

# THE EXTENSIVE POWERS OF THE COMMISSIONER OF INLAND REVENUE IN ASSESSING AND COLLECTING TAX DEBTS

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## I. INTRODUCTION

Taxation law, which includes a regulation of the wide ranging powers of the Commissioner of Inland Revenue (CIR), is largely perceived as a specialist area with its own unique rules. It however shares an important attribute with other areas of law such as administrative law, constitutional law, industrial law and criminal law.<sup>1</sup> This shared attribute is that, like these other areas of law, taxation law forms a significant part of public law. The law of taxation seeks to regulate the relationship between the state and the citizen as far as the impost and collection of tax revenues are concerned.

The Privy Council identified three features which earmarked a “tax”. These were that a tax was compulsory, that this compulsory levy was for public purposes, and that there was legal sanction for the exaction of the impost.<sup>2</sup> These attributes were later adopted by Latham CJ of the High Court of Australia as being of general application in determining when an exaction of money would be characterised as a tax. A tax in his view was “a compulsory exaction of money by a public authority for public purposes, enforceable by law, and not a payment for services rendered”.<sup>3</sup>

The interface between state and citizen in taxation gives rise to a heightened sense of tension and indeed conflict for at least two reasons. First, there is a glaring and substantial imbalance in the power and resources between state and citizen in the taxation relationship. The state, through its agent the

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<sup>1</sup> As stated by Judge Learned Hand in *Moore v Mitchel* 30 F 2nd 600, 604 (1929): “Revenue laws fall within the same reasoning; they affect a state in matters as vital to its existence as its criminal laws”.

<sup>2</sup> *Lower Mainland Dairy Products Sales Adjustment Committee v Crystal Dairy Ltd* [1933] AC 168, 175.

<sup>3</sup> *Matthews v Chicory Marketing Board (Vic)* (1938) 60 CLR 263, 276.

Commissioner of Inland Revenue (CIR)<sup>4</sup> and his Department,<sup>5</sup> can bring a vast amount of power to bear on the hapless citizen. These powers include the ability to require taxpayers or their advisers to supply information about the taxpayers' liability for any tax. The information can also be required to be supplied for the purposes of administering and enforcing the Inland Revenue Acts<sup>6</sup> or for the purpose of carrying out any function lawfully conferred on the Commissioner. This power to have information supplied can be done simply by a statutory notice to this effect<sup>7</sup> or by application for a court order<sup>8</sup> legally obliging the taxpayer or its advisers to supply this information. In the event of failure to comply with the court order, the taxpayer will be in contempt of court. Alternatively, the taxpayer can be prosecuted for the offence of failing to comply with a section 17 statutory notice.<sup>9</sup> More pervasive is the Commissioner's power to enter business or private premises to obtain information about a taxpayer's affairs.<sup>10</sup> The Commissioner is also empowered to require a person to attend and give evidence on oath before the Commissioner or any officer of his Department.<sup>11</sup> There is also power for the Commissioner to hold an inquiry before a District Court Judge for the purpose of obtaining information.<sup>12</sup>

In essence, therefore, through a combination of measures where either information is supplied by the taxpayer or compulsorily and proactively acquired by the Commissioner, extensive information can be obtained about taxpayers. The Commissioner's pervasive powers to gather information are often resented because of the time and expense incurred in complying with them.<sup>13</sup>

The second reason for tension between the taxpayer and the Commissioner arises because of the intrinsic nature of taxation where the private property

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<sup>4</sup> A creature of statute in terms of s 6A (1) of the Tax Administration Act 1994 (TAA). Hardie Boys J, in *Knight v C of IR* [1991] 2 NZLR 30, 42 observed that "the Commissioner is a statutory officer".

<sup>5</sup> Tax Administration Act 1994, s 5.

<sup>6</sup> Outlined in the schedule to the TAA.

<sup>7</sup> Section 17.

<sup>8</sup> Section 17A.

<sup>9</sup> Section 17A(4).

<sup>10</sup> Section 16.

<sup>11</sup> Section 19. For further comment see McClay, "Section 19 inquiries" (July 2001) 3 New Zealand Tax Planning Report 22.

<sup>12</sup> Section 18.

<sup>13</sup> See comments by Lord Templeman in *New Zealand Stock Exchange v CIR* (1991) 13 NZTC 8147, 8151 in respect of third parties who are served with s 17 notices.

rights of the citizen must succumb to encroachment by the state. The nature of taxation is a legally sanctioned right of expropriation by the state of what has hitherto been legitimately acquired private property or wealth by the efforts of individual or corporate taxpayers. The challenge for the taxpayer therefore is legitimately to minimise the state's entitlement to his or her private wealth, as articulated by Lord Tomlin:

Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.<sup>14</sup>

A more illustrative and vivid portrayal of this competing right of the state to private wealth were the comments of Lord President Clyde that:

No man in this country is under the smallest obligation, moral or other, so as to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow – and quite rightly – to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's rocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.<sup>15</sup>

Despite the very long and powerful arm of the Commissioner to interfere in the lives of private citizens, there are legal rules about how the law creates the liability for taxation. These rules set out how this pre-existing liability is quantified and a tax debt created, whereby the citizen becomes liable to make payment. Where there is default in paying the debt when it falls due, the Commissioner has a number of options for enforcing the payment of this debt.

This article seeks to examine specifically the legal issues regarding the creation of the liability for taxation under New Zealand law, the legal process of assessment and its effect in giving rise to a tax debt payable by the taxpayer, the consequences of the taxpayer defaulting in payment of the debt and options available to the Commissioner to enforce payment, recent public and other criticism of the Commissioner's powers to assess and

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<sup>14</sup> *Inland Revenue Commissioners v Westminster* [1936] AC 1, 19-20.

<sup>15</sup> *Ayrshire Pulman Motor Services and D M Ritchie v The Commissioner of Inland Revenue* (1929) 14 Tax Cases 754.

collect debts in an expeditious fashion, and the prospect of more proactive use of the statutory notice procedure to collect tax debts.

## II. THE LIABILITY FOR TAXATION UNDER NEW ZEALAND LAW

McCarthy J, in the Court of Appeal decision in *Reckitt & Colman v Taxation Board of Review* agreed with the argument of counsel for the respondents, Richardson (now Richardson P of the Court of Appeal), in respect of the general scheme of Inland Revenue Acts.<sup>16</sup> This was that liability for tax is imposed by the charging section in the case of income tax by the governing Act. It is the Act itself which imposes, independently, the obligation to pay. This cardinal principle has been reaffirmed by the Court of Appeal in subsequent decisions, namely, those of *Lowe v CIR*,<sup>17</sup> *C of IR v Lemmington Holdings Ltd*,<sup>18</sup> *C of IR v NZ Stock Exchange*, *C of IR v National Bank of NZ Ltd*,<sup>19</sup> *Brierley Investments Ltd v C of IR*,<sup>20</sup> *CIR v Canterbury Frozen Meat Company Ltd*<sup>21</sup>, and *BNZ Finance v Holland*.<sup>22</sup> Section AA 1(a) of the Income Tax Act 1994 (ITA 1994) provides that one of the main purposes of the Act is to impose tax on income, thus confirming that the Act creates the charge for tax.

## III. THE ASSESSMENT PROCESS AND THE CREATION OF A TAX DEBT

### 1. *The Legal Process of Assessment*

The pre-existing liability is quantified by the Commissioner and section 92 of the Tax Administration Act 1994 imposes a duty on the Commissioner to make assessments on the following basis:

From the returns made under sections 33, 34, 36 to 39, 41 to 44, 63, 79, and 80 and from any other information in the Commissioner's possession the Commissioner shall in and for every year, and from time to time and at any subsequent time as may be necessary, assess the taxable income and income tax liability of the taxpayer and the tax payable by the taxpayer.

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<sup>16</sup> [1966] NZLR 1032, 1045.

<sup>17</sup> [1981] NZLR 326, 344.

<sup>18</sup> (1982) 5 NZTC 61268, 61272.

<sup>19</sup> (1990) 12 NZTC 7259, 7262.

<sup>20</sup> (1993) 15 NZTC 10,212, 10214.

<sup>21</sup> (1994) 18 TRNZ 645, 650.

<sup>22</sup> (1997) 18 NZTC 13156, 13160.

In *C of IR v NZ Stock Exchange*, Richardson J commented on the provisions in the then equivalent of sections 16-19 of the TAA for the furnishing of information, the inspection and production of documents, and the holding of inquiries, all designed to facilitate access by the Commissioner to information.<sup>23</sup> The eliciting of such information was to provide a basis for exercising the function of making assessments against taxpayers. The process which the Commissioner must adhere to in making an assessment was the subject of the Court of Appeal decision in *Canterbury Frozen Meat Company Ltd.*<sup>24</sup> An assessment is essentially the making of a judgment by the Commissioner of the amount on which tax is payable and the amount of the tax. Richardson J in the *Canterbury Frozen Meat* case provided a useful summary of his conclusions on the meaning of assessment when he commented as follows:

An assessment is the quantification by the Commissioner of the statutorily imposed liability of the particular taxpayer to tax for the year in question. The making of an assessment, including an amended assessment, requires the exercise of judgment on the part of the Commissioner in quantifying that liability on the information then in the Commissioner's possession. It involves the "ascertainment" of the taxable income and of the resulting tax liability just as it does under the Australian definition of "assessment" which uses the expression ascertainment ....

The making of an assessment determines the indebtedness of the subject to the Crown. That liability is unqualified. Sanctions are provided for failure to pay. It follows that a decision which is tentative, or provisional, or subject to adjustment, or conditional does not reflect the statutory scheme. In short, to constitute an assessment for income tax purposes the decision of the Commissioner must be definitive as to the liability of the taxpayer at the time it is made, and final subject only to challenge through the objection process.<sup>25</sup>

Once an assessment has been made it is conclusively deemed and taken to be correct and its validity cannot be disputed except in proceedings on objection to the assessment under Part VIII or a challenge under Part VIIIA of the TAA.<sup>26</sup>

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<sup>23</sup> *Supra* note 19, at 7262-3.

<sup>24</sup> *Supra* note 21.

<sup>25</sup> *Ibid*, 655. This was reaffirmed by the Court of Appeal in *C of IR v New Zealand Wool Board* (1999)19 NZTC 15476, 15,488-15,489.

<sup>26</sup> Section 109 TAA. The administrative law remedy of judicial review may be available to challenge the validity of the process by which an assessment was made.

