WHAT IS AN ALLOWANCE?

Commissioner of Inland Revenue v. **Parson (No. 2)** [1968] N.Z.L.R. 574

The recent decision of the Court of Appeal in *The Commissioner of Inland Revenue* v. *Parson* (No. 2) [1968] N.Z.L.R. 574[1] deals with a question that is of fundamental importance to the business community at large. The case concerned the liability to tax of a "fringe benefit", a method of conferring advantages on employees which is now widespread in all sectors of commerce and industry, and which is becoming increasingly complex under the stimulus of high rates of taxation. Parson was an employee of Woolworths (New Zealand) Limited, an associate company of Woolworths Limited, an Australian company which holds a large number of the shares in Woolworths (New Zealand) Limited. In the course of a share issue, Woolworths Limited contracted[2] to sell a number of its unissued shares to Parson and other senior employees of the group. The purchase price of the shares was less than the current market value of the issued ordinary shares of the company, but these particular shares were subject to certain onerous restrictions.[3] The Commissioner considered that as a result of the purchase Parson had derived assessable income, on the basis that on the dates of allotment of the shares the market value of ordinary shares in the company was greater than the cost to him of these shares, and that the difference was an allowance received by Parson in relation to his employment within section 88 (1) (b) of the Land and Income Tax Act 1954. Parson objected to this assessment, and a case was stated for the opinion of the Supreme Court. McGregor J. held that if this purported difference could be quantified it would constitute an allowance, and therefore be assessable income, but that, owing to the various restrictions attaching to the shares, the shares had no value beyond what Parson had paid for them.[4] The Commissioner appealed against this decision to the Court of Appeal.

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1. A preliminary objection to the jurisdiction of the Court of Appeal to deal with the case is reported in *The Commissioner of Inland Revenue* v. *Parson* [1968] N.Z.L.R. 375.
2. After consideration of the documents involved in the transaction, the Court of Appeal unanimously held that the company had offered the shares to Parson, and rejected an argument that, as is usually the case, the offer was contained in the shareholder's application for the shares.
3. For example, the company had the right to buy back the shares for the purchase price alone in the event of the employee leaving the organization within five years of the acceptance of the offer to sell the shares; and there was also a prohibition on sale of the shares for a period of five years except in the event of death or retirement upon and after reaching the normal retiring age.
4. *Parson* v. *The Commissioner of Inland Revenue* [1967] N.Z.L.R. 538.

The three members of the Court of Appeal (North P., McCarthy and Haslam JJ.) held first that if any tax liability arose from the scheme then the object attracting tax was the value of the "benefit" arising from Parson's contractual rights under the agreements with Woolworths Limited to purchase the shares, and not the value of the shares allotted in pursuance of the agreements. The court then went on to consider whether the value of this benefit was an allowance within section 88 (1) (b). That section provides as follows:

> (1) 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,—
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> (a) . . .
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> (b) 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 of or in relation to the employment or service of the taxpayer:
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> Provided that where any bonus, gratuity, or retiring allowance (not being money paid to any director of a company pursuant to its articles of association) is paid in a lump sum in respect of the employment or service of the taxpayer on the occasion of his retirement from that employment or service only five percent of that lump sum shall be deemed to be income.

The court was divided on this question, the majority[5] holding that the benefits received by Parson were not allowances within the section. Both North P. and McCarthy J. felt that the benefits constituted an emolument, though no attempt was made to justify this assertion. Their Honours then observed that the words introduced by "including all sums received . . . " did not appear in the original section in the Land and Income Assessment Act 1891 corresponding to section 88 (1) (b). From this fact, they drew a somewhat startling conclusion. This was expressed by the learned President[6] in the following way:

> . . . I think it necessarily follows that Legislature, by enlarging the meaning of the words "all salaries, wages or allowances" to include sums received by the taxpayer by way of bonuses, gratuities or emoluments of any kind has recognized that the first-mentioned words in their natural import did not include any of these benefits.

Since the benefits received by Parson were, in the opinion of the majority, an emolument (though clearly not a sum received by him), those benefits did not constitute an allowance, and were therefore not assessable income within section 88 (1) (b).

