

Dick & Anor v Commissioner of Inland Revenue

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(2002) 20 NZTC 17,961

Court of Appeal, CA 263/01.

Hearing: 22, 23 Jul 2002; Judgment: 14 Oct 2002.

Income tax — Charities — Charitable foundation established to assist in vocational training — Whether foundation's business income subject to tax — Whether settlor and trustee received benefit from trust's businesses — Whether settlor and trustee able to influence nature or amount of any benefit — Whether tax exemption for business income lost — Income Tax Act 1976, ss 61(25), (27), 226

This was an appeal by the taxpayers from a High Court judgment reported as *C of IR v Dick* ([2001\) 20 NZTC 17,396](#).

The taxpayers were the trustee (Ms Dick) and the advisory trustee (Mr Grierson) of the Vocation Education Foundation, which was established in 1987 to assist people in gaining vocational training. The foundation was set up at the instigation of Mr S, a Christchurch businessman. The nominal settlor was Ms Dick, a long-term employee of the businessman. The first trustee was Mr Grierson. In 1988 Ms Dick was appointed co-trustee of the foundation. Some time later Mr Grierson resigned as trustee but remained as advisory trustee. The foundation held gaming machine licences and operated gaming machines. The gaming machine business was later abandoned by the foundation in favour of commercial property development.

The Commissioner accepted that the foundation was a charitable trust for the purposes of s 5 of the Stamp and Cheque Duties Act 1971 and s 73(1) of the Estate and Gift Duties Act 1968 and was therefore exempt from conveyance, gift and estate duties. However, the Commissioner considered that the trust did not qualify for tax exemption for the purposes of the Income Tax Act 1976. In October 1994, the Commissioner issued default income tax assessments for the 1991–93 income years and, in October 1996, assessments were issued for the 1989–94 income years.

The taxpayers issued proceedings challenging the assessments. Those proceedings were heard by the Taxation Review Authority and an interim decision was issued in February 1998 (reported as *Case T50* ([1998\) 18 NZTC 8,346](#)). A final decision was given in April 1998 (reported as *Case U7* ([1999\) 19 NZTC 9,061](#)). The Taxation Review Authority cancelled the Commissioner's assessments. The Commissioner appealed to the High Court.

The High Court found that the foundation was charitable and that no payments were made for the benefit of anyone outside New Zealand. The court concluded, however, that both the settlor and Mr Grierson had the ability to influence and this ability arose out of their relevant capacities as settlor and trustee respectively. The tax exemption in relation to the whole of the business income was therefore lost. The court also ruled on a procedural issue concerning the question of discovery, holding that the jurisdiction existed to make a discovery order during the course of a hearing. The taxpayers appealed to the Court of Appeal.

Held: taxpayers' appeal dismissed; orders made by the High Court referring the matter back to the Taxation Review Authority to determine the quantum of the Commissioner's assessments to stand.

1. The second proviso to s 61(27) applied so that the tax exemption on the business income of the trust was lost for the income years in question.
2. The purpose of the second proviso to s 61(27) of the Income Tax Act was to prevent tax exemptions from being obtained in cases where those in particular positions of influence over a charity were able to derive benefits for themselves. Although the second proviso presented problems of interpretation, its broad meaning was clear. The words "income so derived" did not relate only to the benefit or advantage received but referred to the whole of the income received by the charity from any business during the income year.
3. The trust did carry on a business from which it derived income in each of the income years in question.
4. For the income years ending 31 March 1990 through to the year ended 31 March 1995, Mr S was deemed to have been a settlor of the trust because over that period he had disposed of assets to the trust and had retained or reserved an interest in those assets.
5. Where the Legislature has intended that the word "settlor" should have a wider meaning than that which would normally be applied in the case of a trust, the Act makes specific provision for such wider meaning. Section 226 of the Income Tax Act has many similarities to s 61 and was the first section of a part of the Act dealing with income derived by trustees. Section 226(2) defines "settlor" for the purposes of that section and ss 227 to 233. Section 226 was not applicable to s 61; it applied the term "settlor" to a wider range of circumstances than did s 61.
6. When the ordinary meaning of the word "settlor" was looked at in the context of the legislation, Mr S was an original settlor of the trust and was also a shareholder in the company which purchased the last of the properties for the benefit of the trust. Mr S was therefore caught by the provisions of s 61(27).
7. Mr S did receive a benefit from the trust while a settlor. He was also able, by virtue of his capacity as a settlor, to determine or materially influence the nature or amount of any benefit or income from the business conducted by the trust.
8. Mr Grierson was able to receive a benefit from the trust while he was trustee during the income years 1989–90 and was able, as trustee, to influence the nature of the benefit he received.
9. Section 61(27) was directed at the ability to influence benefits rather than the actual payment of them.

10. The High Court was correct in holding that jurisdiction existed for the Taxation Review Authority to make a discovery order during the course of a hearing. Regulation 12 of the Taxation Review Authorities Regulations 1988 did not exclude orders for discovery being made during the course of the hearing. The utilisation of the District Courts Rules in that regard was not inconsistent with the provisions of reg 12(5).

[Headnote by the CCH Tax Editors]

RW Bell-Booth for the taxpayers

JH Coleman and SF Wellik for the Commissioner

Before: Gault P and Keith and Salmon JJ

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Judgment of the Court delivered by Salmon J:

Issue

[1] This is an appeal from a judgment of *Glazebrook J* in the High Court ((2001) 20 NZTC 17,396). The High Court judgment was on an appeal by way of case stated by the respondent Commissioner against interim and final decisions of the Taxation Review Authority ([reported as *Case T50*] (1998) 18 NZTC 8,346 and [*Case U7*] (1999) 19 NZTC 9,061).

Background

[2] The appellants are the trustee and advisory trustee respectively of the Vocation Education Foundation which was created by a deed of trust dated 8 May 1987. The Foundation was set up at the instigation of a Mr Sloan, a Christchurch businessman who operated games parlours and food businesses. At the time it was set up the Internal Affairs Department was proposing to institute a licensing system to allow gaming machines (which would otherwise contravene the *Gaming and Lotteries Act 1977*) to be operated lawfully provided any profits went to "authorised purposes" (which included charitable purposes). The Foundation was set up to hold such licences and to operate gaming machines. A gaming machine licence was issued to the Foundation limited to 14 machines. The machines were purchased from and were situated in premises owned by Mr Sloan and in which Mr Sloan undertook other business activities. The Foundation entered into a contract with Mr Sloan to service the gaming machines on its behalf.