Under the Australian statutory scheme, in all cases, the service of a notice of assessment is the occasion of liability, “the levying of the tax”.<sup>27</sup> As observed by the majority judgment in *Deputy Commissioner of Taxation v Harkin*, “under the Income Tax Assessment Act the liability of the taxpayer does not come into existence until there has been an assessment by the commissioner of the tax payable and notice of that assessment has been given by the commissioner to the taxpayer”.<sup>28</sup> The High Court of Australia had also concluded that a notice of assessment was essential to the existence of an assessment in *F J Bloemen Pty Ltd v F C of T*.<sup>29</sup>

New Zealand’s position is distinctly different from the Australian position, as very recently confirmed by the Court of Appeal in *Hyslop v C of IR*.<sup>30</sup> The issue on appeal in *Hyslop* was whether failure to give the taxpayers notice of the grounds of assessment invalidated the assessment. The essence of the Court of Appeal decision was that, while the then equivalent to section 111(1) of the TAA 1994 required that the notice of assessment be given to the taxpayer “as soon as conveniently may be after an assessment is made”, the omission to give such notice will not invalidate the assessment in terms of section 111(6). This reinforced the provisions of the then equivalent of section 114 of the TAA 1994 which provides that the validity of an assessment is not affected by failure to comply with any statutory provision in either the TAA 1994 or the ITA 1994. Accordingly, the New Zealand statutory scheme made it clear that it was the assessment that quantified the indebtedness, the validity of which remained unaffected in the absence of notification of such assessment being conveyed to the taxpayer through any of the avenues in section 14 of the TAA.

## 2. An Assessment For Tax and Tax Indebtedness

Once a taxpayer is notified of an assessment for tax, the notification also stipulates a due date by which the tax owing is to be paid. On the expiry of the due date for payment, the debt then becomes not only owing to the Commissioner but also one in respect of which enforcement action can be taken for its recovery.<sup>31</sup> It is useful to make the distinction between on the

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<sup>27</sup> *Batagol v FC of T* (1963) 9 AITR 207, 214, per Kitto J.

<sup>28</sup> (1959) 100 CLR 566, 573.

<sup>29</sup> 81 ATC 4280.

<sup>30</sup> (2001) 20 NZTC 17,031. This was followed recently in *C of IR v Dandelion Investments Ltd* (2001) 20 NZTC 17,293, 17,296, per Tompkins J.

<sup>31</sup> An identical view was expressed by Gibbs CJ in the High Court of Australia decision of *Clyne v DFC of T* 81 ATC 4429 regarding the due date for payment and indebtedness when he said: “At the latest when tax is assessed it becomes a debt due to

one hand the creation of a tax debt by making an assessment and issuing due notification of it, and, on the other, taking enforcement action in good time that recovers the debt.

### 3. *The Consequences of Taxpayer Default and Enforcement Options*

As noted by Richardson J in *Canterbury Frozen Meat Co Ltd*, “sanctions are provided for failure to pay”.<sup>32</sup> The recent report of Parliament’s Finance and Expenditure Committee of its Inquiry into the Powers and Operations of the Inland Revenue Department (chaired by Peter Dunne and hereinafter referred to as the “Dunne Report”), highlights the consequences in these terms:

If the debt remains unpaid and there is no prospect of immediate payment, the department needs to consider management options available to it. Although the department’s preference is to recover debt by voluntary payment in full, recovery can also be by way of voluntary time payment (for example, an instalment arrangement), or by compulsory deduction. If a taxpayer is in financial difficulty the department can, in limited circumstances, provide relief from debt by way of write-off, cancellation or remission.<sup>33</sup>

Section 7A of the TAA provides the Commissioner with a wide-ranging power to take securities in respect of the performance of tax obligations. Section 3 defines “security” for the purposes of section 7A to mean a security given to the Commissioner to secure the performance of a tax obligation, and includes a mortgage or charge or other encumbrance over, or pledge of, an asset or right and a guarantee or indemnity. Where securities become inadequate or insufficient, the Commissioner is empowered to call for additional or substitute securities. The Commissioner can require that securities be transferred into the name of the Commissioner and be held until such time as a tax obligation or obligations are performed. There is also provision in section 7A(1)(e) for enforcement of the security where the taxpayer defaults in the performance of a tax obligation.

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the Crown although it is not payable until the later date specified in the notice of assessment” (at 4432 RHC).

<sup>32</sup> *Supra* note 21, at 655.

<sup>33</sup> Inquiry into the powers and operations of the Inland Revenue Department, *Report of the Finance and Expenditure Committee* (October 1999) 15.

#### IV. CRITICISM OF THE COMMISSIONER'S POWERS TO ASSESS AND ENFORCE TAX DEBTS

##### 1. *The Dunne Report*

The Commissioner and his Department appear to have recently come under sustained criticism for not properly assessing or efficiently collecting tax debt. The Report of the Commission of Inquiry constituted to inquire into certain tax matters (the Davison Commission) – a highly publicised Commission of Inquiry known as “the Winebox Inquiry” – highlighted criticism of the manner in which large corporate tax debts had been assessed. While the Report substantially vindicated the Commissioner’s conduct in respect of matters dealt with in the Report, the findings of the Report were substantially overturned by the Full Court of the High Court in *Peters v Davison*.<sup>34</sup>

Further criticism was made of the way in which the enforcement powers of the Commissioner had been employed both in terms of the options embarked on and their effectiveness. Before making its adverse findings, the Dunne Report found that, while the Commissioners powers were considerable, they were appropriate and their rationale was explained as follows:

While the Commissioner’s powers are extensive, we consider that, by and large, these powers are appropriate for the role the Commissioner is required to undertake. The department is bound to enforce compliance on the part of all taxpayers. Not to do so would seriously damage the integrity of the tax system and undermine the system of voluntary compliance. The extent of the Commissioner’s powers is necessary to ensure that reluctant taxpayers meet their obligations. Those powers ensure that taxpayers who willingly pay their tax are not disadvantaged or required to pay a disproportionate share of the tax burden.<sup>35</sup>

However, in its findings on how effectively these wide powers had been used in the collection of tax debts, the Dunne report was critical. The Department was urged to become involved in collecting outstanding tax at an earlier stage than was the case. Under the Department’s then current policies and procedures, recovery action was being instigated when any realistic chance of recovery had long passed. The report noted that in many cases the first contact with the taxpayer for tax arrears was “several months

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<sup>34</sup> (1999) 19 NZTC 15,391.

<sup>35</sup> Supra note 32, at 6.

after the due date has passed".<sup>36</sup> If the emergence of tax debt was recognised early, there was a better chance of recovery from the Department's perspective and the matter would be more manageable from the taxpayer's perspective before the imposition of late payment penalties and use of money interest (UOMI) caused small debts to become much higher and beyond the ability of the taxpayer to meet.<sup>37</sup>

The Dunne Report then commented on specific management options for tax debt taken by the Department and their effectiveness. These options were bankruptcy action in the case of individual taxpayers and liquidation proceedings in relation to corporate taxpayers.

In respect of bankruptcy proceedings, the report noted that in the period 1 July 1998 to 30 June 1999, the department had referred 1000 individuals for bankruptcy and 995 companies for liquidation. Worth noting was that, in 44 percent of those cases, proceedings were subsequently withdrawn as either the debt was paid in full or arrangements were entered into whereby the debt would be paid over a period of time. The report specifically commented on the effectiveness of the use of bankruptcy proceedings in collecting debt when it said:

Many bankruptcy proceedings could be avoided if the department became actively involved in taxpayers' affairs sooner rather than later, to halt the growth of debt. By the time the department does get involved the debt is so large the department has no other choice but to bankrupt.<sup>38</sup>

While the department acknowledged that bankruptcy and liquidation proceedings were debt management options of last resort, it appeared that bankruptcy action was embarked upon when the debt became unmanageable for the taxpayer. Thus it seems that bankruptcy action was pursued as a means of stopping the continuing rapid escalation of debt rather than as an effective debt collection option. There is a suggestion albeit implied in those comments that the bankrupt's estate usually falls far short of being able to

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<sup>36</sup> Ibid, 15.

<sup>37</sup> Ibid. A recent example of such rapid escalation of debt is illustrated in *Re Hunter, ex parte C of IR; Re Collins, ex parte C of IR* (2000)19 NZTC 15,722, where the initial debts totalled about \$50,000. The payment which was anticipated was \$200 per month, or \$2,400 per year. Robertson J further commented as follows: "In the meantime, late payment penalties were accruing at the rate of 10% every 6 months which is at least \$10,000 per year and very quickly a great deal more than that as the late payment penalties compounded" (at 15,726).

<sup>38</sup> Supra note 32, at 18.

meet any realistic portion of the substantial tax indebtedness. At best perhaps is the prospect of collection of a portion of the preferential amounts of goods and services tax (GST) or Pay As You Earn (PAYE) taxes.

As far as liquidations were concerned, the Report was critical of the statutory preference the department had under section 312 of the Companies Act 1993 and the seventh schedule to that Act. It appeared as if, in addition to having its claim for preferential tax debt paid, it was also in addition to the core debt being paid interest and penalties which did not enjoy the same preferential status as the core debt. The overall consequence was that the Commissioner through his department was obtaining payments which were more than his legal entitlement. This increased claim was being met at the expense of claims by the remaining pool of unsecured creditors who were left with very little if anything of the company's assets from which to have their residual amounts of the company's indebtedness met.

The resonant theme of the Dunne Report, in respect of the Commissioner's tax debt collection efforts, appears to be that the timely pursuit of debt is crucial. There were submissions made to the Dunne Committee, notably by Price Waterhouse Coopers, which suggested that the Department should adopt approaches similar to trading banks and put in place prompt follow-up procedures for overdue debts. The Dunne Report commented that a follow-up system had to be put in place but one which was far more sophisticated than the one for banks in terms of early action for recovery. This was because of the peculiar feature of tax debt which faced the accumulation of late payment penalties and UOMI, causing it to spiral out of control much quicker than in the case of non tax debts.

## *2. Judicial Criticism of Tax Administration by the Commissioner*

It appears therefore that the Commissioner and his department have come under concerted pressure to act early. This is in addition to criticism for delay in the Department's performance in respect of other matters by Judge Willy as the Taxation Review Authority (TRA) in the decision in TRA Case No 93/013. Furthermore, the Court of Appeal in its decision in *Union Steamship Co of New Zealand Ltd v C of IR* criticised the Commissioner for a 21-year delay before a tax dispute finally arrived for a hearing at the High Court.<sup>39</sup>

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<sup>39</sup> (1996) 17 NZTC 12,630, 12,631, per Blanchard J. More recently, Robertson J, in *Re Hunter; ex parte C of IR; Re Collins; ex parte C of IR* (2000) 19 NZTC 15,722 commented on the manner in which the Commissioner and his department dealt with

It is suggested that, in view of such sustained criticism of the Commissioner in regard to his functions of assessing and collecting tax debts, he should become pro-active in collecting debt at a much earlier stage. This may well occur through the use of a highly effective but less-known power of collection, namely, compulsory deductions. The compulsory deductions may be effected by the Commissioner through his departmental officers serving a statutory notice under section 157 of the TAA.