5. North P. and McCarthy J.
6. At p. 13 of his judgment.

This reasoning is clearly unsatisfactory. Even apart from the dubious nature of the conclusion that the word "including" is always used to enlarge the meaning of an expression, the application of the supposed principle of construction to a provision such as this creates serious difficulties. The words "bonus, gratuity, extra salary, or emolument of any kind" have a sufficiently broad meaning to include anything which could properly be called an allowance.[7] Consequently if the word "allowance" does not include anything comprehended by "bonus, gratuity, extra salary, or emolument of any kind" it is difficult to see what meaning remains to be attributed to that word. The majority judges unfortunately made no attempt to explain what residual meaning they considered "allowances" to have.

Nor is the reasoning of Haslam J., the third member of the court, much more convincing. He too considered the history of the legislation, but was drawn to an opposite conclusion to that of the majority. After examining what he called "the natural import" of the word allowances, he proceeded[8] to formulate a definition in the following terms:

> I think that "allowances" has survived in this context as a comprehensive term intended to catch all forms of remuneration outside and beyond the rate of salary or wage agreed upon under the contract of service . . . As a species of assessable income arising from employment, it suggests a benefit coming to the taxpayer in addition to his agreed salary or wage, and capable of being turned to pecuniary account, even if less readily ascertainable in value than salary or wages.

He therefore concluded that since in his opinion the natural meaning of "allowances" is wide enough to cover all the particular forms of remuneration introduced by the words "including all sums received . . . " those forms were not inserted by the legislature to extend the scope of "allowances", but merely for the purposes of clarity and of emphasis. The benefits received by Parson clearly fell within this broad definition if they could be found to be convertible into cash, and he accordingly felt that the monetary value, if any, of those benefits constituted an allowance.

Though the rationale of this judgment is flimsy, the result reached seems at first glance to be somewhat more acceptable. There is no doubt that fringe benefits are a method of tax avoidance, "and on grounds of equity alone there is a strong case for ensuring that income in any form is taxable".[9] Can this result also be justified as a reasonable interpretation of the section? The meaning of the word "allowances" has been considered a number of times by the English courts in dealing with the Public Health Act 1875 (U.K.). In *Burgess* v. *Clark* (1884) 14 Q.B.D. 735, Lord Esher defined the word "allow-

7. For example, "emolument" is generally interpreted as meaning any profit from employment.
8. At pages 4-5 of his judgment.
9. Report of the Taxation Review Committee, p. 256, para. 639.

ance" as used in that Act as meaning a payment beyond the agreed salary of an employee for additional services rendered by him to his employer, but in the same case Cotton L.J. confined the meaning of the word to "the use of a room, or coals, or candles, or articles of the like kind, or an allowance for the repayment of them".[10] In *Reg.* v. *Mayor etc. of Ramsgate* (1889) 23 Q.B.D. 66, Cotton L.J.'s construction was adopted. This view was however rejected, and Lord Esher's interpretation accepted by Lord Halsbury and the other members of the Court of Appeal in *Edwards* v. *Salmon* (1889) 23 Q.B.D. 531.

The application of these authorities in the interpretation of what is now section 88 (1) (b) was considered by the Full Court of the Supreme Court in *Edwards* v. *Commissioner of Taxes* [1925] G.L.R. 247. The court was there dealing with a superannuation allowance paid to a retired judge. Stout C.J. considered that this payment was most correctly described as a pension, but felt that on the construction of the section it could not properly be called an allowance. The remaining members of the court[11] had no doubt that a superannuation allowance was in common parlance an allowance, but in construing the word in its statutory context felt that a narrow meaning must be attributed to it.[12] They went on in their joint judgment at 249 to suggest that the word could be construed in the sense given to it in *Burgess* v. *Clark* (supra) and *Edwards* v. *Salmon* (supra).

