and pro tanto diminish his income. And if any words could be found in the statute which provided that besides paying income tax on income, people should pay for advantages or emoluments in its widest sense..., there is no doubt of Mr. Tennant's possession of a material advantage, which makes his salary of higher value to him than if he did not possess it and upon the hypothesis which I have just indicated would be taxable accordingly.

However, notwithstanding the fact that the taxpayer derived a material benefit that benefit was not one which their Lordships considered to be taxable on a construction of the language of Schedule E. Lord Halsbury L.C. centred on the word "payable" in the fourth rule to Schedule E[34] and concluded that it was "quite impossible to suppose that the mere occupation of a house is reconcilable with the just application of that word."[35] His Lordship considered that the only interpretation consonant with the language used in Schedule E was that that schedule charged only money payments or substantial things of money value capable of being turned into money.

Lord Watson's judgment was in similar terms, being based upon a close analysis of the language of Schedule E. His Lordship said:[36]

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31. [1892] A.C.150.
32. Schedule D levied a tax "upon the annual profits or gains arising or accruing to any person or persons residing in Great Britain from any kind of property whatever...or from any profession, trade or vocation."

33. [1892] A.C. 150,155.
34. In relevant part the fourth rule is set out above.
35. [1892] A.C. 150,156.

> It is clear that the benefit, if any, which a bank agent may derive from his residence in the bank is neither salary, fee, nor wages. Is it then a perquisite or a profit of his office? I do not think that it comes within the category of profits, because that word, in its ordinary acceptation, appears to me to denote something acquired which the acquiror becomes possessed of and can dispose of to his advantage - in other words money - or that which can be turned into pecuniary account. If the context had permitted, it might have been possible to argue that a benefit of that kind was a perquisite. But the fourth rule of Schedule E defines perquisites, for all purposes of the Act, to be "such profits of offices and employments as arise from fees and other emoluments, and payable either by the Crown or by the subject in the course of executing such offices or employments." (Lord Watson's emphasis).

From Tennant v Smith it may be conluded that the convertibility principle in the United Kingdom is attibutable to two main factors. First, it may be attributed to the manner in which income from employment was defined in Addington's income tax Act of 1803.[37] Rather than defining income as being any form of gain the 1803 Act reflected Eighteenth Century concepts of income as being the yield from a productive source. And the yield from labour was defined in that Act in terms connoting monetary payments, or payments in kind which are convertible into money. Secondly, the convertibility principle may be attributed to judicial attitudes to the interpretation of tax statutes. This attitude is best illustrated by Lord Halsbury's opening words:[38]

> This is an Income Tax Act and what is intended to be taxed is income. And when I say 'what is intended to be taxed,' I mean what is the intention of the Act expressed in its provisions, because in a taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes...Cases, therefore, under the Taxing Acts always resolve themselves into a question whether or not the words of the Act have reached the alleged subject of taxation. Lord Wensleydale said, in In re Micklehwait [11 Ex 456], 'It is a well-established rule, that the subject is not to be taxed without clear words for that purpose...'

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36. Ibid. 159. The other members of the House agreed with the convertibility principle. Lord Macaghten, for example, held that Schedule E "extends only to money payments or payments convertible into money." Ibid. 163.

37. The 1842 Act which was considered in Tennant v Smith was largely based upon the 1803 Act.

38. [1892] A.C. 150,154.

This literal approach is clearly illustrated in the dicta of Lord Halisbury L.C. and Lord Watson already quoted.[39] Although their Lordships recognised that the provision of rent-free accommodation provided the taxpayer with a material advantage, a literal interpretation of the charging provisions excluded that advantage from the tax net. By contrast, the Scottish Court of Session, the appeal from whose decision the House of Lords heard in Tennant v Smith, took a more pragmatic approach.[40] There, the majority held that the annual value of the occupation of the house was income. The Lord Justice-Clerk's judgment in particular contains a useful contrast to the judgments in the House of Lords. Basically, his Lordship's reasoning consisted of an assertion that it would be "contrary to common sense"[41] to suggest that an employee would not consider a house provided by his employer to be a profit, gain or emolument of his office. Stating the principle to be applied broadly, the Lord Justice-Clerk concluded that "it is what a man enjoys...upon which he must be assessed for income tax."[42] Had that rationale been accepted by the House of Lords then all manner and form of fringe benefit would have been brought within the charge to tax. However, the convertibility principle subsequently enunciated by the House of Lords successfully excluded the majority of such benefits from the charge.

In the context of Schedule E the converibility principle has more recently been approved by the House of Lords in two cases concerning fringe benefits: Abbott v Philbin,[43] and Heaton v Bell.[44] In the former, the taxpayer was granted an option to purchase 2000 shares at their market value of 68s.6d a share for £20. The taxpayer exercised the option in respect of 250 shares two years later when the market value had risen to 82s. a share. The question falling for determination in the House of Lords was

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39. Supra, n33, n36 and accompanying text.

40. Tennant v Inland Revenue Session Cases Series 4 Vol.18, 428 (1891).

41. Ibid. 434.

42. Idem.

43. [1961] A.C. 352.

44. [1970] A.C. 728.

whether the taxpayer had received a taxable perquisite when the option was granted or when it was exercised. It was freely conceded by the taxpayer that he had received a taxable perquisite, but he argued that it was received upon the granting of the option rather than when the option was exercised. In the House of Lords their Lordships unanimously agreed that the proper test to apply was that enunciated in Tennant v Smith. Applying that test, the majority held that the option was convertible when granted, as at that time the taxpayer could have exercised the option and then disposed of the shares for a cash consideration.

The second case, Heaton v Bell, concerned the assessability of benefits received under a car loan scheme. Under that scheme the taxpayer's employer purchased cars, insured them, paid the road fund tax, and lent them to the members of the scheme. There was then subtracted from the weekly wage of those employees a sum of money which varied according to the type of car on loan. Provision was made for withdrawal from the scheme at two weeks notice, after which time the deduction from the employee's weekly wages would cease. On the grounds that the participants in the scheme were receiving taxable emoluments, the Commissioners assessed the taxpayer - a member of the scheme - on his total wages without making any allowance for the amounts subtracted in respect of the car. The taxpayer disputed that assessment, arguing that as the benefit derived from the use of the car was not convertible into cash, he had derived no emoluments within the terms of Schedule E.

In the House of Lords the taxpayer's argument was rejected on the grounds that the benefit he derived from the scheme was convertible into cash. Once again the convertibility principle was unanimously approved. Lord Reid rationalised that approval as follows:[45]

> Income tax is a tax on income and income means money income. The words profits and gains are used throughout the legislation in reference to sums of money...there is no provision for the valuation in money or other kinds of advantages

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45. [1970] A.C. 728, 744.

> which one might call perquisites. In 1842 income tax was at the rate of a few pence in the pound, 'fringe benefits' were unknown for there was no incentive to create them, and it appears to me to be clear that there was no intention to saddle the commissioners with the difficult and at times unprofitable task of putting money on advantages arising out of the employment which did not sound in money.

Therefore, rather than slavishly following Tennant v Smith Lord Reid sought to explain the convertibility principle by reference to the probable intention of Parliament when the 1842 Act was enacted. Lord Diplock also accepted the convertibility principle but at the same time indicated that if it were not for the history of Schedule E, he would be prepared to hold that the use of the car was a perquisite irrespective of whether or not it was convertible into cash. His Lordship said:[46]

> For my part, if it were permissible to confine myself to a consideration in the current Statutes (namely the Income Tax Act 1952 and the Finance Act 1956) by which income tax under Schedule E is currently charged, I should have little hesitation in deciding that the free use of a car for his own purposes, provided to an employee by an employer by reason of his employment, was a perquisite from that employment...I have no doubt that the man in the street would call the benefit of the use of the car if not a 'perquisite' at any rate a perk.

Lord Diplock was therefore of opinion that according to current usage the use of the car was a perquisite. However, His Lordship held that it was too late "to read the relevant words of the current legislation in what I should regard as their current acceptation"[47] as Tennant v Smith had confined these words to money payments and payments in kind which were convertible into cash.

As in Abbott v Philbin, although there was general agreement as to the requirement of convertibility, their Lordships were divided as to whether or not the car benefit was convertible into cash. The majority held that the benefit was convertible on the grounds that by giving two weeks notice the taxpayer could have withdrawn from the scheme and received money instead of the use of the car.

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46. Ibid. 763-764.
47. Ibid. 764.

2. New Zealand and Australia.

As in the United Kingdom, fringe benefits are not generally taxable in New Zealand unless they are convertible into cash. The requirement of convertibility has arisen in New Zealand for reasons similar to those for its development in the United Kingdom. Thus, both the method of defining income for tax purposes and judicial attitudes to the interpretation of tax statutes have been influential. At the same time, the converibility requirement has not arisen as the result of the New Zealand courts blindly following principles enunciated by the House of Lords in Tennant v Smith. Rather, it has developed upon an independent construction of the relevant New Zealand legislation, section 65(2) of the Income Tax Act 1976. In relevant part that section provides :

> 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)...
>
> (b) All salaries, wages, or allowances (whether in cash or otherwise), including all sums received or receivable by way of bonus, gratuity, extra salary, compensation for loss of office or employment, or emolument of any kind, in respect of or in relation to the employment or service of the taxpayer:

Whether the provision of a fringe benefit attracted the operation of that section fell to be considered in Stagg v I.R.C.[48] There, the taxpayer's employer paid for a trip to England for the taxpayer and his wife. Considering the cost of those air fares to be an allowance within the terms of section 65(2)(b),[49] the Commissioner included an equivalent amount within the taxpayer's assessable income in the relevant income year. The taxpayer objected, first on the ground that the purpose of the trip was wholly or primarily of a business nature so that in

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48. [1959] N.Z.L.R. 1252.

49. In Stagg the relevant statutory provision was s.88(1)(b) of the Land and Income Tax Act 1954. However, as that provision is identical to s.65(2)(b) of the 1976 Act the latter provision will be referred to in the text for the sake of convenience.

effect the cost of the trip was not an allowance, and secondly on the ground that on the authority of Tennant v Smith no benefit to a taxpayer could be assessed as income unless it was convertible into cash.

The taxpayer's first ground of objection was given short shrift by Hutchison ACJ. The learned judge upheld the finding in the Magistrates Court that the trip was for both business and personal reasons. However, it is Hutchison ACJ's treatment of the second ground of objection that is of greater significance for present purposes. Although the taxpayer's submissions had been based largely on Tennant v Smith, his Honour approached the question by analysing section 65(2)(b). Relying on dicta in Edwards v Commissioner of Taxes,[50] the learned judge held that "allowance" must be read ejusdem generis with "salaries" and "wages". Applying that rule, his Honour held that certain characteristics of salaries and wages had a bearing on the meaning of "allowances". These were: first, that they are in relation to an employment or service; secondly, that they are payable under a contract of service and not as a gratuity; thirdly, that they are paid in money, although it was recognised that this factor was affected by the words "(whether in cash or otherwise)"; and fourthly that they are paid periodically. Bearing these factors in mind the learned judge concluded that "allowances" refers generally to sums of money. The words "(whether in cash or otherwise)" were given effect to by the application of the principle that if a taxing provision is reasonably capable of two alternative meanings then the courts will prefer the meaning more favourable to the taxpayer. Thus, the words in parenthesis were given a narrow interpretation:[51]

> Having regard to the strong indications that there are in the paragraph that 'allowances' contemplate payments in money, I agree with counsel for the appellant that the words '(whether in cash or otherwise)' must be read so as to include within

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50. [1925] G.L.R. 247. In particular reliance was placed on the following observations of Sir Robert Stout CJ:
> First, the word 'allowance' as used in [section 65(2)(b)] is mixed up with other terms such as salaries, wages, allowances, bonuses, gratuities, extra salary and emoluments of any kind. These are all to be read together as the class which is dealt with under paragraph [(b)]..the ejusdem generis doctrine, in my opinion, must be applied (ibid.248).

51. [1959] N.Z.L.R. 1252, 1257.

> 'allowances' only such provision for an employee as, if it is not in cash, is convertible into cash by him.

Hutchsion ACJ derived support for this conclusion from the fact that the Legislature felt it necessary to enact what is now section 72. This section deems accommodation benefits to be assessable income. If the word "allowances" encompassed the non-monetary benefits brought to charge by section 72, then, his Honour considered, there would have been no need to enact that provision. Further support was derived from the fact that no machiney was provided in section 65(2)(b) for the valuation of non-monetary benefits which were not convertible into money. Finally, the learned judge pointed out that support for his conclusion could be found in Tennant v Smith. At the same time, however, his Honour emphasized that cases decided on English taxing provisions were "[not] necessarily authoritative on an interpretation of our [section 65(2)(b)].[52] Moreover, it is quite clear from the analysis of section 65(2)(b) undertaken by Hutchison ACJ that the convertibility principle was arrived at independently of any dicta in Tennant v Smith. Therefore, while the approach taken by the House of Lords in Tennant v Smith and by Hutchison ACJ in Stagg v IRC was similar, the holding in Stagg was not a mere reiteration of that in Tennant v Smith.

That the convertibility principle has been adopted in New Zealand is hardly surprising. As with the United Kingdom legislation, the New Zealand Act defines income according to its source. And as with the United Kingdom the definition of income derived from labour is expressed in monetary terms. Furthermore, judicial attitudes as to the proper manner in which taxing statutes should be interpreted are largely the same - hence the reference in Stagg to the principle enunciated in IRC v Ross & Coulter (Blackrock Distllery Co. Ltd)[53] that any ambiguity in a tax statute should be resolved in the taxpayer's favour.

In Australia the convertibility principle is more closely associated with the holding in Tennant v Smith than in New Zealand. Upon an analysis of the Australian legislation, this difference is difficult to explain. Income tax is imposed

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52. Idem.

53. [1948] 1 All E.R.616.

by the Income Tax Assessment Act 1936. By section 25(1) of that Act, a person's assessable income includes that person's "gross income". This is complimented by section 26 which provides a list of specific items which are to be included in assessable income. Finally, "income from personal exertion" is defined in section 6(1) as meaning:

> Income consisting of earnings, salaries, wages, commissions, fees, bonuses, pensions, superannuation allowances, retiring allowances...the proceeds of any business carried on by the taxpayer...any profit arising from the sale by the taxpayer of any property acquired by him for the purpose of profit making by sale...

However, the section 6(1) definition does not define income. As Jordan CJ stated in Scott v C. of T.:[54]

> The definition section, where it deals with income, does not define it...Nor does it define 'income from personal exertion'. It merely enumerates, by way of illustration, various forms of income which are to be treated as derived from personal exertion.

Thus whether a particular item is income in nature falls to be determined according to ordinary concepts, rather than by the statutory provisions. It follows, therefore, that the converibility principle in Australia has arisen due to the courts' perception of what constitutes income according to ordinary usage, rather than to a close analysis of the statute. This is well illustrated by FCT v Cooke and Sherden.[56] There, a soft-drink manufacturing company ran a scheme whereby free holidays were made available to certain retailers of its products. Under the terms of the scheme if the offer of the holiday was not accepted, the retailers would not be entitled to alternative compensation. The holidays were therefore not convertible into cash. However, the Commissioner assessed the taxpayers on the basis that the holidays were income according to ordinary concepts and that therefore their value constituted assessable income by virtue of section 25(1).

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54. (1935) N.S.W. 35 S.R. (N.S.W) 215, 220.
55. Ibid. 219.
56. (1980) 10 A.T.R. 696.

The Federal Court, comprising Brennan, Deane and Toohey JJ, allowed the taxpayers' appeal. First, their Honours held that the scheme of the legislation required income to be expressed as a pecuniary amount:[57]

> An item of income which could not be reckoned as money could not find its way into taxable income so as to be subjected to tax at a rate declared by the Parliament. And s.20 requires that income wherever derived and expenses wherever incurred be expressed in terms of Australian currency. So the Act sufficiently shows that the items of income are to be reckoned as money. Consistently with this notion, the Act makes particular provision for some non-pecuniary receipts by including within assessable income the value of these receipts (see s.26(e) and s.26(ea)), and this brings a pecuniary amount to tax. The notion that the items of income are money or are to be reckoned as money accords with the ordinary concepts of income as 'what comes into [the] pocket' to adapt Lord Macnaghten's phrase in Tennant v Smith...that is not to say that the income must be received as money; it is sufficient if what he receives is in the form of money's worth.

The Court's holding that according to ordinary concepts income must be in the form of money or money's worth has long been recognised as a correct statement of the law.[58]. Applying that test it would be expected that the holidays under consideration were income as constituting money's worth even though they were not actually convertible into money. However, the Federal Court took the matter one step further and held that not only must the particular item be money's worth, but it must also be convertible into money. Their Honours said:[59]

> If a taxpayer receives a benefit which cannot be turned to pecuniary account, he has not received income as that is understood according to ordinary concepts and usages.

Furthermore:[60]

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57. Ibid. 703.
58. Scottish & Canadian General Investment Co.Ltd. v Easson (1922) S.C. 242; Cross v London & Provincial Trust [1968] 1 All E.R. 428, 430.
59. (1980) 10 A.T.R. 696, 704.
60. Ibid. 705.

> If the receipt of an item saves a taxpayer from incurring expenditure, the saving is not income: income is what comes in, it is not what is saved from going out. A non-pecuniary receipt can be income if it can be converted into money, but if it be inconvertible, it does not become income merely because it saves expenditure.

In arriving at that conclusion, the Federal Court placed heavy reliance upon Tennant v Smith. Although the learned members of the Court recognised that the legislation under consideration in that case differed from the Australian legislation, they considered that the dicta as to convertibility were of general application and were not limited to the terms of the legislation under consideration.