## V. TAX DEBT COLLECTION USING STATUTORY NOTICE PROCEDURE

### 1. Introduction

The powers to collect tax debts under section 157 place the Commissioner in a distinctly privileged position vis-a-vis other creditors. An ordinary creditor, in seeking to enforce collection of a trade debt for instance, would first seek to obtain a Court judgment for the debt usually in the District Court. The creditor, having obtained judgment, would then need to obtain a garnishee order from the Court which would enable a garnishee notice to be served on a third party namely a creditor of the debtor. The effect of serving this notice on the third party would be to have it pay the judgment creditor direct rather than the judgment debtor to which it is ordinarily indebted. Thus, in a very common example where this procedure is used to great effect, if a tenant owed rent, the landlord, having obtained a garnishee notice in the manner described, would serve the garnishee notice on the tenant's employer or other creditor. This would have the effect of ordering the employer to pay a portion of the tenant's salary or wages directly to the landlord to offset rent arrears. Section 157 achieves an identical result but without the Commissioner having first to obtain judgment. Simply arriving at an assessment for a tax debt, and waiting for the expiry of the due date for its payment specified in the notice of assessment, are all that is required before a section 157 garnishee notice can be served on a creditor of the taxpayer.<sup>40</sup>

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the taxpayer, as follows: "There is no doubt that bureaucratically things could and should have been done better" (at 15,732).

<sup>40</sup> It was this ambit of the power that perhaps prompted Gibbs CJ of the Australian High Court to comment in respect of the equivalent provision in Australia as follows: "However the section is obviously designed to confer exceptional powers on the Commissioner to facilitate the collection of tax" (*Clyne v DFC of T* 81 4429 , 4433).

## 2. The Provisions of Section 157

Section 157 contains 10 subsections. Subsection (1) provides that, where the taxpayer has made default in paying any income tax or penalty to the Commissioner, the Commissioner may by notice in writing require any creditor of the taxpayer to make deductions from amounts owing to the taxpayer. The creditor will then be required by virtue of the notice to pay the amounts to the Commissioner.

Where the notice relates to deductions from salary, subsection (3) provides that the amount deducted cannot be more than the greater of \$10 per week or the lesser of either 10% per week of the income tax owing or 20% of the wages or salary payable. There is provision in subsection (4) for the Commissioner to revoke such notice at any time. There are procedural matters in subsection (5), namely, that any notice so given must have a copy of it issued to the taxpayer. The rationale is that the taxpayer must be kept informed of the fact that a notice was served on a creditor of the taxpayer, so that the taxpayer can respond if need be. There is no time frame specified in which the taxpayer must be served a copy, the statutory requirement merely being that such must be done “forthwith”. This would usually be either at the time of service on the creditor of the taxpayer debtor or shortly thereafter. Subsection (6) requires the creditor to send the taxpayer debtor a written statement attesting to the fact that a deduction was made and the reason for it.

Subsections (8) and (9) provide that, where a notice is served on an ordinary creditor of the defaulting taxpayer or a bank, the moneys that may be held by them for the taxpayer are, from the point of service, deemed to be held in trust for the Crown and recoverable from the creditor or bank as if they were income tax payable by the debtor.<sup>41</sup>

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<sup>41</sup> In the early decision in *R v Norfolk County Council* (1890) 60 LJQB 379, 380-381, Cave J explained the meaning of deem as follows: “generally speaking, when you talk of a thing being deemed to be something, you do not mean to say that it is that which it is to be deemed to be. It is rather an admission that it is not what it is to be deemed to be, and that, notwithstanding it is not that particular thing, nevertheless, for the purposes of the Act, it is to be deemed to be that thing”. Lord Radcliffe in the House of Lords’ decision in *St Aubyn & Ors v A-G* [1951] 2 AllER 473 at 498 further observed as follows: “the word ‘deemed’ is used a great deal in modern legislation. Sometimes it is used to impose for the purposes of a statute an artificial construction of a word or phrase that would not otherwise prevail. Sometimes it is used to put beyond doubt a particular construction that might otherwise be uncertain. Sometimes it is used to give

### 3. Case Law Commentary on the Application of section 157

There appear to date to have been at least six reported decisions on the application of section 157 and its predecessor section 400 of the Income Tax Act 1976 (ITA 1976). The earliest decision in *Anzamco Ltd (in liq) v Bank of New Zealand*,<sup>42</sup> and the most recent decision in *Hieber v C of IR*,<sup>43</sup> were ones where the issues in dispute concerned whether the statutory procedures for serving an effective statutory notice had been followed.

In *Anzamco*, the company sold farm land for a profit of more than \$3 million and the Commissioner's assessment for income tax of \$623,417 was owing by the company. Shortly thereafter the company went into voluntary liquidation. The liquidator objected to the assessment. In addition, on 22 March 1982, the liquidator placed \$935,500 of the company's funds on a term deposit with the Bank of New Zealand Hamilton North Branch. The liquidator, who had sole control of the money, undertook to hold the amount claimed under the assessment until final determination of the objection. This was done to cover the contingency of the Commissioner succeeding in the objection proceedings.

On 25 August 1982, the liquidator was informed by the Bank of New Zealand, Hamilton Branch, which was separate and distinct from the Hamilton North Branch, that a section 400 notice had been served. The notice required payment to be made of about \$629,000 by 31 August 1982. At the date of the High Court hearing, almost two months after the bank had been served, neither the company nor the liquidator had been served a copy of the notice pursuant to section 400 (6) (section 157 (5)).

The Commissioner was criticised for acting rather arbitrarily in using the statutory notice procedure, for two reasons. First, objection proceedings had been set in train to hear the objection to the tax assessment. Secondly, the actions were taken in complete disregard of deliberate measures taken by the liquidator to hold a lump sum at the Hamilton North Branch in order to meet the contingency of having to pay the whole of the assessed amount in the event of the Commissioner's success at the objection proceedings.

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a comprehensive description that includes what is obvious, what is uncertain and what is, in the ordinary sense, impossible".

<sup>42</sup> (1982) 5 NZTC 61249.

<sup>43</sup> (2000) 19 NZTC 15716. The High Court decision in *Highfield v C of IR* (2000) 19 NZTC 15,609, although it involved a s 157 notice, did not analyse or discuss any aspect of the provisions in s 157, as there was no need to do this.

One of the grounds on which the applicant sought to have the notice set aside was that an inappropriate form had been used inconsistent with what section 400 authorised. Barker J upheld this ground on the basis that the wording of the notice did not meet the statutory test. The notice contained a direction to the bank to deduct a percentage amount from sums payable to the taxpayer. The statutory authorisation had been to direct the deduction of an amount and not a percentage amount.

The Commissioner was accordingly found to have been in breach of the statutory provision as he had made a demand on the bank which he was not authorised to make. It may be argued that the Commissioner failed on a mere technicality, namely through inappropriate wording of the notice, however such a breach was sufficiently serious to invalidate the notice because “[s]ince an attachment order interferes with the rights of the subject, the legislation authorising it must be followed strictly”.<sup>44</sup>

The notice was also sought to be impugned on the basis that it was addressed to the wrong branch of the bank, namely the Hamilton branch, when it should have been the Hamilton North branch. Barker J held that such defect in the notice was not sufficient on its own to invalidate the notice. Furthermore, the notice was sought to be invalidated on the basis that a copy of it had not been served on either the company or its liquidator as was statutorily required. Barker J expressed the view that service was no empty formality as service of a copy provided the taxpayer with an opportunity to contest the notice.<sup>45</sup> As indicated earlier, the provisions of section 157 (5) do not specify a time frame within which a copy of the notice ought to be served on the taxpayer, except to state that it must be done “forthwith”. Barker J opined that the timeframe should be such time by which the garnishee is directed to pay the amount to the Commissioner.

Other than issues of form and procedure for serving such notices, Barker J addressed wider issues of the propriety of issuing such notices in particular circumstances. It seemed pointless in his view to issue the notice when there

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<sup>44</sup> Supra note 35, at 61255.

<sup>45</sup> Contrast this requirement of notification after the notice is served with the taxpayer’s argument in *Woodroffe v DFC of T* 2000 ATC 4656. In response to the argument Mansfield J commented that the decision to issue a s 218 notice [equivalent to a s 157 notice] is not one of which advance notice is required to be given to the proposed recipient of the notice or to others whose money is to be the target of the notice (at 4657). Emmett J in *FC of T v Macquarie Health Corporation Ltd & Ors* 98 ATC 5214, 5237, observed that a notice under s 218 is normally given without the knowledge of the relevant taxpayer, and often against the taxpayer’s wishes.

were funds being held to satisfy the full amount of the Commissioner's assessment in the event that this was warranted. Furthermore, even if the defects in the notice were rectified by a fresh valid notice being served, such later notice would be unreasonable in the circumstances where an amount in excess of the Commissioner's claim had been secured to meet it.

#### *4. Use of a Section 157 Notice When Tax Assessment is Disputed*

Finally, the issue arose as to the interpretation to be given to the then equivalent of section 128 (1) and 138I(1) of the TAA (section 34 of the ITA 1976). The question was whether the Commissioner had an unfettered discretion to pursue recovery action using the statutory notice procedure when the taxpayer had embarked on the process of contesting the assessment through the case stated procedure. Barker J's response to this important question was that the former section 34 was silent on the Court's jurisdiction to stay recovery, when in the circumstances it would clearly be unjust to allow the notice to take effect before case stated proceedings had run their course.

In essence section 34 provided that, where an assessment was being contested before the TRA or the Courts, the tax in dispute was split into deferrable and non-deferrable components. The non-deferrable tax had to be paid to the Commissioner while the deferrable amount would not be paid pending resolution of the dispute. This was despite the fact that both amounts were owing pursuant to a valid assessment. The intervention of legal proceedings contesting the correctness of the assessment allowed this partial dispensation to the taxpayer, but only in respect of the deferrable amount.