The only other reported New Zealand decision prior to 1967 in which this matter has been considered is *Stagg* v. *Inland Revenue Commissioner* [1959] N.Z.L.R. 1252. Hutchison A.C.J. was there dealing with a sum paid by the taxpayer's employer for air fares, travelling, accommodation, and general expenses in connection with a trip to England by the taxpayer and his wife. His Honour expressed the view that the word "allowances" must be read ejusdem generis with "salaries" and "wages", and then proceeded to enumerate four characteristics of salaries and wages which he considered bore on the meaning of "allowances". He stated these as follows at pp. 1256-57:

1. They are in relation to an employment or service.
2. They are payable under the contract of service and not as a gratuity, though this factor is affected by the latter part of the paragraph which includes at least certain gratuities within "salaries, wages or allowances".
3. They are paid in money, though this factor is affected by the words "(whether in cash or otherwise)".
4. They are paid periodically.

It is clear, however, that he did not consider these criteria to constitute

10. As did the court in *The Queen* v. *Mayor and Town Council of Liverpool* (1872) 41 L.J.K.B. 175.
11. Sim, Reed, Adams and Ostler JJ.
12. It is arguable that the discussion by the court on the meaning of "allowances" was obiter dicta, the members of the court being unanimously of the opinion that in any event the payment did not fall within subsection (b) as it did not relate to an existing contract of employment.

an exclusive test of the nature of an allowance. He went on at page 1257 to express the opinion that the criteria merely add colour to the word, and do not supplant the normal meaning of "allowances". This emphasis on the dominance of the "normal meaning" or "the natural import"[13] of the word is the source of much of the confusion surrounding its interpretation. It is submitted that the important factor in the interpretation of the word is the context in which it appears. The focusing of attention on such vague notions as its "normal" or "natural" meaning only serves to avoid the necessity for any careful examination of the application of the word in the setting of section 88 (1) (b). As was pointed out by an Australian judge:[14]

> "Allowance" is one of the many words which take their meaning from a context rather than affecting or controlling the meaning of other words of the context in which they occur. For, considered alone and at rest rather than at work with other words, it means the allowing of a thing or a thing allowed. It is only by its implication that you discover the kind of thing in mind.

How then is the word to be construed in the context of section 88 (1) (b)? That section is concerned with income derived in the course of employment. It is restricted to income which takes the form of money or money's worth,[15] subject however to section 89, which includes the value of board or lodging, or the use of a house or quarters provided to a taxpayer in respect of his employment within the meaning of "allowances". A further limitation is placed on the scope of "allowances" by section 90. That section requires a distinction to be drawn between "benefit" and "reimbursing" allowances. Reimbursing allowances include all allowances where the employee in the course of his duties incurs certain expenses which may reasonably be assumed to be the liability of the employer, and in consideration of an allowance paid, the employee in effect undertakes to discharge the liability.[16] Such an allowance is by virtue of section 90 exempt from income tax. It is in this sense that the word allowance is frequently used in industrial awards, for example, uniform allowances, meal money and tea money allowances, tool and overall allowances. The word "allowances" in section 88 (1) (b) must therefore be read as limited to payments which confer a benefit on an employee, either in money or money's worth.

Support for this interpretation is to be found in the decisions of the Australian courts. In *Mutual Acceptance Co. Ltd.* v. *Federal Commissioner of Taxation* (supra), the High Court of Australia considered the meaning of "allowances" in the phrase "any wages, salary, commission, bonuses or allowances paid or payable in cash or kind, to any employee". Rich J. was of the opinion that "the factor

13. *Parson's* case per North P. at 13; per Haslam J. at 6.
14. Dixon J. in *Mutual Acceptance Co. Ltd.* v. *Federal Commissioner of Taxation* (1944) 69 C.L.R. 389 at 402.
15. *Stagg* v. *Inland Revenue Commissioner* (supra) at 1257.
16. C. A. Staples in "A Guide to New Zealand Income Tax Practice", 24th ed., p. 17.