The correctness of the decision in Cooke & Sherden will be considered in the next section of this paper under the heading "Employment v non-employment income: is the converibility principle universal." Suffice it to say for present purposes that in Australia the convertibility principle has been adopted for reasons quite distinct from those which marked its adoption in New Zealand. Whereas in New Zealand the converibility principle is attributable to the terms of the statute, in Australia it is due to the implementation of the Tennant v Smith rationale.

3. Employment v non-employment income: is the converibility principle universal?

The provision of fringe benefits is traditionally associated only with the employment relationship. This is due not to the fact that for the self-employed opportunities for tax planning are so great that recourse to non-monetary benefits is not necessary, but rather to the fact that the convertibility principle applies only to income from employment. By way of example, if a company provided trips to Hawaii for partners in a law firm which had acted on its behalf then these partners would be assessable on the value of the trips provided. According to ordinary concepts of income, as opposed to those applying to employment income, a receipt is income if provided in money or money's worth. So long as payment in kind is in money's worth, it is not a prerequisite to the treatment of such payment as income that it be convertible

into money. Although on the face of it Tennant v Smith may appear to contradict that proposition, a close analysis of their Lordship's judgments in that case indicates that the convertibility principle was arrived at on a construction of Schedule E of the 1842 Act rather than on an analysis of general concepts of income. Thus, in discussing Schedule E,[61] the first rule of which brought into change certain items, including "perquisites" which were "payable", and the fourth rule of which defined "perquisites" as meaning "profits" of employment arising from fees or other "emoluments", Lord Halsbury LC said:[62]

> ...none of the words, either 'perquisites,' 'profits,' or 'emoluments,' are properly applicable, inasmuch as by the rule in which these words are used or explained, the word 'payable' as applied to them renders it quite impossible to suppose that the mere occupation of a house is reconcilable with the just application of that word.

His Lordship then went on to say that things of money value capable of being turned into money could fall within Schedule E. However, quite clearly his Lordship's conclusion was based upon the fact that non-convertible benefits could not be "payable". Lord Watson's judgment was in similar terms, although his Lordship thought that the converibility principle extended to Schedule D.[63]

Lord Hannen also arrived at the convertibility principle on similar grounds to Lord Halsbury L.C. His Lordship said:[64]

> ...I am of opinion that the occupation of this house does not fall within the description of '.salaries, fees, wages, perquisites, profits or emoluments' in the sense in which these words are used in the Act.

In Cooke and Sherden, however, the Tennant v Smith rationale was given under application. Their Honours held:[65]

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61. In relevant part Schedule E is set out above.
62. [1892] AC 150, 155.
63. Reproduced in relevant part supra n.32.
64. [1892] AC 150, 165.
65. (1980) 10 A.T.R. 696, 703-704.

> Although Tennant v Smith...was concerned with the operation of legislation different in structure from the Income Tax Assessment Act, some parts of their Lordships' speeches applied ordinary conceptions to the construction of the terms of the Act there under consideration. Thus Lord Halsbury said at 157:-
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> > 'I came to the conclusion that the Act refers to money payments made to the person who receives them, though, of course, I do not deny that if substantial things of money value were capable of being turned into money they might for that purpose represent money's worth and be therefore taxable.'
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> ...And Lord Watson at 165 held that :-
>
> > 'profits in its ordinary acceptation, appears to me to denote something acquired which the acquirer becomes possessed of and can dispose of to his advantage - in other words money - or that which can be turned to pecuniary account.'

With respect, the dicta from Tennant v Smith cited in Cook and Sherden are not illustrations of "ordinary conceptions" being applied to the Act as their Honours suggest. Rather, they are merely illustrative of the conclusions reached in the House of Lords upon a close construction of Schedule E. The comments of Lord Halsbury which are quoted were made after his Lordship had analysed the language of Schedule E and concluded that the mere occupation of a house was not reconcilable with the use of the word "payable" in that Schedule. And the quotation from Lord Watson's judgment has been extracted from his Lordship's discussion of the word "profits" as used in Schedule E. In the context of that quotation, Lord Watson was not discussing ordinary concepts of income. Therefore, it follows that the quotations from Tennant v Smith are not authority for the propositions for which they were cited in Cook and Sherden.

The approach adopted by the Federal Court in Cooke and Sherden was also adopted by McMullin J in Dawson v C.I.R.[66] There the taxpayer subscribed to debenture stock in a television rental company under a debentureholders colour television plan.

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66. (1978) 3 N.Z.T.C. 61,252.

Under that plan subscribers would receive the use of a television free of charge for five years in lieu of interest. The Commissioner assessed the taxpayer under section 65(2)(1) on the basis that he had received "income from any other source whatsover". Relying on Cross v London and Provincial Trust Ltd[67] where it was held that income includes money or money's worth, the Commissioner argued that the use of the television rent free represented money's worth upon which an assessment could properly be made. McMullin J rejected this argument, preferring instead the taxpayer's submission that as the use of the television was not convertible into cash the benefit thereby derived was not income. In reaching that conclusion the learned Judge placed reliance upon both Tennant v Smith and Stagg v IRC. As has already been indicated in the discussion of Cooke and Sherden, the holding in Tennant v Smith was based on a construction of Schedule E of the 1842 Act which brought to charge certain receipts associated with employment. With respect to McMullin J. his Honour was incorrect in extracting from Tennant v Smith the proposition that the convertibility principle is of general application. The better view is that Tennant v Smith is only authority for the proposition that non-monetary benefits which are not convertible into cash are not perquisites under Schedule E of the United Kingdom Act. McMullin J's reliance upon Stagg is also open to criticism. As indicated in the discussion of that case in the preceding section of this paper, Stagg was decided upon a close construction of section 65(2)(b). It is quite clear from that case that in holding that "allowances" included only monetary allowances, or those convertible into money, Hutchison A.C.J. was not enunciating a principle of general application to all forms of income.

That convertibility is not a prerequisite to all forms of income is evident from the decision of the House of Lords in Lady Miller v Commissioners of Inland Revenue.[68] There, the House of Lords was concerned with whether the occupation of a mansion constituted income under Schedule A of the United Kingdom Act. That Schedule brought to charge "the property in all lands, tenements, hereditaments, and heritages in the United Kingdom, for every 20 shillings of the annual value thereof. By rule 1

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67. [1938] 1 All E.R. 428.

68. (1930) 15 T.C. 25.

of the rules under the Schedule it was provided that "tax under this Schedule shall be charged on and paid by the occupier for the time being. If the right to occupy was income, then by sections 4 and 5 of the Income Tax Act 1918 the value of that right was included within the taxpayer's income for super tax purposes.

In the Scottish Court of Session it was held, relying on Tennant v Smith, that the right to occupy was not income as it was not convertible into cash.[69] In the House of Lords, however, Tennant v Smith was distinguished and the right of occupation was held to be income by virtue of the Schedule A charge. Lord Buckmaster said:[70]

> It is impossible to examine the judgments [in Tennant v Smith] closely without realising that they were based upon the fact that, whatever advantage the agent might have enjoyed from his residence, it could not possibly be made the subject of assessment under Schedules D and E...To my mind...this case in no way governs the present.

Therefore, his Lordship expressly limited Tennant v Smith to Schedules D and E. Viscount Dunedin and Lord Warrington reached the same conclusion, the former commenting that "[t]he Bank case...has, I think, been only misunderstood."[71] Lord Warrington held that Tennant v Smith "is no authority in support of the Respondent's case,"[72] and overruled the Court of Session's decision as follows:[73]

> The majority of the Juges in the Court of Session appear to have based their conclusion on the view that unless the annual value is capable of conversion into money either by letting or otherwise, it cannot be treated as income of the occupier, and further that, in the present case, on the construction of the settlement, it was not capable of such conversion. Thinking as I do that there is no ground in law for their general propositon, I do not think it necessary to decide the point on the construction of the particular settlement..

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69. Reported along with the decision of the House of Lords at (1930) 15 T.C. 25.
70. (1930) 15 T.C. 25,79.
71. Ibid.83.
72. Ibid.85.
73. Ibid.84-85.

It could perhaps be argued that Lady Miller's case applies only to Schedule A of the United Kingdom Income Tax Act. Prior to 1963 that Schedule included within the charge to tax the right to occupy property.[74] In many cases that right would not be convertible into cash. Therefore, it is not surprising that the House of Lords held that the right of occupation was assessable under Schedule A irrespective of convertibility. But that holding, it could be argued, is limited to Schedule A, which rendered liable to tax not some form of receipt, as with the other schedules, but the right to use an asset. Thus, because of the nature of the charge under that Schedule, Schedule A was a special case which in no way affected the convertibility requirement in relation to other forms of income. However, in London County Council v Attorney-General[75] the House of Lords made it clear that the Schedules merely provided separate methods of assessing various classes of income and that what was brought to charge under each Schedule was income in the ordinary sense of that word. Lord Macnaghten said:[76]

> Income tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else. It is one tax, not a collection of taxes essentially distinct. There is no difference in kind between the duties of income tax assessed under Schedule D and those assessed under Schedule A or any of the other schedules of charge. One man has fixed property, another lives by his wits; each contributes to the tax if above the prescribed limit. The standard of assessment varies according to the nature of the source from which taxable income is derived. That is all...In every case the tax is a tax on income, whatever may be the standard by which the income is measured. It is a tax on 'profits or gains' in the case of duties chargeable under Schedule A and everything coming under that Schedule...just as much as it is in the case of the other schedules of charge (emphasis added).

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74. In 1963 the charge on the beneficial occupation of land was abolished due to widespread criticism from home owners: Simons Taxes (London, Butterworths,1983) Vol.A para A4.101.

75. [1901] A.C.26.

76. Ibid. 35-36.

Therefore the right to occupy property was income in the ordinary sense of that word. Schedule A did not operate as a deeming provision to include within the meaning of income something which otherwise would not be so classified. It follows that income in its ordinary sense is capable of encompassing items which are not convertible into cash and that the convertibility principle enunciated in Tennant v Smith may be restricted to the particular provisions under consideration in that case.

The convertibility principle is therefore of limited application. In the United Kingdom it applies to Schedule E and there was some indication from Lord Watson's judgment in Tennant v Smith that it may apply to Schedule D.[77] In New Zealand Stagg has established that section 65(2)(b) encompasses only "allowances" which are convertible into cash. It is doubtful that the convertibility principle could be extended any further. It could be argued that as it was indicated in Tennant v Smith that the convertibility principle applied to Schedule D, which brought to charge "profits or gains arising...from any profession, trade or vocation", it also applies to section 65(2)(a) of the Income Tax Act 1976, which includes within assessable income "all profits or gains derived from any business". However, Lord Watson's holding in Tennant v Smith that the expression "profits or gains" in Schedule D was not wide enough to encompass "a servant's residence in his master's house, or a meal or a suit of livery supplied by the master"[78] was made by way of obiter dictum. The House of Lords in that case were concerned only with the question of whether the occupation of premises fell within the Schedule E charge. Moreover, Lord MacNagtan's dictum in London City Council v Attorney-General that Schedule A applied to "profits or gains"[79] and the conclusion reached in Lady Miller's case that Schedule A applies to the right to occupy land whether or not that right is convertible into cash, together indicate that the expression "profits or gains" is wide enough to encompass items which are not convertible into cash. The same conclusion may be reached by an analysis of the expression "profits or gains". Although the words of a statute must be read in context, it would

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77. [1892] A.C. 250,161.

78. Idem.

79. Supra n.76 and accompanying text.

appear that, by using both "profits" and "gains" in section 65(2)(a) Parliament was indicating these these words had distinct, albeit similar, meanings and that both profits and gains should be brought within the charge to tax. In Tennant v Smith Lord Watson held that the word "profits" in its ordinary acceptation meant "something acquired which the acquirer becomes possessed of and can dispose of to his advantage - in other words money - or that which can be turned to pecuniary account."[80] Bearing in mind that "profits" means things acquired which are in cash or convertible into cash, it is necessary to give some meaning to "gains" which is distinct from that of profits.[81] The shorter Oxford Dictionary defines "gains" inter alia, as "increase of possessions, resources, or advantages, consequent on some action or event; profit, emolument; opp[osite] to loss." And in re Riverton Sheep Dip[82] Mayo J in discussing the meaning of "gain" said that "[t]he most appropriate definition to be found in a dictionary may be 'increase in resources or business advantages resulting from business transactions or dealings.'"[83] However, this definition would appear to be too wide for the purposes of section 65(2)(a) as it would clearly encompass gains of a capital nature. Since income tax was first introduced in New Zealand in the Land and Income Tax Assessment Act 1891, Schedule D of which brought to charge the "profits or gains" from any business, the expression "profits or gains" in the context of the taxation of business profits has been understood to refer only to revenue profits or gains. It would now be too late to extend the meaning to capital profits or gains.[84]

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80. [1892] AC 150,159.

81. The relevant principle of statutory interpretation is stated in Halsbury's Laws of England (4 ed. Butterworths, London, 1980) vol 43, Statutes, para 861 as follows:

> It may be presumed that words are not used in a statute without a meaning and are not tautologous or superfluous, and so effect must be given, if possible, to all the words used, for the legislature is deemed not to waste its words or say anything in vain.

82. [1943] S.A.S.R.344.

83. Ibid.347. See also In Re Commonwealth Homes & Investment Co.Ltd. [1943] S.A.S.R.211.

84. Although in Lowe v C.I.R [1981] 1 N.Z.L.R. 326 the Court of Appeal recognised that ss.67(4)(e) and 67(4)(f) encompassed capital "gains or profits".

Bearing in mind the wide meaning of the word profits, and the fact that in the context of section 65(2(a) "profits or gains" refers to revenue profits or gains, it is difficult to attribute any meaning to the word "gain" that is not already covered by the word "profit". It is suggested that the only sensible construction that can be placed on "gains" is that it covers things of money's worth which come in but are not convertible into money.

It may therefore be concluded that the convertibility principle applies only to income from employment. Contrary to the decisions in Dawson and Cooke & Sherden, the better view is that the principle does not extend to other forms of income.

4. When is a benefit convertible into cash?

Although benefits in kind granted to employees are not taxable unless in cash or convertible into cash, - at least in the United Kingdom, Australia and New Zealand - the courts appear willing to hold that non-monetary benefits are convertible into cash. In Abbott v Philbin[85] the share option in question was non-transferable. However, in the House of Lords the majority held that it was convertible into cash because the taxpayer could have exercised the option and then disposed of the shares for a cash consideration. Viscount Simmonds held that the test of convertibility is "whether it is something which is, by its nature, capable of being turned into money."[86] And Lord Radcliffe said of fringe benefits:[87]

> If they are by their nature incapable of being turned into money by the recipient they are not taxable, even if they are, in the ordinary sense of the word, of value to him.

Therefore, it appears that a benefit is convertible or non-convertible according to whether or not by its nature it is convertible or non-convertible. Contractual stipulations, as for example the stipulation against transfer in Abbott v Philbin,

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85. [1961] A.C.352; supra n.43 and accompanying text.
86. Ibid. 366.
87. Ibid. 378.

would appear to be irrelevant. However, Lord Radcliffe made it clear that the proper test to be applied is by no means settled. His Lordship postulated the following questions:[88]

> Must the inconvertibility arise from the nature of the thing itself, or can it be imposed merely by contractual stipulation? Does it matter that the circumnstances are such that conversion into money is a practical, though not a theoretical, impossibility; or the other, that conversion, though forbidden, is the most probable assumption?

If the proper test is whether the benefit in its nature is convertible into cash then there would be few inconvertible benefits. Motor cars, accommodation, overseas trips and share options are all intrinsically capable of being converted into cash. In practice, the courts have looked to the terms of the contract rather than to the nature of the benefit. Thus, in Stagg v IRC[89] and FCT v Cooke & Sherden[90] the overseas trip and the holiday respectively were both items which of their nature were convertible into cash but which under the terms of the agreements in question were found not to possess that quality.

However, notwithstanding the fact that the courts look to the terms of the contract contractual stipulations as to non-transferability will not always preclude a finding of convertibility. Thus, although the share options in Abbott v Philbin were not able to be transferred they were found to be convertible into cash. Similarly, in Heaton v Bell[91] the contractual prohibition on assignment of the car did not preclude convertibility. Lord Reid said:[92]

> Admittedly he could not assign it and he could not get money so long as he kept the right. But he could have surrendered the right and if he had done so the agreement provided that his wage would be increased. So why should he not be taxed on the amount of increased wages which he had it in his power to get by making that surrender?

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88. Idem.
89. [1959] N.Z.L.R 1252.
90. (1980) 10 A.T.R. 696.
91. [1970] A.C.728.
92. Ibid. 746.

In Heaton v Bell there was provision in the particular agreement for the taxpayer to receive a higher wage if he withdrew from the car loan scheme. The situation is unclear where there is no such provision in the employment contract, or any collateral contract, but it is understood that the employee will receive a lower salary than would otherwise be the case as a result of accepting a fringe benefit and that if he decided to forgo the benefit he would receive a higher salary. The better view is that such a benefit is convertible as the taxpayer is able to receive a higher salary by forgoing the benefit. That the taxpayer doesn't actually avail himself of the opportunity to convert the benefit is irrelevant. Based on the Heaton v Bell rationale, the ability to convert is the operative test. If this view is correct, then many of the fringe benefits currently provided will be convertible into cash. Company cars, for example, are often provided in lieu of a salary in order to reduce the taxpayer's liability to tax. In many cases it is likely that if the car was not accepted then a higher salary would be payable. In the absence of a written agreement, however, there would of course be some difficulty in establishing that a higher salary could be obtained if a fringe benefit was forgone.

