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CHEATING AT CARS

Mr Justice Chilwell is not one for mincing words. His swingeing comments on the Judge's Rules in *R v Lee* [1977] NZLJ 409) have been followed by his observations on the law relating to transfer of ownership of motor vehicles.

"When" he asked, "will the Legislature heed the call for a form of title and a code for transfer of ownership of motor vehicles so that innocent people can be protected from the cheat?"....

Cases deciding which of two innocent persons must suffer for the fraud of a third pad the textbooks and interest students, but "why" he asks "should the interest of students be preferred to the interest of the defrauded when intelligent legislation could cure the problem where it affects our people the most – the fraudulent sale of motor vehicles?"

The case His Honour was deciding *(Byrnes v Moriarty Motors Ltd* (Supreme Court Auckland 26 October 1977 (A 315/77)) was a carefully executed replay of an old and familiar theme. A cheat replied to an advertisement for the sale of a car. He represented himself to be a licensed motor vehicle dealer. The vendor agreed to accept a cheque from a licensed motor vehicle dealer. After negotiations a cheque was made out on a cheque book preprinted by a bank for a dealer and the signature of a person authorised to sign cheques for that dealer was forged. It was not until that stage that the vendor knew the name of the firm with whom he thought he was dealing. The cheat sold the car to another before his title could be avoided and then disappeared. The vendor sought to transfer his loss to the innocent purchaser by arguing that he intended to deal only with the dealer whose cheque he had accepted. Taking an objective view of the facts Chilwell J concluded that the vendor appeared to intend to contract with the cheat.

This type of case is far from uncommon, and each has its foundation, not in any shortcoming of the law, but in the failure of a vendor to ensure that he is protected for the price. The vendor takes an unnecessary chance, loses, and seeks to transfer his loss to a purchaser who has no practical way of checking the title to his purchase. The unfair aspect of an objective contractual analysis of the transactions involved is that a completely innocent purchaser may lose out through the actions of a vendor who, in effect, has set him up.

There are many variations; theft followed by sale; payment followed by cancellation of a cheque and, sales of cars purchased on hire purchase are but a few. In some cases the vendor will have been careless (as accepting a cheque or failing to lock his car), in others it will be the purchaser (as by accepting a story about loss of ownership papers). Will legislation help? It is doubtful. The different situations are simply too various. At most it could inject a test of fairness to decide where the loss should fall, on vendor or purchaser but this would be at the risk of distorting the contractual rules relating to title. One is left wondering whether judicial innovation is really so spent. After all the risk of accepting payment by cheque, and the consequences that may follow, not only to vendor but also to others is so notorious as to raise questions of one's duty to others. Could we not leave contract to settle title; and negligence to

apportion the loss?

Title registration has often been considered doubtless with the analogy of land transfer registration in mind. There are features of land transfer that make the analogy dubious. The most obvious is that land transactions are almost invariably settled by solicitors whose function is to ensure that the parties get what they bargained for – money for land. Thus the root cause of most motor vehicle sales problems is countered as a matter of practice – not law, or registration. When one considers the magnitude of the administration that would be required to counter what is in effect the carelessness of a few, enthusiasm begins to cool.

Folly, gullibility and dishonesty cannot be controlled by legislation. At best it can help to mop up afterwards. In this case the question is how best to apportion the loss when two parties suffer from the dishonesty of a third. If judicial innovation is spent there is a case for legislation. But the apportionment should be based on fairness, not inflexible rules as has already been recognised by the legislature in the case of illegal contracts.

Tony Black

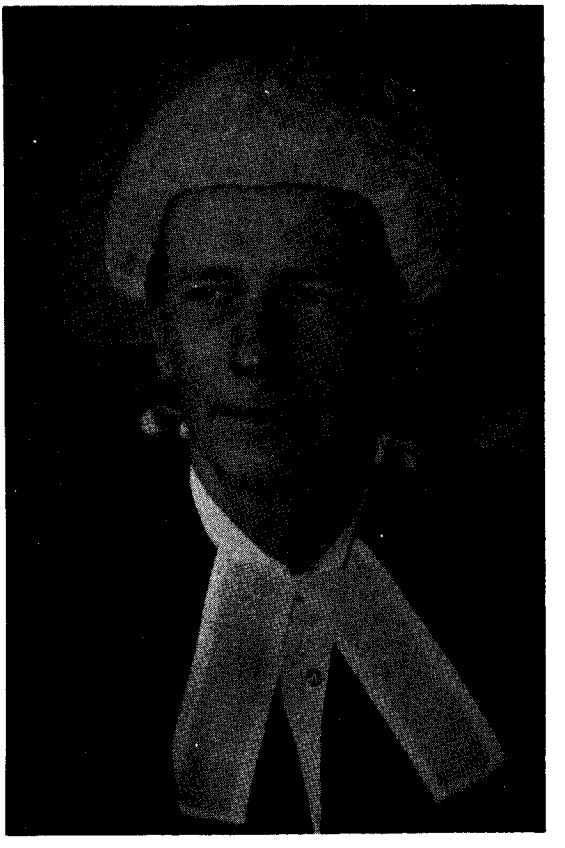
MR JUSTICE VAUTIER

On 17 August 1977 at Auckland, Mr Justice Perry presided over the swearing in of Mr Justice Vautier as a Judge of the Supreme Court. Also in attendance were four Judges now retired, namely, Right Honourable Sir Alfred North, the Honourable Sir Trevor Henry, the Honourable Mr Justice Wilson and the Honourable Mr Justice Coates. In addition, the ceremony was attended by the Mayor of Auckland Sir Dove-Meyer Robinson, by the Lady Mayoress Mrs Goodman and also by the Roman Catholic Archbishop of Auckland the Most Reverend Bishop Mackie and by the Deacon of the Diocese of Auckland the Very Reverend J O Rymer.

Mr Justice Vautier was born at Hamilton and educated at the Hamilton High School and Auckland University College. He graduated LLB in 1936 and LLM in 1938, being admitted in 1936. Before the War he served in the Auckland firm of Earl Kent & Co and in the Wellington firm of Chapman Tripp & Co. After war service he joined the late Mr A T O'Donnell of Auckland in partnership in that city followed by practice on his own account culminating with his appointment as one of Her Majesty's Counsel in 1976.

His Honour lectured part-time in law subjects both at Victoria University and Auckland University from 1946 to 1964. He was president of the Auckland District Law Society from 1970 to 1972 and was a member of the Council of the New Zealand Law Society from 1968 to 1972. He also served as a member of the Council of Legal Education from 1968 to 1974.

In extending to his Honour the congratulations of the Government the Solicitor-General, Mr RC Savage QC referred to remarks made by Lord Kilmir, when, as Lord Chancellor he addressed the New Zealand Law Conference some 17 years ago. He had said that probably the greatest tribute to the Judiciary in British countries was found in the compendium of qualities we take for granted



Mr Justice Vautier

– impartiality, the gift of wise silence, wide knowledge of the law, a quick grasp of fact and vast experience of human nature. All qualities demonstrated by His Honour in the course of some forty years practice in the profession.

The best wishes of the profession were extended by the President of the New Zealand Law Society Mr L H Southwick QC who referred particularly to the part a Judge plays in the development of the law. Recent examples cited by him were in the fields of administrative Law, liability for negligent mis-statement and liability for unauthorised use of confidential information.

"I believe" he said, "that it is true that the law as seen, commented on and developed by Judges denies the truth of the old adage that the law itself is the government of the living by the dead. Justice Holmes once said, 'That the present has a right to govern itself so far as it can; and it ought always to be remembered that historic continuity with the past is not a duty, it is only a necessity'. Let me make the comment that it is my belief that more and more the Judge's responsibility will be seen to fulfil his role by observing the necessity but not making too much of a virtue of it.

"The role of Judges in our society is real and vital. I know that Mr Justice Vautier is fully aware of that role and with humble sincerity I wish him well in it".

CASE AND COMMENT

Paternity proceedings and corroborative evidence

Bradburn v Fraie (the judgment of White J was delivered on 9 August last) is important in the context of paternity proceedings. It was an appeal against a finding in a paternity case in the Magistrate's Court at Lower Hutt. At the close of the case for the appellant, the Magistrate accepted a submission of counsel for the respondent that there was no evidence of corroboration. Counsel were, however, agreed that if the decision of the Supreme Court was that there was no evidence of corroboration the case must be remitted to the Magistrate's Court so that the trial could continue. The general ground of appeal was that the Court below had been wrong in law and fact. It was submitted that the appellant's evidence, which, if accepted, and standing alone, certainly established intercourse over the relevant period with the respondent and no one else, was corroborated as required by s 49 (2) of the Domestic Proceedings Act 1968. The case for the appellant was that her father had given evidence of association, that there was no evidence of association with any other man and that, most importantly, when the appellant's father confronted the respondent with the information that the appellant was pregnant his response was evidence amounting to an admission of paternity.