common to all these forms of remuneration is that they are payments designed to confer on the employee a substantial benefit for himself and from which he in fact obtains such a benefit" (supra at 399). A similar conclusion was reached by Lukin J. in *Issacs* v. *Commissioner of Income Tax* [1916] S.R.(Q.) 95. The Supreme Court of Queensland was there dealing with a taxation statute which provided that "every allowance benefit or advantage of any kind whether in money or otherwise" shall be deemed to be part of the income of the taxpayer. After examining the nature of the payment in question and the comparable legislation of several other states, he concluded at page 108 "that the allowance, in order to become the taxpayer's income, must be either money or something of monetary value or of real advantage and benefit to the taxpayer. . . . " Two other attempted definitions of allowances which have misused or ignored the requirement of benefit must be mentioned. Both are to be found in *Mutual Acceptance Co. Ltd.* v. *Federal Commissioner of Taxation* (supra). The first is that of Latham C.J., who considered that where the word allowance is used in connection with the relation of employer and employee it means a grant of something additional to ordinary wages for the purpose of meeting some particular requirement connected with the employment or as compensation for unusual conditions of that service. He then pointed out that the second class of allowances comprised in that definition are "wages" in the ordinary sense of the word, and if the word "allowances" was limited to this class it would not extend the statutory definition, and would therefore have no significance or effect. He therefore concluded that "allowances" must include both classes of allowances, that is, "benefit" and "reimbursing" allowances. This conclusion illustrates the defect contained in his definition. The Chief Justice correctly drew the distinction between "benefit" and "reimbursing" allowances, but defined "benefit" allowances too narrowly. Payments in compensation for unusual conditions of service are certainly "benefit" allowances, for example, "dirt" money, but it cannot be argued that such payments constitute the exclusive content of "benefit" allowances. It is the benefits beyond compensatory payments for unusual conditions of service which extend the scope of "allowances" beyond that of "wages".

The second definition is that of Dixon J. After suggesting that "wages" and "salary" refer to ordinary forms of remuneration for work done, "commission" covers percentage rewards, and "bonuses" occasional or periodical additions to salary, he continued as follows:

> The next word "allowances" seems to me naturally to follow as an attempt to make sure that any other kind of gain or reward allowed or conceded by the employer to the employee for his work is brought within the definition. In language borrowed from Lord Esher, it is intended to cover any payment beyond the agreed salary of the employee for services or additional services rendered by him. (*Burgess* v. *Clark*) (Ibid., 403).

This definition is unsatisfactory in that it ignores the distinction between

"benefit" and "reimbursing" allowances altogether. It seems likely that this defect is brought about by the reliance of Dixon J. on the definition established by the English cases discussed earlier. Since those cases were not concerned with a taxation statute, the distinction there was immaterial. It is however of crucial importance when the word is being considered in the context of section 88 (1) (b). This factor casts doubt on the usefulness of the joint judgment of Sim, Reed, Adams and Ostler JJ. in *Edwards* v. *Commissioner of Taxes* (supra).

"Allowances" must, as suggested earlier, be read in its context, and this of course includes its relationship to the words which surround it in the section. The logical consequences of this is that the word should be read as ejusdem generis with "salaries" and "wages".[17] A definition of "salary or wages" is provided by section 2 of the Income Tax Assessment Act 1957.[18] It is interesting to note, however, that this definition is very similar in its terms to section 88 (1) (b) itself, and in fact is somewhat broader in its scope. Neither in *Stagg* v. *Inland Revenue Commssioner* (supra) nor in the present case was reference made to this overlap.[19] which prima facie appears to make the bulk of paragraph (b) superfluous. The 1957 Act establishes the P.A.Y.E. system, and it is possible that the framers of that Act, being primarily concerned with the concept of income from personal services, took the wording of section 88 (1) (b) as an acceptable expression of that concept and for the purposes of brevity defined it as "salary or wages", without thereby intending that the words "salaries" and "wages" in section 88 (1) (b) should be read in the light of section 2 of the 1957 Act.