D. The United States

1. Background

In the United States the taxation of fringe benefits is not restricted by any requirement of convertibility. As in the other jurisdictions surveyed income is defined in section 61(a) of the Internal Revenue Code 1954 on a source basis.[93] However, the courts in the United States have construed the word "income" in a much wider sense than in those other jurisdictions. That wider concept of income is not sufficiently broad as to encompass unrealised capital gains. However, it is broad enough to bring fringe benefits within the charge to tax.

The wider concept of income adopted in the United States is due partly to historical and constitutional factors and partly to judicial attitudes to the interpretation of statutes. Both of these factors are considered in this section of the paper.

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93. Section 61(a) includes within the definition of "gross income" "income from whatever source".

2. Historical and constitutional background.

By Article 1, section 8, clause 1 of the United States Constitution Congress has the power :

> To lay and collect taxes, duties, imposts and exises, to pay the debts and provide for the common defence and general welfare of the United States, but all duties, imposts and excises shall be uniform throughout the United States...

However, the taxing power is circumscribed somewhat by section 2 clause 3 of Article 1 which provides :

> Representative and direct taxes shall be apportioned among the several States which may be included within this Union, according to their respective numbers...;

and by section 9 clause 4 of Article 1 :

> No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken...

Thus, direct taxes, a term undefined in the Constitution, could only be imposed if apportioned among the States according to their various populations.

Until the Civil War customs receipts formed the backbone of the federal tax system. However, those receipts proved insufficient to enable the North to finance its war effort and in 1846 an income tax was introduced. By section 27 of that Act a tax was imposed on :

> ...the annual gains, profits, and income of any person...whether derived from any kind of property, rents, interests, dividends, or salaries, or from any profession, trade, employment, or vocation...or from any other source whatever.

In Springer v U.S.[94] the constitutionality of that Act was upheld. The Supreme Court held that an income tax was an indirect tax and was thus not subject to the apportionment requirements of the Constitution. Rather, such a tax was

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94. 102 U.S. 586 (1880).

considered to be more in the nature of an excise or duty. Direct taxes were held to include only capitation taxes, where a levy is imposed on a per capita basis, and taxes on real estate.

In 1894 another income tax was imposed along the lines of the 1846 tax. The constitutionality of the tax on rent from land imposed by that Act was challenged in Pollock v Farmer's Loan Trust.[95] There, the Supreme Court held that the tax on rents from land was in fact a tax on the land itself and as such was unconstitutuional unless apportioned. As a substantial part of the Act was held to be invalid the Court held that it was invalid as a whole.

Thus, subsequent to Springer and Pollock Congress could have imposed a tax on income from wages and salaries as such a tax was regarded as being indirect. Furthermore, a tax could have been imposed on income from property so long as such a tax was apportioned. However, apportionment would have been too difficult, and to impose an income tax only on earned income would have been politically inexpedient.[96] Therefore, the Sixteenth Amendment to the Constitution was promoted and ratified removing the requirement that direct taxes be apportioned among the States according to population. The Amendment provided :

> The Congress shall have power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several States, and without regard to any census or ennumeration.

3. Income tax and the courts

The Sixteenth Amendment had been ratified by February 1913 and was followed soon after by enactment of the Revenue Act 1913. By Part A of that Act a tax was imposed on "the entire net income arising or accruing from all sources" of citizens of the United States. By Part B net income was defined as including :

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95. 157 U.S. 429 (1895).
96. In discussing the background to the Sixteenth Amendment Bittker records that:
> While unearned income is only a small fraction of total notional income it becomes an increasingly important component of individual income as income rises; and this meant that taxing earned income but not income from investments was not politically acceptable (emphasis in the original).

B.I.Bittker Federal taxation of Income, Estates and Gifts (Warren Gorham and Lamont, Boston, 1981) Vol 1, ch1, p19.

> gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property...

It will be seen that as in the other jurisdictions surveyed "income" itself was not actually defined but was described as being something arising from various sources. It is interesting to note that income was expressed to include "profits, gains, and income...in whatever form paid". Payment in kind was therefore expressly encompassed within the definition.

The ambit of the income tax first fell to be considered by the Supreme Court in Eisner v Macomber.[97] There, Mr. Justice Pitney, delivering the majority judgment, adopted the definition enunciated in two cases under the Corporation Tax Act 1908 that "income may be defined as the gain derived from capital, from labour, or from both combined."[98] Therefore, as in other countries, income was seen essentially as being the yield of a productive source. The distinction between income and capital was metaphorically described as follows:[99]

> 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 depicted as a resevoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time.

However, Mr. Justice Pitney's dictum as to the nature of income has been emasculated by subsequent Supreme Court decisions. In C.I.R. v Smith[100] the taxpayer was given by way of compensation for his services an option to purchase shares at their market value when the option was granted. The taxpayer exercised the option in two later years when the market value of the shares was greater than the option price. In the Supreme Court it was held that the taxpayer received taxable income upon the exercise of

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97. 252 U.S.189 (1920).

98. Stratton's Independence v Howbert 231 U.S. 399, 415, (1913); Doyle v Mitchell Bros.Co. 247 U.S. 179,185 (1918).

99. 252 U.S. 189,206 (1920). The definition of income enunciated in Eisner v Macomber has been approved in the United Kingdom in IRC v Blott [1921] 2 A.C. 171.

100. 324 U.S. 177 (1945).

the option in the amount of the difference between the option price and the then market value of the shares. Chief Justice Stone, delivering the majority judgment, considered that section 22 (a) of the 1938 Act[101] "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation, whatever the form or mode by which it is effected."[102] This approach is wider than that taken in Eisner v Macomber and clearly brings fringe benefits within the tax net.

The Supreme Court reiterated the broad approach to the definition of income in C.I.R. v Glenshaw Glass Co.[103] There, the Court was concerned with the assessability of punitive damages received in settlement of an antitrust and fraud action. Although the case was not concerned with a fringe benefit, the following dictum of Chief Justice Warren is of general application :[104]

> This Court has frequently stated that this language [ie section 22(a)] was used by Congress to exert in this field the 'full measure of its taxing power...' Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature... And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted.

Eisner v Macomber was distinguished by the Court as applying only to cases where it is necessary to distinguish income from capital. Mr. Justice Warren commented that the test in Eisner v Macowber "was not meant to provide a touchstone to all future gross income questions."[105]

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101. Section 22(a) of the Inland Revenue Code 1939 provided:
'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service...of whatever form paid, or from professions, vocations, trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property ...or gains or profits and income derived from any source whatever.
In the Inland Revenue Code 1954 section 61(a), which replaces section 22(a) provides:
'Gross income' includes all income from whatever source derived.

102. 324 U.S. 177,181 (1945).

103. 348 U.S. 426 (1955).

104. Ibid. 429-430.

105. Ibid. 430.

In Glenshaw Glass the Court held that although the definition of "gross income"contained in the 1954 Code differed considerably from that in the 1938 Code, the wide concept of income formulated in Smith, based as it was on section 22(a) of the 1938 Code, applied with equal force to section 61(a) of the 1954 Code.[106] That concept is clearly wide enough to encompass fringe benefits, as Smith itself illustrates. Further illustration is provided by Rudolph v U.S.[107] There, the Commissioner assessed an insurance agent on the value of an employer-paid trip for the taxpayer and his wife to New York. The trip, ostensibly for a business convention, took one week in total and of the two and a half days spent in New York only one morning was devoted to business. The Supreme Court, applying the test laid down in Smith that section 61(a) included as income any economic or financial benefit conferred on an employee as compensation, upheld the Commissioner's assessment. As the trip was predominantly for recreational purposes it was considered that its value represented a financial benefit to the taxpayer.

Thus, the distinction enunciated in Tennant v Smith between that which comes into the pocket and that which saves the pocket from expenditure is not recognised in the tax jurisprudence of the United States. Accordingly, whether or not a benefit in kind is convertible into cash is irrelevant. The overriding test is whether the benefit confers on the taxpayer an economic or financial gain of some form. At the same time, the courts do not go so far as to approve the concept of income as understood by economists.[108] As was stated by Mr Justice Holmes in Weiss v

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106. Supra n.99 for the texts of ss.22(a) and 61(a). That the wide concept applies to s.61(a) was also recognised in U.S. v Gotcher 401 F.2d 118 (1968) where Mr Justice Thornberry said :

> The concept of economic gain to the taxpayer is the key to section 61...this concept contains two distinct requirements : There must be an economic gain, and this gain must benefit the taxpayer personally. In some cases, as in the case of an expense-paid trip, there is no direct gain, but there is an indirect economic gain inasmuch as a benefit has been received without a corresponding diminution in wealth.

107. 370 U.S. 269 (1962).

108. For a discussion of economic concepts of income see supra Pt II, B,1 "Income in the economic sense".

109. 279 U.S. 333 (1979).

Wiener: "The income tax laws do not profess to embody perfect economic theory."[110] If income tax laws do not embody economic theory, then it is not surprising that judicial pronouncements on the meaning of income also fail to embody such theory.

4. The United States and the Commonwealth jurisdictions compared.

The wider concept of income in the United States, and hence the assessability of fringe benefits according to ordinary concepts of income rather than by specific statutory provision, is attributable both to the statutory definition of income and to the manner in which that definition has been interpreted in the courts. Although as in the Commonwealth countries surveyed in this paper income is defined in the United States on a source basis, the statutory definition in the United States is couched in more general terms. Thus, the courts have been willing to hold that income includes all forms of economic or financial benefit. In the United Kingdom, on the other hand, income is more specifically defined. As a result the cases turn more on a close analysis of the statutory language than on general principles. The same is true of the New Zealand legislation.

More important, however, is the different judicial attitudes to the interpretation of statutes. In the Commonwealth countries taxing statutes in particular are narrowly construed, the classic statement being made in Tennant v Smith that "in a taxing Act it is impossible...to assume any intention" so the court must determine "whether a tax is expressly imposed."[111] In the United States, on the other hand, the approach is markedly different.

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110. Ibid. 335.

111. [1892] AC 150, 154. This approach was recently reiterated in New Zealand in Lowe v CIR [1981] 1 N.Z.L.R. 326, 342 where Richardson J approved of Rowlatt J's statement in The Cape Brandy Syndicate v Commissioners of Inland Revenue [1921] 1 K.B.64, 71 :

> ...in taxation you have to look simply at what is clearly said. There is no room for any indendment; there is no equity about a tax: there is no presumption as to a tax, you read nothing in, you imply nothing, but you look fairly at what is said and at what is said clearly and that is the tax.

There, the courts are prepared to ascertain the intention of Congress by reference to the reports of debates in the House of Representatives and to apply that intention to the statutory provision under consideration.[112] This is well illustrated in Glenshaw Glass where by reference to reports of the proceedings in Congress, the Court held that the broader wording of the definition of gross income in the 1954 Code as contrasted with the 1938 Code did not alter the meaning of the definition.[113] Similarly, in Pollock the meaning of "direct" tax in Article 1 of the Constitution was determined in large part by reference to the debates preceding the ratification of the Constitution in 1789. Thus, the stricture in Tennant v Smith against assuming any intention in a taxing Act has no counterpart in the United States. Rather, the Courts there adopt a purposive approach. In Smith and Glenshaw Glass, for example, section 22(a) of the 1938 Code was interpreted on the basis that Congress in enacting that provision intended to exert "the full measure of its taxing power."[114]

It is also noteworthy that in the United States the courts are more willing to distinguish earlier decisions and limit their application to specific factual situations. Thus, in Glenshaw Glass the test enunciated in Eisner v Macomber as to the nature of income was limited largely to the factual situation then before the Court although a reading of the case indicates that the test was intended to be of general application. In the Commonwealth jurisdictions, however, the courts are more reluctant to adopt this approach. Thus, the test as to convertibility laid down in Tennant v Smith remains in force even though it was recognised by Lord Diplock in Heaton v Bell to be no longer in keeping with ordinary concepts of income.

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112. The broad approach preferred by the courts in the United States is illustrated in the following comments of Mr. Justice Holmes in Johnson v U.S. 163 F 30,32 (1908):

> The legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognised and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an adequate discharge of duty for the courts to say : We see what you are driving at, but you have not said it, and therefore we shall go on as before.

113. 348 U.S. 426, 432 (1955).

114. Ibid. 429.

PART III ANTI-AVOIDANCE MEASURES

III ANTI-AVOIDANCE MEASURES

A. Preamble.

Part II of this paper was concerned with establishing that fringe benefits generally fall outside the tax net, and with analysing the reasons for that exclusion. In this part of the paper consideration is given to the measures adopted in the jurisdictions surveyed to ensure that fringe benefits are brought within the tax net. First, the problems associated with any attempt to tax fringe benefits will be highlighted. Secondly, the tax regimes adopted to counteract tax avoidance by the provision of fringe benefits will be discussed. Thirdly, consideration will be given to general anti-avoidance provisions which seek to bring all fringe benefits within the charge to tax. And finally, as in Part II of the paper, the tax treatment of fringe benefits in the United States will be considered separately.

B. Problems Associated with Taxing Fringe Benefits.

1. Identification.

In seeking to tax fringe benefits the benefits upon which tax is to be levied must first be identified. In some cases it may be difficult to distinguish between conditions of work and fringe benefits. That difficulty could be resolved by listing certain items which, if provided by the taxpayer's employer, are to be treated as fringe benefits in all cases and taxed accordingly. However, that approach would be intrinsically unfair as the following extract from King & Kaye's book on the British tax system indicates :[115]

> It is difficult to determine any sensible borderline between conditions of work and benefits. The employer who provides a congenial washroom for his employees is presumably simply offering a reasonable working environment, while the one who installs a coloured suite in the bathroom of their homes is providing a fringe benefit; but there is a spectrum of benefits in between...

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115. King and Kaye The British Tax System (Oxford University Press, 1979) p.41.

Thus, a blanket taxation of all employer-provided washrooms would prove unfair to those for whom the facility was provided in order to make their working environment more pleasant. The same applies with the more common forms of fringe benefit. Blanket taxation of all employer-provided cars, for example, would prove unfair to those for whom the car was a condition of employment. Travelling salesmen and employee taxi drivers would suffer under any such tax. Clearly, then, if particular benefits are to be singled out for tax treatment rules need to be formulated to ensure that only benefits conferring some form of financial benefit attract the operation of the taxing provisions.

Assuming that particular benefits are to be singled out for tax purposes, questions arise as to which benefits should be chosen. Should employer-subsidised meals and creches be taxed? Should free newspapers and car parking facilities be taxed? Or would the time spent on administering a tax imposed on such items make the tax uneconomic?

In practice the problem of identification is dealt with by taxing certain specific benefits and then providing a general sweeping up clause which catches all "other benefits of any kind whatever"[116] or "other benefits and facilities of whatsoever nature."[117] The specific benefits are generally those likely to generate the most revenue: motor cars, accommodation, low interest loans and share options being common examples. The effects of the general sweeping up provision is to confer on the revenue authorities of the country concerned a discretion as to which benefits should be selected for tax treatment. Thus, although free newspapers may fall within the statutory language the revenue authority may, for the purposes of administrative efficacy, treat them as being non-taxable. At the same time, however, more valuable benefits, such as overseas trips and the payment of school fees, which also fall within the terms of the sweeping-up clause, may be treated as taxable.

The problems associated with general sweeping-up provisions, or more aptly general anti-avoidance provisions, will be discussed

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116. Section 6(1)(a), Income Tax Act 1970 (Canada).
117. Section 61(1), Finance Act 1976 (United Kingdom).

later in the paper. Suffice it to say for present purposes that from the point of view of those charged with administering the tax system such provisions, if liberally interpreted by the courts, resolve any difficulties in identifying the benefits to be taxed. The de facto discretionary power which they confer allows the authority to select for tax treatment the benefits which will generate the most revenue and which will be easier to administer.

2. Valuation.

The major difficulty in taxing fringe benefits lies in valuing them for tax purposes. In many cases fringe benefits perform a dual function. Thus, low interest loans to bank employees serve not only to provide the employee with a benefit but also to provide the bank with long-term employees. Similarly, benefits may be provided with strings attached, so that an executive provided with free accommodation, for example, may be required to use that accommodation to entertain company clients. In other situations, the benefit provided may entail a restriction of choice so an employee provided with a Ford motor car if left to his own choice may have preferred a Toyota. In other cases, the benefit provided may be more extravagant than the employee would himself have provided. Thus, a host of subjective factors affect the value of the benefit to the taxpayer. Whether these subjective factors should be taken into account in valuing the fringe benefit, and if so to what extent, are problems which confront any Legislature seeking to tax fringe benefits.

As an alternative to value to the employee fringe benefits could be taxed according to their cost to the employer. Therefore, if a car cost the taxpayer's employer $20,000 the value of the taxable benefit to the employee could be expressed as a percentage of that cost. The major objection to that approach is that it may operate arbitrarily. Suppose, for example, that two employees, Fagin and Sykes, are provided with a car by their respective employers. Fagin, an executive with a large publicly listed company, has unrestricted use of the car provided by the company. On the other hand Sykes, a public servant, is unable to use the car provided for his use for private purposes during weekends. Clearly, in that situation, any calculation of the taxable value of the benefit solely by reference to the cost to the employer would work unfairly in Fagin's favour to the detriment of Sykes.