[3] Despite the fact that the Commissioner accepted that the Foundation was a charitable trust for the purposes of s 5 of the *Stamp and Cheque Duties Act 1971* and s 73(1) of the *Estate and Gift Duties Act 1968*, and therefore exempt from payment of conveyance duty, gift duty and estate duty, the Commissioner nevertheless took the view that the Foundation did not qualify for tax exemption for the purposes of the *Income Tax Act 1976*.

[4] The Foundation had trouble with the Internal Affairs Department concerning the manner in which it operated the gaming machines and the application of the proceeds from those machines. One of the matters in issue was the wish of the Foundation to retain moneys for future investment and the view of the Internal Affairs Department that all moneys must be distributed in each financial year in accordance with the Foundation's object.

[5] It had originally been the Foundation's intention to substantially increase the number of gaming machines operated by it

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but, because of the limited licences obtained and the difficulties being encountered, it decided to cease operating the gaming machine business and to purchase commercial property for the purpose of obtaining rental income therefrom.

[6] As mentioned above the Foundation purchased the 14 gaming machines from Mr Sloan. It is not entirely clear how this was done but there is evidence that he made a substantial sum of money available to the Foundation for the purchase of gaming machines. Most of this was for the purchase which did not go ahead. However, we infer that the money was also used for the purchase of the 14 machines referred to above.

[7] In fact the Foundation continued to operate the gaming machine business until 30 June 1993 but on the limited scale referred to. It also, from 1989, became involved in the purchase of commercial property.

To enable it to do so Mr Sloan lent substantial sums of money to the Foundation. He was not, however, recorded as the settlor of the trust despite the fact that both the gaming machines and the capital funds needed to achieve the objects of the trust were all provided by him. The settlor was the appellant, Leslie Jane Dick. She is recorded in the deed establishing the Foundation as having settled the sum of \$20 upon it. Ms Dick had a long association with Mr Sloan as his secretary and she lived with him from time to time.

[8] The original trustee of the Foundation was Mr Grierson. In December 1988 Ms Dick was also appointed as a trustee. On 30 September 1989 Mr Grierson retired and was appointed as advisory trustee. Earlier in that month Mr Grierson purchased a property in Mayall Avenue, Birkenhead, in respect of which he signed a declaration of trust in favour of the Foundation. This was the first of the properties purchased by the Foundation. Mr Grierson retained an option to purchase Mayall Avenue and indeed did purchase it back from the Foundation at a later date.

[9] In October 1989 the Foundation purchased a property on the corner of Gasson and Kingsley Streets, Christchurch, for \$130,000 and a property in Gloucester Street, Christchurch for \$350,000. In July 1992 it purchased a property at 97–101 Riccarton Road, Christchurch, for \$4,725,000. In September 1993 the Foundation gave Mr Sloan a mortgage over the above three Christchurch properties to secure the advances he had already made.

[10] In January 1994 a further property at 14 Cathedral Square, Christchurch, was purchased for \$4,300,000. This property was held in the name of VEF Holdings Ltd. The shareholders of that company were Mr Sloan (who held all but one of the shares) and Mr Grierson. Mr Sloan declared that he held his shares in trust for the Foundation.

[11] In August 1994 formal application was made by the Foundation to the respondent for approval of charitable status. That application was declined in 1996. Meanwhile in February 1995 Mr Sloan had entered into possession and receivership of the Foundation's properties and incomes as mortgagee. His declared purpose for doing so was to protect those assets against Inland Revenue assessments.

[12] The gaming machines were sold in 1992.

[13] In October 1994 the respondent had issued default Income Tax assessments for the 1991, 1992 and 1993 years totalling \$13,551. In October 1996 the respondent issued assessments for the years 1989 to 1994, totalling \$2,361,937 including penalties.

[14] Proceedings challenging these assessments were issued. Those proceedings were heard by the Taxation Review Authority in August 1997 and a decision was given in February 1998. That was an interim decision because the Authority considered it did not have sufficient information concerning the Riccarton Road property referred to above. Accordingly, the hearing was resumed in March 1999 and a final decision given in April. The Taxation Review Authority cancelled the Commissioner's assessments.

[15] Finally, by way of background we note that the total amount distributed by the trust pursuant to its charitable objects was \$90,000.

[16] The Commissioner appealed by way of case stated and that appeal was heard by *Glazebrook J* in May 2001. Her judgment made findings which resulted in her sending

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the proceedings back to the Taxation Review Authority to deal with a number of matters. The appeal to this Court followed.

[17] The case stated and the High Court decision will be referred to again in more detail later in this judgment.

The decisions of the Taxation Review Authority

[18] The issues for determination in these proceedings have varied significantly as the proceedings have progressed. When the matter came before the Authority there had been pre-trial orders made and an agreement reached between the parties as to the issues for determination. They are recorded in the Authority's decision as follows [at 18 NZTC p 8,347]:

After consideration of the submissions filed by each counsel on procedural disputes between the parties, both counsel have acceded to my proposal that the fixture proceed pursuant to the following statement of issues, namely,

1. Whether the assessments in these proceedings are correct.
2. Whether the (disputant) has been a charitable trust since its establishment in May 1987 so that it is exempt from tax.
3. If the Authority finds the above two issues in favour of the objector then leave will be reserved for the parties to apply (if they are unable to agree between themselves) upon the application of the Authority's decision that the points listed by Mr Grierson in paragraph (b) sub-paragraphs (a) to (h) inclusive of his statement of claim filed herein (challenging disputable decisions of the Commissioner) dated 25 November 1996.

[19] The Authority then records that in its opening the Foundation stated the issue before the Court rather more widely but then agreed that the dispute between the parties was whether or not the Foundation was at all material times a charity and whether for any reason it had lost the taxation advantages which flow from that status. Towards the end of the hearing, however, counsel for the Commissioner submitted that the charitable status of the Foundation was not an issue that needed to be determined. Rather, the issue to be determined was whether the income of the objector was tax exempt. Faced with this rather confusing background to the issues the Authority recorded that he approached the matter in this way [at NZTC p 8,348].

(a) I will first determine on the facts and the law whether or not the disputant [the Foundation] is a charity in the eyes of the law.

(b) I will then decide whether or not for any of the reasons advanced by the Commissioner the disputant loses the taxation advantages otherwise available to a charity in any of the years under consideration.