His Honour considered *Wiedeman v Walpole* [1891] 2 QB 534. That was an action for breach of promise where it was held that the failure of the man to answer the woman's letter was not corroboration and that, in the absence of evidence corroborating the plaintiff materially, the case should have been withdrawn from the jury. His Honour cited Bowen L J, who said at p 540: "The case only illustrates the limitation to be placed upon the doctrine that silence is not evidence of an admission unless it is reasonable to expect that if the statements made were untrue they would be met with an immediate denial.

The Magistrate quoted in his judgment a passage from *Bromley & Webb's Family Law* at pp 739 and 740. It was not disputed that the passage stated the principles which had to be applied. As a result it was accepted that it was necessary that "part of the mother's story which implicates the man must be corroborated in some material particular"; that in many cases "circumstantial evidence that the father had intercourse with the mother at or about the time when the child could have been conceived will have to be relied on"; that "there must be something which is not merely corroboration of the view that the alleged father might find it difficult to resist a case made against him. . . . there must be something that amounts to an admission on his part of paternity. . . ." "It is quite true that such an admission may arise, not merely from words, but from the conduct of the putative father when it becomes material for him to deal with the allegation that he was the father of the child. His Honour noted the reference to *McKenzie v Scott* [1957] NZLR 1069, where, as in the present case, there was evidence of opportunity. In *McKenzie's* case there was evidence that, at least on one occasion about the time of conception the parties had been together for some hours in a lonely and secluded spot. Besides this there was evidence of association for some time. The facts of the present case, the learned Judge

observed, were similar but in *McKenzie's* case, the putative father had offered to pay confinement expenses, later denying paternity and intercourse, however, withdrawing his offer on the grounds that it had been "an affectionate gesture". It was found that there was evidence of corroboration.

His Honour went on to deal with *Moore v Hewitt* [1947] 1 KB 831, 838, where Lord Goddard CJ had pointed out that it is "very often the only way of giving corroborative evidence in these cases, to prove that the two young people concerned were, perhaps, a courting couple or sweethearts or, at any rate, were associating together on terms... of intimacy and affection." Lord Goddard proceeded to say that the word "intimacy" was not being used in "the newspaper sense, meaning sexual intercourse". In that case the association had been a longer one but it was similar in many respects to the case under review, including visits to the girl's home and there was no evidence that she was associating with anyone else. In *Moore's* case it was argued that there was no more than proof of opportunity, but the Court drew a distinction between the facts which White J had referred to compared with the facts in *Burbury v Jackson* [1917] 1 KB 16 and *Thomas v Jones* [1921] 1 KB 22, where, in both cases, "the two persons were not associating for any other reason than that they were thrown together in the ordinary natural course of things, in the one case because they were employed at the same farm, and, in the other case, because the woman was acting as housekeeper to the man".

White J proceeded to deal with the father's evidence, which was claimed to be corroborative in the case before him. He noted that the Magistrate had said that, in his opinion, it was not sufficient to corroborate the intimacy and that there was nothing to show a close association. Dealing specifically with the interview between the appellant's father and the putative father, the Magistrate had said:

> "There is an interview at which there is no discussion about whether the defendant had had sex with his daughter. There is a discussion which commences upon the basis that his daughter was pregnant. There is a reply from the defendant reported by the father, that he did not admit nor did he deny paternity, but that he wanted to be sure and that he would wait and see. This latter attitude was recorded by the father as coming from the defendant. In these circumstances there is a construction clearly open that although the defendant had been told by the father that his daughter was pregnant the defendant did not altogether believe or accept it, and secondly the defendant wanted further time within in [sic] which to define his situation. Therefore, he was not prepared to make any affirmation or positive denial which could be construed as confirming the applicant's testimony that he had in fact had sex with the daughter on an occasion prior to that and was in fact the father of her child".

White J thought the short point in the present case was whether there was evidence of corroboration in the evidence of association and "the conduct of the putative father when it becomes material for him to deal with the allegation that he was the father of the child".

In examination in chief, the appellant's father said that he rang up the Fraie home and said, "You had better get your son over here". Either before the respondent came, or soon after he arrived, he was told that the appellant was pregnant. The appellant's father summed up the respondent's response as: "He said he wanted to be sure, to wait and see to be sure, and that was about it. He didn't deny it neither did he acknowledge it". Asked about this in cross-examination, he confirmed the evidence he had given, saying: "Yes I can't give you word for word but he wanted to wait until further tests were carried out". In answer to questions from the Magistrate, the appellant's father said there was no discussion of intimacy, or suggestion that he might be the father because he had sex with the daughter. Asked what it was that he refused to confirm or deny, the father of the applicant answered: "Well all he wanted to do was wait until further tests were carried out".

The learned Judge thought it undesirable to say any more about the evidence except that "I consider, in the circumstances of this case, the evidence of opportunity and the conduct of the respondent provided corroborative evidence. It seems to me that, faced by the appellant's father and knowing that the appellant claimed she was pregnant to the respondent, the answer he gave of "wanting to be sure" of the pregnancy was conduct capable of being held to amount to an admission of paternity. In my view, there could be no doubt in the respondent's mind what [the girl's father] meant when he sent for the respondent and told him that his daughter was pregnant. But there is no evidence of any denial or surprise, merely the expressed wish to be sure that the appellant was pregnant".

His Honour allowed the appeal and remitted the case to the Magistrate's Court.

PRH Webb

COMMERCIAL LAW

SALE OF GOODS CONTRACTS AND DEPOSITS

By ROGER CONNARD, *Senior Lecturer in Law, University of Auckland.*

The recent decision of Coates J in *Reid Motors Ltd v Wood and Kwok (trading as Apollo Amusements (a)* concerns a problem on which there is surprisingly little authority; does a purchaser who has paid a "deposit" under a sale of goods contract lose it if he subsequently repudiates the contract? Judicial consideration of this question has mainly been limited to contracts for the sale of land. There, the deposit, say 10% of the purchase price, will normally be a deposit in the strict sense of the word, "a security for completion of the purchase" *(b)*. It will also constitute a prepayment of part of the purchase price. Thus if the vendor refuses to accept a repudiation of the contract by the purchaser, the sum that he can claim will be the purchase price less the deposit. If on the other hand he accepts the repudiation and thus rescinds the contract, the deposit is forfeited. The vendor must, however, take the deposit into account in calculating the amount of his loss in any action for damages that he may bring against the purchaser.

Where a more substantial prepayment is involved, the court may consider that the parties intend it solely as a prepayment of part of the purchase price. In this event, the purchaser can recover it even though he himself is the party in default, unless the vendor refuses to accept his repudiation and sues for the balance of the purchase price under the contract. A vendor who accepts the repudiation may, of course, counterclaim for damages for the amount of his loss *(c)*. Thus in *Dies v British and International Mining and Finance Corporation (d)*, where the purchaser repudiated the contract having made a prepayment of £100,000 out of a total purchase price of £235,000, Stable J held that, despite his default, he was entitled to recover the £100,000 subject only to the vendor's counterclaim for its net loss of profit on the deal. It is clearly, therefore, of vital importance whether a payment is construed as a deposit in the strict sense of the word or merely as a prepayment of part of the purchase price.

In the *Reid Motors* case, the defendants had signed "vehicle purchase orders" to buy two motor cars from the plaintiff dealers, a Mazda (price $5,495) and a Hillman (price $4,495). It was agreed that the requisite 60 percent deposit under the Hire Purchase and Credit Sales Stabilisation Regulations 1957 would be satisfied in part by the trade-in of the defendants' Holden car valued at $3,000. Of this sum, $2,700 was to serve as the deposit on the Hillman, and the balance of $300 plus a cheque for a further $3,000 was to be the deposit on the Mazda. Having handed over the cheque for $3,000, the defendants arranged to return the following day to sign hire purchase agreements, hand over the trade in and take delivery of the cars. Early the next day, however, the defendants telephoned to say that they had changed their minds. Payment of the cheque was countermanded. Six days later the plaintiff resold the Mazda for $5,995 and about three months later the Hillman was resold for $4,495. The plaintiff now sued the defendants on the cheque for $3,000 and interest.

Having rejected defences based upon lack of a concluded contract and breach of the Hire Purchase and Credit Sales Stabilisation Regulations, Coates J held that each "vehicle purchase order" constituted a "binding provisional agreement" for the purchase of the cars. These the defendants had repudiated and the plaintiff had rescinded by its resale of the cars *(RV Ward Ltd v Bignall* [1967] 1QB 534 (CA). Was the "deposit" a deposit in the strict sense or was it a prepayment of part of the price? The largeness of the sum, the fact that it had been arrived at mainly, if not solely, to comply with the Hire Purchase and Credit Sales Stabilisation Regulations, and the fact that it was referred to in the plaintiff's printed receipt as "being payment towards purchase of . . ." all led his Honour to hold that it was, in like manner to the payment in *Dies v British and International Mining and Finance Corporation* (Supra), a prepayment of part of the price. Judg-

(a) Supreme Court, Auckland. 18 July 1977 (A.38/76).

(b) Per Bowen LJ in *Howe v Smith* (1884) 27 ChD 89 at 98.

(c) *Benjamin's Sale of Goods* 1st ed (1974) para 1204.

(d) [1939] 1 KB 724. Contrast eg *Sprague v Booth* [1909] AC 576 (PC).