Where benefits are provided at little or no cost to the employer it will be impractical or impossible to adopt cost to the employer as the basis of valuation. Thus, it would not be practical to value the benefit conferred on airline employees allowed to fill vacant seats on flights run by the airline on the basis of the cost to the employer providing that benefit. Similarly, where a newspaper company provides free newspapers for its employees, or where a retailer gives produce to his employees which otherwise would deteriorate, the value of the benefit conferred could not be measured by reference to the cost to the employer of providing the benefit.

As a third option, the market value could provide the basis of valuation. Thus, rent free accommodation could be valued according to the prevailing market rentals in the area in which the accommodation is situated. As with cost to the employer, market value could be unfair to the taxpayer in some circumstances. A New Zealand diplomat stationed in Tokyo or Washington, for example, could be faced with a large tax bill if assessed on the market value of his accommodation.

In practice fringe benefits are valued according to all three methods. In Australia, for example, fringe benefits are valued according to their value to the taxpayer. Thus, in relation to rent free or low rental accommodation sections 26AAAA and 26AAAB of the Income Tax Assessment Act 1936 contain detailed provisions calculated to ensure that the taxpayer is taxed upon the value to him of the accommodation benefit rather than upon some objective basis. On the other hand, in the United Kingdom the value of fringe benefits is determined by a mixture of cost to the employer, market value and value to the taxpayer.

C. The Scheme of Anti-Avoidance Legislation.

1. New Zealand.

The tax regime governing fringe benefits in New Zealand follows closely the pattern to be found in other jurisdictions. Section 65(2)(b) of the Income Tax Act 1976 is a general anti-avoidance provision which includes within assessable income all "allowances (whether in cash or otherwise)". Specific provision is then made

in section 69 for benefits conferred under share option or share purchase schemes and under section 72 for benefits provided by way of board, lodging or house allowances.

Prima facie section 65(2)(b) is wide enough to encompass any form of non-monetary benefit. However, its effect in relation to such benefits has been rendered nugatory by the courts. In Stagg v I.R.C.[118] the expression "allowances (whether in cash or otherwise)" was held to apply only to cash allowances or to allowances which are convertible into cash. And in C.I.R. v Parson[119] "allowances" was strictly construed so as to apply only to items which were regarded as being allowances in 1900. Therefore, unless specific provision is made fringe benefits may be regarded as being non-taxable in New Zealand.

2. Australia.

Provision for the taxation of fringe benefits has been made in the Australian legislation since the federal income tax was first introduced in 1915. By section 14(g) of the Income Tax Assessment Act 1915 assessable income was deemed to include "all allowances...whether in money or goods or sustenance or land...to the amount of the value of such allowances." The present legislation contains a similar, although wider, provision. By section 26(e) of the Income Tax Assessment Act 1936 assessable income includes:

> [T]he value to the taxpayer of all allowances, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him, whether so allowed, given or granted in money, goods, land, meals, sustenance, the use of premises or quarters or otherwise.

Section 26(e) is complemented by section 26AAC which provides a basis for the valuation of benefits provided by way of share purchase or share option schemes, and by sections 26AAAA and 26AAAB which make provision for the valuation of employee housing.[120].

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118. Supra. n.48 and accompanying text.

119. [1968] N.Z.L.R. 574; considered later in the paper.

120. Sections 26 AAAA and 26AAAB are considered in Part IV of this paper.

It will be seen that as in New Zealand, the Australian legislation does not contain a comprehensive scheme for the taxation of fringe benefits. Although section 26(e) is wide enough to encompass all fringe benefits, in practice it is limited to the specific benefits mentioned therein. Thus, fringe benefits in the form of "land, meals, sustenance, the use of premises or quarters" are taxed, while some of the more common forms of benefit, such as cars and low interest loans, escape the tax net.

3. Canada.

Compared with Australia and New Zealand Canada has a comprehensive fringe benefit tax regime. The general taxing provision is contained within section 6(1)(a) of the Income Tax Act 1972 which includes within "income from an office or employment:"

> the value of board, lodging and other benefits of any kind whatever received or enjoyed by him in the year in respect of, in the course of, or by virtue of an office or employment...

In addition specific provision is made for the taxation of motor cars,[121] low interest loans,[122] and share purchase and share option schemes.[123]

4. United Kingdom

Of the countries surveyed the United Kingdom has enacted the most complete regime for the taxation of fringe benefits. This is due in part to the decision in Tennant v Smith[124] that Schedule E encompasses only perquisites that are convertible into cash, and in part to the decision in Hochstrasser v Mayes[125] that Schedule

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121. Section 6(1)(e) Income Tax Act R.S.C.1970.
122. Section 80.4 Income Tax Act R.S.C.1970.
123. Section 7 Income Tax Act R.S.C.1970.
124. [1892] A.C. 150.
125. [1960] A.C. 376.

E brings to charge only benefits of which the employment is the causa causans[126] and not those of which the employment is the causa sine qua non.[127] Combined with the high personal tax rates enjoyed in the United Kingdom for many years the ineffectiveness of Schedule E in relation to fringe benefits encouraged the Legislature to enact a comprehensive regime to prevent tax avoidance by the granting of fringe benefits.

The provisions governing the taxation of fringe benefits are divisible into two categories : those that apply to all taxpayers; and those which apply only to higher paid employees and directors. For the sake of convenience the scheme of the legislation is set out in Table 1.

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126. Defined in Black's Law Dictionary (5 ed., West Publishing Co. Minnesota, 1979) as "The immediate cause; the last link in the chain of causation."

127. Defined in Black's Law Dictionary (Idem) as "A cause without which the effect in question would not have happened...A cause without which the thing cannot be."

Table 1.: Legislation governing the taxation of fringe benefits in the United Kingdom.

A. Benefits taxable to all employees

1. Perquisites.	2.Accommodation	3.Vouchers & Credit Tokens	4. Share Purchases and options
Schedule E Income Tax Act 1970: taxess all emoluments, which are defined in s.183 including "perquisites". Of limited effect in relation to fringe benefits due to Tennant v Smith and Hochstrasser v Mayes	Sections 33 & 33A, Finance Act 1977: (a) Section 33 provides that the taxpayer is taxed on the annual value of employer-provided accommodation. (b) Section 33A imposes a special charge in addition to s.33 where the cost of the accommodation was more than £75,000	Sections 36 & 36A Finance Act 1975: (a) Section 36 provides that the employee is taxed on the cost of any voucher provided by his employer. (b) Section 36A makes similar provision in relation to credit tokens	Sections 186 Income Taxes Act 1970; 77 & 79 Finance Act 1972, and 47 Finance Act 1980.

B. Benefits Taxable only to higher paid employees and directors.

5. Benefits	6.Cars & Car Fuel	7. Accommodation	8. Low Interest loans
Section 61 Finance Finance Act 1976: Brings to charge all "benefits", defined in s.61(3) as accommodation other than living accommodation, entertainment, domestic or other services and "other benefits of whatsoever nature."	Sections 64 & 64A Finance Act 1976: (a) s.64 brings to charge the 'cash equivalent' of the benefit derived from the car (b) s.64A brings to charge the 'cash' equivalent' of employer provided fuel for the car.	Section 63A Finance Act 1976: Provides that amounts reimbursed on heating,lighting, cleaning, repairs, maintenance and the provision of furniture are taxable.	Section 66 Finance Act 1976: Provides that the 'cash equivalent' of any low interest loans is included within the taxpayers income

7. Scholarships
Section 62A Finance Act 1976: Ensures that scholarships provided for a member of the taxpayer's family are included within the taxpayer's taxable income.

Due to the two-tier system those who are directors or are engaged in higher paid employment are at a distinct disadvantage. Not only are they taxed on certain benefits which are taxable to all taxpayers, but they are also singled out for special treatment in relation to several other benefits. Furthermore, although the distinction between higher paid employees and other may be considered justified on the grounds that the higher paid are more likely to receive fringe benefits than are those in lower income brackets, section 69(1) of the Finance Act 1976 defines "higher paid employment" as meaning employment with emoluments of £8,500 per annum or above. This, the "higher paid employment" provisions apply not only to those who would normally be regarded as high income earners but also to those in the middle income bracket. Moreover, by section 69(2) emoluments are calculated by including all amounts brought to charge under the Finance Act 1976. Therefore, it would not be possible to avoid categorisation as a higher paid employee by providing, for example, a salary of £8,499 per annum along with a low interest loan and the use of a company car. Both the benefits provided and the salary paid are taken into account in calculating whether the £8,500 limit has been exceeded.

D. General Anti-Avoidance Legislation.

1. Background.

From the discussion in the preceding section of this part of the paper it is evident that the scheme of anti-avoidance legislation aimed at fringe benefits is in many respects similar. Although the anti-avoidance legislation in Canada and the United Kingdom may be more all-embracing than in New Zealand and Australia, the basic scheme - whereby specific provision is made for several benefits and a general provision is aimed at others - is the same. In this section of paper the effectiveness of the general anti-avoidance provisions is considered: first, by reference to the manner in which such provisions have been interpreted by the courts; and secondly by reference to certain problems associated with such provisions.

2. The courts' approach to general anti-avoidance provisions.

a. New Zealand.

Section 65(2)(b) of the New Zealand Act includes within assessable income :

> All salaries, wages or allowances (whether in cash or otherwise), including all sums received or receivable by way of bonus, gratuity, extra salary or emolument of any kind, in respect or in relation to the employment or service of the taxpayer:

The meaning of the word "allowances" in that provision was considered by the Court of Appeal in C.I.R. v Parson.[128] There, the Court were concerned with the assessability of amounts derived on the exercise of an option to purchase shares. In the relevant income year the taxpayer had exercised an option to purchase 1500 shares in his employer company, Woolworths Ltd. At the time the option was exercised the market value of 1500 shares was £1008, however the taxpayer paid only £600. The difference of £408 was considered by the Commissioner to be an "allowance" within the terms of section 65(2)(b)[129] and an assessment was issued on that basis.

In the Court of Appeal the majority, comprising North P. and McCarthy J., rejected the Commissioner's argument that the sum in question was an "allowance". Based on an historical analysis of section 65(2)(b) their Honours formulated a very limited test as to what constitutes an "allowance". North P. outlined the history of the provision and considered the effect of that history as follows :[130]

> I have examined the history of the legislation since the enactment of the Land and Income Tax Act 1891. In that year the words 'including all sums received or receivable by way of bonus...' did not appear. They first appeared in the Land and Income Tax Assessment Act 1900 and have been carried forward in each succeeding Act with slight amendments in language. Section [65(2)(b)], in its present form, first appeared in the Land and Income Tax Act 1916 (s.85). If [s.65(2)(b)] had stopped at the words 'all salaries, wages or allowances (whether in cash or otherwise),...in respect of or in relation to the employment or service of the taxpayer', it may possibly have been arguable that the word 'allowances' was wide enough to include all benefits whether in cash or otherwise...

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128. [1968] N.Z.L.R. 574.

129. In Parson the relevant provision was s.88(1)(b) of the Land and Income Tax Act 1954. However, as that provision is identical to s.65(2)(b) of the present Act reference is made to s65(2)(b) in the present context.

130. [1968] N.Z.L.R. 574, 585.

However, as Parliament had added the words "including all sums received or receivable by way of bonus, gratuity, extra salary, or emolument of any kind" North P. considered that "allowances" must be construed narrowly. Applying the principle enunciated in Dilworth v Commissioner of Stamps[131] that the word "include" is generally used in interpretation clauses to enlarge the meaning of words or phrases, the learned Judge concluded that by adding the words after "including" "[Parliament] has recognised that the first mentioned words [i.e. salaries, wages or allowances] in the natural import did not include any of these benefits"[132]. Accordingly, as Parliament had recognised that the expression "salaries, wages or allowances" had a limited meaning North P. was not prepared to give it a wide construction so as to include within its ambit a benefit derived on the exercise of a share option.

Although it is clear from North P's judgment that the word "allowances" must be narrowly construed, it is not clear what forms of non-monetary benefit, if any, his Honour considered that the word encompassed. Some assistance in that regard may be garnered from McCarthy J's judgment. As with North P, McCarthy J based his judgment on an historical analysis:[133]

> In my view the word 'allowances' in its original context in Schedule E to the 1891 Act had a narrow meaning and was intended to apply only to the then commonly recognised forms of allowances, such as a house allowance, and that it was because Parliament recognised the limitations of the word that it found it necessary in 1900 to add 'including all sums received or receivable by way of bonus, extra salary or emolument of any kind'. That was a plain example of extending a meaning. No one, I imagine, would have contended in 1900 that the word had been enlarged sufficiently to include all benefits even those not received in the form of money... Basically, the language has not changed since 1900, and I feel unable in these circumstances now to construe it as covering something which though it probably is an emolument, is not received in a sum of money.

It follows logically from McCarthy J's reasoning that the only non-monetary allowances caught by section 65(2)(b) are those which were regarded as being allowances in 1900 when the words

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131. [1899] A.C. 99. P.C.

132. [1968] N.Z.L.R. 574, 587.

133. Ibid. 589.

succeeding "including" were introduced into the section. This conclusion follows from His Honour's comments that prior to the enactment of the 1900 Act "allowances" applied only to the then recognised forms of allowances; that the limited meaning of "allowances" was recognised by Parliament in 1900 when its meaning was extended to include "sums received or receivable by way of bonus, extra salary, or emolument of any kind"; and that as the language of the section had not significantly changed since 1900 it could not now be construed in a wider sense. Thus "allowances" means things which were regarded as being allowances in 1900 and "sums received or receivable by way of bonus, extra salary or emolument of any kind." If this conclusion is correct then section 65(2)(b) must be regarded as being ineffective as against fringe benefits. It has been suggested that the only non-cash allowances being provided in 1900 were housing and accommodation, board and meals, and travel and work clothing.[134]

By contrast, Haslam J., in a dissenting judgment, concentrated on an analysis of the statutory language of section 65(2)(b) rather than on its historical background. The learned Judge considered that in the context of the phrase "salaries, wages or allowances (whether in cash or otherwise)" the word "allowance" was wide enough "to embrace a rent free house for an employee, or by way only of further example, a special discount on the firm's goods given to staff members by virtue of their employment.[135], and that it was "inherently capable of a general application."[136] As for the effect of the words "including all sums received or receivable by way of bonus, gratuity, extra salary, or emolument of any kind" his Honour held that as the word "allowances" in its natural import already covered such payments their express mention could not be read so as to limit the meaning of "allowances." Rather, such payments were given separate expression "solely for the purposes of clarity and of emphasis".[137] Support for this conclusion may be derived from

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134. Richardson & Congreve, supra n.8, p.19.

135. [1968] N.Z.L.R. 574, 592.

136. Idem.

137. Ibid. 593.

Wakefield Local Board of Health v West Riding and Grimsby Railway Co.[138] where it was held that statutory definitions not adding anything to the ordinary meaning of a particular word should be treated as having been inserted in an abundance of caution, and should not be taken as limiting the meaning of the word defined. If Haslam J is correct, and "allowances" does in its usual sense include the sums referred to expressly in section 65(2)(b), then based on the Wakefield Local Board of Health case the expressly mentioned words could in no way limit the meaning of "allowances". Therefore, "allowances" should be interpreted solely in the context of "salaries, wages or allowances (whether in cash or otherwise)" rather than in the more limited context suggested by North P. and McCarthy J. Read in that context "allowances" is wide enough to include non-cash allowances of any type.

With respect, it is submitted that Haslam J is correct. The sums mentioned in the second part of section 65(2(b) add nothing to the ordinary meaning of "allowances". Therefore, reading "allowances" in the context of "salaries, wages or allowances (whether in cash or otherwise)" it is clearly wide enough to encompass non-monetary allowances or benefits. It must be conceded that the learned Judge gave little weight to the legislative history of section 65(2)(b), in particular to the alterations made in 1900. However, an analysis of that history shows that his Honour was correct in taking that approach. Schedule E of the Land and Income Assessment Act 1891 provided that every person was liable to tax in respect of income derived from employment or emolument. "Income from employment or emolument" was defined as meaning :

> the gains or profits derived or received...from the exercise of any profession, employment or vocation of any kind not otherwise liable to taxation under this Act, or from any salary, wages, allowances, pension, stipend or charge or annuity of any kind...(emphasis added)

Schedule F contained a number of miscellaneous rules relating to assessments. Rule 5 provided :

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138. (1865) L.R. 1 Q.B. 84.

> Allowances made to any person by way of house-rent, and all amounts received or receivable by way of extra salary, bonus allowance, or emolument shall be taken into account as part of the annual income liable to taxation (emphasis added).

It will be seen from the italicised parts of Schedule E and rule 5 of Schedule F that those provisions contained the basic ingredients of section 65(2)(b) as it stands today. In 1900 the 1891 Act was repealed and replaced by the Land and Income Assessment Act 1900. The major feature of the new Act was the replacement of the schedular system and the incorporation of the charging provisions previously contained in schedules into sections contained in the body of the Act. Section 58 of the 1900 Act provided inter alia that tax was to be levied on "income derived from employment or emolument". That expression was defined in section 60(2) as meaning the profits derived from:

> ...any salary, wages, allowances, stipend or pension (other than a pension hereinbefore exempt from tax) including all sums received or receivable by way of bonus, extra salary, or emolument of any kind.