[20] The Authority then set out in some detail the background, including the history of negotiations and relationships with the Internal Affairs Department and the Inland Revenue Department. A large amount of this information is taken from an extensive correspondence between Mr Grierson and the Department. The Authority clearly formed an adverse impression of the officer of the Department principally concerned with the management of this case.

[21] The Authority then addressed the question as to whether the Foundation was a charity and concluded that it was. That finding has not been challenged by the respondent.

[22] The Authority reviewed relevant provisions of the trust deed. He then examined in some detail the provisions of s 226 of the *Income Tax Act* 1976. That section is concerned with the identification of circumstances which would prevent a trust being a charitable trust in relation to any particular income year. The Authority was particularly concerned with the provisions of subs (9) of s 226. In the High Court and in this Court the focus was on subs (27) of s 61 of the Act a section which lists income wholly exempt from tax. Subsection (27) of s 61 and subs (9) of s 226 contain virtually identical provisions, in the one case outlining the circumstances in which a tax exemption for business income will be lost, and in the other case the circumstances in which charitable status will be lost. The Authority's findings in relation to the provisions of s 226(9), therefore, although directed to a different

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objective, are of relevance to the issues which ultimately came before this Court.

[23] There is, however, one important respect in which s 226 may be distinguished from s 61. Section 226(2) contains a detailed expanded meaning of the term "settlor". That expanded definition does not apply to the term "settlor" where it is used in s 61.

[24] The respondent argued before the Authority that the expanded definition in s 226 was wide enough to catch Mr Grierson, his son and Mr Sloan. In the case of Mr Grierson the facts which it was said supported this proposition related to the purchase of the property in Mayall Street, Birkenhead. Mr Grierson and his wife purchased this property for \$280,000 with the intention of ultimately utilising a part of it as his professional office, which up until then was operating from his home. The purchase price was \$280,000. Mr

Grierson and his wife signed a declaration of trust to the effect that the property was purchased on behalf of the Foundation. The Foundation provided \$200,000 towards the purchase price. Mr Grierson paid the Foundation \$250 per week for the part of the property he was intending to occupy.

[25] The Authority accepted evidence that this was in excess of the going rate for rentals of such a property at the time. The arrangement with the Foundation included an option for Mr Grierson to purchase the property at the original price of \$280,000 provided that option was exercised within a certain time.

[26] The Authority appears to have accepted the evidence that Mr Grierson did not profit from this transaction. He rejected a submission on behalf of the Commissioner that the trustee had received a variety of benefits from the transaction and in that regard noted that Mr Grierson had retired as a trustee seven days before lease payments commenced. The Authority does not seem to have appreciated the fact that the property was actually purchased some weeks before Mr Grierson's retirement as trustee. He held that Mr Grierson obtained no benefit from the transaction whilst still a trustee and was not caught by the expanded definition of "settlor". As to benefits to the son of the trustee, the Authority held that these were received after Mr Grierson had resigned that office.

[27] The Authority then considered a submission that Mr Sloan was caught by the extended definition because he derived benefits from a number of transactions entered into by the Foundation. The first of these related to the sale of the Foundation's gaming machines in 1992.

[28] These machines and video game machines owned by Mr Sloan were sold as part of a composite transaction effecting the sale of three of Mr Sloan's businesses to a third party. The Authority's decision wrongly records that the video machines were never owned by the trust. In fact that is not correct. The video machines were sold by Mr Sloan to the trust and then immediately on sold by the trust at a higher price to the third party. Apparently the transaction, structured in that way, benefited both vendor and ultimate purchaser. The Authority's decision that Mr Sloan received no benefit from that transaction is based upon an incorrect appreciation of the facts. An analysis of the evidence shows that the 140 video game machines were sold by Mr Sloan to the Trust at book value. The Trust then on sold them to the purchaser at a much higher value. There was then a relatively small amount paid by the purchaser direct to Mr Sloan for goodwill. Mr Sloan had wanted the transaction with the ultimate purchaser to include a higher figure for goodwill and a lesser figure for the value of the machines. The purchaser would not agree to that. The intermediate sale to the Trust enabled both vendor and purchaser to achieve their objectives. It seems too, on the basis of a letter written by Mr Grierson that the difference between the price paid by the Trust for the machines and the price obtained from the ultimate purchaser was to be treated as a debt due from the Trust to Mr Sloan.

[29] The Authority analysed the real property investments. He then considered an argument by the Commissioner that even if the Foundation had charitable status nevertheless the income from the properties was taxable. At this point the Authority turned to a consideration of s 61(25) and (27). Again the Authority has misunderstood the facts. He found that the Foundation received no income from the properties.

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That is incorrect. It received substantial income from the properties.

[30] The Authority made no findings as to the application of subs (27) of s 61. He held that the trust had not received income capable of founding the Commissioner's assessment and that the assessments should be cancelled.

[31] At the resumed hearing into the Riccarton Road property, the Authority found that that property was at all material times beneficially owned by the Foundation and that any income received from it was exempt pursuant to subs (25) of s 61 and that the assessment insofar as it related to that property should be cancelled.

[32] Overall the Authority's decision is based upon a misconception as to essential facts and upon an examination of statutory provisions which played little part in the further stages of these proceedings.

[33] At the request of the respondent the Authority stated a case on appeal. The questions for determination contained in that case are as follows:

(1) Did the Trust carry on any business from which it derived income in any of the income years from 1989 to 1994 inclusive?

AND IF SO:

(a) Were payments from that income made to an organisation which was not situated within New Zealand during any of the income years 1989 to 1994 inclusive AND IF SO to what extent is any income of the Trust assessable for income tax during any of those years?

(Question (1)(a) is a question of mixed fact and law and relates to the findings of the Authority referred to in para 26 and 27).

(2) Did PD Sloan dispose of any asset to the Trust which was used by the Trust in its business and in respect of which PD Sloan retained or reserved an interest and if so, in which income years did this occur?

(This is a question of mixed fact and law and relates to the findings of the Authority referred to in para 51, 51, and 53).

(3) Did PD Sloan otherwise become a Settlor of the Trust by virtue of any special relationship with the trustee or advisory trustee or by virtue of his involvement with any business activities of the Trust?

(This is a question of mixed fact and law and relates to the findings of the Authority referred to in para 54–56).