(e) Per Lord Macnaghten in *Soper v Arnold* (1889) 14 App Cas 429 at 435.

ment was therefore given for the defendants.

The plaintiff might well be forgiven for feeling aggrieved that the defendants could thus repudiate their contract with impunity. Admittedly, the plaintiff, as it happened, had been able to resell the Mazda for $500 more than the contract price, but this must have been offset to some extent by the expenses of resale and the cars remaining in stock for a longer period. The vehicle purchase orders signed by the plaintiffs referred to the payment as a "deposit" and although it was described in the receipt as a payment towards the purchase, most deposits in the strict sense will also serve this dual function. The payment was a large one, but looking at the transaction as a whole and bearing in mind that the trade-in had not yet been handed over, it constituted only 30 percent of the total purchase price. Might not the parties at the time the cheque was handed over properly be taken to have intended it at least in part as a "guarantee that the purchaser means business"? *(e)*

Two decisions, not referred to in the judgment, lend support to the view that, at least in earlier days, the courts were prepared to regard fairly large sums as nevertheless being intended as deposits in the strict sense of the word. In *Commission Car Sales (Hastings) Ltd v Saul* [1957] NZLR 144 the purchaser handed over a car valued at £300 as the deposit on a car he agreed to buy for £1,200. He subsequently repudiated the contract and this repudiation was accepted by the vendor (appellant). In these circumstances, Turner J considered that

> "... the appellant was clearly entitled, as Mr Monagan concedes, to treat any deposit as forfeited. This result follows equally when a deposit is (as here) also a payment on account of the purchase price."

Was counsel's concession too readily made?

Gallagher v Shilcock (f) concerned the sale of a boat for £665. The purchaser had paid a deposit of £200. Finnemore J stated:

"The only real evidence which I have is the document of May 17. In that document the £200 is described as a deposit, and, that being the only indication, I think that those who use that word must be taken to know what it means and to intend it to bear that meaning ... I therefore think that I am bound to hold that this £200 paid by the purchaser was a deposit in the strict sense of the term, although, no doubt, if the purchase had been completed, it would have gone against the purchase price. In short, it was both a deposit and a prepayment of part of the price" (p769).

Both these decisions can, of course, be distinguished in the instant case. Could, however, the standard form purchase order be redrafted in such a way as to enable the vendor to keep at least part of the "deposit" in a subsequent case involving similar facts? Suppose, for example, the sum paid were described as to $550 (10 percent of the price of the Mazda) as "deposit" and as to the balance of $2,450 as "prepayment of part of the price". It would seem arguable that such a description would provide almost conclusive evidence that in the event of the purchaser repudiating the contract, he could recover at most only $2,450 *(g)*. The same reasoning would not apply however, where the signed contract constitutes a hire purchase agreement within the meaning of the Hire Purchase Act 1971, since in that event the resale and account provisions of that Act would come into effect, at least if the purchaser has at some stage taken possession of the goods *(h)*.

Two further reasons for finding in favour of the defendants were given by Coates J. The first was based upon the distinction which his Honour was prepared to draw between a purchaser's action to recover a deposit paid and a vendor's action to obtain payment of the deposit after the contract had been rescinded.

In *Lowe v Hope* [1970] Ch 94 the purchaser of land had paid only £40 of the deposit of £629 payable under the contract. The vendor sought both rescission of the contract and an order for payment of the balance of the deposit. Pennycuick J held that

> "the vendor having elected to bring the contract to an end by rescission is not entitled to insist on the performance of the contract in relation to the deposit. This is admittedly so, in so far as the deposit bears the character of part of the unpaid purchase price. It seems to me it must equally be so, in so far as the deposit bears the character of a pledge; for once the vendor has rescinded the contract there are no outstanding obligations of the puchaser in respect of which the vendor can be entitled to be protected by a pledge" (p98).

In the instant case Coates J considered that

(f) [1949] 2 KB 765. The case was overruled in *RV Ward Ltd v Bignall, supra,* but no criticism was made of this aspect of the decision.

(g) Cf *Mayson v Clouet* [1924] AC 980 (PC).

(h) Sections 24 and 26-35. It would seem that the Act makes no provision for the situation where the purchaser repudiates the contract before he has taken possession of the goods. The vehicle purchase orders in the instant case could presumably not be hire purchase agreements as defined in s 2 of the Act because they included a provision whereby the purchaser agreed "to complete *before delivery* the vendor's usual hire purchase agreement" (emphasis added).

> "[b]y seeking to recover the amount of this cheque for $3,000, payment of which has been stopped by the defendants, the plaintiff here is claiming in effect the amount payable, but not paid, under the contract which the plaintiff has rescinded. Although the plaintiff has sued on the cheque, I should not ignore the reasons for which the cheque was given and what the amount appearing in it really represents."

It is respectfully submitted that a vendor's action on a cheque given as deposit should not be equated with a vendor's action to enforce payment of a deposit under the contract. In *Johnson v Jones* [1972] NZLR 313 (not referred to in the judgment McMullin J followed *Lowe v Hope* (Supra) in a case involving similar facts. However his Honour noted that

> "there are one or two cases in which a claim for recovery of an unpaid deposit has been sustained on other grounds. One such case is *Hodgens v Keon*. [1894] 2 IR 657]. A closer examination of that case reveals that it was an action by an auctioneer who sued for the amount of a deposit payable under an IOU which, without the vendor's consent, he had taken from the purchaser to pay the amount for which it was given and so constituted a separate head of liability between the auctioneer and the purchaser. Another case is *Hinton v Sparkes* [(1868) LR 3 CP 161] which also turned on the giving of an IOU for the amount of a deposit" (p318).

Neither *Hodgens v Keon* nor the more recent case of *Pollway Ltd v Abdullah* [1974] 1 WLR 493 (CA) can be regarded as strong support for recovery under the cheque by the vendor in a case such as the present, since both cases turn essentially on the involvement of a third party, the auctioneer. In *Hinton v Sparkes* (Supra) the point was not argued. Considerable support can, however, be obtained from the underlying principle which led to the court holding in both *Lowe v Hope* (Supra) and *Johnson v Jones* (Supra) that the vendor could not sue for the balance of the deposit under the contract. Pennycuick J stated in *Lowe v Hope*:

> "It would, I think, be quite contrary to principle that a vendor having rescinded a contract so that the contract is at an end should *at that stage be entitled to insist that the purchaser shall hand over to him a contractual pledge with a view to its forfeiture*" (emphasis added) (p98).

McMullin J put it thus in *Johnson v Jones*:

> ". . . the very nature of a deposit is such that before it can be forfeited it must first be paid. A vendor is entitled to insist upon a purchaser paying a deposit on a sale as a pledge or earnest to be forfeited upon a purchaser's default but, if, *having stipulated for payment of a deposit, the vendor does not collect it before he elects to rescind* . . . then in my view he cannot subsequently sue for it" (emphasis added) (p317).

Where a cheque has been handed over, the deposit has been paid, the cheque being conditional payment. A long line of procedural cases, such as *James Lamont & Co Ltd v Hyland* [1950] 1 KB 385 and *Cebora SNC v SIP (Industrial Products) Ltd* [1976] 1 Lloyds Rep 271, have emphasised that as an ordinary rule commercial necessity demands that bills of exchange can be treated as cash *(i)*. If, therefore, in the instant case, the cheque had been intended as a deposit in the strict sense of the word, it is respectfully submitted that the plaintiff should have been entitled to recover under it.

The second further reason accepted by Coates J for finding for the defendant was that he considered that it would be unconscionable to allow the plaintiff to recover the sum of $3,000 when it had suffered no loss by reason of the default by the defendants but, indeed, had made a profit in the resale of the Mazda motor car. Authority for the giving of equitable relief in this way was to be found in the dicta of Denning LJ (as he then was) in *Stockloser v Johnson (j)*. Although not referred to by Coates J, a similar approach was recently taken by Wild CJ in *Codot Development Ltd v Potter and Cherry* [1977] NZ Recent Law 64, a case concerning a contract for the sale of land. The English decisions suggest that this equitable principle is equally applicable to contracts for the sale of goods *(k)*, although *Benjamin's Sale of Goods* (1st ed) (1974) para 1203 notes that "there is no reported case in which the principle has been positively applied to grant relief to a buyer of goods."

(i) See also *Brotherston v Gould Car Sales Ltd* (1975) 1 NZ Recent Law (NS) 147.

(j) [1954] 1 QB 476, especially at 491-492.

(k) In New Zealand, the dicta by the Court of Appeal in *Riddiford v Warren* (1901) 20 NZLR 572 (as to the general non-availability of equitable remedies in contracts governed by the Sale of Goods Act 1908) provide some support for the view that the principle has no application in a case such as the present. This point involves a wider issue and is not considered here. For a general discussion of the dicta, see Leys and Northey, *Commercial Law in New Zealand* 5th ed (1974) pp 244-247.