It is apparent from the language of section 60(2) that that provision represents a consolidation of the italicised parts of Schedule E and rule 5 of Schedule F; a consolidation that was rendered necessary by the abolition of the schedular system contained in the 1891 Act. The sums described in the second part of the paragraph were therefore included not, as North P. suggested, because Parliament recognised that "salaries, wages or allowances" did not include those sums,[139] but rather in an excess of caution or, as Haslam J suggests, "for the purpose of clarity and of emphasis."[140] Leaving aside Parliamentary intent, the most plausible explanation is that the draftsman of the 1900 Act was concerned to ensure that the Act he was drafting did not exclude from the charge to tax anything that was taxed under the 1891 Act. To effect that objective, the draftsman simply combined, virtually verbatim, the parts of Schedule E and rule 5 of Schedule F relating to income from employment. Of course, speculation as to the intent of statutory draftsmen is of no assistance in the interpretation of a statutory provision.

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139. Supra n.132.

140. Supra n.137.

However, in relation to section 60(2) of the 1900 Act, such speculation is in any event unnecessary as it is evident from the provision itself that the sums mentioned in the second part of the paragraph were included merely in an abundance of caution.

The history of section 65(2)(b) therefore supports the approach adopted by Haslam J. rather than that adopted by the majority. Support for his Honour's approach may also be derived from the fact that by analysing only the language of section 65(2)(b) effect could be given to the words "(whether in cash or otherwise)" which were inserted in 1916. The approach adopted by the majority, on the other hand, virtually rendered those words meaningless.

For practical purposes, it is of little significance that North P. and McCarthy J. may have incorrectly construed section 65(2)(b). As Haslam J. was in the minority his judgment is of academic interest only.

It follows from Parson that if a particular fringe benefit is not an "allowance" within the limited meaning given to that term it is immaterial whether or not that benefit is convertible into cash. Therefore, the correct approach in determining whether a fringe benefit is deemed to be assessable income by section 65(2)(b) is first, to ascertain whether it is an "allowance" within the terms of the Parson rationale, and secondly, having ascertained that it is an "allowance" to determine whether or not it is convertible into cash. That approach was approved by Wallace J. in Sixton v C.I.R.[141] There, the question falling for determination was whether a prize received by an employee under an incentive scheme in the form of a non-transferable points cheque, and which was subsequently converted into a supertub, was an allowance within the terms of section 65(2(b).
The Commissioner sought to distinguish Parson on its facts, arguing that in that case the benefit was unrelated to the services being performed while in the case of the prize granted

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141. (1982) 5 T.R.N.Z. 844.
142. Ibid. 846.

to Sixton the benefit was so related and accordingly must be regarded as an allowance. However, Wallace J. rejected that argument. His Honour held that Parson was indistinguishable: first, on the grounds that the facts in Parson and Sixton were similar as both related to benefits provided as part of an incentive scheme; and secondly on the grounds that in Parson the Court of Appeal regarded the question before them as one of principle turning upon a correct construction of section 65(2)(b). And as Parson had been decided on the basis of principle, and not merely on the facts of the particular case, Wallace J. felt constrained to apply the reasoning adopted by North P. and McCarthy J. From North P.'s judgment Wallace J. derived the proposition that "a non-monetary perquisite or emolument is not included in the word 'allowances'",[142] and from McCarthy J's judgment that "non-monetary benefits caught by the term 'allowances' are limited to those existing in 1900."[143] Applying those principles the learned judge held that the points cheque was not an allowance within the terms of section 65(2)(b).

On the question of convertibility, Wallace J. accepted the submission made on behalf of the taxpayer that convertibility was irrelevant to any determination of whether the benefit in question was an allowance and that it became relevant only once it had been established that the benefit was an allowance. Having decided that the points cheque was not an allowance his Honour felt it unnecessary to consider whether or not the cheque was convertible into cash.

The combined effect of Stagg, Parson and Sixton is to render section 65(2)(b) ineffective as against fringe benefits. However, it would be possible to by-pass that provision by arguing that fringe benefits are income according to ordinary concepts and as such are chargeable to tax by virtue of section 38.[144] In Duff v C.I.R.[145] the Court of Appeal held unanimously that in determining whether a profit or gain is income the -

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143. Ibid. 847.

144. Section 38 provides that:
(2)... income shall be payable by every person on all income derived by him during the year for which the tax is payable."

145. [1982] 2 N.Z.L.R. 710; supra n.21 and accompanying text.

proper approach is to consider whether it is income according to ordinary principles before having recourse to the extended meanings of income contained in section 65(2). Based on the argument made in Part II C of this paper, it could be argued that fringe benefits are income according to ordinary principles being something provided in money's worth which comes in to the taxpayer. That a particular benefit may not be convertible into cash would be irrelevant as income in its ordinary sense need not necessarily be in cash or in the form of something which is convertible into cash.[146]

Richardson and Congreve recognise that an argument could be made to tax fringe benefits under section 38. However, the learned authors state:[147]

> Whatever the arguments which might have been made along those lines, the present position seems clear, namely, that the taxation of fringe benefits is governed exclusively by [section 65(2)(b)] and by other specific provisions. This for two reasons : first, the Commissioner has always approached the problem, and the Courts have dealt with it on that basis, and, second, in a sense as a result of the practice of the Commissioner and the approach of the Courts, fringe benefits falling outside these specific provisions have not in New Zealand been regarded as income according to ordinary concepts.

With respect, those arguments may readily be disposed of. First, although it may previously have been the practice to determine whether a profit or gain is income solely by reference to the provisions of section 65(2), Duff established quite clearly that the correct approach is to consider whether the profit or gain is income according to ordinary principles before regard is had to section 65(2). And secondly, fringe benefits falling outside

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146. See Part II C under the heading "Employment v non-employment income: is the convertibility principle universal?".

147. Supra n.10 p.13.

section 65(2)(b) have not previously been regarded as income according to ordinary concepts simply because no argument has previously been made before the courts that they are income in the ordinary sense of that word. In the light of Duff and the points made in Part II of this paper as to the nature of income, the failure to raise such an argument is clearly open to reappraisal.

b. Canada, Australia and the United Kingdom.

In Canada, Australia and the United Kingdom the courts have construed general anti-avoidance provisions less strictly than in New Zealand. Section 6(1)(a) of the Canadian Income Tax Act, which includes within "income from office or employment" all "benefits of any kind whatever", fell to be construed in Waffle v. M.N.R.[148] There, the taxpayer, a shareholder-employee in a Ford motor vehicle dealership, was awarded a holiday for two in the Carribean. The Minister assessed the taxpayer in the amount of $1384 - being the cost of the trip to Ford - on the grounds that the cost of the trip fell within the terms of the expression "other benefits of any kind whatever". In the Exchequer Court, Cattanach J. upheld the Minister's assessment. His Honour said :[149]

> The obvious intention of [section 6(1)(a)] is to include in the taxable income of a taxpayer those economic advantages arising from his employment which render the taxpayer's office of greater value to him.

Moreover, the learned judge gave short shrift to the taxpayer's argument that section 6(1)(a) applies only to benefits which are convertible into cash :[150]

> I think that the language employed in [section 6] to the effect that the 'value of board, lodging and other benefits of any kind whatever' is to be included in taxable income, overcomes the principle laid down in Tennant v Smith. Obviously board which has been consumed and lodging which has been enjoyed cannot be converted into money by the taxpayer either subsequently or prior thereto and, in my view, the identical considerations apply to 'other benefits of any kind whatever'.

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148. [1968] C.T.C. 572.

149. Ibid. 577.

150. Ibid. 578.

The broad language in the Canadian provision is therefore sufficient to bring within the charge to tax any benefits conferring an economic advantage on the taxpayer.[151] This has encouraged the Canadian revenue authorities to issue a series of interpretation bulletins outlining the benefits which are regarded as taxable and those which are regarded as non-taxable.[152] The former include : board and lodging, rent-free and low-rent housing, holiday trips and tuition fees; and the latter : subsidised meals where the employees pay a reasonable charge, discounts on merchandise, transportation passes for the employees of bus and rail companies, and airline passes to airline employees where the employee does not pay less than 50 per cent of the economy fare. It will be seen that applying the test enunciated by Cattanch J in Waffle v M.N.R. the items treated as non-taxable by the revenue in the strict sense qualify for tax treatment. However, it is no doubt considered to be administratively too onerous to seek to exact from employees tax on the value of discount purchases or on subsidised meals.

The United Kingdom legislation contains a broadly framed general anti-avoidance provision similar to that in the Canadian legislation. Section 61 of the Finance Act 1976 provides :

> (1)...Where in any year a person is employed in director's or higher paid employment and -
> (a) by reason of his employment there is provided for him, or for others being members of his family or household, any benefit to which this section applies,
> (b) ...
> there is to be treated as emoluments of the employment, and accordingly chargeable to income tax under Schedule E, an amount equal to whatever is the cash equivalent of the benefit.

Section 61(1) therefore operates by including certain benefits within the Schedule E charge to tax. These benefits are listed in section 61(2) as :

> accommodation (other than living accommodation), entertainment, domestic or other services, and other benefits and facilities of whatsoever nature...

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151. The value of employer-financed trips have also been held to be taxable in Ferguson v M.N.R. [1972] C.T.C. 2105; and Philp v M.N.R. [1970] C.T.C. 330.

152. Interpretation Bulletin IT-470 1981 (as amended 22 February 1982); reproduced in H. Stikman (ed.) Canada Tax Service (loose leaf, 8 vol., Richard De Boo. Canada) ch.6, pp.16A-18.

The expression "other benefits and facilities of whatsoever nature" in section 61(2) has not been considered by the courts, however, it appears to be of wide import. Lord Denning, in Wicks & Johnson v Firth,[153] described section 61 as "a comprehensive clause designed to make fringe benefits taxable in the hands of the recipients."[154]

As with the Canadian and United Kingdom provisions, section 26(e)[155] of the Australian Act would appear to be sufficiently wide to encompass fringe benefits. Any benefits not specifically mentioned would constitute benefits "otherwise"[156] allowed, given or granted. However, there is an argument that section 26(e) applies only to benefits in kind which are convertible into cash. This stems from the Federal Court's holding in FCT v Cooke & Sherden that "income" according to ordinary concepts includes only money or that which is convertible into money, and from dicta in Hayes v FCT[157] that section 26(e) only applies to items which are income according to ordinary concepts. In Hayes, Fullagar J said :[158]

> I doubt very much whether s.26(e) has the effect of bringing into charge any receipt which would not be brought into charge in any case...by virtue of the general conception of what constitutes income...The words 'directly or indirectly' are doubtless intended to cast the net very wide but it is clear that there must be a real relation between the receipt and an 'employment' or 'services'...If the receipt in the present case does not fall within the general conception of 'income', it is not, in my opinion, caught by section 26(e).

The learned Judge's comments were made by way of obiter dictum, however support may be derived from Scott v C.of T.[159] where Windeyer J said :[160]

> [Section 26(e)] does not bring within the tax-gatherer's net money or moneys' worth that are not income according to ordinary concepts. Rather it prevents receipts of money or moneys worth that are in reality part of a taxpayer's income from escaping the net.

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153. [1982] 2 All E.R.9 (C.A), [1983] 2 A.C.214 (H.C).
154. Ibid.12.
155. Set out supra Part III.C.2 under the heading "Australia",
156. In National Association of Local Government Officers v Bolton Corporation [1942] 2 All E.R. 425,428 Lord Simon L.C. said that "or otherwise" means simply "or in another way".
157. (1956) 96 C.L.R. 47 (H.C.).
158. Ibid. 54.
159. (1966) 117 C.L.R. 514.
160. Ibid.

Assuming that section 26(e) applies only to receipts that are income according to ordinary concepts, and assuming that in Australia income according to ordinary concepts applies only to money or that which is convertible into money,[161] then it follows that the only non-monetary benefits falling within the terms of section 26(e) are those which are convertible into money. If this analysis is correct then section 26(e) is not an effective anti-avoidance mechanism. At the same time, though, the courts appear willing to find that non-monetary benefits are convertible into cash. Therefore, by comparison with section 65(2)(b) of the New Zealand Act section 26(e) is not impotent in relation to fringe benefits.

From the foregoing discussion of the various general anti-avoidance provisions it may be concluded that statutory formulae such as "other benefits of whatsoever nature", or "benefits of any kind whatever", are successful as against fringe benefits. There is an argument that the Australian provision applies only to convertible benefits, however that argument is yet to be tested and even if proved correct would not render the section totally ineffective. The New Zealand provision must be seen as a special case, its limited effect being attributable to historical factors and judicial attitudesrather than to any inadequacy of the language employed.

3. Common problems associated with general anti-avoidance provisions.

a. Whether the benefit is provided in respect of employment.

Fringe benefits are a phenomenon associated only with employment income. Therefore, the legislation governing their taxation generally makes specific reference to the employment relationship. Thus, section 26(e) of the Australian Income Tax Assessment Act

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161. This assumption is based upon FCT v Cooke & Sherden discussed supra. In discussing that case it was suggested that it was incorrectly decided, based as it was on the Tennant v Smith rationale. Be that as it may, the Federal Court's judgment was not appealed to the High Court and its ratio must be regarded as providing the test to be applied in Australia in determining whether or not an item is income.

1936 brings within the definition of assessable income any benefits provided "in respect of, or for or in relation directly or indirectly to, any employment", and section 6(1)(a) of the Canadian Income Tax Act includes within the definition of income from an office or employment any benefit provided "in respect of,in the course of, or by virtue of an office or employment." The limitations of such formulae were made apparent by the House of Lords judgment in Hochstrasser v Mayes.[162] That case concerned a scheme run by I.C.I. Ltd. whereby transferring employees were reimbursed for losses sustained upon the sale of their houses. The House of Lords held that amounts paid to the taxpayer under the scheme were not taxable under Schedule E[163] on the grounds that the housing scheme was constituted by an agreement separate from the employment contract.
Lord Cohen said :[164]

> [I]t is not enough for the Crown to establish that the employee would not have received the sum on which tax is claimed had he not been an employee. The court must be satisfied that the service agreement was the causa causans and not merely the causa sine qua non of the receipt of the profit.

In Hochstrasser v Mayes reimbursement would not have been made to the taxpayer if it were not for the fact that he was an employee of I.C.I. Ltd. However, the immediate cause of the payment was the collateral agreement rather than the taxpayer's employment. Accordingly, the sums reimbursed fell outside the statutory charge.

The test enunciated in Hochstrasser v Mayes has also found favour in Canada. Faced with a similar factual situation to that obtaining in Hochstrasser v Mayes, Noel J. held in Ransom v M.N.R. that :[165]

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162. [1960] A.C. 376.

163. Schedule E provides that tax is charged upon "[E]very person having or exercising an office or employment of profit...in respect of all salaries, fees, wages, perquisites or profits whatsoever therefrom..."

164. [1960] A.C. 376, 394-395.

165. [1967] C.T.C. 346, 358.

> The question whether a payment arises from an office or employment depends on its causative relationship to an office or employment, whether the services in the employment are the effective cause of the payment. I should add here the question of what was the effective cause of the payment i.e. to be found in the legal source of the payment...

Applying that test so long as the legal source of the benefit was not the contract of employment the benefit would not be taxable to the employee. It would therefore be a simple matter to provide tax free fringe benefits by way of collateral agreements or by setting up a trust in favour of various employees and providing benefits via that trust. Indeed, in Wicks & Johnson v Firth[166] Lord Denning attributes the enactment of section 61 of the Finance Act 1976 - the general fringe benefit anti-avoidance section in the United Kingdom - to the increase in the provision of fringe benefits occasioned by the Hochstrasser v Mayes decision.[167]

The narrowing effect of the Hochstrasser v Mayes rationale could be overcome by adopting wider language. Section 26(e) of the Australian Income Tax Assessment Act 1936, for example, brings within a taxpayer's assessable income benefits which are "allowed, given or granted...in respect of or for or in relation directly or indirectly to, any employment". The effect of that particular part of section 26(e) was considered in F.C.T. V Dixon.[168] There, the High Court held that weekly payments to make up the difference between the rate of civilian pay of an employee who had enlisted in the armed forces, and his defence force pay, was in the nature of income. Although the Court's decision in that regard finalised the matter, Dixon CJ and Williams J also discussed the operation of section 26(e). Their Honours said :[169]

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166. [1982] 2 All E.R.9 (C.A.).
167. Ibid. 12.
168. (1952) 86 C.L.R. 540.
169. Ibid 553-554.

> It is hardly necessary to say that the words 'directly or indirectly' extend the operation of the words 'in relation to'. In spite of their adverbial form they mean that a direct relation or an indirect relation to the employment or services shall suffice. A direct relation may be regarded as one where the employment is the proximate cause of the payment, an indirect relation is one where the employment is a cause less proximate, or, indeed, only one contributory cause.

This analysis removes the distinction made in Hochstrasser v Mayes between situations where the employment agreement is the causa causans of the payment and those where it is only the causa sine qua non. So long as the employment is "one contributory cause" the requirements of section 26(e) are met. At the same time though, their Honours placed one limitation on section 26(e) :[170]

> We are not prepared to give s.26(e) a construction which makes it unnecessary that the allowance, gratuity, compensation, benefit, bonus or premium shall in any sense be a recompense or consequence of the continued or contemporaneous existence of the relation of employer and employee or a reward for services rendered given either during the employment or of or in consequence of its termination.

In other words, the employment must at least be the sine qua non of the benefit if not the causa causans. It is thought, therefore, that benefits provided to shareholder-employees qua shareholder, rather than qua employee, would fall outside the scope of section 26(e).

Circumvention of fringe benefit anti-avoidance legislation by the use of collateral agreements is no longer possible in the United Kingdom. Section 61 of the Finance Act 1976 brings to charge benefits which are provided "by reason of" the taxpayer's employment. By section 72(3) "all such provision as is mentioned in this Chapter which is made for an employee...are deemed to be paid to or made for [the taxpayer]...by reason of his employment." Therefore, the provision of a company car to an employee pursuant to a collateral agreement would be deemed to be provided by reason of that employee's employment. Furthermore, even without the deeming provision in section 72 it is clear from Wicks and Johnson v Firth[171] that the expression "by reason of" -

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170. Idem.