(4)

(a) If the answer to (2) or (3) is “Yes” did Mr Sloan receive a benefit from the Trust while a settlor in circumstances that justify the Appellant treating the income of the Trust as not being exempt from taxation for any of the income years 1989 to 1994?

(We observe that this is an unnecessary question. As we note below that the section is not concerned with actual benefit or advantage but rather, with the ability to influence benefits. This is the issue addressed in the next part of the question.)

(b) Was the Appellant justified in forming the opinion that Mr Sloan was able by virtue of his capacity as a settlor directly or indirectly to determine, or to materially influence in any way the determination of, the nature or the amount of any benefit or advantage or income or the circumstances in which they were received or were to be received, gained, achieved, afforded, or derived from the Trust AND IF SO to what extent is any income of the Trust assessable for income tax during any of the income years 1989 to 1994?

(These are questions of mixed fact and law and relate to the findings of the Authority referred to in para 51–56).

(5) Did BM Grierson receive a benefit from the Trust or was he able to receive a benefit from the Trust while he was a trustee in circumstances that entitled the Appellant to treat the income for any of the years 1989 to 1994 as not being exempt from taxation?

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(This question is one of mixed fact and law and relates to the findings of the Authority referred to in para 63).

(6) Was the Authority correct in finding that the Appellant was wrong to issue the amended assessments for the income years 1989 to 1994 inclusive and that the assessments be cancelled?

(This question is one of mixed fact and law and relates to the findings of the Authority referred to in para 64 and 65).

The judgment of the High Court

[34] The High Court judgment does not directly follow the format of the questions nor does it specifically address answers to each of them. *Glazebrook* J identified four issues:

1. Whether the Foundation was a charitable trust.
2. If it was, whether its purposes were limited to New Zealand.
3. Whether the Foundation's business income is liable for income tax.
4. Whether the Commissioner was entitled to raise the second and third issues at the litigation stage.
5. Whether the Taxation Review Authority was correct in holding that it had no power to order discovery during trial.

[35] As to the first issue, she upheld the decision of the Authority that the Foundation was charitable. That finding has not been challenged in this Court.

[36] As to the second question, she held that the finding that no payments were made for the benefit of anyone outside New Zealand should not be disturbed. She made other findings as to the purposes of the Foundation in that regard. None of them is the subject of challenge in this Court.

[37] The next issue, and the one which was central to argument in this Court, was whether the second proviso to s 61(27) of the Act applied. If it did, then the trust's business income would become taxable. There is a detailed consideration of the subsection later in this judgment. Suffice it to say, that one of the issues considered by *Glazebrook* J was whether Mr Sloan was a settlor in terms of subs (27). In this regard the Judge reviewed the facts, noted that there was no relevant definition of "settlor" for the purposes of s 61 and that the ordinary definition of "settlor" must apply. She noted that the common definition was "one who makes a settlement". She referred to the definition of "settlement" suggested in *Halsbury's Laws of England* Vol 42 para 601 and continued [at 20 NZTC p 17,402]:

[40] Thus the main factor which may define the act of settlement, at least in the context of a trust, is that it results in the creation of trust obligations in respect of the property settled. The act of creating a trust occurs when trust obligations are created in the trustees with respect to a particular item of property. This means that, technically, a trust is created every time further property is added to a trust fund, because the trustees are acquiring obligations in respect of further property.

[41] This definition appears at once too wide and too narrow in the context of s 61(27). It is too wide in that it would appear to encompass every person who makes a donation, however small, to a charity. On the other hand it could exclude people who have had a much more instrumental role in the charity but who have technically not settled any property on the trust.

[38] The Judge then referred to the *Hansard* Debate at the time when the major part of the second proviso of subs (27) was introduced and concluded that it was intended that the word "settlor" should be given a wide meaning and that it should encompass people with the kind of role in establishing the trust that Mr Sloan had. She said, correctly, that there was no doubt that Mr Sloan was the instigator of the Foundation and that while he did not appear to have settled property on the Foundation he did sell property to it funded by interest free loans. She held that in 1994 he settled the shares of VEF Holdings on the Foundation. She recorded that his role through the life of the Foundation has been vital and concluded [at 20 NZTC p 17,403]:

[45] Taking a purposive view of the provisions as being intended to encompass a person being an instrumental figure in the establishing of a charity, it seems to me that, in the

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particular circumstances of this case and given the extent of Mr Sloan's and his associates' involvement both in the initial stages of the Foundation and throughout its life, Mr Sloan is a settlor of the Foundation. He can be seen as having been so from the commencement of the Foundation.

[39] She then considered whether in terms of the second proviso, any of the settlors or trustees were able to receive a benefit, advantage or income from the Foundation in the carrying on of the business. In relation to the trustees she noted that no trustee can receive a benefit or advantage or income from a trust unless that is specifically authorised in the trust instrument or by the Court. She referred to cl 7(c) of the deed of trust which contains power to sell real or personal property and expressly provides for trustees to sell to any trustee. She then referred to cl 7(q)–(v) which allows trustees to go into partnership with any person and cl 7(z) which allows the employment of any person, including a trustee. She concluded that persons with the requisite capacities are “able” (in the sense of legally able) to receive income from the Foundation under cl 7(z) and probably under cl 7(q)–(v).

[40] She then directed her attention to the second part of the test which was whether a settlor or trustee is, in the opinion of the Commissioner, able by virtue of that capacity in any way (whether directly or indirectly) to determine or to materially influence the determination of the nature or the amount of that benefit or advantage or that income or the circumstances in which it is to be received.

[41] The Judge first noted that the inclusion of the words “in the opinion of the Commissioner” indicated that the inquiry was not just as to a legal ability to influence but, also a practical ability to do so. She made this important finding:

[65] In the situation where benefits and income have never been accorded and where the practice has been to utilise any surplus for the charitable objects of a trust it would not be reasonable for the Commissioner to take the view that any of the persons having the requisite capacities were for those income years able to influence materially the amount of benefits or income. In addition, where it is clear from the trustee minutes that the setting of any benefit, advantage or income has been undertaken in a scientific manner to ensure that no more than market value is paid (including perhaps surveys of similar positions) then again it would be difficult for the Commissioner to come to a fair and reasonable view of material influence.