This issue of the interrelationship between recovery action and the appropriateness of such action when a tax assessment was being disputed in the course of objection proceedings before a court arose for comment by Blanchard J in *Miller v C of IR*.<sup>46</sup> Although they were made in the context of bankruptcy proceedings that were being pursued by the Commissioner in respect of non-deferrable tax, the Judge's comments are equally relevant when recovery of non-deferrable tax is being pursued using the statutory notice procedure. Blanchard J's instructive comments were as follows:

Section 34(2) (b) [section 128(1) and section 138I(1) of the TAA] provides that the obligation to pay and the right of the Commissioner to receive any tax, not being deferrable tax, "shall not be suspended by any objection, appeal or case stated, made

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<sup>46</sup> (1993) 15 NZTC 10,187.

or requested under this Part of this Act". So the Commissioner is able to pursue the taxpayer against whom an assessment has been made while a case stated remains outstanding under Part III [now Part VIII of the TAA] and can obtain judgment against the taxpayer, levy execution and, at least in theory, bankrupt the taxpayer if the non-deferrable tax remains unpaid. The Commissioner is in the process of taking such steps against the Millers and the O'Neils who say they are quite unable to pay and are in danger of being bankrupted.<sup>47</sup>

Towards the end of his Honour's judgment, indications were given of the Court's view of the propriety of the Commissioner's conduct in taking enforcement action in respect of non-deferrable tax, pending conclusion of objection proceedings. These comments would equally apply in cases where a statutory notice were used as the instrument of enforcement. His Honour's more salient comments were as follows:

Nevertheless, it does not follow that the Commissioner would be justified in enforcing his post-assessment right to non-deferrable tax under s 34 [section 128 and section 138I of the TAA] pending the conclusion of the objection procedures, except in such a way as may be necessary or prudent to protect the position of the revenue.

.... The Commissioner is by s 34 given very large and unusual powers and, where the fate of an objection is not clearcut, the Commissioner should use those powers sparingly. Seizure and certainly sale of assets may often be unjustified. The Commissioner ought also to proceed cautiously in the bringing of bankruptcy proceedings, particularly if security can be obtained or there is some other means of ensuring that available assets can be preserved until objections are determined. It would be cruel and inappropriate if a citizen should without good cause be made bankrupt by an agency of the State when ultimate liability for the debt in question has not been determined and, indeed, may be found not to exist. The Courts will lean in favour of protecting a taxpayer where the Commissioner's powers are being used excessively.<sup>48</sup>

It would be reasonable to infer that, when His Honour made reference to "seizure of assets", the rubric of the phrase could also extend to moneys that are "seized" pursuant to a section 157 notice. In cases where objection or challenge procedures are taking their course, the Commissioner should instead, and where feasible, seek security over other assets of the taxpayer, such as for example taking a security under section 7A of the TAA over a taxpayer's house or other property.

Certainly the approach of Barker J in *Anzamco* on the use of a section 157 notice to enforce payment of non-deferrable tax, and the approach of

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<sup>47</sup> At 10,193 LHC.

<sup>48</sup> *Supra* note 46, at 10,206 RHC.

Blanchard J in *Miller v C of IR* on the use of bankruptcy proceedings also to recover non-deferrable tax, seem to have a consistent approach. This is that such enforcement action is unwarranted where some other available asset can be taken as security or is indeed offered as security for the debt until challenge proceedings have been determined. There also seems to be an implication in both judgments that this cautious approach is warranted to safeguard the taxpayer's interest, pending ultimate resolution of the Commissioner's tax assessment. The Courts seem willing to take this approach where either the taxpayer's conduct is exemplary and directly protects the Commissioner's interest as in *Anzamco*, or as a minimum the taxpayer has not actively sought to prejudice the Commissioner's interest in any way as is illustrated in *Miller v C of IR*.

However, the Courts appear quite willing to enforce directly the Commissioner's statutory right to non-deferrable tax where the taxpayer's actions give the appearance of tax evasion or there is a real risk that the taxpayer will dissipate its assets in a bid to frustrate the Commissioner's efforts to seek payment of assessed tax. This strict approach seems to have been evident in the most recent decision to consider section 157, namely, *Hieber v C of IR*.<sup>49</sup> This case involved Mr Hieber an individual New Zealand taxpayer as the first applicant, a trust as the second applicant in which Mr Hieber was a trustee, a partnership between him and the trust as the third applicant, and a property-owning company controlled by Mr Hieber as the fourth applicant. As a result of investigations into Mr Hieber's affairs, the Commissioner concluded that Hieber had systematically sought to defraud the New Zealand Revenue using an overseas company that he controlled. The result of the investigation led to tax assessment notices being issued for millions of New Zealand dollars. When the Commissioner suspected that assets were being dissipated to frustrate the effect of the assessments, he successfully applied ex parte for a charging order over a property owned by Hieber and, as a second measure, served section 157 notices on the tenants of a commercial complex in respect of the rental payments that they normally paid to the second and third applicants as owners and managers of the properties.

The argument against the section 157 notices was in respect of their validity. This was that the notices could be valid only in cases where a taxpayer had defaulted in paying income tax for which it had become liable. The further and essential argument was that, where an assessment for tax was subject to challenge proceedings pursuant to Part VIIIA of the TAA that sought to

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<sup>49</sup> (2000) 19 NZTC 15716 and discussed in detail in Henderson, "Threshold Challenge to S157" (July 2000) 3 New Zealand Tax Planning Report 23.

challenge its correctness, no liability existed until such time as the liability pursuant to those proceedings had been finally determined. The Court responded to the argument by invoking the provisions of section 109 of the TAA which deems an assessment to be correct unless determined otherwise in objection proceedings under Part VIII or challenge proceedings under Part VIIIA. The statutory presumption of correctness of an assessment under section 109 was, in Laurenson J's view, conclusive of final liability for the assessed tax.

The Commissioner, being conscious of the fact that dispute proceedings would be filed by the taxpayer, limited the sums subject to the section 157 notices to half of the tax assessed which was the non-deferrable amount. The non-deferrable amount was subject to an express statutory provision in section 138I of the TAA which made it payable to the Commissioner despite the fact that challenge proceedings were in train. Laurenson J was in no doubt that section 138I of the TAA was clear that, in dispute proceedings in relation to an assessment, 50 percent of the disputed tax had to be paid nonetheless, even though liability had not been finally resolved. Thus, a combination of section 109 which deemed an assessment to be correct and section 138I which made 50% of that deemed liability payable, was sufficient to have met the threshold requirement for the validity of a section 157 notice.

#### *5. Use of Section 157 To Attach Amounts Not Subject To Tax Assessments*

The recent High Court decision in *Singh v C of IR*<sup>50</sup> is perhaps the first of its kind in New Zealand in that it allows the Commissioner to retain excess amounts obtained under a section 157 notice where an expected assessment is very likely to be made of a taxation liability in the future. Such amounts can be retained where the Commissioner expects that, due to pending litigation, the taxpayer will be assessable for a future tax liability, which the retained amounts will to some extent satisfy. The decision in *Singh* appears to accept that a section 157 notice can be issued once there is an assessment giving rise to a tax debt. However, if the tax debt reduces to a sum that is less than the amount obtained pursuant to the notice, there is no obligation on the Commissioner to refund the balance to the taxpayer.

In *Singh*, the applicant prepared and filed income tax returns for others. He claimed false refunds in his own returns and also in returns prepared and lodged on behalf of his clients. He retained all the falsely obtained refunds. On 4 November 1992 the Commissioner issued default assessments in

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<sup>50</sup> (1999) 19 NZTC 15,050.

relation to the false refunds and also imposed additional tax. The applicant objected to the assessment and a case stated was set for hearing before the Taxation Review Authority (TRA).

On 4 November 1994, the Commissioner served section 400 notices on various bank accounts under the applicant's control and thereby seized just under \$87,000. On 12 December 1994, the Commissioner amended the original tax assessment which reduced the tax owed by the applicant. The applicant objected to this assessment also and asked for the dispute to be determined by the TRA. The applicant requested the Commissioner to refund him the difference between the amount in the second tax assessment and the \$87,000 seized under the section 400 notice. This request was declined by the Commissioner and duly communicated to the applicant by letter dated 28 February 1995. On 8 June 1995 the applicant was convicted on 66 charges of filing false returns of income. On 6 July 1995 the applicant was convicted on six charges of theft in relation to tax refunds made to his clients who were duly entitled to them. As a consequence of the criminal convictions for offences under the Crimes Act 1961 and ITA 1976, which were essentially for acting dishonestly, the applicant was assessed for a substantial amount in penal tax. The applicant commenced judicial review proceedings against the Commissioner's decision not to refund the balance that arose after the second assessment had been made.

Of interest in *Singh* is that what the Commissioner held as surplus funds appeared to include the whole amount of the assessments in dispute and not only the non-deferrable sums, as had so far been the issue in relation to *Anzamco*, *Miller v C of IR* and *Hieber*. In this respect *Singh* appears to have broken new ground. Laurensen J in his judgment makes the significant point that, when the applicant was notified on 28 February 1995 that his request for a refund would not be met, the Commissioner's investigation had reached a point where 67 informations had been laid against the applicant alleging that false returns had been filed. The crucial point was that:

as at 28 February 1995, the respondent had not only determined a clear picture of the applicant's tax liability, but he had also good reason to believe that the liability would be substantially increased by the imposition of penal tax if it was subsequently found that the applicant had, in fact, filed false returns in respect of his own affairs.<sup>51</sup>

The above comments amply demonstrate the very close nexus that must exist between the surplus funds retained and a related future though

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<sup>51</sup> At 15054 RHC.

impending tax liability. The impending liability must be very directly linked to the basis for obtaining the surplus funds in the first place. Any other nexus between existing funds and a general future liability would not suffice. It has to be as close as in *Singh* where the assessments related to the refunds falsely claimed and section 400 notices were served to meet assessments for such refunds. The surplus moneys from issuing the section 400 notices could be held in order to meet future assessments for penal tax which were to be raised as a direct consequence of such deceptive conduct.

The other rationale for entitlement to hold such surplus funds would be where the impending assessments will almost certainly exceed the surplus held, thereby nullifying any practical usefulness of making the refund. As observed by Laurensen J:

The important point to note, as I see it, is that the balance of the monies held by the respondent as at the date of his decision, of approximately \$40,000, were less than the total liability finally established of approximately \$105,000. In fact all the monies obtained pursuant to the s 400 notice have been allocated by the respondent in part payment of the above sum.<sup>52</sup>

Having so closely circumscribed the circumstances where surplus monies so obtained can be retained, it appears that Laurensen J was mindful of the injunction by Barker J in *Anzamco* that since a notice interferes with the rights of the subject the legislation must be strictly construed.