171. [1982] 2 All E.R.9.

is of wide effect. There I.C.I. Ltd established an educational trust for the benefit of children of their higher paid employees. I.C.I. made payments into the trust fund from which the trustees were empowered to award scholarships to deserving children. The Crown claimed that the students' parents were taxable under section 61 on the amounts received by the students. The Court of Appeal agreed.[172] Lord Denning considered that the expression "by reason of his employment" was designed to close the gap left by Hochstrasser v Mayes. His Lordship said:[173]

> The words cover cases where the fact of the employment is the causa sine qua non of the fringe benefits, that is where the employee would not have received fringe benefits unless he had been an employee. The fact of employment must be one of the causes of the benefit being provided, but it need not be the sole cause, or even the dominant cause. It is sufficient if the employment was an operative cause, in the sense that it was a condition of the benefit being granted.

The conclusion reached by Lord Denning as to the meaning of "by reason of" is by and large the same as that reached by Dixon C.J. and Williams J in FCT v Dixon as to the effect of the relevant wording in section 26(e) of the Australian Act. However, any of the shortcomings in the Australian legislation are overcome in the United Kingdom legislation by the deeming provision in section 72(3).

b. Third parties

Fringe benefits are usually provided as part of an employee's salary package. The employee receives these benefits in addition to monetary compensation. It is therefore a common feature of fringe benefit anti-avoidance legislation that only benefits

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172. The taxpayer in Wicks & Johnson argued that the payments were exempt tax by s.375(1) of the Income Tax Act 1970 which exempted "income arising from a scholarship". In the Court of Appeal Lord Denning agreed, holding that s.375 totally exempted scholarship income both to the recipient of the scholarship and to anyone else. Oliver and Watins L.JJ disagreed, holding that s.375 was limited to the recipient of the scholarship. In the House of Lords Lord Denning's interpretation of s.375 prevailed (reported [1983] 2 A.C. 214). However, as that judgment did not turn on s.61(1) it is not considered in this paper.

173. [1982] 2 All E.R. 9,17.

provided to "the employee" are taxed. Accordingly, benefits provided to the employee's spouse, or to some other member of the employee's family, escape the tax net. Both the Australian and the Canadian legislation demonstrate this point.

Section 26(e) of the Australian Income Tax Assessment Act 1936 includes within assessable income certain benefits which are granted to "the" taxpayer. Thus, in a 1945 Board of Review[174] case it was held that a gift of land to the taxpayer's wife did not constitute a benefit which had been granted to "the" taxpayer. On the other hand, more recently the Board held that payment of school fees by an employer was a benefit to the employee within the terms of section 26(e).[175] The Board reasoned that the taxpayer had been relieved of the burden of paying the fees so pro tanto he had received a taxable benefit. Neither case provides compelling authority as to whether benefits provided to third parties fall within the terms of section 26(e). Of more assistance are comments made by the Asprey Committee in its report on the Australian tax system.[176]

The report states:[177]

> ...it is doubtful whether the law is adequate to cover the case where the benefit is given, not to the employee, but to a member of his family
> ....
> In the Committee's view it is...necessary, in order that all situations be clearly covered, to provided generally in section 26(e) that a benefit arising from the employment relationship enjoyed by a member of the employee's family be deemed to be a benefit derived by the employee.

The Committee's recommendations were never acted on. Therefore, as stated in the first extract cited above, it is doubtful that section 26(e) covers fringe benefits granted to third parties.

An even stronger argument exists in relation to the Canadian legislation for suggesting that it does not cover benefits

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174. Case 16 12 C.T.B.R.(O.S) 309 (1945).

175. Case 61 C.T.B.R. (N.S) 537 (1979).

176. Taxation Review Committee, Full Report, Parliamentary Paper No.136, 1975.

177. Ibid. paras 9.4, 9.7.

granted to third parties. Section 6(1)(a) of the Canadian Income Tax Act includes within the taxpayer's income benefits "received or enjoyed" by "him". By contrast, section 6(1)(e), which establishes the basis of the charge for employer-provided motor vehicles, includes within the charge vehicles provided to the taxpayer "or to a person related to him". It is suggested that apart from the fact that the language of section 6(1)(a) does not appear to cover third party benefits, the specific inclusion within section 6(1)(e) of motor vehicles provided for relatives, and the absence of any specific provision in section 6(1)(a) to the same effect, leads to the conclusion that section 6(1)(a) does not cover benefits given to third parties.

As would be expected, the Legislature in the United Kingdom has moved to pre-empt any attempt to circumvent the anti-avoidance legislation by providing benefits to third parties. Section 61(1) of the Finance Act 1976 brings to charge not only benefits provided to the taxpayer, but also those provided "for others being members of his family or household." Then, section 72(4) provides that "References to members of a person's family or household are to his spouse, his sons and daughters and their spouses, his parents and his servants, dependents and guests." Of course, the United Kingdom legislation may be too specific. By including certain specified persons others are automatically excluded. Therefore, although a taxpayer's spouse is included within the definition, his mistress is not. Nor, for that matter, are his brothers and sisters. Perhaps section 6(1)(e) of the Canadian Act, which merely refers to persons "related" to the taxpayer, provides a more effective formula for dealing with benefits provided for third parties.

c. Valuation.

As has already been indicated there are essentially three bases on which fringe benefits may be valued: cost to the employer, market value, and valuer to the taxpayer. One base may be appropriate for one type of benefit but not for another. Thus, although market value may be an appropriate base upon which to value a motor car benefit, value to the taxpayer may be more

appropriate for employer-provided accommodation. Therefore, where statutory provision is made for specific benefits, it is not uncommon for different methods of valuation to be adopted for different benefits. In the case of general anti-avoidance provisions, however, that approach is not possible. Accordingly, such provisions generally state that tax is to be levied on the "value" of the benefit without specifying how the benefit is to be valued. Section 6(1)(a) of the Canadian Act is couched in such general terms, providing only that "the value" of the benefit is to be included within the taxpayer's income. In Waffle v M.N.R.,[178] where the taxpayer was provided with an overseas trip, it was held that the taxpayer was assessable on the cost of the trip to the employer. Cattanach J said:[179]

> I can see no grounds for holding that the amount should be limited to an assessment of an amount which the appellant might have spent on the trip himself if [the employer] had not borne that cost.

Subjective factors were therefore ignored in arriving at the value of the trip.

In the interpretation bulletins published by the Canadian revenue authorities it appears that the basis of valuation varies from be benefit to benefit.[180] Lodging, rent free and low rent housing, holiday trips and the use of an employer's aircraft are valued according to market value. On the other hand, subsidised meals, tuition fees and the provision of financial counselling services are valued according to cost to the employer. It will be seen that the interpretation bulletins do not refer to value to the taxpayer as being an applicable basis of valuation.

There is an argument that where the statute merely provides that the "value" of a benefit is taxable, then the proper basis of valuation is value to the taxpayer rather than cost to the employer or market value. That argument will be outlined when section 72 of the New Zealand Act is discussed later in the paper.

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178. [1968] C.T.C. 572; supra n.148 and accompanying text.
179. Ibid.578.
180. Supra n.152.

In Australia section 26(e) is more specific as to the basis upon which benefits are to be valued. That section provides that "the value to the taxpayer" of benefits granted is to be included within assessable income. Subjective factors, such as onerous conditions attached to the use of the employer's property, are therefore relevant in determining the value of the benefit for tax purposes. However, in cases where value is difficult to ascertain it appears acceptable to determine value according to objective criteria. In Donaldson v F.C.T.[181] Bowen C.J., in considering the valuation of a share option, said :[182]

> [I]t is appropriate in ascertaining value to the taxpayer to determine what a prudent person in his position would be willing to give for the rights rather than fail to obtain them.

Be that as it may, it is unlikely that Bowen C.J's test is of general application to benefits caught by section 26(e). What the prudent person is willing to pay for a particular benefit would not generally be representative of value to the taxpayer.

In the United Kingdom the Finance Act 1976 provides a more specific method of valuing fringe benefits. Section 61(1) provides that benefits are chargeable "[in] an amount equal to whatever is the cash equivalent of the benefit". By section 63(1) the "cash equivalent" is "an amount equal to the cost of the benefit, less so much (if any) of it as is made good by the employee to those providing the benefit." Primarily, cost to the employer is therefore the basis of valuation. Thus, if there is no cost to the employer, as with the provision of low interest loans, there is no "cash equivalent" under section 63(1), upon which tax can be levied.[183]

In the case of benefits provided by way of the transfer of second-hand assets, section 63(3) provides that the cost of the benefit, and hence the cash equivalent under section 63(1) is deemed to be "the market value of the asset at the time of

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181. (1974) 4 A.T.R. 530.

182. Ibid. 546.

183. As "the cash equivalent" of low interest loans could not be calculated under s.63(c) specific provision has been made in s.66. Section 66 provides that the "cash equivalent" of a low interest loan is equal to the amount of interest on the loan at the official rate (which is fixed by Order in Council) less any amount paid on the loan for the year.

transfer." Specific provision is also made for determining the "cost" of benefits which consist of the placing of an asset at the taxpayer's disposal. By section 63(4) the cost of such benefits is deemed to be "the annual value of the use of the asset" plus any expense incurred in providing the benefit. The means by which the "annual value" is determined is set out in section 63(5). Basically, the annual value of benefits consisting of the use of land is calculated according to the market rental of that land, while the annual value of benefits consisting of the use of some other asset is twenty per cent of the market value of the asset.

Shortly stated, the value of fringe benefits rendered taxable by section 61(1) is primarily cost to the employer with provision for market value to be the relevant yardstick in certain situations. No provision is made for subjective factors, such as limitations on the use of the asset provided as a benefit, to be taken into account. Therefore, if the benefit consisted of the provision of a personal computer, for example, but the employee was required to use the computer for employment related purposes, then the "cash equivalent" would still be calculated at twenty per cent of the market value of the computer[184] irrespective of the onerous conditions attached to its use. No doubt from the Revenue's point of view a scheme whereby subjective factors are ignored for the purposes of valuation is easier to administer. Nevertheless, such an arbitrary method of valuation could be unfair between taxpayers. Taking the above example of the computer provided for home use, if two employees were provided with such computers and only one was required to use the computer for employment purposes, each employee would still be taxed on the same amount: that is twenty percent of market value. A more equitable system would tax the employee having unrestricted use of the computer at a higher rate than the employee having to use the computer for employment purposes.

Although the United Kingdom legislation addresses the problem of valuing fringe benefits, it does not deal satisfactoirly with benefits provided in the form of services. The provision of free or low cost legal or accounting services, for example, would

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184. By virtue of ss.63(4) and 63(5) of the Finance Act 1976.

fall within the terms of section 61(1) as being "other benefits...of whatsoever nature." However, by section 61(3) - the alternative methods of valuation not being relevant for the purposes of valuing benefits provided in the form of services - the "cash equivalent" of the benefit so received is the cost of providing the services. In many cases it would be inpractical to value the provision of services in that manner. Take for example a large finance company with in-house investment analysts whose advice was provided free of charge to certain employees. The cost of providing the service could perhaps be determined according to the salary paid to the analyst and the time spent in giving the advice. But the cost would also include such factors as secretarial services and even mere indirect costs such as heating, lighting and air conditioning. Then there are questions of what types of advice confer taxable benefits. Would tips given over morning tea confer a benefit? Or would only more formal consultations qualify?

Similar problems would be encountered with other services. Suppose, for example, that in the same finance company the tax returns of certain employees were prepared free of charge by in-house accountants and that it was possible to determine the cost of the services so provided by reference to the salaries paid to the accountants. It would follow that if the return of one employee was prepared by an accountant earning £10,000 per annum while that of another was prepared by an accountant earning £12,000 per annum, then the former employee would be taxed less merely because his return was prepared by someone earning less.

In practice it is unlikely that benefits provided in the form of professional services are taxed.[185] In most cases the difficulty of calculating the cost of such benefits would be insuperable.

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185. Simons Taxes (London, Butterworths, 1983) makes no mention of professional services in discussing fringe benefits.

E. Taxation of Fringe Benfits in the United States.

1. Background.

As was discussed in Part II D of this paper, the concept of "gross income" contained in section 61(a) of the Inland Revenue Code 1954 is wide enough to encompass fringe benefits. It follows that in the United States there has been no need for anti-avoidance legislation aimed at fringe benefits. Strictly speaking, then, the taxation of such benefits in the United States should not be considered in the part of the paper dealing with fringe benefit anti-avoidance measures. However, the tax treatment of fringe benefits in the United States represents such a complete contrast to that in other jurisdictions that such a consideration is warranted at this stage.

It has already been seen that taking as a starting point the proposition that fringe benefits are not taxable as income, the various Commonwealth jurisdictions have adopted legislative measures to ensure that those benefits are taxable. By comparison, in the United States the starting point is the proposition that fringe benefits are taxable and due both to legislative action and to administrative practice the move has been in the opposite direction towards their non-taxability. Therefore, commencing at polar opposites the fringe benefit tax regimes of the United States and the Commonwealth jurisdiction have moved towards each other's original starting points. The moves in the Commonwealth jurisdiction towards a fully taxable situation have already been discussed. In this section of the paper the moves in the United States in the opposite direction will briefly be considered. That consideration will look first at administrative practice and secondly at legislative action.

2. Administrative practice.

By and large it has been the admninistrative practice of the Commissioner of Inland Revenue to treat fringe benefits as non-taxable. Bittker[186] traces the Commissioner's treatment of

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186. Supra n.94.

fringe benefits back to Internal Revenue Service rulings of 1920 and 1921 that supper money paid to employees working overtime, and that travel passes issued to railway employees and their families, did not generate taxable income. The learned author states:[188]

> This relaxed administrative approach to fringe benefits has never been embodied in either an official statement of the applicable rules or a catalog of excludible items. There are, in fact, only a few isolated rulings and litigated cases exempting fringe benefits from taxation, and they can be matched in number by cases holding that a few other benefits are taxable.

In view of the broad concept of income in the United States it is difficult to see why the Commissioner has treated fringe benefits as being non-taxable. One writer suggests that the admninistrative practice is due in some cases to perceived difficulties in valuation and in others to social policy.[189] In the latter category is employer provided insurance. However, while it may be conceded that one of the major difficulties in taxing fringe benefits lies in valuation and that certain benefits
do perform a socially desirable function, those reasons do not provide a compelling explanation for the practice. Perhaps the better explanation is that the administrative practice became established when fringe benefits were uncommon, so that when under the stimulus of high taxation their incidence increased it became difficult to reverse the practice without some form of legislative or regulatory action. Support for this hypothesis is derived from the fact that in 1975 the United States Treasury issued draft regulations governing the tax status of fringe benefits.[190] Although the regulations were never passed and Congress placed a moratorium on the promulgation of any further regulations, the fact that the Treasury sought to alter the tax status of fringe benefits by regulatory action indicates that the administrative practice is too firmly entrenched to be reversed merely by way of a change of policy. This serves to illustrate the large part the administrators of any tax system play in determining taxpayers' liability to tax. In large part, and this applies not only to the United States, tax liability depends not only on statutory rules but also to a complex of conventions, practices, procedures and rules of thumb.[191]

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190. Biffher, supra n,96, p ch 14, p4.

191. For a paper to this effect in relation to the New Zealand tax system see R.C.Congreve "Tax Administration and Practice" (1983) 13 V.U.W.L.R.94.

3. Statutory provisions

Congress has made specific provision for the exemption from tax of certain benefits. In view of the administrative treatment of fringe benefits it may well be thought that such exclusiory provision is superflous. Be that as it may, Congress has seen fit specifically to exempt employer-provided meals and accommodation.[191] group term life insurance up to $50,000 of insurance,[192] group legal services,[193] and education assistance programmes.[194] However, each exemption is subject to conditions. By section 120 of the Code, for example, amounts contributed by employers to qualified group legal services plans for employees or their families are excludable from the employees' gross income. But, in order to qualify, there must be a written plan, and the plan must be non-discriminatory as amongst the employees and shareholders of the company. If these conditions are not met, the amounts paid into the plan are taxable to the employee beneficiaries. Therefore, the curious situation can arise whereby statutory provisions enacted to exempt fringe benefits from tax can operate to render those benefits taxable. For if it were not for the statutory exclusion all of the benefits, and not only those meeting the relevant criteria, would have been treated as non-taxable by virtue of the Commisisoner's administrative practice.

4. Conclusion.

In effect, the tax treatment of fringe benefits in the United States is similar to that in New Zealand. By and large fringe benefits remain tax free in the hands of the taxpayers of both countries. The reasons for this generous tax treatment differ: in the United States administrative practice is the major factor; while in New Zealand the history and terms of the legislation are the cause. However, in both countries the reasons for the continued tax-free status of fringe benefits are similar. In

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191. Inland Revenue Code 1954, s.119.