[42] However, she concluded that in the present case, neither of the above circumstances applied. There were no trustee minutes in evidence, funds have not necessarily all been utilised for charitable purposes, for much of the life of the Foundation there has only been one trustee and in each case that person is reasonably closely associated with Mr Sloan and that Mr Sloan has had a major influence on the Foundation. She held that there had been benefits accorded to Mr Grierson and Mr Sloan: in the case of Mr Grierson, the purchase of Mayall Avenue and his ability to use that property whilst selling his own, and in the case of Mr Sloan, his service contract and arguably, the fact of the purchase of the machines by the Foundation and the operation of them in his premises.

[43] She concluded that both Mr Sloan and Mr Grierson had the ability to influence and that this ability arose out of their relevant capacities as settlor and trustee, respectively.

[44] As to the consequences of coming within the second proviso, *Glazebrook J* referred to other arguments put forward on behalf of the appellants, in particular, that the income affected by her finding was only that related to the particular transaction. She rejected that submission and held that the exemption in relation to the whole of the business income was lost.

[45] The Judge then directed her attention to a procedural issue concerning a ruling on the question of discovery.

[46] Finally, she recorded her decision in the following paragraphs [at 20 NZTC pp 17,408–17,409]:

[91] The finding of Judge *Willy* that the Foundation is a charitable trust is not disturbed. The finding of Judge *Willy* that the first proviso to s 61(27) does not apply

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in the manner contended by the Commissioner is confirmed. The question of whether any apportionment is appropriate in respect of retained income is referred back to the Authority.

[92] The appeal is allowed to the following extent. The decision is that Mr Sloan is a settlor of the Foundation. He and the trustees are legally able to receive income from the Foundation in the carrying on of any business by the Foundation. This is because the trust deed (in the case of the trustees)

allows them to do so and (in the case of Mr Sloan) does not prohibit him from doing so. Mr Sloan and Mr Grierson are also able to influence the nature, amount and circumstances of the income by virtue of their capacity as settlor and trustee. This means that the Foundation's business income is not exempt from tax.

[93] The matter now must revert to the Taxation Review Authority to deal with issues of quantum. This will entail argument on what is business income, including whether any Foundation income comes within the deeming provisions of s 61(27)(f). It will also entail argument as to the amount of that business income (and any relevant deductions). Of course the onus will be on the Foundation to show the extent to which the Commissioner's assessments are incorrect.

The arguments in this Court

[47] The jurisdiction of the High Court and this Court is limited to answering the questions in the case stated, and to making any findings or orders consequential upon those answers. We propose, therefore, to structure this part of the judgment by reference to the questions insofar as they remain in contention.

[48] Before turning to a consideration of the questions in the case stated, it is appropriate to set out the provisions of subs 27 of s 61 of the *Income Tax Act*. The provisions of that subsection are fundamental to a determination of the issues arising in this appeal. The correct interpretation of the subsection was a matter of extensive argument. Section 61 deals with incomes wholly exempt from tax. Subsection (27) applies to businesses carried on by or for the benefit of charities. It exempts

(27) Income derived directly or indirectly from any business carried on by or on behalf of or for the benefit of trustees in trust for charitable purposes within New Zealand, or derived directly or indirectly from any business carried on by or on behalf of or for the benefit of any society or institution established exclusively for such purposes and not carried on for the private pecuniary profit of any individual:

Provided that if the aforesaid purposes are not limited to New Zealand the Commissioner may apportion the income in such manner as he deems just and reasonable between such purposes within New Zealand and the like purposes out of New Zealand, and may allow to the trustees, society, or institution a partial exemption accordingly:

Provided also that in any case where, in any income year, in the carrying on of the said business, any benefit or advantage, whether or not convertible into money, or any income of any of the kinds referred to in section 65(2) of this Act is able to be afforded to, or received, gained, achieved, or derived by any person—

- (a) Who is a settlor or trustee of the trust by which the business is carried on; or
- (b) Who is a shareholder or director of the company by which the business is carried on; or
- (c) Who is a settlor or trustee of a trust that is a shareholder of the company by which the business is carried on; or
- (d) Where that person and that settlor or trustee or shareholder or director referred to in any of the foregoing paragraphs of this proviso are associated persons—

and that person is, in the opinion of the Commissioner, able, by virtue of that capacity as settlor or trustee or shareholder or director or associated person, in any way (whether directly or indirectly) to determine, or to materially influence in any way the determination of, the nature or the amount of that benefit

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or advantage or that income or the circumstances in which it is or is to be so received, gained, achieved, afforded, or derived, the exemption provided in this section shall not apply to any of the income so derived directly or indirectly from that business in that income year, and notwithstanding any other provision of this Act, where that business is carried on by or on behalf of or for the benefit of trustees in trust, the income shall be trustee income as defined in section 226 of this Act and the trustees of the trust shall be assessable and liable for income tax on the income in accordance with section 228 of this Act; and for the purposes of this paragraph—

(e) A person shall, in relation to a trust, be deemed to be a settlor of the trust and to gain a benefit or advantage in the carrying on of a business of the trust, in any case where that person has disposed of or disposes of, to the trust, any asset that is used by the trust in the carrying on of that business, and where that person retains or reserves an interest in that asset or that asset will revert to him:

(f) The deriving by any trustee of any rents, fines, premiums, or other revenues from any asset shall, in any case where any person, being a person of any of the kinds referred to in paragraphs (a) to (d) of this proviso, has disposed of or disposes of, to the trust, any asset that is used by the trustee in the deriving of those rents, fines, premiums, or other revenues, and where that person retains or reserves an interest in that asset or that asset will revert to him, be deemed to be the carrying on of a business by the trustee:

(g) Income shall be deemed not to be derived by any person of any of the classes referred to in paragraphs (a) to (d) of this proviso in any case where that income consists of interest on money lent that, in the opinion of the Commissioner, is payable at not more than current commercial rates, having regard to the nature and term of the loan:

(h) A person shall not, by reason only that he renders professional services to any trust or company by which a business is carried on, be considered to be able to determine, or to materially influence the determination of, the nature or the amount of any benefit or advantage or income afforded to, or received, gained, achieved, or derived by him or the circumstances in which it is or is to be so received, gained, afforded, or derived, in any case where that ability to so determine or to so materially influence results from the rendering by that person, in the course of and as part of the carrying on as a business of a professional public practice by that person, of professional services to the trust or company by which the business first mentioned in this paragraph is carried on; and, for the purposes of this subparagraph, the Public Trustee, the Maori Trustee, and any trustee company within the meaning of the Trustee Companies Act 1967, shall each be deemed to be a person carrying on as a business a professional public practice:

[49] The second proviso is of particular relevance to this case. We have no doubt as to the purpose of the proviso. It is to prevent tax exemptions from being obtained in cases where those in particular positions of influence in respect of the charity are able to derive benefits for themselves. Presumably the primary purpose of the subsection was to address the case of charities set up or operated, not for genuine purposes, but as a means of tax avoidance. The subsection will also catch those cases where there is a mix of motivation behind the setting up or operation of the particular charity.