TORTS

SUPERSTUDS AND CONFIDENCE

By GRANT HAMMOND

The Litigation between four of the best known English pop stars (professionally known as Tom Jones, Englebert Humperdink, Gilbert O'Sullivan and Gordon Mills) and their press relations agent and reported as *(Woodward v Hutchins* [1977] 1 WLR 760 is of considerable interest in the area of the law relating to defamation and breach of confidence *(a).*

The facts of the matter were simple and possibly predictable. The four pop stars concerned, along with certain associated companies, had employed the defendant, Christopher Hutchins, as a press relations agent. This defendant in this capacity went on tour with the pop stars concerned and "saw all their doings" *(b).* As their press agent it was for him to see that the plaintiffs received favourable publicity and that their activities were shown to the public in the best light.

At one time the defendant was asked to sign a letter in which he (amongst others) promised not "to make any statement or give any interview or pass any information to any third party touching or concerning the principals in the group either during the employment or at any time afterwards". There was some argument on the facts at the hearing as to whether the defendant had subsequently (but before the acts complained of at the hearing) been released by further agreement from that obligation.

The defendant's employment came to an end but after that time he approached the Daily Mirror newspaper group and he gave that newspaper much information not theretofore disclosed about the lives of Mr Tom Jones and the other members of the group.

The first article appeared on a Saturday in April 1976 and described a very unsavoury incident in which "Tom got high in a Jumbo jet". A further article on the following Monday described in fairly graphic terms (again in relation to Tom Jones) "The Marji Wallace affair. Enter a Sexy Lady". The very next morning another article appeared on the front page entitled "Tom Jones Superstud – More Startling Secrets of the Family, by Chris Hutchins".

Not surprisingly these events produced a fairly swift reaction. The group issued a writ seeking an injunction to restrain the further publication of the series, the hearing took place for two hours on the afternoon of Tuesday 19 April, and an appeal from the decision of Slynn J granting an injunction was heard by the English Court of Appeal on that very afternoon. The appeal was upheld.

The case for an injunction had been put on three grounds: libel, breach of contract and breach of confidential information.

(a) As far as the claim for an injunction based on libel was concerned, Lord Denning M R had no difficulty in disposing of that claim. The Court was told that the respective defendants would plead justification and His Lordship noted that the Courts rarely, if ever, grant an injunction when a defendant is going to justify because "the interest of the public in knowing the truth outweighs the interest of a plaintiff in maintaining his reputation" (p 763E). The other judgments (of Lawton and Bridge LJJ) appear to accept Lord Denning's views on that point.

(b) As far as the cause of action for breach of contract was concerned, Lord Denning's judgment was the only one to deal with that aspect of the matter. His Lordship reached the view that on the evidence as it stood at that time as to the tearing up of the letter it was a permissible view that the promise not to disclose any information was rescinded and that on that account no injunction should be granted. However, it should be noted in passing that His Lordship's judgment contains, with respect, a somewhat startling proposition. He said that "even if that letter still stood, I doubt whether the promise in it would be enforced. A serious question would arise as to whether it was reasonable to impose such a fetter on freedom of speech" (p 763F). No authority was cited for that proposition which, with respect, appears to be an entirely novel one.

(c) Having dealt with the first two grounds of the claim, the Court was faced squarely with the issue of breach of confidence. It was clear that if an injunction was to be granted at all in view of the previous findings of fact that it could not be on any contractual ground and the equitable doctrine of confidence would have to be relied

(a) And see R G Hammond, "Developments in the Equitable Doctrine of Breach of Confidence" [1976] NZLJ 278.

(b) Per Lord Denning M R at 762 E.

on, although this is nowhere expressly so stated in the judgments.

On this issue Lord Denning took the view: 'If a group of this kind seek publicity which is to their advantage, it seems to me that they cannot complain if a servant or employee of theirs afterwards discloses the truth about them. If the image which they fostered was not a true image it is in the public interest that it should be corrected. In these cases of confidential information it is a question of balancing the public interest and maintaining the confidence against the public interest in knowing the truth" (p 763-4). The Master of Rolls further considered that the injunction in the Court below had been so vaguely worded that it would be difficult for anyone, whether the defendant, the Court or the newspaper, to know where it stood. He held also that the plaintiffs' real complaint was that the words complained of were defamatory and that as they could not get an interlocutory injunction on that ground, neither should they in respect of confidential information. Finally, on the issue of the balance of convenience in the granting of an injunction he held against the plaintiffs.

Lawton L J likewise appears to have considered that the allegation of confidentiality was so interwoven with the claim for damages for libel that the balance of convenience was entirely on the side of allowing the publication to go on.

Bridge L J held: "It seems to me that those who seek and welcome publicity of every kind bearing upon their private lives so long as it shows them in a favourable light are in no position to complain of an invasion of their privacy by publicity which shows them in an unfavourable light" (p 765). His Lordship held, however (apparently on the issue of convenience), that if the defendants could not in due course make good their claims it was quite plain that the plaintiffs would recover very considerable damages for libel, "to say nothing of any damages they may recover for breach of confidentiality". In so far as there is (with respect) still room for argument on the damages aspect of breach of confidence *(c)* that statement may be open to question.

As might have been expected in a case which had to be argued with a maximum of expedition and a minimum of research by counsel or the Court, there was no searching examination of authority, but in view of the importance of the issues raised in relation to "public figures" it is suggested that it is appropriate to review the earlier authorities and to endeavour to ascertain where the law now stands on the defence of "public interest" in relation to a claim for breach of confidence and to consider the wider implications of the decision.

(1) Previous authority

Although the Courts have long been adamant that an employee is under a duty not to disclose, whether during or after his employment, information gained in confidence in the course of that employment there has, for some considerable time, been some doubt as to whether there was a defence of "just cause or excuse" and if so what the proper bounds of that defence were. Clearly on the authority of *Gartside v Outram* (1856) 26 LJ Ch 113 and *Weld-Blundell v Stevens* [1919] 1 KB 520 there was a defence in the case of a crime or fraud. In *Gartside v Outram* Wood V-C suggested that the true basis of the exception was that there could be no confidence as to the disclosure of an iniquity.

The next decided case was *Initial Services Ltd v Putterill* [1967] 3 All ER 145. In that case the former sales manager of a laundry company resigned taking with him documents from the company's files which he gave to a newspaper. An article was published in which what was tantamount to a "price ring" between laundries was described. The laundry chose, instead of bringing an action for libel, to sue both the ex manager and the newspaper for an injunction and damages alleging breach of confidence and claiming delivery up of confidential papers. The sales manager pleaded in defence that the alleged arrangement to keep up prices was within s 6 of the Restrictive Trade Practises Act 1956 (UK) but was not registered as required by the Act. The plaintiffs moved to strike out this defence and both the Master and a Judge on appeal refused to accede to this motion and the case was reported only on the appeal from the interlocutory application to Cusack J.

The plaintiff's determination to have that aspect of the defence struck out was obviously misguided because there was a clear and longstanding principle of procedure that the law will not drive any litigant away from the Court prior to trial by striking out either claim or defence unless it is unarguable either that there is no cause of action whatsoever or that the defence is legally completely untenable. Even a thin case will usually survive this test and the defendant had at worst on the facts an arguable defence. In these circumstances it is hardly surprising that the Court of Appeal dismissed the appeal and in his judgment in that case Lord Denning suggested that the exception "extends to any misconduct of such a nature that it ought, in the public interest, to be disclosed" (p 148). This is the first occasion on which a "public interest" test was suggested by any Judge. The narrow view of *Initial Services Ltd v Putterill,* however, would be to classify

(c) See article cited in note (a) supra at 281.

the case as one where the plaintiff was simply not able to demonstrate that there was no possibility of the defence succeeding. The only authority before Lord Denning in *Initial Services Ltd v Putterill* had been the statement of Wood V-C in *Gartside v Outram* that "there is no confidence as to the disclosure of iniquity", and whether the statement of Wood V-C could properly have been read as widely as the learned Master of the Rolls suggested may well have been open to question.

Lord Denning had occasion to return to the issue in *Frazer v Evans* [1969] 1 QB 349, 362 when he stated that, "there are some things which may be required to be disclosed in the public interest in which event no confidence can be prayed in aid to keep them secret".

Lord Denning was again a member of the Court when the most recent reported case prior to *Woodward,* namely *Hubbard v Foster* [1972] 2 WLR 389, arose. In that case Foster was the author and the second defendant was the publisher of a book which was very critical of the cult of scientology. Foster had been a member of the Church of Scientology for 14 years and he left after being declared in "a condition of enemy". Foster had used in his book substantial extracts from books about scientology by Hubbard, who was the inventor of the word, and also from various of Hubbard's papers, some of which were treated as confidential. Some of these papers, including one for which confidence was claimed, included potentially "dangerous" material. Hubbard's claim was brought in the form of an injunction for breach of confidence and copyright. In the course of that judgment Lord Denning said: "In copyright actions, we ought not to restrain a defendant who has a reasonable defence of fair dealing. Nor in an action for breach of confidence if the defendant has a reasonable defence of public interest. The reason is because the defendant, if he is right, is entitled to publish it; and the law will not intervene to suppress freedom of speech except when it is abused" (p 397).