#### *6. A Section 157 Notice and Other Fiduciary Relationships*

The High Court decision in *King v Leary*<sup>53</sup> dealt with the issue of how wide a construction could be given to the obligation to pay money which was clearly identifiable as an “amount payable” as the phrase is defined in section 157(10). Thus, the Court had to decide whether the primary obligation to pay as between payer and payee could be extended to charge all persons who in any paying capacity had control of funds which were to pass to the taxpayer.

The facts in *King v Leary* illustrate that the notice can be used by the Commissioner as a potent instrument for collecting unpaid taxes. The section 400 notice was issued at the same time as the default assessment was issued which created the debt. The notice was issued to the defendant solicitor and taxpayer. After the notice was issued, the defendant as trustee

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<sup>52</sup> Supra note 42, at 15054.

<sup>53</sup> (1988) 10 NZTC 5067.

of the taxpayer's family trust received a cheque from the trust. Part of the amount represented by the cheque was paid out to the taxpayer by the defendant acting in his capacity as trustee, pursuant to instructions from the taxpayer's father who was settlor of the family trust. The Commissioner alleged that the payment to the taxpayer by the defendant solicitor was a clear breach of section 400, and brought a prosecution action under the then equivalent of section 157A of the TAA (s 400 (9)(a) of the ITA 1976). The prosecution action was first heard in the District Court which decided that the funds had been held by the defendant on account of the family trust. When the money was paid out to the taxpayer, the amount was not payable by the defendant to the taxpayer, as was required by section 400, because the trust was the payer and not the defendant solicitor who was merely acting on instructions. Since the trust was the payer, the moneys so held were impressed by that trust. The Commissioner appealed by way of case stated to the High Court. Counsel for the Commissioner argued that, having regard to the authorities, the phrase "to be made from any amount payable by him to a taxpayer" (in the then equivalent to section 157 (1) (a)) had always been wide enough to override contractual relationships, fiduciary relationships and the relationship between a trustee and beneficiary.

Heron J agreed with submissions made by counsel for the Commissioner that a much wider meaning was intended of the obligation to pay. Heron J agreed with the finding of the District Court that it was indeed correct to say that the amount in question was certainly one which was payable by the trust to the taxpayer but the obligation to pay was not restricted merely to this primary obligation to pay. His comments were as follows:

The same amount was also "payable" by the solicitor to the taxpayer. He held monies on behalf of his client, the trust, but they became payable by him to the taxpayer on receipt of instructions from the trust. I think the section was not designed to confine itself to the primary obligation to pay, recognising only the ultimate relationship between the payer and payee. It was I believe designed to charge all persons who in any paying capacity had control of funds which were to go to the taxpayer. I think that is consistent with the practical interpretation that the words "payable" and "paid" have received and the policy of the section designed, once default has occurred, to intercept funds and cut across other obligations, whatever they may be, except where otherwise provided by statute.<sup>54</sup>

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<sup>54</sup> At 5073. It appears that s 157(10)(6) in defining "amount payable" gives effect to the decision in *King v Leary* by including amounts which are payable by a person as a trustee.

### 7. Section 157 and Statutory Priorities

The comments towards the end of Heron J's judgment above suggest that a statutory notice cannot frustrate what statute may have already prescribed as the priority in which payments ought to be made. The statutory notice will take effect subject to any prior charges such as a mortgage, as illustrated in the High Court decision in *Murphy v New Zealand Newspapers Ltd*.<sup>55</sup>

In *Murphy*, the plaintiff solicitor, acted for the mortgagee in a mortgagee sale. After the realisation of proceeds from the sale, the mortgagee's claims were met in full. There was, however, a surplus of funds left over after the mortgagee's claims were satisfied, and efforts were made to contact the mortgagor with a view to paying over the surplus to the mortgagor in accordance with section 104 of the Property Law Act 1952 (PLA 1952). These efforts proved unsuccessful and the solicitor prepared to follow the procedure prescribed by the PLA 1952 and Land Transfer Act 1952 (LTA 1952), whereby the surplus moneys, being *bona vacantia* (unclaimed), would be paid to the Crown. Before the solicitor could embark on this procedure, he was served with a section 400 notice in respect of tax arrears owed by the mortgagor. Shortly after receiving the Commissioner's statutory notice, he was served with a charging order by a creditor of the mortgagor. The plaintiff solicitor sought a declaratory judgment as to whether the sums had to be paid in total to the Crown because they were *bona vacantia*, or alternatively whether the Commissioner's and creditor's claim had to be satisfied first.

Holland J responded to the competing claims on the basis of a construction of the statutory provisions. First, the provisions of section 104(1) were couched in mandatory terms when outlining the priority that had to be adhered to in dealing with the proceeds of a mortgagee sale. The priority was as follows: payment of expenses in facilitating the sale; meeting the claims of the first mortgagee; meeting the claims of subsequent registered mortgages and charges; and finally, paying any surplus to the mortgagor. In contrast to section 104(1) were the provisions in section 104(2) and section 102A of the PLA 1952, which were directory or discretionary in nature. Section 104(2) provided that, where the mortgagor could not be found, the surplus may be paid to the Secretary to the Treasury. Section 102A(2) provided that, where any surplus money from a mortgagee sale could not be paid to a mortgagor because he could not be found, the proceeds may be paid to the Crown by remitting them to the Secretary to the Treasury.

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<sup>55</sup> (1982) 5 TRNZ 876.

Holland J placed a great deal of importance on the differing statutory wording which meant that, in the event of the mortgagor not being found, the mortgagor did not lose his right to the surplus funds and so the funds could not automatically go to the Crown. If it was intended that, on the mortgagor not being found, the mortgagor had lost his entitlement to the surplus and that it should be paid to the Crown, then it would have been a simple matter for sections 102A and 104(2) of the PLA 1952 to say so.

Simply because the mortgagor could not be found meant that, up until the moneys were paid over to the Crown, the mortgagor was still entitled to the surplus. Holland J then made reference to the Unclaimed Moneys Act 1971 to support his view that inability to find the mortgagor did not mean that the mortgagor automatically lost entitlement to the surplus funds. Under the Unclaimed Moneys Act 1971 (UMA 1971) there were many instances where the mortgagee would have had to retain the money for six years before repaying the residual amount to the Crown. The effect of provisions such as sections 102(A)(2) and 104(2) was simply to relieve a mortgagee from retaining unclaimed moneys for extended periods of time. After unsuccessful efforts had been made at locating the mortgagor, the moneys could be paid to the Crown.

On the facts in *Murphy*, this meant that, since the moneys had not been paid over to the Crown, the mortgagor was still entitled to the surplus. Accordingly, the amounts claimed under the section 400 notice and the charging order could be met, although for practical reasons the full amount of the claim under the charging order could not be met in full as there were insufficient funds.

There are other significant points that arise from the facts in *Murphy*, although not discussed in the judgment. Of interest is how *Murphy* illustrates that a Commissioner's notice will take effect subject to equities provided for by other statutes. Holland J as a first step identified the mortgage as one provided for by the LTA 1952.<sup>56</sup> It was implicit that the priority for the disbursement of funds under a mortgagee sale had to be followed as prescribed by the LTA and the Commissioner's notice could not cut across such a pre-determined statutory priority. This seems clearly to be the case and cannot be affected by how early in time the Commissioner serves a statutory notice.

The chronology in which the events occurred in *Murphy*, from the Commissioner's tax recovery point of view, would appear to be irrelevant

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<sup>56</sup> At 878.

only in regard to prior statutory priorities but very relevant in respect of subsequent claimants. The sale of land occurred on 1 September 1981. After commission had been deducted the balance of the deposit totalling \$2,315.20 was received by the plaintiff solicitor on 16 September 1981. On 4 September 1981, the solicitor received a section 400 notice requiring payment of about \$365 in tax arrears owing by the mortgagor. On 12 October 1981, the solicitor was served a charging order for a debt of just under \$7000 owed by the mortgagor to New Zealand Newspapers Ltd as the first defendant. The plaintiff deposed on 29 October 1981 that the total surplus moneys held from the mortgagee sale was \$4762.63.

The very early action taken in serving the notice as early as 4 September was pivotal in securing the Commissioner's position, as 38 days later a charging order was served for an amount far in excess of the surplus funds available. Had the charging order been served before the Commissioner's notice, it appears that, not only would the full amount claimed under the charging order not be met, but the Commissioner by being second in time would have no funds to meet his claim. Thus, early action made the Commissioner's enforcement action quite effective. Both *Murphy* and *King v Leary* are models of how swiftly and effectively the Commissioner can in fact use the statutory notice procedure.

There is another aspect regarding the promptness with which the Commissioner served the statutory notice. The promptness was material in securing payment to the Commissioner, assuming that there were no other creditors besides the Commissioner. Even if there were other creditors, the Commissioner can still secure a prospect for payment where he is either first in time as in *Murphy*, or, even where the Commissioner is not first in time, other creditors' claims are not so large as to defeat any practical gain that the Commissioner may have in the surplus funds. The promptness was advantageous because it meant that, while the mortgagor was technically still entitled to the surplus, in terms of section 400/section 157 there was an "amount payable" in terms of section 157(10)(a) to which the notice could effectively attach. Had there not been prompt service of the notice, there would have been a real risk of the solicitor paying the money over to the Treasury, as he would not have been required to hold it for say six years as under the Unclaimed Moneys Act 1971 before paying it to the Crown. Once he had discovered that the mortgagor could not be found, he could have at that point paid the money over to the Treasury as indeed he was entitled to under the relevant provisions of the PLA 1952.

If the notice had been served after the solicitor had paid it to the Crown, then the Commissioner's notice though valid would have had no effect as there

would be no “amount payable” which would make the notice effective. In other words, once the amount was paid over to the Crown as unclaimed moneys or surplus moneys, the prospect of effectively using a statutory notice becomes redundant. It may be argued that the futility was only in respect of the effectiveness of the notice and not in the overall effect of the Crown ultimately receiving the money. It would appear that this argument may be partially valid. While it may close the avenue for an effective notice, the Crown receives the money as unclaimed or surplus money that the mortgagee or other creditor of the mortgagor has not claimed. Technically the Commissioner as an agent of the Crown would still have a tax debt owing. The net result is that the Treasury as one agent of the Crown gets the whole lot. However, if there had been a promptly served statutory notice, the Commissioner would have had the tax debt met and any balance (if any) would go to the Crown. Alternatively, if there were creditors other than the Commissioner as in *Murphy*, then assuming there were sufficient funds, the Commissioner’s debt would be satisfied while the balance of the surplus would go to satisfy the other creditors in which case no residual sum is available for the Treasury as the other Crown agent.