192. Ibid. s.79.

193. Ibid. s.120.

194. Ibid. s.127.

the United States, although the Treasury formulated draft regulations for the taxation of fringe benefits those were rejected by Congress. Bittker records that the draft regulations attracted criticism as being either too lenient or too severe.[195] Political considerations therefore governed the withdrawal of the regulations and the subsequent moratorium placed on further regulations by Congress. In New Zealand the case for the taxation of fringe benefits was argued strongly by the Task Force on Tax Reform in 1982.[196] Although many of the Task Force's recommendations in relation to tax avoidance were acted on in the Income Tax Amendment Act (No.2) 1982, those in relation to fringe benefits were ignored. As in the United States, political considerations appear to have weighed heavily in the decision. Economic concepts of income demonstrate that in logic there are no grounds for excluding fringe benefits from the tax base, and overseas experience indicates that although there may be admninistrative difficulties in taxing fringe benefits those difficulties are not insuperable. Clearly, then, extraneous considerations, such as the reaction of the electorate, appear to have influenced the Government's decision.

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195. Supra n.96 ch.14, p.4.

196. Report of the Task Force on Tax Reform (Government Printer, 1982) pp.152-165.

PART IV SPECIFIC FRINGE BENEFITS

IV. SPECIFIC FRINGE BENEFITS

A. Background.

Fringe benefits are provided in a myriad of shapes and forms. While it is not possible within the confines of this paper to compare the relative tax treatment of a large number of fringe benefits, a study of the taxation of several of the more common forms is warranted. To that end, consideration is given in this part of the paper to the taxation of employer-provided motor vehicles and employer-provided accommodation.

B. Motor Vehciles

1. Introduction

Of all fringe benfits the provision of a car for an employee's use is perhaps the most common. In large part that phenomenon is due to the fact that where such provision is made benefits accrue both to the employer and the employee. The employer is able to claim a deduction for depreciation and for repairs and maintenance, while the employee receives a valuable benefit which he would otherwise have to pay for himself. Because of those advantages there is a strong incentive for any employer providing fringe benefits to include a car within the package. However, the high profile nature of car benefits means that where legislative action is taken against fringe benefits specific provision is generally made for their taxation. In discussing the taxation of motor car fringe benefits reference will briefly be made to their tax treatment in Australia and New Zealand. Then the recommendations of the New Zealand Task Force on Tax Reform in relation to motor car benefits will be considered. As the Task Force's recommendations appear to be based on Canadian and British legislation that consideration will necessarily entail a discussion of the Canadian and British statutory provisions.

2. Tax status of car benefits in Australia and New Zealand.

It has been seen that the general tax -free status of fringe benefits in New Zealand is attributable to the courts' restrictive construction of section 65(2)(b) of the Income Tax

Act 1976. Because of that construction, the Commissioner does not presently assess taxpayers on the value of car benefits. It may be argued that car benefits are income according to ordinary concepts and as such are taxable independently of section 65(2)(b).[197] Howver, the Commissioner has not adopted that argument and so any moves to tax car benefits would require legislative amendment.

In 1982 the Task Force on Tax Reform recommended that legislation should be enacted to render car benefits taxable.[198] Such a move, it was considered, would generate an annual revenue yield in the vicinity of $150 million. To date that recommendation has not been implemented. However, recent statements made by the Under Secretary for Finance, the Hon. Mr de Cleene, indicate that moves may be made in the near future to ensure that car benefits are brought within the tax net.[199] Any such moves would most likely be based upon the Task Force's recommendations so further consideration will be given to those recommendations below.

In Australia car benefits are prima facie taxable by virtue of section 26(e). However, that section provides no practical method by which car benefits could be valued. Provision is merely made for the "value to the taxpayer" of the benefit to be included within assessable income. Therefore, a host of subjective factors such as restrictions on use and the reliability of the car must be taken into account.

In view of the prevalence of car benefits in Australia[200] the

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197. Supra n.144 and accompanying text.

198. Supra n.196 para 6.A.1.

199. E.g. in The Dominion, Wellington, New Zealand, 17 August 1974, p1 it was stated:

> The company car - unless it is necessary for business - may be chopped as a tax avoidance perk. And the taxman will also be eyeing other tax avoidance perks such as the company boat and blatantly low interest mortgages, the new Under-Secretary for Finance, Mr Trevor de Cleene, said yesterday.

200. E.g. a survey of 17 August 1984 issue of the Australian Financial Review revealed twelve situations vacant advertisements referring specifically to cars being provided and numerous others referring to "salary packages" which in many cases would have included cars.

case by case approach to valuation contemplated by section 26(e) would clearly be impractical. That difficulty was recognised by the Australian government and in 1974 comprehensive legislation governing the valuation of car benefits was enacted.[201] Basically, provision was made for the "stand-by value" of a car made available for the taxpayer's private use to be included within his assessable income. The "stand-by value" was to be calculated on a percentage of the purchase price of the car. That provision was shortlived, however, and before coming into operation was repealed in 1975.

The current tax status of motor car benefits in Australia is summed up in the following statement of the Federal Commissioner of Taxation :[202]

> It is important to keep in mind that it is the value to the employee of the benefit which is subjected to tax. No liability arises if an employee is simply provided with a car to use in carrying out his official duties and even where an employee also uses the car for private purposes the Commissioner would not expect any amount to be included in the employee's income tax return if this private use was only occasional and relatively insignificant...[However] where a taxpayer does gain a substantial benefit from the provision of a car by his employer, he should make a reasonable estimate of the value to him of that benefit and include that value in his return. If in doubt he can set out the facts in his return and leave it to the assessor to make a determination.

Therefore, whether the value of the use of a car is included within a taxpayer's income appears to be a matter left largely to the taxpayer's discretion. It is unlikely that any but the most diligent taxpayer would include the value of the use of a car in his annual return. And it is even less likely that a taxpayer would file a return setting out the facts of his use of an employer-provided car so as to enable an assessor to make a determination. It follows that for practical purposes it is a simple matter to avoid the operation of section 26(e) in relation to car benefits.

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201. Act.No. 126, 1974, which inserted s.26 AAB into the Income Tax Assessment Act 1936.

202. Reported in Commerce Clearing House. Australian Federal Tax Reporter para 13-695.

3. The Task Force's recommendations.

The Task Force were concerned primarily with setting out various options as to how car benefits could be valued for tax purposes. Three options were suggested without any preference being expressed.

The first option suggested by the Task Force was to calculate the taxable value by applying a fixed percentage rate to the cost of the car. Table 2 indicates current[203] operating costs of cars of all sizes.

Table 2 : Operating costs of cars at 16,000 kilometers per annum.

Vehicle size[204]	Annual Operating Costs [205]	Approximate Vehicle Cost[206]	Percentage of cost of vehicle per month
Small	$4348	$12,537	2.9
Medium	5576	17,371	2.7
Large	7254	26,274	2.3

Based upon Table 2 the taxable value of a small car would be 2.9 per cent per month of the cost of that car. The annual value would therefore be calculated as follows :-

$$(\$12,537 \times \frac{2.9}{100}) \times 12 = \$4,368.$$

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203. Table 2 was compiled from information contained in New Zealand Motor World August 1984. The figures represent the cost of purchasing and operating a car prior to the devaluation and the price increase in petrol announced in July 1984.

204. Vehicle size: "Small" - Mazda 323 hatchback; Honda Civic LX; Toyota Starlet D.X 3-door
"medium" - Ford Telstar 1.6.L; Honda Accord LX 4 door; Toyota Corona G.L.
"large" - Ford Falcon 4.1 G.L; Holden Commodore Berlina

205. New Zealand Motor World August, 1984. p.4.

206. Approximate costs were calculated by taking the average cost of the cars listed in n.204. The cost of these cars may be found in New Zealand Motor World August 1984 p.93-94.

However, the Task Force recommended that the rate to be applied should be fixed at the low level of two per cent per month. It was considered that that lower figure took into account the fact that the operating costs of the car could in many cases be met by the employee; that the car could be superior to that which the employee would have purchased for his own use; and that there could be restrictions placed on the private use of the car. Using the Task Force's recommended two per cent rate the annual taxable value of a small car would be calculated as follows :-

$$(\$12,537 \times \tfrac{2}{100}) \times 12 = \$3,000$$

The Task Force's first option is similar to the basis of valuation adopted by Canada. By section 6(1)(e) of the Canadian Income Tax Act employer provided motor vehicles are taxable to the employee in the amount by which "a reasonable standby charge" exceeds any amounts paid by the employee for the use of the vehicle. By section 6(2) the "reasonable standby charge" is calculated basically at two per cent per month of the cost of the car. The actual charge is calculated according to the number of days in the year during which the automobile is actually made available to the employee divided by 30 and rounded to the nearest whole number. That formula may be represented as follows: :

$$(2\% \text{ of cost}) \times \frac{\text{days car made available}}{30} = \text{reasonable standby charge.}$$

Supposing, for example, that a car cost $12,000 and was made available for the employee's private use for 150 days in the income year. In that situation the "reasonable standby charge" would be calculated as follows :

$$(2\% \times \$12,000) \times \frac{150}{30}$$

$$= \$240 \times 5 = \$1,200 \text{ reasonable standby charge}$$

By section 6(2)(k) the standby charge may be reduced if the employee establishes that actual use of the vehicle for private purposes is less than 1000 kilometres per month. In that case,

the standby charge is reduced according to the number of kilometres for which the car is actually used. The formula thus altered may be represented as follows :-

$$(2\% \text{ of cost}) \times \frac{\text{days car made available}}{30} \times \frac{\text{kilometres used}}{\text{number of months available} \times 1000}$$

$$= \text{reasonable standby charge}$$

Using the above example, where the car was available for five months, the following result obtains where the car was only used for 3000 kilometres:

$$(2\% \times \$12{,}000) \times \frac{150}{30} \times \frac{3000}{5 \times 1000}$$

$$= \$240 \times 5 \times \frac{3}{5}$$

= $720 reasonable standby charge

Provision is also made for the calculation of a standby charge where the employer leases the motor vehicle. The basic charge for a leased car is two thirds of the rental cost of the car for the period it is made available to the employee. If, for example, the rental cost of a car was $150 per month and it was made available for five months then the standby charge would be calculated as follows :

$$(\$150 \times 5) \times \frac{2}{3} = \$500$$

Two features of the Canadian scheme are noteworthy. First, there is provision to reduce the standby value of the car benefit where the car is used for private purposes for less than 1000 kilometres per month. That concession places an onus on any employee seeking to lower the standby charge to keep a record of the distance he has travelled in the car and of the proportion of that distance which has a private element. From the taxpayer's point of view the concession has the advantage of allowing use of

the car to be taken into consideration in calculating the amount upon which tax is to be levied; and from the revenue's point of view it has the advantage of being relatively simple to administer as the onus is placed on the taxpayer to establish the extent to which the car is used for private purposes.

The second noteworthy feature of the Canadian scheme is that the standby charge is a function of the cost of the vehicle rather than of its depreciated (book) value. It could perhaps be argued that that basis of valuation would be unfair to the taxpayer after the car had been used for several years its value for tax purposes would be based upon an artificially high cost. Indeed, such arguments appear to have persuaded the Task Force into recommending as a second option that the charge be based upon the book value of the car. In practice, however, to base the charge upon book value would prove overly generous to the taxpayer. The Commissioner allows depreciation on motor cars on a twenty per cent dimishing value basis.[207] Invariably an allowance for depreciation at that rate will be higher than an allowance calculated upon the actual depreciation suffered by the car. Table 3, constructed from information contained in the August 1984 issue of New Zealand Motor World[208] and from the Inland Revenue Department's information pamphlet on depreciation allowances, provides evidence to that effect.

Table 3: Actual depreciation of motor cars compared with depreciation at the Commissioner's rates.[209]

Vehicle Size	Average Cost	Actual Depreciation	Depreciation at the Commissioner's rate of 20% D.V.
Small	$12,537	$1,440	$2,507
Medium	17,371	2,160	3,474
Large	26,274	3,056	5,254

207. Inland Revenue Department Information Pamphlet "Depreciation Allowances" April, 1984.
208. Supra. n.206.

It will be seen from Table 3 that for cars of all sizes actual depreciation is considerably less than the depreciation allowed by the Commissioner. Therefore, if the charge was to be calculated on the book value then after the car had been used for several years the charge would be based upon an artificially low cost rather than an artificially high cost. It follows that the Task Force's second option would not provide a practical method of valuing car benefits.

The Task Force's third option was to fix a specific value which varies according to the size of the car. The specific value selected by the Task Force was 2 per cent of the approximate vehicle cost. Table 4 contains the values which would apply under that formula in 1981 and 1984 terms.

Table 4. Value of car benefit calculated according to car size.[210]

Size of car	Approximate value to be assessed for each month of availability	
	1981	1984
Small (up to 1350 c.c.)	188	250
Medium (1350 to 2000 c.c.)	248	347
Large (over 2000 c.c.)	410	525

It will be seen that the Task Forces' first and third options are in effect similar. The annual value of a small car applying Table 4 would be $3,000, as it would be for an average car under the Table 2 rates. The difference between the two options is that in the first the calculation is made by applying the 2 per cent rate to the cost of the actual vehicle while in the third it is made by applying that rate to the average cost of vehicles of the same size.

209. Vehicle size and average cost are calculated on the same basis as in Table 2 supra. Actual depreciation was calculated from a table contained in New Zealand Motor World (supra n.205) p.4.

210. 1981 figures were taken from the Task Force's report (supra n.196) p.159; 1984 figures were calculated as 2 per cent of the approximate vehicle costs contained in Tables 2 and 3 supra.

It will also be seen from Table 4 that if the value of car benefits is to be calculated as a percentage of the cost of the car then the table rates would have to be amended regularly. In inflationary times it would be necessary to amend the table rates annually if they were to bear any relationship to the current costs of vehicles.

The Task Force expressed no preference as to which basis of valuation should be adopted. The second option - whereby value is calculated upon book value - has been discounted as being impractical. The first option would more accurately represent the value of the benefit received by the employee if that benefit is to be determined according to the cost of the car. However, the third option would be easier to administer as it would merely involve ascertaining the size of a particular car and then applying the table rates. Neither option takes into account the age of the car, and, although the Task Force indicated that the percentage rate was fixed at two per cent in recognition of the fact that many taxpayers would travel less than 16,000 kilometres, neither option effectively takes into consideration the distance travelled by the taxpayer. A basis of valuation which took such factors into account would appear to be fairer.

The United Kingdom legislation demonstrates that it is possible to value car benefits on the basis of a tabular charge and take subjective factors, such as the age of the car, into account at the same time. By section 64(1) of the Finance Act 1976 directors and higher paid employees are taxable on cars provided by reason of their employment and which are available for private use. Tax is levied on the "cash equivalent" of the benefit of the car which is calculated according to scale charges set out in Schedule 7 of the Act. The scale charges are updated annually by Order in Council, the latest being set out in Table 5.[211]

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211. As amended by the Income Tax (Cash Equivalents of Car Benefits Order) 1983 s.1. 1983/1102.

Table 5.: Tabular charges in the United Kingdom.

TABLE A
CARS WITH ORIGINAL MARKET VALUE UP TO £16,000 AND HAVING A CYLINDER CAPACITY

Cylinder capacity of car in cubic centimetres	Age of car at end of relevant year of assessment	
	Under 4 years	4 years or more
1,300 or less	£375	£250
More than 1,300 but not more than 1,800	480	320
More than 1,800	750	500

TABLE B
CARS WITH ORIGINAL MARKET VALUE UP TO £16,000 AND NOT HAVING A CYLINDER CAPACITY

Original market value of car	Age of car at end of relevant year of assessment	
	Under 4 years	4 years or more
Less than £4,950	£375	£250
£4,950 or more, but less than £7,000	480	320
£7,000 or more, but not more than £16,000	750	500

TABLE C
CARS WITH ORIGINAL MARKET VALUE MORE THAN £16,000

Original market value of car	Age of car at end of relevant year of assessment	
	Under 4 years	4 years or more
More than £16,000 but not more than £24,000	£1,100	£740
More than £24,000	1,725	1,150

It will be seen that the "cash equivalent" is based either upon the cylinder capacity of the car or upon its "original market value". Unlike Canada, some concession is made for the age of

the car in that different rates apply depending on whether the car is over or under five years old. Concession is also made for the distance travelled in Part 1 of Schedule 7 of the Act which sets out the rates at which the table charges are to be applied. Table 6 contains these rates.

Table 6. Rates of charge in the United Kingdom.

Business travel (miles)	Table Amount
More than 18,000	½ Table
2500 - 18,000	Full Table
less than 2500	Table + ½

The operation of the United Kingdom legislation is best illustrated by an example. Suppose that in the 1984 income year a company makes available to one of its employees a 1981 Ford Cortina with a cylinder capacity of 2500 cubic centimetres and an original market value of £8,500. As the original market value is below £16,000, and the car has a cubic capacity, the scale charge is calculated under Table A. And as the cubic capacity is more than 1800 and the car is less than four years old the relevant charge is £750. Suppose, however, that the car is not used for any business purposes whatsoever. In that case, by virtue of Part 1 of Schedule 7 the charge to tax comprises one and a half times the table rate or in the example given £750 x 1.5 = £1,125.

C. Accommodation.

1. Introduction

The provision of accommodation by an employer is a convenient and practical means of compensating employees. For that reason, all of the countries surveyed have enacted legislation governing the provision of benefits by way of free or low rental housing. As with motor car benefits, identifying the existence of a benefit is not difficult. The major problem lies in valuation.

Accommodation is not always provided solely for the benefit of the employee. Thus, accomodation for a ship's crew, for example,

may properly be regarded as a condition of employment rather than a fringe benefit. Similarly, the provision of luxurious accommodfation for an executive with the proviso that it be used to entertain company clients will not be of the same worth to the employee as the provision of accommodation with no strings attached. In order to overcome such difficulties, Australia and the United Kingdom have adopted statutory rules by which the value of an accommodation benefit is more easily able to be determined. On the other hand, in New Zealand and Canada, there are no such rules and tax is levied on the "value" of the benefit. Problems may therefore arise in determining to what extent, if any, subjective factors are to be taken into account in determining value. Then, in the United States, the provision governing accommodation benefits is exclusionary: excluding accommodation benefits from the tax net so long as certain criteria are met.