Thus at the time that *Woodward v Hutchins* came before the Court of Appeal there were few factual instances in which the defence had been raised.

(2) The present scope of the defence of "public interest"

Woodward v Hutchins does not afford any final resolution as to just how wide the exception in the public interest really is, although it is hardly realistic to suggest that in the particular circumstances of this case the Court of Appeal had any time for any searching examination of principle, even if it had been so minded. It seems inescapable, however, that the narrower basis of the earlier cases has been broadened by Lord Denning into a test of "public interest". In all four cases abovementioned in which Lord Denning has been involved he has viewed the test as one of "public interest". This, with respect, is somewhat wider than the expression "just cause or excuse for breaking confidence" which was the expression used in the earlier cases. Public interest is obviously a very flexible concept and in the undeveloped state of the case law it is obviously difficult to form any definite conclusion regarding the proper scope of that exception. The English Law Commission in its Working Paper on Breach of Confidence *(d)* criticised this situation and said: "In whichever form the defence is expressed its scope remains obscure. In the absence of a substantial body of case law there are few guidelines by which those to whom their information has been entrusted in confidence can regulate their conduct". The Commission asked, for instance, if there should be a defence of privilege to cover the disclosure of information in breach of confidence in circumstances in which the disclosure would be privileged under the law of defamation. As the Commission itself commented: "Such a case might at present be covered by the broad defence of public interest but no authority on the point exists" (p 39). Indeed the very uncertainty of this area of the law was one of the reasons that the Law Commission recommended legislative clarification of the law on breach of confidence. The only clear indication that can be taken from the line of cases as they now stand would seem, with respect, to be that the tendency of modern judicial thinking is to emphasize the "public interest" element in the defence rather than the element of "misconduct".

(3) *Woodward v Hutchins* serves also as a useful reminder, if such be required, that the doctrine of breach of confidence is not confined to contractual situations, neither is it confined to the area of trade secrets or protection of industrial information. Unfortunately because most breach of confidence cases arise in these latter areas, a somewhat distorted view of the proper scope of the equitable doctrine of breach of confidence is all too often gained *(e).*

(4) All three judgments in the Court of Appeal in *Woodward v Hutchins* show a pronounced underlying value judgment in favour of freedom of speech. Given the current vogue of protest against closed decision making and matters of that kind, as well as the traditional interest of

(d) Working Paper No 58 (1974), page 38.
(e) And see *Argyll v Argyll* [1967] Ch 302.

the common law in freedom of speech, that attitude is no doubt commendable but there are other considerations which, with respect, in the development of this area of the law ought not to be lost sight of. It could fairly be said, for instance, that there is a substantial element of public interest also in the preservation of confidences and the task of the Court considering a defence of public interest would (or perhaps should) therefore be to balance this against the public interest in disclosing the information to which a confidence related. This is a function which the Courts already discharge in other spheres – there is, for instance, the line of three recent cases in which the House of Lords has had to consider the question of where the balance of the public interest lies in relation to a claim for Orders for Discovery *(f)*. Likewise the Courts have never had any particular difficulty in defamation suits in ruling on defences of "fair comment on a matter of public interest" which involves like considerations.

(5) A more profound question which arises relates to the status of the plaintiffs. Bridge L J in the *Woodward* case said: "It seems to me that those who seek and welcome publicity of every kind bearing upon their private lives so long as it shows them in a favourable light are in no position to complain of an invasion of their privacy by publicity which shows them in an unfavourable light" (p 765). It has long been plain that in any reform of the law relating to defamation, privacy or confidence (or any one of them) one of the single most difficult tasks is to deal with the status of a prominent person – ie whether a person who is somehow in the public eye is, or should be, deprived by virtue of such prominence or position from protection in respect of "private" matters. Is it the case that the whole scope of such a person's life, character and actions is to be thrown open to public scrutiny merely because that person is seeking the approbation (in the case of a politician) of the public to conduct affairs of State on behalf of other citizens? If the answer to this question is that there are areas of interest which may legitimately be termed "public" and "private" the second limb of any enquiry must surely be to determine either the boundaries of those areas or a workable formula whereby the boundaries may be determined in the circumstances of any given case. As the leader writer of the "Times" commented on the Mancroft Privacy Bill, "at what point do the personal affairs of parsons and film stars end and their pastoral work or publicity begin?" *(g)*. It is unfortunate that, in view of the exigencies which attended *Woodward,* no really searching examination of the difficulties attendant on finding an acceptable dividing line between "public" and "private" took place. It is suggested, however, that sooner or later public figures are going to demand, with some justification, that a real attempt be made to define with some greater degree of precision at what point their affairs can legitimately be said to be public and thus open to criticism and discussion and at what point they remain truly private *(h)*. The resolution of that issue remains central to many of the difficulties to be found at present in the law of defamation, breaches of confidence and in a consideration of the protection, if any, to be given in respect of so called breaches of privacy.

Note

Since the foregoing was written the decision in *Foster v Mountford and Rigby Ltd* (1977) 14 ALR 71 has come to hand. This is perhaps the most unusual breach of confidence case since the case of Queen Victoria's etchings *(Pollard v Photographic Co* (1888) 40 ChD 345). Mountford was the author and Rigby Ltd were the publishers of a book containing revelations of Australian Aboriginal cultural and religious secret ceremonies disclosed in confidence to Doctor Mountford (an anthropologist) some 35 years before. The book was prefaced by a caveat that where Aboriginals were concerned the contents should be used only after consultation with male religious leaders. This for the reason that the concept of what is secret to women, children and the uninitiated varied through Australia and moreover it is plain from the judgment that the learned trial Judge accepted that much of the material went to the whole of the Aboriginal family and social structure. When the book was presented for sale in the Northern Territory of Australia it came to the attention of members of an unincorporated body, the Pitjantjara Council, which immediately sought ex parte on behalf of the Aboriginal people concerned an injunction prohibiting publication of the book within the Northern Territory. In the result Muirhead J held that a prima facie case had been made out that continuing publication of the defendants' book would reveal secrets to those to whom it was always understood such secrets would not be revealed, thereby occasioning social damage of a serious nature and of a type to which monetary damages were irrelevant.

(f) *Norwich Pharmacal Co v Customs and Excise Commissioner* [1974] AC 133; *Alfred Crompton Amusement Machines Ltd v Customs and Excise Commissioner* [1974] AC 405; *D v National Society for the Prevention of Cruelty to Children* [1977] 2 WLR 201.

(g) Editorial, *"What is Reasonable?"*, The Times (London) 13 March 1961, p 15, col 4.

(h) See also R G Hammond "Privacy and the Prominent Person" (unpublished dissertation, Auckland University Law Library).

Again the case had to be considered as a matter of urgency and ex parte and there is, therefore, no full examination of the authorities but it is plain that the learned Judge relied on the now well established principle that a cause of action for breach of confidence does not necessarily require to be sound in contract or property but rests on some wider basis.

The case is a most unusual and graphic illustration of the application of the equitable doctrine of breach of confidence and emphasises again, if such emphasis be needed, that this doctrine does not relate solely to the field of trade secrets. In an increasingly complex world the conceptual shortfall in the traditional common law armory is becoming more and more apparent and it is suggested that the immense conceptual breadth of the doctrine of breach of confidence, when put in its proper perspective, is a most important advance in our jurisprudence. Nevertheless there are two features of the judgment under review which contain some distinct problems for the future:

(a) Who is entitled to complain of a breach of confidence?

(b) What, if any, relevance should be paid to the fact that the material concerned is of a scientific nature?

As to the first of these. In *Frazer v Evans* [1969] 1 All ER 8, 11 Denning MR said, ". . . the party complaining must be the person who is entitled to the confidence and to have it respected. He must be a person to whom the duty of good faith is owed." It would appear from the judgment that the information complained of was gathered some 35 years earlier by Doctor Mountford on a camel trip through the area concerned and although the judgment does not make it plain, it would appear that on the facts the information was garnered from persons other than the plaintiffs in the present action. In short it was descendants of those who originally gave the information who appear to have come to the Court complaining of the secrets that were about to be made public by the book in question. The learned Judge said (at p75) ". . . they sue on their own behalf, not merely as members or representatives of the Pitjantjara people, if they can be so identified. They allege that they, as individuals, are threatened with damage . . ." In the result, in this particular action the learned Judge held without having heard argument on the matter that the claim was not one which could only be pursued by a relator action brought in the name of the Attorney-General. It is quite plain from the judgment taken as a whole that the learned Judge had a strong sympathy for the plaintiffs' position and he appears to have assumed for the purpose of granting relief that there was status in the plaintiffs to bring an action. Bearing in mind that liberty was reserved to the defendants to move to discharge the injunction on seven days' notice there is no doubt a great deal of practical merit in the course adopted but the substantial and interesting question as to the real merits of the plaintiffs' status was left unresolved. So far as can be gained from the judgment there appears to have been no legal relationship (other than possibly a blood one) between the plaintiffs and their predecessors and at least as matters stand, therefore, on the result to date in this litigation a duty of confidence may be owed to a class of persons. Plainly factual instances of the application of the doctrine in these kinds of circumstances will be rare but the decision may have some significance in relation to religious orders and secret societies.