Those words can probably best be construed in the context of section 88 (1) (b) as meaning ordinary forms of remuneration for work done.[20] Attributing this meaning to "salaries" and "wages", the word "allowances" can, it is submitted, be defined as a payment which an employer makes to an employee in addition to his basic salary or wage[21] because of something done or to be done in the service of the employer, such payment being either in money or money's worth, and conferring a

17. *Stagg* v. *Inland Revenue Commissioner* (supra) at 1256; *Edwards* v. *Commissioner of Taxes* (supra) at 248; *Commissioner of Taxes* v. *Joss* [1910] S.A.L.R. 100 at 107; *Mutual Acceptance Co. Ltd.* v. *Federal Commissioner of Taxation* (supra) at 399.
18. This Act is. by section 1, deemed to be part of the Land and Income Tax Act 1954. Further, section 2 provides that the definition shall apply "For the purposes of the principal Act (including this Act) . . . " Accordingly, that definition is applicable to section 88 (1) (b) of the Land and Income Tax Act 1954 (the principal Act).
19. Though the point was raised by counsel for the taxpayer in *Parson's* case in his submissions to the Court of Appeal.
20. *Mutual Acceptance Co. Ltd.* v. *Federal Commissioner of Taxation* (supra) per Dixon J.
21. The objection could be made here that allowances are often built into the basic salary or wage under various awards, for example, allowances paid to employees required to handle dangerous substances such as acids. The answer is, in the writer's opinion, that such allowances are in fact part of the employee's salary or wages, and there is no need to bring them within the word "allowances" in section 88 (1) (b).

benefit[22] on the employee. This is, of course, substantially the definition put forward by Haslam J. in the Court of Appeal.

There has been discontent with the vagueness of section 88 (1) (b) for some time, and the majority decision of the Court of Appeal in *The Commissioner of Inland Revenue* v. *Parson* makes an amendment of the section a strong possibility. The Commissioner is not likely to accept as authoritative an interpretation of the section which will make it extremely difficult ever to tax the wide variety of fringe benefits not directly paid in cash. To conclude, it is significant in this regard that the Taxation Review Committee in its Report on Taxation in New Zealand[23] considered that steps were required to ensure that such benefits are liable for tax. In particular, they recommended at pages 261-262:

1. That section 88 should be amended so as to include in the term "assessable income" the total benefits arising in a particular income year from the exercise of rights granted in an earlier year.
2. That the provisions of section 89 should be widened so as to include in the term "allowances" benefits in cash or kind in respect of the use of cars and other assets, cheap interest rates, travel, and stock options.
3. That specific provision should be made in the return of income forms for the declaration of all cash allowances and benefits in cash or kind and a taxpayer incurring expenditure out of such an allowance should be required to keep sufficient records to substantiate such expenditure where he claims a deduction.
4. That employers should be required to disclose all allowances and benefits in cash or kind given to or provided for employees.
5. That employers should be required to make an assessment of the value of benefits in kind provided for employees and to account for P.A.Y.E. tax payable in respect of such benefits.

If these recommendations are to be made part of the law then obviously some legislative amendment will be necessary to overcome the restrictive interpretation of the Court of Appeal in *The Commissioner of Inland Revenue* v. *Parson* (No. 2). In this regard, the Minister of Finance has declared his intention in the 1968 Budget at page 29 to introduce legislation during 1968 to provide for benefits conferred on employees through the granting of stock and share buying privileges to be taxed as income.

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22. The question then arises as to the method of valuation of the benefit to be adopted. In *Parson's* case, the Commissioner merely took the market value of the shares as at the date of allotment and deducted the amount payable by Parson, thereby disregarding the effect of the various restrictions attaching to the shares, particularly the company's right of repurchase. McGregor J. felt that because of the existence of this right the shares were not immediately realisable, and therefore had no value beyond what Parson had paid for them. North P. and McCarthy J. also considered this point, though their comments were, of course, obiter dicta. They disagreed with McGregor J., and said that the real question was not whether Parson could sell the shares, but whether he could have raised money on them in any way; for example, whether a speculator or moneylender would have been prepared to loan him a sum of money on the security of his contractual rights without a personal covenant on his part.

23. Published subsequent to the decision of McGregor J. in the Supreme Court, but prior to the matter reaching the Courth of Appeal.