2. New Zealand

In New Zealand the taxation of accommodation benefits is governed by section 72 of the Income Tax Act 1976. That section provides:

> Without limiting the meaning of the term 'allowances' as used in section 65(2)(b) of this Act, the said term shall be deemed to include (in the case of a taxpayer who in any income year has been provided in respect of any office or position held by him with board or lodging, or the use of a house or quarters, or has been paid an allowance instead of being so provided with board or lodging or with the use of a house or quarters) the value of those benefits; and the value of the benefits shall be determined in case of dispute by the Commissioner.

Although section 72 clearly identifies the benefits which are deemed to be allowances within the terms of section 65(2)(b), it is of little assistance in calculating the value of the benefit. By merely stating that "the value of those benefits" is an allowance section 72 does not indicate whether "value" in that context is value to the taxypayer, market value, or cost to the employer. Staples suggests that section 72 contemplates that the full market value of the accommodation be brought within the taxpayer's assessable income.[212] With respect, that view is incorrect. In the context of section 72 "value" means value to the taxpayer rather than market value. After listing the

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212. Staples Guide to New Zealand Income Tax Practice (44 ed, Sweet & Maxwell N.Z. Ltd., Auckland, 1984) para. 55.

benefits to which the section applies, section 72 provides that it is the "value of those benefits" which is deemed to be an allowance. The word "benefits" in that context is not used as a term of art, but rather in its ordinary sense to mean an "advantage, profit or good."[213] Therefore, in determining the "benefit" under section 72 any factors which reduce that benefit must be taken into account. Where, for example, an employee was provided with a house for which he paid a market rent it could hardly be argued that the market rental value of the house could be brought within the employee's assessable income. In that situation, the employee has derived no benefit other than the intangible benefit of having a roof over his head.

In practice the Commissioner has adopted a number of rules of thumb for calculating value for the purposes of section 72. Those rules of thumb, although generous to taxpayers assessed under section 72, have no statutory basis. To methods of valuation are adopted: first, accommodation benefits in certain industries are valued according to a fixed value; and secondly in the case of employee-shareholder accommodation, the value is calculated as a function of the cost price of the accommodation. Hotel workers fall into the former category. The Inland Revenue Department's internal rulings[214] provide that the value of accommodation to hotel keeps and hotel managers is to be calculated as follows:[215]

(1) Hotels, three star and over -[216]
- $208 per annum in respect of licensee
- $208 per annum in respect of licensee's wife or husband.
- $208 per annum in respect of adult members of family or any relatives staying free of charge.
- $52 per annum for each child over 6 years of age.

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213. Shorter Oxford Dictionary.

214. Access to which is available upon application under the Official Information Act 1982. These rulings will hereafter be referred to as the "Departmental rulings".

215. Departmental rulings Ch.19 Part I para 55.

216. The reference to stars is presumably to the star rating system developed by the Automobile Association in its guides to accommodation.

(2) Hotels, graded below three star
- $156 per annum in respect of the licensee.

- $156 per annum in respect of the licensee's wife or husband and adult members of family.

Where there are children over 6 years of age -

- $130 per annum in respect of licensee.

- $130 per annum in respect of licensee's wife or husband.

- $130 per annum in respect of adult members of the family and relatives staying free of charge.

- $52 per annum in respect of each child over 6.

The value of board and lodging for hotel workers is fixed at $2 per week.

The Departmental rulings also make provision for farm employees. The weekly value of various benefits to such employees has been fixed by the Commissioner as follows :[217]

Details of Allowance	Single man or married man accompanies by wife/children	Married man accompanied by wife/ children
Food and Lodging	$2.00	$4.00
Food only	$1.50	$3.00
Lodging only	$0.50	$1.00

Where a free house is supplied to a farm employee the Departmental rulings advocate a case by case approach to valuation. They state:[218]

> The value assessed should be realistic bearing in mind the value of the house and its remoteness from town...A rental value of $2 per week is suitable in the majority of cases but in special cistcumstances when the accommodation is above or below the average standard, this value could be varied upwards or downwards. For example, a farm manager occupying a high standard dwelling could possibly be assessed with a rental value up to $6 per week. These values quoted are only a guide and should not be regarded as necessarily appropriate to all cases.

It will be seen that the values fixed by the Commissioner bear little relationship to the actual value of the benefit to the

217. Departmental rulings Ch.19, Pt.IV, para 14.

218. Idem.

taxpayer. While it may be necessary for administrative purposes to adopt rules of thumb as to how benefits under section 72 are to be valued, to be effective the fixed rates would have to be updated on a regular basis. However, it appears that these rates have not been altered for many years. Staples first referred to the taxation of accommodation benefits provided for hotel employees in its 1945 edition,[219] although the precessor of section 72 had been inserted into the Land and Income Tax Act 1923 in 1932.[220] The 1945 edition stated: [221]

> In the case of a hotelkeeper's or hotel manager's assessment, an estimated amount is added to cover the cost of domestic establishment, i.e. an estimate of the value of keep, rent, etc, applicable to private domestic purposes. The amount to be added will be in accordance with the following schedule :-
>
> 1. City and Town hotels catering for the travelling public and providing good accommodation.
>
> £104 per annum in respect of the licensee
> £104 per annum in respect of the licensee's wife or husband
> £26 per annum in respect of each child over 6 years of age.
>
> 2. Country hotels and city and town hotels which do not provide good accommodation for the travelling public:
>
> £78 per annum in respect of the licensee.
> £78 per annum in respect of the licensee's wife or husband. Where, however, there are children over 6 years of age the amounts will be :
> £65 per annum each in respect of the licensee and the wife or husband, and
> £26 per annum in respect of each child over 6 years of age.

The Commissioner's fixed rates for farm employees also have their origin in 1945. Staples stated: [222]

> In the case of free housing the employer should assess the rental at a fair and reasonable figure, having regard to current rental values. In the case of food and/or lodging for farm employees, the Commissioner has assessed the value to the employee as follows :-

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219. Staples A Guide to New Zealand Income Tax Practice (6 ed. Financial Publications Ltd., Wellington, 1945).

220. By s.3 of the Land and Income Tax Amendment Act 1932-1933.

221. Supra n.219 p.142.

222. Ibid. 133.

	Single Man or Married Man not accompanied by wife and/or children	Married Man accompanied by wife and/or children
Food and Lodging	£1 0 0	£2 0 0
Food only	£0 15 0	£1 10 0
Lodging only	£0 5 0	£0 10 0

Therefore, apart from the alterations necessitated by the change to decimal currency in 1967, the rates applied by the Commissioner in 1984 remain the same as those applied almost forty years ago. Clearly, while it may have been realistic in 1945 to assess the value of accommodation to a hotel manager as £104 it is no longer realistic to assess him on the dollar equivalent of that sum.

The second method of valuation adopted by the Commissioner is to apply a formula based on the cost of the accommodation. For shareholder employees whe value is valuclated as the total of :[223]

(a) 3% of cost price - including land,
(b) Depreciation at normal scale rates
(c) Repairs and maintenance
(d) Rates and insurance.

A similar formula is applied to accommodation supplied to marired farm employees who are related to the owner of the farm and to part proprietor employees.[224] However, in the case of such employees the formula is calculated upon three per cent of the cost of the building only and provision is made to reduce the value if it is not situated in a domestic area. Suppose, for example, that a part-proprietor employee of a farming enterprise occupies rent free a brick dwelling erected at a cost of $25,000 (excluding land). Annual insurance costs are $300 and repairs and maintenance cost $450. In that case, the value for the purposes of section 72 would be calculated as follows :

223. Departmental rulings Ch.5 Part 1 para.54.
224. Idem.

3% of $25,000	$750
Depreciation at 2%	500
Estimated repairs	450
Insurance	300
Total	$2,000
Less ¼ for remoteness	500
	$1,500

Specific provision is also made in the Departmental rulings for determining the value of accommodation supplied to executives in public companies.[225] It is stated that in calculating the value of such accommodation the fact that the executive may have no choice of accommodation, that he may be required to occupy more pretentious premises than he would otherwise have selected, and that he may be required to entertain company clients, should be taken into consideration. In cases of doubt it is recommended that the following formula be used as a guide :

(i) 3% of cost price including land
(ii) 5% of cost of furniture (if provided)
(iii) repairs and maintenance
(iv) rates and insurance.

As with the fixed value method of valuation the formulae adopted by the Commissioner bear no relationship to the requirements of section 72. First, section 72 does not contemplate the value of the accommodation benefit as being a function of the cost price of the accommodation. And secondly, it is difficult to understand how amounts deducted for rates, insurance, depreciation and repairs and maintenance can be included within the formula for the purposes of calculating the value to the employee. In relation to shareholder-employees the rationale is presumably that as the employee controls the company he has already derived an economic benefit when the company claimed a deduction for those various items. Therefore, it could be argued, in calculating the value of the benefit to the employee those items should be taken into account as they represent part of the benefit that he has derived. However, that rationale ignores the separate personality of the company and its shareholders. In view of that separate personality it is illogical to connect deductions claimed by a company with benefits accruing to an employee of the company.

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225. Idem.

It will be seen from the above discussion of section 72 that the methods of valuation adopted by the Commissioner bear little relationship to the actual value of the accommodation. In large part that is attributable to the language of the section. Little assistance is provided as to how "value" should be calculated. Ideally a case by case approach should be adopted, but for reasons of administrative efficiency and in the interests of maintaining consistency between different Inland Revenue Department offices it is imperative that some form of administrative rules be adopted. If the rules or guides to valuation which have been identified in this section of the paper were amended to reflect current values of accommodation it is likely that he would be met with taxpayer resistence. Accordingly, if accommodation benefits are to be effectively taxed in New Zealand it would be necessary to enact legislation detailing fully the manner in which those benefits are to be valued. Both the United Kingdom, and Australia have enacted legislation to that effect.

3. Australia and the United Kingdom.

Both Australia and the United Kingdom have enacted comprhensive legislation to enable accommodation benefits to be valued for tax purposes.

Section 26(e) of the Australian Act provides that the "value to the taxpayer...of the use of premises or quarters" is to be included within the taxpayer's assessable income. By section 26AAAA a number of factors which the Commissioner is required to take into account in determine that value are set out. These comprise: the remoteness of the location of the accommodation; whether it is customary for employees in the taxpayer's industry to be provided with accommodation benefits; whether there is any reasonable alternative accommodation; whether the accommodation is of a higher standard or is of a larger size than could reasonably be expected to be provied for the taxpayer; and whether any onerous conditions are attached to the use of the accommodation.

In practice the application of section 26AAAA can have a marked effect on the value of accommodation. Case 12[226] concerned a minister who lived rent free in a house owned by his church. The market rental of the house was between $2680 and $2860 per annum. However, by applying the discounting factors set out in section 26AAAA the Commissioner arrived at an assessable value, subsequently upheld by the Board of Review, of $585 per annum. Similarly, in Case 77[227] the assessable value of accommodation to a prison officer was reduced from $30 per week to $15 per week due to the fact that the accommodation was located within the prison grounds.

Provision is also made in the Australian legislation for the value of the accommodation to be reduced where the accommodation is in a remote area,[228] or where the taxpayer is required to live within close proximity of his work place. In such cases, section 26AAAB provides that the value of the benefit is ten percent of the annual rental value of the accommodation reduced by any consideration paid by the taxpayer.

As the result of the combined effect of sections 26AAAA and 26AAAB a fair approximation is able to be made as to the value to the taxpayer of the accommodation benefit. In the United Kingdom, on the other hand, the valuation of accommodation benefits is more arbitrary. Section 33(c) of the Finance Act 1977 provides :

> ...where living accommodation is provided for a person in any period by reason of his employment... he is to be treated for Schedule E purposes as being in receipt of emoluments of an amount equal to the value to him of the accommodation for the period, less so much as is properly attributable to that provision of any sum made good by him to those at whose cost the accommodation is provided.

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226. 26 C.T.B.R. (N.S.) p.100 (1982).

227. 26 C.T.B.R. (N.S.) p.531 (1982).

228. By s.26AAAB(1) an area is remote if neither the accommodation nor the taxpayer's usual place of employment was located in or near an eligible urban area. "Eligible urban area" is defined in s.26AAAB(10)(a) as an area with a census population of not less than 12,000. By s.26AAAB(10)(b) if a taxpayer resides within 40 kilometres of a centre with a population of more than 12,000, or within 100 kilometres of a centre with a population of more than 100,000, then he is deemed to be adjacent to an eligible urban area and therefore not entitled to the discount in s.26AAAB.

Prima facie, it appears that section 33(1) is of similar effect to section 26(e) of the Australian Act in that it brings to charge the "value to him [i.e the taxpayer] of the accommodation." However, by section 33(2) the value of the accommodation is taken to be the market rental value of the premises or, if greater, the rent paid for the premises by the person at whose cost the accommodation is provided. Therefore the value of the accommodation is determined according to objective, rather than subjective, criteria. Unlike Australia, no provision is made for the value of the accommodation to be reduced if, for example, it is situated in a remote location or if onerous conditions as to use are attached. However, there is provision in section 33(4) for an accommodation benefit to be exempt from the charge to tax where the accommodation is necessary for the performance of the taxpayer's duties, and where it has been the practice in employment of the nature carried on by the taxpayer to provide accommodation and that accommodation enables the employee's duties to be performed better.

Provision is also made in the United Kingdom for an additional charge in relation to more expensive accommodation. By section 33A where the cost of providing the accommodation exceeds £75,000 the employee is charged on the "additional value" of the accommodation to the employee. The "additional value" is defined in section 33A(3) as "the rent which would have been payable...if the premises had been let to him at an annual rent equal to the appropriate percentage of the amount by which the cost of providing the accommodation exceeds £75,000." Pursuant to section 33A(4) the "cost of providing the accommodation" is the aggregate of the cost of acquiring the property and any amounts expended on improvements to that property. And the "appropriate percentage" is defined in section 33A(11) as being the rate prescribed by the Treasury under section 66(a) of the Finance Act 1976.[229] Thus, the means by which the amount to be charged under section 33A is to be calculated may be illustrated by the following formula :

Section 33A charge = (cost of providing accommodation - £75,000) x appropriate percentage.

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229. Section 66 of the Finance Act 1976 relates to the provision of low interest loans. Pursuant to S.I. 1983/1273 the current prescribed rate is 12%.

The combined effect of sections 33 and 33A is best illustrated by an example. Suppose that in 1982 a company acquired a property at a cost of £140,000 and that £30,000 was subsequently spent on improvements. Suppose also that the taxpayer moved into the premises in 1983 without paying any rent. Taking the market rental value of the premises as £10,000 per annum, and the appropriate percentage as being 12%, the emoluments chargeable to the taxpayer will be calculated as follows :-

(a)	Section 33: value of accommodation	
	Market rental value	£10,000
(b)	Section 33A: additional value of accommodation	
	Cost of providing accommodation	140,000
	Cost of improvements	30,000
		£170,000
	Excess amount	
	Aggregate cost of providing accommodation	170,000
	Less: statutory exemption	75,000
		£ 95,000
	Emolument for Schedule E purpose - 95,000 x 12%	£11,400
(c)	Total emoluments	
	Section 33: value of accommodation	10,000
	Section 33A: additional value	11,400
		£21,400

V. CONCLUSION.

At the time of writing it appears likely that the Government will enact legislation to ensure that fringe benefits are taxed more comprehensively than at present. A number of statements have been made by the Hon. Mr. de Cleene, Associate Minister of Finance, indicating that such legislation is being contemplated,[230] and a Treasury report strongly advocating the taxation of fringe benefits has recently been released.[231] That move towards taxing fringe benefits is not surprising for two reasons. First, there is no logical reason for the exclusion of such benefits from the tax net. It has been demonstrated in this paper that the present tax-free status of most fringe benefits in New Zealand is attributable to the method by which income is defined for tax purposes and to the approach of the courts in construing tax legislation, rather than to any intrinsic characteristic which renders those benefits unsusceptible to an income tax. Secondly, the move to tax fringe benefits is in keeping with the conflict indentified in the introduction to this paper between the need of the State to meet its expenditure requirements by exacting taxes from its citizens and the desire of the citizen to retain as much of his wealth as possible. In the case of employees the desire to retain one's wealth has manifested itself in the prevalence of fringe benefits. Now, the need of the State to meet its expenditure requirements through exactions has manifested itself in the moves to tax fringe benefits. Legislation already enacted in the United Kingdom and Canada may be regarded in that light.

However, it is clearly too simplistic to characterise the change in tax status of fringe benefits as part of a wider conflict between the State and its citizens without having regard to the role of the courts. In the United States the approach taken by the courts in construing legislation has meant that "income" has

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230. E.g. supra n.200.

231. The Treasury Economic Management (Government Printer, Wellington, July 1984) p.215.

been interpreted sufficiently widely as to encompass fringe benefits. By contrast, in New Zealand, the courts have followed a much narrower path. Although the legislation appears wide enough to encompass fringe benefits, a conservative judicial approach to the construction of tax legislation has led to their exclusion from the tax net. To overcome that conservative approach, it would be necessary to follow in the footsteps of the United Kingdom Legislature by enacting a comprehensive regime governing the tax status of fringe benefits. However, even with such a comprehensive regime it could be expected that the courts would play an important role in balancing the needs of the State against the desires of its citizens.