The other aspect of the decision which went unanswered (although the Judge noted it as being a possible issue) is whether, as a matter of public policy, there should be a right to disseminate the results of scientific or anthropological research notwithstanding that that material may have originally become available as a matter of confidence. Does the public interest in knowing the scientific truth outweigh the public interest in the social stability of this particular class of persons? Leave was reserved to take the matter to the High Court of Australia and if the matter proceeds that far the decision will be received with some interest.

OBITUARY

Mr Lalu Patel

The sudden death occurred at Auckland on 2 October 1977 of Mr Lalu Patel, at the age of 58. Mr Patel was born in India and came to New Zealand in 1939. He was educated at Auckland University College and was admitted in 1949. He was the first Indian to graduate in Law in New Zealand. He was, for many years, well known as "Mick" Robinson's clerk. He handled much unpaid domestic work, in those days of no legal aid.

He commenced practice on his own account in 1960 with the late Mr McLiver, which practice is still subsisting.

Mr Patel was a respected leader of the Indian community for many years. He acted as legal adviser to their many associations. He was a natural gentleman.

Mr Patel is survived by his wife and two children.

TAXATION

DIRECT OR INDIRECT TAXATION?

A Comment on the Retail Sales Tax Proposals of the Monetary and Economic Council

By LINDSAY McKAY, *Senior Lecturer, Victoria University of Wellington.*

Introduction

In its report of October 1976 *(a)* the Monetary and Economic Council proposed a major restructuring of the New Zealand taxation system. It repeated and in part re-argued its recommendations in its report of May 1977 *(b)*. The thrust of the reform advocated was a shift away from direct taxation as a source of government revenue and a movement towards greater reliance on indirect taxation. It described our present degree of reliance on the former – of which the personal income tax is the most significant component *(c)* – as "the basic defect in the New Zealand [tax] system" *(d)*.

The object of this note is to conduct a brief examination of both the reform suggested by the Council and the charges it lays against the present tax structure. This survey must necessarily be conducted at a general level: the Council's recommendations are quite lacking in specificity and are debated by it at an extremely abstracted level. The argument is forwarded by the present writer that, in limited circumstances and subject to important prerequisites the Council's proposals have something to commend them. But the argument is also advanced that these pre-conditions are not yet proven to be satisfied and that an immediate movement towards a greater emphasis upon indirect taxation cannot be justified on the basis of the arguments marshalled by the Council.

The Council's reasoning

It is helpful at the outset to summarise the Council's reasoning in support of its recommendations. In essence there are apparently four considerations that it sees as supporting the shift it advocates.

(a) *Imbalances compared with other OECD countries*

More by inference than by direct accusation the Council sees New Zealand as being out of line with other western countries in both the degree to which it depends upon direct taxation as a source of revenue and upon the extent of its reliance upon personal income taxation as a component of the overall yield from direct taxation. As to the first of these apparent criticisms, the Council's Table 4, entitled *Sources of Tax Revenue in 1973 (e)*, is the basis of its case. That table shows the percentage of revenue derived from direct taxes *(f)* in New Zealand and other OECD members in the year in question to be as follows:

New Zealand	–	66
Netherlands	–	71
Sweden	–	65
United States	–	66
Germany	–	69
Norway	–	59
Italy	–	61
France	–	58
United Kingdom	–	58
Australia	–	53
Canada	–	55

New Zealand ranks third on this table, behind Germany and the Netherlands. The Council's report does not explicitly state what significance this relatively high ranking possesses, though presumably the inference is that New Zealand is out of kilter with the prevailing international pattern.

Presumably our even higher position on the table which compares the proportion of total revenue contributed by personal income taxation is intended to persuade to the same conclusion. The statistics here show that New Zealand relies to a greater degree than any other OECD member on revenue from this source: at 51 percent of total revenue we are over 4 percent higher than

(a) Report No 31. (Government Printer, Wellington, 1976) pp 15–24.

(b) Report No 32 (Government Printer, Wellington, 1977) pp 38–39.

(c) See the Council's Table 4, set out post.

(d) Report No 32, p 38.

(e) Report No 31, p 17.

(f) More accurately, revenue derived from "income, profits, capital gains [taxes] and social security contributions". Other direct taxes, most notably estate duties, are not included.

the next countries in the table *(g)*. The significance of these figures is apparently in the Council's view enhanced by the increasing proportion of both total revenue and direct taxation receipts contributed by personal income taxation. In 1964–65 receipts from personal income taxation amounted to 43 percent of all revenue; in 1973–74 for 51 percent and in 1974–75 for 54 percent. *(h)*.

An evaluation of whether these statistics have any real significance, or whether they materially assist the Council in persuading to a movement to indirect taxation is conducted in the following section of this note.

(b) *Productivity, savings and investment incentives*

Again principally by inference, the Council sees a stimulation to productivity and savings arising from a greater emphasis upon indirect taxation; It quotes from the report of the Ross Committee *(i)* which concluded upon this question that:

> "[A]ll the analysis and arguments upon the relative merits of different taxes in encouraging savings and giving incentives to work and enterprise to stimulate economic growth point to the superiority of the expenditure base [or indirect] taxes. ... [T]here are several good reasons to believe that a shift away from income tax to [indirect taxes] would foster growth" (p 35).

Seemingly, the Council adopts this argument, for it comments in a later part of its report that "there is little doubt that [indirect taxation] would favour those who save in the community and give incentives for work and enterprise" *(j)*. The basis of supposed superiority of indirect taxes over direct taxes and in particular over the personal income tax vis-a-vis savings is not stated: but presumably it is the notion that by levying the personal income tax at source and assessing its quantum irrespective of the use of the income by the taxpayer no taxation incentive is given to save. In regard to the supposed superiority of indirect taxes vis-a-vis "work and enterprise" the argument is presumably that the increasing marginal rates of income tax faced by a taxpayer who is contemplating more or harder work are a disincentive to that greater productivity when compared to an indirect tax which is both non-progressive *(k)* and which can be avoided if the receipts from that additional "work or enterprise" are channelled into savings rather than into consumption.

The validity of these assumptions will be considered in the following section of this paper.

(c) *Equity advantages*

In both its October 1976 and May 1977 reports the Council suggests an equity or "fairness" benefit to be derived from the shift in emphasis it proposes. Its suggestion is that in the absence of a capital gains tax – which it brands as "a clumsy instrument" *(l)* – many gains escape the net of income taxation. This is of course especially so in a time of high inflation. In its view indirect taxation, if expenditure based, ensures some contribution to overall revenue from these gains in the event of their utilisation for current consumption.

(d) *Fiscal Advantages*

Discussing the advantages of retail sales taxes over other forms of indirect taxation, the Council suggests:

> "[T]he large tax base offered by a general retail sales tax means that a low tax rate could provide large amounts of revenue; that small adjustments could have large revenue effects without undue economic disturbance for traders; and that the retail tax could be a flexible and fast acting fiscal instrument because it operates on consumption" *(m)*.

Having made these arguments in favour of a greater reliance on indirect taxation, the Council turned to an examination of the various forms of indirect taxation which might be relied upon. It saw three devices as potentially available: the value-added tax (VAT), a tax on personal expenditure and a retail sales tax. VAT involves taxing the "added value" at each stage of the production process *(n)*. **The Council saw this form as being** too difficult and costly to introduce in the New Zealand context, "especially in view of [the] small average size" *(o)* of New Zealand enterprises. The notion of a tax on expenditure it saw as justified on both equity and efficiency grounds – especially, one senses, in its May 1977 report, where the proposal seems more sympa-

(g) See Report No 31, fn i, p 18, Table 5.

(h) Ibid, p 19, Table 6.

(i) *Report of the Taxation Review Committee* (Wellington, 1969). Many of the arguments of the Council have been taken from this Report.

(j) Report No 31, p 23.

(k) There is no conceptual contradiction in the notion of a progressive retail sales tax: see Due, *Sales Taxation* (London, 1957) pp 380–382. In practice however it gives rise to acute administrative difficulties: See Due, ibid, 381. The Council's proposals are limited to a sales tax of a fixed, non-progressive character.

(l) Report No 32, p 39.

(m) Report No 31, p 22.

(n) See generally the useful discussion of VAT in the Ross Committee Report, supra, fn (i) at pp 343–349.

(o) Report No 31, p 23.

thetically discussed – but saw it as posing "formidable" obstacles in its administration. Among these it instanced

> "problems of definition, the annual calculation of returns, the treatment of specific items avoidance and evasion, and exemptions and deductions. . . . The basic problem . . . is that every taxpayer would need some form of personal balance sheet or at least the reporting of changes in assets and liabilities, which affect the amount of funds available for spending" *(p)*.

The third alternative, a general retail sales tax, the Council saw as the preferable vehicle for implementing the shift in question. In addition to the advantage previously attributed to it by the Council in paragraph (d) above, it saw such a tax as being easy to administer, non-discriminatory as between various forms of expenditure *(q)* and in general productive of the savings and productivity incentives previously described.