This raises a further point which flows on from Heron J’s comments in *King v Leary* that a section 157 notice cuts across other obligations, except where otherwise provided by statute. It could be said that *Murphy* takes matters further than *King v Leary* in that in *Murphy* there were two statutes, namely the ITA 1976 and the PLA 1952, which each sought to claim moneys for the Crown albeit by different agents of the Crown. Holland J resolved the matter on a technicality based on an issue of statutory construction of the relevant provisions of the PLA 1952 only. It appears that it is implicit in Holland J’s reasoning that, despite the technical approach he adopted in resolving the issue, there is a particular effect. This is that the Crown cannot claim entitlement to all money as unclaimed sums under one statute when a claim is made under another statute by another Crown agent. In other words, the statute which claims the surplus or any part of it as a debt to the Crown must be given precedence over the statute that merely allows the surplus to be paid to the Crown for want of any claimant to the surplus. It was this argument that the Attorney-General in *Murphy* did not appreciate.

This argument is a very logical one and has a great deal of merit. The wider policy underpinning this argument is that any surplus is payable to the Secretary to the Treasury only when there are no claims being made on it prior to it being paid to the Treasury. In other words, it must in fact be an amount which is *bona vacantia*. If there are claims, then the amount logically cannot be treated as a surplus which may be paid to the Crown, for only sums which no one is entitled to or does not claim an entitlement to are

payable to the Crown as unclaimed moneys. This principle seems to underpin the Unclaimed Moneys Act 1971 in that so far as moneys are unclaimed they logically may be paid to the Crown. This demonstrates that the Attorney-General should fail when he seeks to claim money as payable to the Crown when there are prior claimants as happened in *Murphy*.

The argument that the Attorney-General cannot claim moneys that are the subject of a claim by another Crown agent is not merely academic. It can have significant implications for the Commissioner using the statutory notice procedure. The notice procedure has been discussed in relation to income tax debts. However, there is an identical notice procedure in the Goods and Services Tax Act 1985 (GST Act),<sup>57</sup> the Student Loan Scheme Act 1992,<sup>58</sup> the Gaming Duties Act 1971<sup>59</sup> and the Child Support Act 1991.<sup>60</sup>

Furthermore, under the Accident Insurance Act 1998,<sup>61</sup> the Commissioner can serve as the statutorily appointed agent for the collection of premiums. Under this Act the Commissioner is similarly empowered to use the statutory notice procedure under that Act to collect outstanding premiums.<sup>62</sup>

The implications of the decision in *Murphy* appear to be that, provided that the notices are served before any surplus is paid to the Treasury, the notices are valid and effective. The notices if served promptly have the potential of collecting a range of revenues, and such collection cannot be defeated by any claims that the surplus must be paid to the Treasury.

#### 8. Section 157 and Sums Payable in the Future

Another practical point worth noting is that a notice can attach moneys that in the future become an “amount payable”. The notice does not become invalid merely because once served there is no amount then held by either a bank or a creditor in favour of the taxpayer. This is envisaged by section 157(1)(a) and (b) as well as by section 157(10)(b) and (c)(ii). The notice subsists until money becomes credited to the taxpayer at a future date.

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<sup>57</sup> Section 43.

<sup>58</sup> Section 46.

<sup>59</sup> Section 12L.

<sup>60</sup> Section 154.

<sup>61</sup> Section 316.

<sup>62</sup> Section 313. Also of note are s 46 of the Accident Compensation Act 1982 and s 130 of the Accident Rehabilitation and Compensation Insurance Act 1992 (both repealed), and which were the then statutory notice equivalents to s 313 of the 1998 Act.

The Australian equivalent provision in section 218(1) of the Income Tax Assessment Act 1936 (ITAA 1936) is similar to New Zealand's in that it also refers to the prospect of amounts being subject to the notice which are "accruing" or may become due to a taxpayer. Fox J in *Huston & Anor v DFC of T* expressed the view that, when issuing a notice under section 218 of the Australian Act, the Commissioner was not confined to situations in which there was, at the time of service of the notice, money due and payable by any person to the taxpayer or which otherwise at the time satisfied one of the paragraphs of section 218.<sup>63</sup> His Honour proceeded to comment that:

A notice can be issued under sec 218 which may have only a prospective application. I do not mean, in putting the matter that way, to suggest that the Commissioner, if challenged, must establish that at some time one of the paragraphs will apply, but rather that he is by the section enabled to issue a notice even if it may apply only to circumstances arising in the future, as between garnishee and taxpayer.<sup>64</sup>

The Federal Court of Australia in *Re Edelsten; Donnelly v Edelsten*,<sup>65</sup> referred to this future liability by the debtor when it noted that the words "any money, may become due" are "apt, in the context, to refer to an identifiable sum payable upon a contingency".<sup>66</sup> Thus, there was a strong intimation that future amounts which become payable, on their coming into existence, may come within the purview of section 218.

The decision in *Re Edelsten; Donnelly v Edelsten* was appealed against by the Deputy Federal Commissioner of Taxation to the Full Federal Court. The Full Federal Court decided the appeal in its decision in *Deputy Federal Commissioner of Taxation v Donnelly & Ors* which is recognised as the leading case on section 218.<sup>67</sup> The Full Federal Court examined the issue of the extent to which section 218 affected sums of money which became owing to the taxpayer in the future.

Von Doussa J of the Full Federal Court agreed with comments of Burchett J in the Federal Court decision that the words "any money ... may become due" in section 218(1)(a) were apt in context to refer to an identifiable sum payable upon a contingency.<sup>68</sup> Von Doussa J, however, opined that, if the conditions of section 218(1) did not exist when a notice was issued, this did

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<sup>63</sup> 83 ATC 4525.

<sup>64</sup> At 4531 LHC.

<sup>65</sup> 88 ATC 4958.

<sup>66</sup> At 4965.

<sup>67</sup> 89 ATC 5071.

<sup>68</sup> Cited at supra note 65.

not mean that the notice was then and forever null and incapable of taking effect in the future should the contingent provisions of section 218(1) later come into existence. The notice would simply not be binding at the time when it was given. The effect of a notice served in such circumstances was expressed as follows:

In my opinion a notice may be given prospectively under sec 218. When this is done, no obligation is imposed on the third party unless or until circumstances arise between the third party and the taxpayer which bring into existence an identifiable debt owing to the taxpayer, whether payable forthwith, or on a fixed date, or on a contingency. The principles which apply to the assignment of future property do provide a helpful guide. Equity fastens upon the future property to make the assignor a trustee of the legal right of ownership for the assignee when the property comes into existence and when it is identifiable as property meeting the description of the assignment .... Until identifiable property comes into existence there is no subject matter in respect of which the assignment can operate. Likewise, in the case of a prospective notice given under sec 218, until there is an identifiable sum of money owing to the taxpayer by the third party the conditions of the section are not met. It is the coming into existence of the identifiable debt which crystallises the obligation on the third party to pay to the Commissioner the “money” referred to in sec 218 (1) and provides the measure of the obligation which is imposed by the notice. If for any reason circumstances do not arise after the giving of the notice where “money” answering the description in sec 218 (1) comes into existence, no obligation is ever imposed on the third party to make any payment to the Commissioner. Where “money” does come into existence later, only at the point in time when it does so is an obligation imposed on the third party.<sup>69</sup>

Lockhart J agreed with the conclusion of von Doussa J on this point, that a notice may be given under section 218 which is prospective in the sense that it may operate with respect to debts that are not brought into existence until after the date of service of the notice.<sup>70</sup> Furthermore, Lockhart J acknowledged that the specific point on the prospective effect of a notice had not been argued before the Full Federal Court, but accepted that his conclusion must be correct and was also supported by the language of the section which had the phrases “or may become due” and “or may subsequently hold”. Hill J, the third member of the Court, concurred.<sup>71</sup>

This approach was confirmed by Brennan J in the High Court of Australia decision in *Clyne v DFC of T* when he said:

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<sup>69</sup> Supra note 67, at 5080 RHC.

<sup>70</sup> Ibid, 5076 LHC.

<sup>71</sup> Ibid, 5094 LHC.

when a notice is given pursuant to the section, it takes effect according to its tenor. The third person is immediately bound to comply with it, though his obligation is not to be discharged until some later time.<sup>72</sup>

Thus, a notice which seeks to attach amounts payable to the taxpayer in the future does not entitle the Commissioner to require a debtor of the taxpayer to pay the amount owed to the taxpayer before the debt becomes payable.<sup>73</sup> The notice on being served is dormant and operates as if it were a floating charge so that as soon as the debt comes into existence the charge created by the section 157 notice crystallises. There is no provision for any time limit that any notice stays effective for, as once it is issued, it takes effect until such time as a notice of revocation is issued by the Commissioner.

Although there is no New Zealand decision that articulates the prospective effect of a notice as in Australia pursuant to the Full Federal Court decision in *Donnelly & Ors*,<sup>74</sup> it could be argued that *Murphy* implicitly recognised that this was the case in its result. It could be argued that the chronology of the events in *Murphy* strongly suggest that the Commissioner was successful only because he had served a notice which could only have had prospective effect. In *Murphy*, although the sale had occurred on 1 September 1981, the balance of the deposit was not received by the solicitor until 16 September 1981. The Commissioner's notice was served on 4 September 1981 and was prospective in effect, but crystallised on 16 September when the solicitor finally received the balance of the proceeds of the deposit.

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<sup>72</sup> 81 ATC 4429, 4442 RHC.

<sup>73</sup> This was confirmed in the High Court of Australia decision in *Clyne v DFC of T* 81 ATC 4429, with Brennan J saying: "But the third person cannot be required to pay the Commissioner before the money becomes due and payable; the notice does not accelerate the time for payment" (at 4442). Mason J, who provided the leading judgment in *Clyne v DFC of T*, also said as follows: "and it cannot be that the Commissioner can by notice require a debtor of a taxpayer to pay the money which he owes to the taxpayer before the debt, as between the debtor and the taxpayer, has become payable" (at 4436 LHC).

<sup>74</sup> More recently in *DFC of T v Conley and Ors* 98 ATC 5090, Tamberlin J of the Full Federal Court commented: "Thus a s 218 notice can be given when no money is presently due to the taxpayer but where it may become due and where it may be held by the recipient on account of the taxpayer" (at 5092 RHC).