[50] The second proviso undoubtedly presents problems of interpretation but we have concluded that its broad meaning is clear. Income derived by any business carried on by trustees for charitable purposes loses its exemption from taxation in any income year where, in that income year, a benefit or advantage or income (other than that excepted by para (g)) is able to be obtained by one of the persons listed in para (a), (b), (c) or (d) and that person is able, by virtue of his position to determine or materially influence the nature or amount of that benefit.

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[51] It was argued on behalf of the appellants that the second proviso only applied where benefit or income was actually received and only to the extent of such benefit. That is to say that the exemption provided by the section was only lost in respect of a benefit actually received. Indeed, this proposition was described as being at the heart of the case. The appellants submitted that the words “income so derived” where those words appear in the second proviso, relate to the benefit or advantage received. We do not accept that interpretation. We consider that those words relate back to the beginning of the subsection and refer to the whole of the income received by the charity from any business during the income year under consideration.

[52] It is also necessary to determine whether para (e) applies to Mr Sloan. Other issues arising for consideration are whether the income received from the Trust came from a “business” and whether Mr Sloan was a “settlor” of the Trust either in the primary meaning of that word, or in the extended meaning given by para (e).

The trust deed

[53] The terms of the trust deed are important to a consideration of whether any benefit is able to be afforded to any of the persons listed in para (a), (b), (c) and (d) of subs 27. As noted above, *Glazebrook J* concluded that cl 7(z) and probably cl 7(q) to (v) meet this test. We think there are other clauses that are also relevant in this regard. Clause 7(e) allows the trustees to lease any freehold or leasehold property to or from anyone, including a trustee, on such terms and conditions as the trustees think fit. Clause 7(z) allows the employment of trustees and the payment to them of such fees, salaries, wages or other remuneration as the trustees deem expedient. Obviously, a settlor would also be included in these two provisions. Clause 7(q) to (v) would allow the trustees to go into partnership with anyone and to split the profits as they think fit and this would include a partnership with a settlor.

The case stated

Question 1. Did the Trust carry on any business from which it derived income in any of the income years from 1989 to 1994 inclusive?

[54] It should be noted that the supplementary part of that question does not need to be answered. No issue arose on appeal concerning the question as to whether payments were made to an organisation not situated within New Zealand.

[55] On behalf of the appellants, Mr Bell-Booth accepted that the gaming machine enterprise was a business. He submitted, however, that the investments in the real estate holdings were not a business. He submitted that the real estate was a passive investment. That all the plaintiff was doing was receiving rent cheques and that that did not constitute a business. He noted that all the leases were long-term net rent leases. That the lessees were required to do all the maintenance and that the rent was paid to a nominated account. Each property had only one tenant. In this case the trustee identified the properties, negotiated the agreement for sale and purchase, provided the funds for the purchase, gave instructions to the tenant as to the bank account into which rentals were to be paid, received the bank statements to verify payment, received rates notices, insurance invoices and tendered them to the tenants for payment, visited the properties for inspection from time to time to verify compliance with covenants of the lease and took advice as to the appropriation of the investment and the suitability of the properties.

[56] Business is defined in the Act as including:

any profession, trade, manufacture, or undertaking carried on for pecuniary profit.

A similar definition appeared in earlier legislation.

[57] In *Grieve v C of IR* (1984) 6 NZTC 61,682 at p 61,691; [1984] 1 NZLR 101 at p 110 *Richardson J* in delivering the principal judgment of the Court said this:

It follows from this analysis that the decision whether or not a taxpayer is in business involves a two-fold inquiry — as to the nature of the activities carried on, and as to the intention of the taxpayer in engaging in those activities. Statements by the taxpayer as to his intentions are of course relevant but actions will often speak louder than words. Amongst the

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matters which may properly be considered in that inquiry are the nature of the activity, the period over which it is engaged in, the scale of operations and the volume of transactions, the commitment of time, money and effort, the pattern of activity, and the financial results. It may be helpful to consider whether the operations involved are of the same kind and are carried on in the same way as those which are characteristic of ordinary trade in the line of business in which the venture was conducted. However, in the end it is the character and circumstances of the particular venture which are crucial. Businesses do not cease to be businesses because they are carried on idiosyncratically or inefficiently or unprofitably, or because the taxpayer derives personal satisfaction from the venture.

[58] In our view there is no doubt that the property related transactions constitute a business. Substantial incomes were received from the properties. There is evidence of a profit making intention. Ms Dick deposes

that the decision to stop relying on the proceeds of gaming machines was because the foundation needed to

Obtain other more permanent investments instead of income only from the gaming machine business so as to be sure that from its income it could support those seeking valid training through courses extending over several years.

[59] There are references to carrying on the business of a landlord deriving rental income and to commercial property business. We have no doubt that the Trust did carry on business from which it derived income in each of the income years referred to in the question.

Question 2. Did PD Sloan dispose of any asset to the Trust which was used by the Trust in its business and in respect of which PD Sloan retained or reserved an interest and if so, in which income years did this occur?

[60] The relevance of this question has to do with the extended definition of “settlor” in para (e) of subs (27). In the case stated the Authority records that it found that up to 30 June 1993 Mr Sloan's only involvement in the affairs of the Trust was to service the gaming machines. As to the sale of the video game machines he held that when properly analysed Mr Sloan sold these machines and that the Trust did not own or sell them. As already indicated the Authority misconceived the factual situation in relation to the video game machines.

[61] The question is whether Mr Sloan retained any interest in respect of the gaming machines. He certainly provided the money for the purchase of them and he entered into a contract with the Foundation to service those machines. We do not consider that the service contract constitutes the type of interest referred to in para (e) nor is there any evidence that he had any interest by way of mortgage over those machines.

[62] The next question is whether para (e) applies to Mr Sloan insofar as money was lent by him to the Trust. There can be no dispute that money is an asset in the ordinary meaning of that term. The money was certainly used by the Trust in the carrying on of its business. It is not clear whether the money advanced for the purchase of the gaming machines constituted a loan. Certainly the advance for the purchase of the properties did.