Two disadvantages of this form of indirect taxation were, however, noted. The first was the effect of a retail sales tax on the consumers' price index. This the Council concluded however was not a major obstacle for the reason that:

> "despite an increase in the consumers' price index, a controlled movement towards taxing outlays instead of incomes need not lead to increased inflation as long as it is clearly demonstrated that the purchasing power of after-tax incomes (including both income and sales tax) is not going to be eroded. Compensating changes in income tax rates and allowances, and in benefits, would provide this evidence *(r)*.

The second objection to the retail sales tax was seen to be "the emergence of inequities" arising through the regressive nature of sales taxation. The term "regressive" in this context is used to describe a phenomenon inherent in general retail sales taxes implemented without off-setting adjustments *(s)* namely, that they absorb a higher proportion of the incomes of those on lower incomes than those on higher, an effect the direct reverse of progressive income taxation. The Council did not however see this tendency as destructive of the case for its employment, and suggested three ways in which it might be corrected: the exemption from the tax of goods and services which comprise a large proportion of the expenditure of low income families; by increasing the degree of progressivity in the income tax (which would of course continue to apply, though productive of a lower proportion of total revenue); and thirdly, "by a provision of tax exemptions or cash grants to those with large families or other reasons for special treatment" *(t)*.

Summary of Council's proposal

In broad outline, the restructuring proposed by the Council may be summarised as involving a greater degree of reliance upon indirect taxation, probably in the form of a retail sales tax, together with an income tax which would possess lower marginal rates than that presently adopted but which would be more progressive in character.

Beyond that broad outline it is impossible to go. The rate of proposed retail sales tax is not suggested. Nor the precise extent of its coverage. Nor, most significantly, the proportion of total government revenue it is seen as contributing following its implementation *(u)*. In regard to income tax component of the proposal, the degree of progressivity it would retain is noted. Nor the commencing or concluding marginal rates. Nor whether it would operate upon the same "income" base as the existing levy. Nor how presently available deductions, exemptions and credits would be accommodated in either

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(p) Ibid, p 21. On expenditure taxation generally the classic work is that of Kaldor, *The Expenditure Tax* (London 1955). For a comment of the efficacy and practicality of such a tax, see the Ross Committee Report, supra, fn (i) at pp 343–349.

(q) A fault of non-general sales taxes (usually referred to as excises) is their capacity to distort expenditure patterns: see generally, Due, supra fn (k) at pp 376–377. Notwithstanding the Council's suggestion that retail sales taxes avoid this distortion, at least one aspect of the scheme it recommends could in fact have that consequence: see post.

(r) Report No 31, p 23. In support of this view, see *Report of the Royal Commission on Taxation* (the Carter Commission) 1966, Ottawa, Vol 5 p 3. The Commission goes further in this respect than does the Council, arguing that sales taxes are as popular "as any tax can be" – ibid.

(s) For a discussion of those recommended by the Council, see post.

(t) Report No 31, p 23.

(u) "Most significantly" because it is principally this consideration that will influence the degree of regression within the overall tax structure that will be brought about by the introduction of retail sales taxation. Overseas practice indicates a huge divergence in this respect. The United Kingdom for instance relies upon various forms of expenditure taxes to roughly the same extent as it relies upon income taxation; see *Economic Trends* No 281 (March 1977). Cf India and Ceylon, which relied upon expenditure taxation to the extent of less than 1 percent of total revenue: see Pepper, *Expenditure Tax: An Obituary?* (1967) Brit TR 133.

theory or practice within the overall restructuring.

While it is quite understandable that Council should reserve its opinion on finer points of detail it is both perplexing and disappointing that it did not elaborate upon the principles of its proposals to a greater extent. Its voice of condemnation is loud and assertive: its voice of construction noticeably muted. Notwithstanding the kite-flying character of its exercise, more was clearly needed, for within the extremely broad themes of its proposals a vast array of legislative programmes substantially different in both emphasis and consequence are possible.

Comment on Council's reasoning

Let us first consider the four specific arguments raised in favour of the shift to greater indirect taxation.

(a) *Imbalances compared with other OECD countries*

The Council's case under this head is not strong: indeed it is probable that its discussion of this topic should be viewed not as an argument in itself in favour of its recommendations but only as providing a loose comparative background for its later discussion. The first of these charges must be fairly levelled. Taxation generally, and income taxation in particular, is the product of an individual nation's social, economic and political philosophies. The fact of any one nation's departure in any particular respect from a supposedly "average" position is a subject of some interest, but nothing more than that: the fact of the "departure" in itself is conclusive of nothing. It certainly falls far short of providing in and of itself a compelling case in favour of the error of the "deviant's" ways. Were the position otherwise New Zealand would be presumed to be at fault in each of an array of respects in which our taxation system does not conform to some or other international norm.

This is not of course to say that the statistics noted by the Council may not hold a lesson for us, nor that they may be dismissed without careful analysis. What significance then do they hold?

Varying significance, it is suggested. Those that relate to the proportion of total tax revenue contributed by direct taxation *(v)* are of only limited interest. Two countries, the Netherlands and West Germany, have higher percentages. Two more, Sweden and the United States, the same. The average for all countries in the table is 62.5 percent or a mere 3.5 percent below the figure attributed to New Zealand. The statistics which illustrate the proportion of total revenue raised through personal income taxation *(w)* are more interesting, if only because the degree of our departure from the practice of others is greater in this respect. As earlier noted, New Zealand heads the list in question. Further, its proportion is 11 percentage points higher than the average for all countries in the table.

A number of points must however be made to keep these personal income tax statistics in perspective.

First, it is important to appreciate that the apparent purpose for which these statistics are adduced is not to suggest that New Zealanders are overtaxed in either absolute or comparative terms. At least as at 1973, the last year for which full international statistics are available, none of the usual measures of relative tax burdens would justify any such suggestion. Quite the contrary. In terms of both total revenue as a percentage of GNP *(x)* and our annual percentage of revenue growth *(y)* New Zealand was significantly behind the average for the OECD members. Rather, the purpose of the Council's reliance upon them is more to suggest an imbalance in the taxation *mix*. As we shall see, the Council's recommendations proceed throughout on the assumption that the overall burden of taxation is in itself unexceptionable *(z)*.

Secondly, the apparent disparity between New Zealand's reasonably "average" reliance upon direct taxation and our clearly "above-average" reliance upon personal income tax as a component of that direct taxation may be referrable in part to the nature of corporate activity in New Zealand. It is well established that as a proportion of total taxation receipts the yield from corporate taxation in New Zealand is among the lowest of any OECD country *(aa)*. The Council itself comments on this phenomenon in Report No 31:

> "This could partly be the result of the number of unincorporated enterprises in New Zealand, whose taxation is classified as coming from personal income. The relatively small size of companies, lower profits or tax

(v) Supra, p 2.

(w) Ibid.

(x) See Report No 31, p 16, (based on OECD Revenue Statistics 1965–1973). This assertion is unquestionably correct as to the years to 1974. The increase in percentages in 1974 and 1975 have probably brought New Zealand closer to the average. Full statistics are not available, but see the *International Comparisons* annexure to OECD *Economic Surveys* 1976.

(y) Report No 31, p 16.

(z) See post.

(aa) Report No 31, pp 17–18.

concessions could be other factors" (p 17). In short, the less corporate activity there is and the lower the profitability of what there is, the less the significance of corporate taxation and the higher the contribution of the personal income tax as an item of direct taxation.

There is also a third consideration. One of the arguments upon which the Council seems to rely is that the degree of our reliance upon personal income taxation is on the increase, as is illustrated by the mounting percentage of total revenue referrable to that source. It should be borne in mind, however, that New Zealand is not alone in this respect. While there are unquestionably some OECD countries in which the proportionate contribution of the personal income tax has remained more or less static over recent years – the United Kingdom and the United States being the most noticeable *(ab)* – others illustrate the same broad pattern of increasing reliance as New Zealand *(ac)*.

There is in addition a fourth consideration. Even if New Zealand was totally out of time in all the respects for which the Council adduces statistics – and as the previous points indicate, it clearly is not – the question would still remain: what is the harm in those departures? No prize is awarded for conformity as such. Nor is a penalty exacted by the OECD from its "abnormal" members. Accordingly the most that the statistics can effectively tell us is that in limited respects and in part for reasons inherent in the nature of New Zealand's economic substructure we lean rather heavier than is usual on direct taxation and in particular personal income taxation. They themselves are incapable of substantiating any suggestion that we are *in error* in doing so or that our reliance is excessive.

(b) *Productivity and incentives*

The Council's arguments from the standpoints of productivity and incentives are however clearly in a different category. The thrust of its entire commentary upon this issue is directly to substantiate the suggestion that our position *is* one of error.

In theory, incentives to productivity might be seen as best promoted by a reduction in the total revenue demands of government. It needs to be stated at the outset that this is not the means by which the Council sees productivity as being fostered. Rather, it realistically proceeds on the assumption that total revenue demands will not be decreased in the near future and that any increase in productivity and work incentives must come through a readjustment of the tax structure rather than a reduction of the tax-take *(ad)*.