## VI. EXCLUSIONS FROM THE AMBIT OF SECTION 157

1. *Statutory Exclusions*

The definition of “amount payable” in section 157(10) specifically does not include money in an account that is a Home Lay-By Account under the Post Office Act 1959, a Home Ownership Account under the Home Ownership Savings Act 1974, a Farm Ownership Account under the Farm Ownership Savings Act 1974, or a Fishing Vessel Ownership Account under the Fishing Vessel Ownership Savings Act 1977.

It appears that the saving of the above categories of accounts from the effect of section 157 notices is based on public policy grounds designed to facilitate the ownership of homes, farms and fishing vessels. It is worth noting that the Australian equivalent to section 157 does not contain such exempt accounts and neither does section 224 of the Canadian Income Tax Act which is the equivalent provision.

2. *Section 157 and Joint Accounts*

The issue has arisen of whether joint accounts can be attached. The principle under ordinary banking law is that a garnishee order will not be effective on joint accounts. The judgment of Pollock B, in *Beasley v Roney*, is an early articulation of the principle that:

the debt owing by a garnishee to a judgment debtor which can be attached to answer the judgment debt must be a debt due to the judgment debtor alone, and that where it is only due to him jointly with another it cannot be attached.<sup>75</sup>

In *Hirschhorn v Evans*,<sup>76</sup> a judgment debtor and his wife had a joint account with the appellant bank, on which account either of them could draw. A garnishee order was made on this account in respect of a debt owed by the husband. The Court of Appeal held that a joint account with a bank, even if owned by a husband and wife, could not be attached under a garnishee order in respect of a debt by one of the joint owners. Slessor LJ articulated the majority view of the Court in opining as follows:

I think that one has to look at the account as a whole, and, looking at the account as a whole, I think that it is in the nature of a joint account on which the bank are liable to both parties jointly, and, consequently, the garnishee order is misconceived in stating

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<sup>75</sup> [1891] 1 QB 509, 512.

<sup>76</sup> [1938] 3 All ER 491.

that the bank are indebted to the said judgment debtor in the sum there stated, whereas, in reality, they are indebted to the judgment debtor and to his wife jointly.<sup>77</sup>

In Canada, the Court of Appeal in *Banff Park Savings and Credit Union Ltd v Rose*<sup>78</sup> held that a joint bank account could not be attached under a garnishee order on the same reasoning.

This being a consistent principle in banking law as far as a garnishee order is concerned, the question arises whether there is any change in its application in the case of statutory notices issued in respect of tax debts. Both Australia and New Zealand are consistent in their approaches in that the principle of banking law just discussed also applies in the case of statutory notices and tax debts.

The issue was considered in the Supreme Court of New South Wales decision in *DFC of T v Westpac Savings Bank Ltd & Ors*.<sup>79</sup> There was a bank account in the joint names of three taxpayers on which the Commissioner served a section 218 notice, for the taxation liability that each had incurred separately in their own individual right. Bryson J followed the reasoning of Slesser LJ in *Hirschhorn v Evans* that it is in the nature of a joint account that the bank is jointly liable to both parties. However, Bryson J was not content to base his reasoning only on Slesser LJ's in *Hirschhorn v Evans*. His Honour commented that section 218 proceeded on the basis of distinctness of obligation of the taxpayer, and of entitlement of the taxpayer. This in His Honour's view accorded "with the personal and several nature of the obligations to pay tax which the legislation lays on taxpayers".<sup>80</sup>

It would be quite incongruous with the statutory scheme if the legislation created a situation where one person or one person's assets came under an obligation for payment of tax levied on some other person, which would precisely be the effect if a joint account could effectively become subject to a section 218 notice. As submitted by the first defendant, if Parliament intended to override the law as settled in *Hirschhorn v Evans*, "there would be a need for express language".<sup>81</sup>

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<sup>77</sup> At 496.

<sup>78</sup> (1982) 139 DLR 3d 769.

<sup>79</sup> 87 ATC 4346.

<sup>80</sup> *Ibid*, 4352 RHC.

<sup>81</sup> *Ibid*.

In New Zealand the High Court considered the effect of a section 157 notice on a joint account in *C of IR v ANZ Banking Group (New Zealand) Ltd.*<sup>82</sup> This was pursuant to a practice of the Commissioner of applying deduction notices to a joint account if the signatory was “either or”. The Commissioner assessed the husband for approximately \$141,000 in income tax. The husband and wife had a joint account, and the Commissioner served a notice on the Bank thereby demanding payment of all monies in the joint account. The question Ellis J had to determine was whether the monies in the joint account were “payable in relation to the taxpayer”. Following Slesser LJ in *Hirschhorn v Evans*, he held that the monies were not payable to the taxpayer without the wife’s authority, as the bank was jointly indebted to both the husband and the wife and not to the husband exclusively. Accordingly, the Bank was entitled in its actions to disregard the notice.

Although the Commissioner failed in his bid in *C of IR v ANZ Banking Group (New Zealand) Ltd* to attach a joint account using a section 157 notice, he does have the power to deduct money from joint bank accounts for debts under the Child Support Act.<sup>83</sup>

The Commissioner is quite entitled to use a section 157 notice to seize money in a term investment even before its maturity date. Money in investment portfolios can also be seized, such as superannuation schemes, however the Commissioner accepts that he cannot by serving a notice on a bank account put a taxpayer into, or further increase, an existing overdraft.<sup>84</sup>

The position regarding a statutory notice and a current account is contrary to banking law. The law has long established that the relationship of banker and customer in respect of a current account is one where the bank is merely a debtor of the proprietor of the current account, and on this basis as a matter of law cannot be said to hold money on account of such person.<sup>85</sup> However, unlike the position with respect to joint accounts, section 157(10)(c) specifically overrides this general principle of banking law pertaining to current accounts. In the definition of “amount payable” where the person is a bank, it includes money, including interest on that money, which is on current account.

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<sup>82</sup> (1998) 18 NZTC 13,643.

<sup>83</sup> Section 155. Also note s 86D of the Social Security Act 1964 which contains an identical provision for attaching joint accounts.

<sup>84</sup> (August 1999) 11 *Tax Information Bulletin* No 7, 5.

<sup>85</sup> *Foley v Hill* (1848) 11 HLC 28 (9 ER 1002); *Joachimson v Swiss Bank Corporation* (1921) 3 KB 110.

## VII. FRUSTRATING THE EFFECT OF SECTION 157

1. *Diverting Funds Before Receipt By Third Party*

From the discussion thus far, a notice can be frustrated if a taxpayer holds his or her funds in a joint account. Certainly from the comments by Von Doussa J in *Donnelly*,<sup>86</sup> it is clear that the obligation on the third party to comply with the notice does not arise till the “money” comes into existence. So although these comments in *Donnelly* were in respect of the validity of a prospective notice, it will despite being valid not have an effect on the third party until funds actually arrive in the custody or control of the third party. This means that, once a notice is served and in terms of section 157 (5) a taxpayer is notified, there does not appear to be any impediment statutory or otherwise from enabling a taxpayer to frustrate the notice. One way in which it may be frustrated would be to assign future payments to another person or that other person’s account for valuable consideration in disregard of notices served under section 157. Alternatively, instalments payable under a loan by a debtor to a taxpayer’s bank can on instructions be made payable to another bank or person as agent of the taxpayer. In the case of a bank for instance it appears that the taxpayer can instruct prospective creditors of the taxpayer paying money not to pay it to a particular bank but to re-route the payments through another bank. On the basis of *Anzamco*,<sup>87</sup> it would not be sufficient to have funds merely diverted to another account in another branch of the same bank. It would have to be an entirely different bank or third party such as a credit union or building society to which funds have to be diverted.

However, the diversion, if it is to occur, has to occur before the funds reach the third party subject to the notice. Once the funds which are subject to a prospective notice arrive in the custody of this third party, any subsequent attempts to divert the funds through an assignment for instance will have no effect, as clearly illustrated by the High Court of Australia decision in *Clyne v Deputy Federal Commissioner of Taxation*.<sup>88</sup> The facts in *Clyne* were that, on 9 July 1979, the Commissioner served an income tax assessment on the taxpayer for the year ended 30 June 1979. The tax owing was assessed at \$118,436. The assessment notice stated that the tax was due and payable on 8 August 1979. On 10 July 1979, the Commissioner gave notices under section 218 of the Australian Act (similar to section 157) to a branch of the Commonwealth Trading Bank where the taxpayer held interest-bearing deposits of \$70,000 which matured on the following dates: \$10,000 on 21

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<sup>86</sup> Supra note 67, at 5080 RHC.

<sup>87</sup> Supra note 42.

<sup>88</sup> 81 ATC 4429.

September 1979; \$25,000 on 9 April 1980; and \$35,000 on 20 April 1980. The notices required the bank to hand over the \$70,000 to the Commissioner in part payment of the taxpayer's tax liability when the deposits matured at various dates after 21 September 1979. On 4 September 1979, the taxpayer, by deed, assigned the deposits to the second appellant as security for future advances and gave notice of the assignment to the bank. There were a number of issues that were raised as a consequence of the notices being served, but the one of direct relevance was whether the taxpayer was correct in his argument that the subsequent assignment of the right to the deposits operated to defeat the notices. Gibbs CJ answered this argument as follows:

Subsequent actions by the taxpayer cannot render the requirement nugatory or ineffective. ... However, once the notice is given, it operates to prevent any subsequent dealing with the money which will prevent compliance with the notice when the time for compliance arrives. An assignment made by the taxpayer after the date of the notice will be ineffective to relieve the person to whom the notice is given of his statutory obligation to pay the money to the Commissioner. Notwithstanding the assignment, the money will be "due" at the time when it would have become payable to the taxpayer if it had not been for the subsequent assignment whose effect is to be ignored.<sup>89</sup>

Brennan J articulated his response to the taxpayer's argument saying:

Between the time when the notice is given and the time when the obligation is to be discharged, the third person is not at liberty to pay to the taxpayer the money falling within the terms of the notice; the third party is obliged to retain it in order to discharge the obligation to pay the money to the Commissioner in compliance with the requirement expressed in the notice .... The giving of the notice thus affects the rights of the taxpayer who, once the notice is given, is statutorily divested of his right to payment of the whole or a part of the money specified in the notice ... an obligation to obey the assignor's direction cannot prevail over an earlier statutory requirement to pay the money to the Commissioner.<sup>90</sup>

For New Zealand purposes, the comments in *Clyne* would apply but with one additional significant difference. This is that on service of the notice by virtue of section 157 (8) the money subject to the notice is deemed to be held in trust for the Crown. In other words, service of the notice creates a proprietary interest and so the Commissioner's right to payment

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<sup>89</sup> At 4433RHC-4434 LHC. Mason J agreed saying: "The effect of imposing the obligation is to make it unlawful for the recipient to pay the moneys to anyone but the Commissioner after service of the notice" (at 4440 RHC).