[63] The remaining question is whether it can be said that Mr Sloan “disposed” of the money to the Trust. An ordinary dictionary meaning of the word is “to part with”. That certainly describes what Mr Sloan did with the money. The word “disposed” cannot be used in the sense of parting with something permanently because that would be inconsistent with the possibility that the asset revert to the person disposing of it. We conclude, therefore, that for the income years ending 31 March 1990 through to the year ended 31 March 1995, Mr Sloan is deemed to have been a settlor of the Trust in that over that period he had disposed of assets to the Trust (the money lent) and had retained or reserved an interest in that asset (because he was entitled to be repaid).

Question 3. Did PD Sloan otherwise become a Settlor of the Trust by virtue of any special relationship with the trustee or advisory trustee or by virtue of his involvement with any business activities of the Trust?

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[64] In the High Court *Glazebrook* J applied an extended definition of the term “settlor” and held that Mr Sloan was a settlor of the Trust from its inception. That finding has been challenged on appeal.

[65] The basis upon which *Glazebrook* J reached her conclusion that Mr Sloan was a settlor of the Trust appears earlier in this judgment. We agree with the conclusions that she reached, but for slightly different reasons. It is necessary to express some caution in approaching the meaning to be given to the word “settlor”. The reason for this is that the Act has specific provisions which define circumstances where the word is to be given a wider meaning.

[66] Within subs (27) itself there is the deeming provision in para (e). It is also relevant to consider the provisions of s 226 of the Act. As already observed, that section has many similarities to s 61. Section 226 is the first section of a part of the Act dealing with income derived by trustees. Subsection (2) defines the term “settlor” for the purposes of that section and ss 227 to 233. It is not made applicable to s 61. It applies the term “settlor” to a wider range of circumstances than does s 61.

[67] The importance of this provision and of para (e) of subs (27) is that where the legislature has intended that the term “settlor” should have a wider meaning than that which would normally be applied in the case of a trust, the Act makes specific provision for such wider meaning.

[68] The question then is as to the ordinary meaning of the word “settlor” in this country and in the context of this legislation. In particular, it is necessary to determine whether we are bound in this case by the terms of the Trust Deed in determining who is the settlor. The Deed describes Ms Dick as the settlor and she did indeed, settle a nominal sum of money. But in a practical sense the person who settled the Trust with the assets that enabled it to conduct its business and to fulfil its purpose was Mr Sloan. The *On-Line Oxford English Dictionary* defines a settlor as one who makes a settlement of property. From the practical point of view that person was Mr Sloan. He provided the gaming machines and if he did not give those machines to the Trust he provided the money with which the Trust was able to buy them.

[69] As earlier noted, it is not entirely clear whether that money was a gift or whether it was a loan. If it was a loan it is caught by para (e) for the reasons already outlined. If it was a gift then, for the reasons set out above, Mr Sloan was, in the ordinary sense of the word, the real settlor of the Trust.

[70] A similar approach in respect of earlier tax legislation was taken in two decisions of the Supreme Court. The first was *Baldwin v C of IR* [1965] NZLR 1, a decision of *McArthur J* and the second was *Tucker v C of IR* [1965] NZLR 1027, a decision of *Woodhouse J*.

[71] In each case the Court held that a Trust was created by the person who was the principal benefactor of the Trust even though that person was not named as the settlor. In the later of the two cases, referring to the intention and purpose of creating a Trust, *Woodhouse J* said at p 1030:

In my opinion his intention and purpose was effected and a trust created in respect of the property when he made use of the existing trust deed in order that its terms should become applicable to his own dispositions.

The same may be said in this case.

[72] It is true, as the respondent argued, that a different approach has been taken in a decision of the High Court of Australia. In *Truesdale v Federal Commissioner of Taxation* 70 ATC 4056; (1971) 120 CLR 353 the Court was considering the meaning of the words “created a trust”. At p 362 the Court noted the:

... obvious difference between creating a trust in respect of property, on the one hand, and, on the other, transferring property to a trustee to hold upon the terms of an established trust.

[73] The Court noted that if an expanded meaning were to be given to those words the transfer to the trustee of property to be held as part of the assets of an already constituted trust would create a second trust.

[74] The distinction which we think can be drawn is that it is possible for a settlor to settle property upon an existing trust. It is all

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a question of intention and an appreciation of the realities of the situation. As we have said earlier, in fact it was Mr Sloan that created this Trust.

[75] Although not directly raised by the question there is a further respect in which Mr Sloan is caught by the provisions of subs (27). He is a shareholder (albeit holding the shares in trust) in the company VEF Holdings Ltd, which in January 1994 purchased the last of the properties for the benefit of the Trust. He is thus, caught by para (b) of subs (27).

[76] The answer to Question 3, therefore, is that Mr Sloan was an original settlor of the Trust and is also a shareholder in terms of para (b).

Question 4. (a) If the answer to (2) or (3) is “Yes” did Mr Sloan receive a benefit from the Trust while a settlor in circumstances that justify the Appellant treating the income of the Trust as not being exempt from taxation for any of the income years 1989 to 1994?

(b) Was the Appellant justified in forming the opinion that Mr Sloan was able by virtue of his capacity as a settlor directly or indirectly to determine, or to materially influence in any way the determination of, the nature

or the amount of any benefit or advantage or income or the circumstances in which they were received or were to be received, gained, achieved, afforded, or derived from the Trust AND IF SO to what extent is any income of the Trust assessable for income tax during any of the income years 1989 to 1994?

[77] This and the following question raise what are really the crucial issues in this case. They require a consideration of that passage in subs (27) which immediately follows para (a) to (d). It will be noted that that passage requires the Commissioner to form an opinion.

[78] In the present case the Commissioner formed an opinion adverse to Mr Sloan. The question is whether that opinion was one which it was open to the Commissioner to form on the evidence. The issue may be stated as whether Mr Sloan by virtue of his capacity as settlor in terms of para (e) or under its ordinary meaning or as a shareholder in terms of para (b), was able to determine or materially influence the nature or amount of any benefit or income from the business conducted by the Trust.

[79] The findings of *Glazebrook J* in this respect are set out at para [40] to [42] above. We agree with her conclusions. Mr Sloan received a benefit from the Trust in respect of the maintenance contract on the gaming machines. He also received a significant benefit as a result of the sale of the video machines to the Trust. Additionally, there can be no doubt about his ability to influence, even though he was not a trustee. His influence is apparent from the evidence of Ms Dick. Indeed, Mr Bell-Booth accepted in his submissions that Mr Sloan and Mr Grierson had that ability. Mr Sloan's involvement is apparent from evidence of Ms Dick. At para 38 of an affidavit dated 9 December 1996 she says:

At no time have I been personally able to make the decision as to how the Foundation's funds would be employed or what businesses it would conduct. Firstly, the conduct of the gaming machines under the licence from the Internal Affairs Department required someone such as Mr Sloan who understood the machines technically and the nature of that business. Subsequently he has made in consultation with Mr Grierson all investment decisions with regard to commercial properties acquired from which the Foundation's revenue is derived and has advanced substantial funds free of interest to the Foundation to make those investments possible. On frequent occasions he and I have resorted to Mr Grierson for legal advice on all matters concerning the Foundation's businesses and as to beneficiaries who could receive grants or donations (some have been declined), and without Mr Sloan's financial support it would not have been possible for the Foundation to continue to make any charitable decisions. I do not consider that I have sufficient knowledge of business to make those investment decisions or even to influence them and I have not done so ...

[80] Of course, the question is not just whether he was able to influence what the Trust did but whether he was able to influence the determination of the nature or the amount of any benefit.

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[81] On the evidence recorded above there seems little doubt that he was in such a position. The evidence just recited records that he lent money interest free. His position of influence, however, was such that had he demanded interest it is reasonably certain that it would have been paid.

[82] None of this should be taken as any reflection on Mr Sloan or any suggestion that he had other than good intentions. The legislation is directed at the ability to influence benefits rather than the actual payment of them.

[83] For the sake of completeness we accept that Ms Dick's position, on the basis of the evidence given by her, was not such as to enable her to exercise the necessary influence.

[84] The answer to Question 4(b) is that the respondent was justified in forming the opinion referred to therein. The answer to Question 4(a) is that Mr Sloan did receive a benefit from the Trust, but we say again that the section is directed to the ability to influence benefits rather than the receipt of them.

Question 5. Did BM Grierson receive a benefit from the Trust or was he able to receive a benefit from the Trust while he was a trustee in circumstances that entitled the Appellant to treat the income for any of the years 1989 to 1994 as not being exempt from taxation?

[85] Mr Grierson retired as a trustee on 30 September 1989. He was a trustee for the financial years ended 31 March 1989 and 31 March 1990. The Mayall Street property was purchased on 7 September 1989. We

think there is no doubt that the Mayall Street purchase provided a benefit to Mr Grierson, if only to provide him with the certainty of office premises whilst his home was on the market. Indeed, the submissions on behalf of the appellant recorded that Mr Grierson “saved the blood, sweat and tears of having to physically move his practice twice”.

[86] We accept the evidence that the rental he paid to the Trust was fair and that Mr Grierson did not profit financially from the transaction. The transaction is, however, evidence of Mr Grierson's ability as trustee to influence the nature of the benefit that he received. Accordingly, the opinion formed by the Commissioner in respect of the financial years during which Mr Grierson was a trustee was one which was open to him.

[87] The answer to Question 5 is that Mr Grierson was able to receive a benefit from the Trust while he was a trustee. Because he retired during the 1990 financial year this answer is relevant only to the income years 1989 and 1990.

Question 6. Was the Authority correct in finding that the Appellant was wrong to issue the amended assessments for the income years 1989 to 1994 inclusive and that the assessments be cancelled?

[88] We are in no position to form any view as to the appropriateness of the quantum of the assessments issued by the Commissioner. The conclusions we have reached, however, support the Commissioner's determination that the income exemption given by subs (27) was lost for the income years in question.

[89] One of the issues argued before us was whether interest received by the Trust on loans should be classified as business income. We do not have sufficient evidence before us to reach a firm conclusion on that issue, nor is it raised by the questions in the case stated. We do not intend to interfere with the order made by *Glazebrook J* referring the matter back to the Taxation Review Authority to deal with issues of quantum. The question of the interest can be dealt with at that stage. We make it clear that the questions whether the rents constitute business income, and whether there is to be any apportionment for overseas income, do not remain open. Indeed, it may be that in the light of this judgment there are no issues outstanding. However, in case that is not so the order of the High Court should remain.

Discovery

[90] The appellants also appealed against a finding made by *Glazebrook J* relating to a procedural ruling on discovery. It is not immediately apparent to us how this matter came before the High Court. It is not raised in the appeal by way of case stated. The point was, however, argued by the appellants and the respondent and we will, therefore, express our views on the issue.

[91] It first needs to be said that the High Court judgment deals only with the legal

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issue of whether it is possible for the Taxation Review Authority to order discovery during a hearing. The judgment did not address the question as to whether, in the exercise of his discretion, the Authority should or should not have ordered discovery. If the power to order discovery is available then there are obviously important considerations arising from the provisions of reg [12\(5\)](#) of the *Taxation Review Authority Regulations* 1998 and s [138\(g\)](#) of the *Tax Administration Act* 1994 which are relevant to the exercise of discretion.

[92] It was argued for the appellants that discovery was not available during the course of the hearing because reg [12](#) referred only to interlocutory applications made at any time before a hearing. It was also argued that recourse could not be had to reg [4](#) which applies the *District Court Rules* because those rules are inconsistent with reg [12\(5\)](#).

[93] Essentially for the reasons set out in the High Court judgment we do not accept the appellants' submissions. Regulation [12](#) does not exclude orders for discovery being made during the course of the hearing. The utilisation of the *District Court Rules* in that regard is not inconsistent with the provisions of reg [12\(5\)](#). That subclause goes to the exercise of discretion, not to the question of jurisdiction.

[94] The appellants referred to decisions under previous legislation suggesting that discovery orders would be made only in rare cases. The issues raised in the submission again go to the question of the exercise of discretion, not to jurisdiction.

[95] We conclude that *Glazebrook J* was right to hold that jurisdiction existed to make a discovery order during the course of a hearing.

Conclusion

[96] We have reached essentially the same conclusions as those reached by *Glazebrook J*. The appeal is, therefore, dismissed. The orders made referring the matter back to the Taxation Review Authority still stand. The respondent is entitled to costs of \$10,000 together with disbursements (if any) to be fixed, if necessary by the Registrar.