<sup>90</sup> At 4442-4443.

distinguishes him from a garnishor of a debt who obtains no proprietary interest in the debt owing to the judgment debtor. Consequently, any attempt to divert or assign moneys subject to the notice is tantamount to breach of trust but more seriously an act of theft or misappropriation as it is inconsistent with the Crown's deemed proprietary interest. This is all the more reason why, if any action is to occur to frustrate the operation of a notice, it occurs so as to prevent money coming into the hands of the third party in the first place so as to avoid the property becoming Crown property.

## 2. *Effect of Bankruptcy And Discharge From Bankruptcy*

Another way in which a section 157 notice can be frustrated is by the taxpayer becoming bankrupt and subsequently being discharged from bankruptcy. On being discharged, no amount of tax is thereafter due and the consequence of a notice served prior to bankruptcy in such circumstances is that it will lapse.

The effect of a statutory notice served in such circumstances is not such as to be able to attach amounts due to the taxpayer after being discharged from bankruptcy. The taxpayer's status on being discharged is as if he or she has no prior debts, whether tax debts or other debts. Accordingly, a notice served prior to bankruptcy does not survive even so as to remain dormant through the bankruptcy only to crystallise and attach debts or amounts owing to the taxpayer after being discharged from bankruptcy. This seems to be the position pursuant to a decision of the Australian Full Federal Court in *DFC of T v Government Insurance Office*.<sup>91</sup>

In *DFC of T v Government Insurance Office*, notices of assessment of income tax were issued on 3 April 1986. On 1 July 1986 the taxpayer commenced civil proceedings against a third party, namely, Government Insurance Office ("GIO"). On 3 October 1986 the Deputy Commissioner served a section 218 notice requiring the GIO to pay to the Commissioner so much of any moneys that may become due as a consequence of the litigation to the taxpayer up to the amount of \$52,499.82. On 14 July 1987 the taxpayer became bankrupt on his own bankruptcy petition. On 15 July 1990 the taxpayer was discharged from bankruptcy and on 13 August 1991 the taxpayer obtained judgment against the GIO for the sum of \$10,793 plus costs. The Full Federal Court by majority held that the notice served prior to bankruptcy did not survive the bankruptcy and discharge from bankruptcy so as to attach the judgment amount. Being discharged from bankruptcy meant that the status of the taxpayer had radically changed whereby he was

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<sup>91</sup> 93 ATC 4901.

completely absolved from his prior indebtedness. It therefore followed that action for the recovery of prior debts would not subsist on the taxpayer's discharge from bankruptcy.

### 3. *Accounts Denominated In Foreign Currency*

Another avenue in which a notice can be frustrated is when it is served on accounts denominated in foreign currency. If the notice demands a New Zealand dollar amount but the bank account is denominated in US dollars, there is an absence of uniformity in the unit of account. The Full Federal Court of Australia in *DFC of T v Conley & Ors*,<sup>92</sup> considered this very question in the context of a section 218 notice served to attach \$67,242,842.05 in accounts with the National Australia Bank which were denominated in United States dollars. The Court held that the Australian Act recognised the necessity for money to be expressed in terms of a unit of account. The unit of account for the Act was Australian currency and an assessment made under the Act had to be expressed in Australian currency. If section 218 was intended by the legislature to apply to foreign currency, there would be an expectation of some indication of the time and method of conversion to Australian currency to be contained in the Act. However, no such mechanism existed. The lack of a conversion mechanism created anomalies, especially in cases where the debt due to the taxpayer which formed the subject of the section 218 notice was not presently payable. A significant lapse of time, between the time of service of a notice and the time when money becomes payable, could result in significant fluctuations in the relevant exchange rate. This could result in significant differences between the amount of foreign currency calculated and the amount of tax owing by the taxpayer. Emmett J, who provided the leading judgment in *Conley*, articulated some of these difficulties as follows:

The difficulties as to the time at which a conversion calculation is to be made in order to determine how much of foreign currency is attached by a notice under section 218 indicates, in my opinion, that foreign currency is not intended to be the subject of such a notice. The absence of any indication in section 218 itself that it was intended to apply to foreign currency and the absence of any mechanism for conversion ... reinforces the conclusion that foreign currency is not intended to be the subject of a notice under section 218.<sup>93</sup>

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<sup>92</sup> 98 ATC 5090. (A more detailed discussion of the decision in *Conley* is by Bolwell, "When money is not money" (July 2000) 3 New Zealand Tax Planning Report 21).

<sup>93</sup> At 5099-5100.

These same difficulties also arise under section 157 and the reasons outlined by Emmett J would apply in frustrating the effect of a section 157 notice on accounts denominated in foreign currency.

#### 4. Successful Objection or Challenge of an Assessment

Other circumstances in which a notice could be frustrated is where a taxpayer objects to or challenges an assessment and such objection is allowed either in proceedings before the TRA or the High Court. This necessarily raises the issue of an assessment being issued and a notice also being served close in time so as to deprive the taxpayer of its rights effectively to object to or challenge the assessment.

It appears that the taxpayer will be given the chance successfully to object to or challenge the assessment rather than have such a right forfeited by a statutory notice. This certainly is being advocated by the cautionary comments of Burchett J in *Edelsten v Wilcox & Anor*<sup>94</sup> that:

Section 218 [equivalent to section 157] must, I think, be seen as part of the whole scheme of the Act for the collection and recovery of tax, which of course, includes rights of objection and appeal. It is a strong power designed to protect the revenue but it was not intended to subvert the principle which has been established at least since Magna Carta, that a citizen's property should not be subject to arbitrary seizure. It cannot have been contemplated that the power should be used to negate the rights to contest assessments contained in the Act by the complete wiping out of a business of a taxpayer who is genuinely pursuing avenues of appeal.<sup>95</sup>

This last point raises another matter which may have been largely implied up to this point and that is the relationship between an assessment and a section 157 notice. The notice follows from the assessment, and the notice itself does not create the indebtedness for a tax liability. As stated by Hill J:

section 218 [equivalent to section 157] could not operate to impose a tax. Section 218 is properly to be characterised as a law to facilitate the recovery of tax initially due and owing, rather than as a law imposing some new tax.<sup>96</sup>

A number of consequences flow from this relationship between an assessment and a section 157 notice which are not expressed in the provisions of section 157 and which therefore need to be determined

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<sup>94</sup> 88 ATC 4484.

<sup>95</sup> At 4494 RHC–4495 LHC.

<sup>96</sup> Supra note 91, at 4913 RHC.

pursuant to this relationship. Section 157 is silent on its effect in the event that tax no longer becomes payable because for instance its effect is frustrated for the reasons just discussed. In such circumstances does the section envisage that the third party in receipt of the notice must still make payment to the Commissioner of tax no longer payable, or must the recipient pay only where tax is properly payable? It would follow that, if the section 157 notice takes life from the assessment, then it cannot still be used to demand payment where the assessed debt has been dealt with. So, if the assessment has been successfully challenged or objected to or the assessed debt has been cleared through a discharge from bankruptcy, the section 157 notice suffers the same fate in that it too is neutralised or lapses. If the section 157 notice is however seen as creating a debt in its own right which is still payable, although in terms of the assessment there is no tax properly payable, a preposterous situation arises. This is because a taxpayer would still be required to make payment to the Commissioner only then to reverse the effect of this by seeking to recover an amount that was wrongly paid. This could not have been the intention of Parliament.<sup>97</sup>

## VII. CONCLUSION

As observed by Richardson J in *Controller and Auditor-General v Davison*,<sup>98</sup> the imposition and operation of taxes is a public governmental activity. The learned judge went further to state that, more importantly, the due imposition and collection of taxes is fundamental to the functioning of government.<sup>99</sup> Tax is imposed by the Income Tax Act 1994 and the Commissioner's role is to quantify and collect the tax that is found to be owing. Bingham LJ in *R v Board of IR ex parte MFK Underwriting Agencies*<sup>100</sup> summarised this as common knowledge that the Revenue is a tax-collecting agency, not a tax-imposing authority.

It is the act of the Commissioner in assessing the tax which determines the indebtedness of the subject to the Crown. The assessment for tax is the statutory judgment of the liability of every taxpayer which the Commissioner has a legal obligation to make and in respect of which he does not have a general dispensing power.<sup>101</sup> It is perhaps because taxation and the collection of taxes are pivotal to the functioning of government that tax debts appear to be subject to a unique regime. The regime is unique both

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<sup>97</sup> *DFC of T v Government Insurance Office* 93 4901, 4912 RHC.

<sup>98</sup> [1996] 2 NZLR 278, 303.

<sup>99</sup> At 306.

<sup>100</sup> [1990] 1 All ER 91, 110.

<sup>101</sup> *Brierley Investments Ltd v CIR* (1993) 15 NZTC 10212.

in terms of how the debt is arrived at and in the way in which it can be collected.

The Commissioner's powers to collect taxes, simply using the statutory notice procedure prescribed by section 157, would appear to place him in a privileged position not enjoyed by other creditors. Simply having made an assessment, and given the taxpayer a due date for payment, allows enforcement to commence after the expiry of the due date. As noted by Casey J in *Brierley Investments Ltd v C of IR*,<sup>102</sup> it cannot be an abuse of power for the Commissioner to collect taxes when they are properly due. The unique powers enabling the Commissioner to collect tax debts pursuant to section 157 do not require prior notification to the taxpayer before being used. For, as Mansfield J said in *Woodroffe & Anor v DFC of T*, in respect of the Australian equivalent:

In my view, such an intention is clearly evidenced by section 218 itself. Its object is to secure the payment of taxation liability. It would frustrate the fulfilment of that object if such advance notice were required to be given, which might facilitate the movement of the funds the subject of the proposed notice.<sup>103</sup>

Use of the notice procedure by the Commissioner may become more prevalent, not only because of recent criticisms of the Commissioner's actions in collecting tax debts, but also in the drive to shore up the actual annual tax take by Government.

The exercise of the power can come as a rude shock to many a hapless taxpayer, primarily because of the stealth with which it is used. The best insurance against the exercise of such an invasive power is to ensure that, not only are taxes paid, but more importantly that they are paid when they fall due.

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<sup>102</sup> At 10214.

<sup>103</sup> 2000 ATC 4654, 4657.