As we have seen *(ae)* the Council sees such a beneficial readjustment inherent in a shift of emphasis from direct to indirect taxation. Its case is founded on two bases: first, the disincentive effects of progressive income taxation; and secondly, the incentive effects of retail sales taxes. The case in theory for the disincentives allegedly inherent in progressive income taxes is strong. At that level the Ross Committee gave it support. So too does Due in the classic work on retail sales taxation *(af)*. That writer put the case against progressive income taxation in this way, referring first to its effects on investment and secondly to its effect on work incentives:

> "The income tax, by taking a portion of all earnings from investment, may restrict the development of new businesses and the expansion of the old, in part by lessening the supply of money capital available for expansion, in part by lessening the incentives to expand .... Furthermore ... by taking a portion of all earnings from work [the income tax] may alter the incentives to undertake work, particularly marginal activity, such as overtime work or that of additional members of the family" (p 31) *(ag)*.

By way of analysis it should first be noted that the observations of both Due and the Ross Committee *(ah)* on this point are placed and maintained at the level of theory. To this writer's knowledge there is scanty empirical data to support them. There are, however, several major overseas studies which bring their validity seriously

(ab) In the case of the United Kingdom personal income taxation has contributed about 40 percent of total revenue for the last 25 years: see eg *Economic Trends* No 281 (March 1977). In the United States personal income tax has contributed about 45 percent of total revenue for over 35 years: see Bittker, *Federal Income Estate and Gift Taxation* (1972), Little, Brown) p 11 Table 2.

(ac) Australia being one of the more noticeable: see *OECD Economic Survey – Australia* (December 1976) p 64, Table 6.

(ad) See eg Report No 32, p 38.

(ae) Supra.

(af) Due, *Sales Taxation* (London, 1957).

(ag) The assumption in this reference to "additional members of the family" is that the family is in itself the unit of taxation. Virtually all of the jurisdictions reviewed by Due took the family as the tax unit.

(ah) See the quotation from the Ross Committee Report set out supra.

into question. Take for example the assertion in the concluding portion of the quotation from Due to the effect that "the income tax ... may [reduce] the incentives to undertake work". None of the empirical surveys carried out over the last two decades in the United Kingdom, Canada or the United States bears this out *(ai)*. In very general terms those studies suggest two phenomena relevant to this paper: first, that most workers, be they male or female, full-time or part-time, piece workers or highly paid executives, alleged neither a disincentive effect nor an incentive effect from increases in marginal rates of the progressive income taxes: and secondly, the few who did allege a disincentive effect from such an event were outweighed in all cases by a greater number who alleged an *incentive* effect. Put in the terminology used in these studies increases in the marginal rates of taxation have neither an income nor a substitution effect; and in those cases where the effect is other than neutral the income effect is more pronounced than the substitution effect. Put in lay terms the first proposition suggests that most taxpayers do not measure or calculate the degree of their productive effort by reference to the portion of their salary taken by income taxation. In similar terminology, the second proposition suggests that of those whose productivity is, at least by their own allegation, influenced by income tax considerations a greater number are likely to produce more or work harder following an *increase* in income taxation in order to restore their net earnings to the pre-increase level than are likely to throw up their hands in horror, down dictaphones and cry "Its just not worth it any more" *(aj)*.

On the basis of such of these studies as were then available *(ak)* the author of the Canadian Carter Commission's paper *The Effects of Income Taxation on Work Choices* felt able to conclude that the arguments against the income tax as a disincentive to productivity were "weak" *(al)*. Similarly described was the argument against that tax – not raised by Council, but frequently voiced by opponents of progressivity – to the effect that it distorts occupational choices by rendering highly paid jobs less attractive. Central to both these conclusions was the author's view that tax considerations of any description play a reasonably minor role in determining both work effect and work choices when compared to other non-tax considerations. In regard to taxpayers on lower incomes financial and family commitments and obligations were seen as being both more persuasive in these respects and as leaving such taxpayers little choice but to "positively" respond to income tax increases by working harder. In regard to those in higher paid occupations, the author saw other considerations as playing dominant roles in determining both effect and occupation, quoting with approval the conclusion

> "The evidence is overwhelming that the business executive [puts] a full measure of work and energy into his regular job. His grumbling at the taxes he pays and his wry allusions to working most of the time for the government rather than for himself are only a superficial front on the large fact that his effort is not abated by reason of them; he is still going full blast" *(am)*.

The considerations in the above paragraphs do not of course "prove" that the progressive personal income tax operates in New Zealand without disincentive effects on either work or productivity. As this writer has noted elsewhere *(an)* there are a number of reasons why the significance of the overseas studies may be doubtful in this country. It must also be conceded that there is indeed a possibility that the New Zealand tax structure may well be operating at present in such a way as to be providing disincentives – in other words that our marginal rates and overall structure are even now leading to substitution effects that outweigh income effects. But it is nevertheless suggested that these studies are sufficiently persuasive in their conclusions to throw upon the Council the onus of proving its case other than

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(ai) The major surveys are those of Break, *Income Taxes and Incentives to Work: An Empirical Study* 47 American Economic Review 529; Morgan, Barlow and Brazer, *A Survey of Investment Management and Working Behaviour Among High Income Individuals* (Published by the Brookings Institution, in *Studies of Government Finance* (1966)); Sanders, *Effect of Taxation on Executives* (Boston, 1951); *Royal Commission on the Taxation of Profits and Income, Second Report*, Cmd 9105 (London, 1954); Rolfe and Furness, *The Impact of Changes in Tax Rates and Methods of Collection on Effort* 39 Review of Economics and Statistics 394; Chatterjee and Robinson, *Effects of Personal Income Tax on Work Effort* (1969) 17 Can TR 211.

(aj) For a general analysis and review of these findings, see *Studies of the Royal Commission on Taxation Paper No 4 – The Effect of Income Taxation on Work Choices* (Ottawa, 1966).

(ak) The Chatterjee and Robinson survey (supra, fn *(ai)* post-dates the Carter paper.

(al) Supra, fn *(aj)*, p 33.

(am) Ibid, p 19: taken from Sanders, supra fn *(ai)* at p 17.

(an) See the discussion of a related point in *Structural Inequity and the New Zealand Tax System* (1976) 3 Otago LR 479.

at the theoretical level if it is to convince of an actual disincentive to productivity inherent within the income tax.

The opponents of the income tax might of course reply that such evidence is unnecessary for the reason that *whatever* the influence of income taxation on incentives, the influence of retail sales taxation is inevitably more positive. As earlier noted *(ao)* this argument is seemingly the second limb of the Council's case on the productivity point.

Barker *(ap)* puts the case in favour of the superiority of retail sales taxation in this respect in this way:

> "The reward for effort is reduced by the income tax when the income is earned and by the consumption tax *(aq)* when the income is spent; however the individual worker will be aware of the collection of the income tax but will not be aware of the collection of a consumption tax, which, after all, does not impinge directly on his gross earnings and is merely reflected in product prices.... He may believe that the reward for effort is greater under the consumption tax ..." *(ar)*.

There is however a major difficulty in the way of attributing great weight to this argument. Even on the assumption that substantial numbers of taxpayers would indeed suffer from the illusion alleged in the concluding portion of the quotation, it is far from certain that increased productivity will be the outcome. As Barker himself notes, on the basis of the studies earlier referred to *(ai)*, "an increase in the [apparent] reward will simultaneously both stimulate and deter work effort and the net outcome is unpredictable" *(as)*. The deterrence to work effort arising from the (illusory) increase in wages is another aspect of the substitution effect earlier noted: its significance here is that as an apparent rise in wages takes place, some taxpayers will take their gains in the form of added leisure *(at)*. Productivity could accordingly be reduced rather than promoted by the shift to retail sales taxation. Nor is this a purely theoretical possibility. There is evidence in both the United States and Canada which strongly suggests a negative correlation between wage rates and hours worked *(au)*.

Once again, it is not suggested that a shift to indirect taxation in this country would result in a decline in productivity. It is not even suggested that that would *probably* be the result. The assertion is rather that at the level of theory the possibility of a disincentive effect clearly exists and that there is some empirical evidence to support that view. The conclusion may therefore fairly be drawn that the Council has failed to convince of the superiority of retail sales taxation in the respect in question.

(c) *Savings incentives*

The Council suggests "there is little doubt that a shift towards [retail sales taxation] ... would favour those who save in the community" *(av)*. The necessary implication is that greater aggregate savings would result – "necessary" because there is presumably no economic or broader societal benefit to be derived from any other consequence. That assumption is however a somewhat dubious one at both the theoretical and the practical levels. As to the theoretical; writing in the Harvard Law Review Andrews observes that it is not clear what effect a shift from direct to indirect taxation would have on aggregate savings. In his view

> "[It is uncertain] how a shift from an accretion-type to a consumption-type personal income tax would affect aggregate saving. The substitution or price affect would indeed be to increase the net interest return from saving and thereby to induce a shift from spending to saving. But for some persons at least there would be a contrary income effect. For one who is saving to meet some particular objective exemption of savings from the personal income tax would make it easier to meet that goal and would therefore operate to let the individual spend a higher portion of ... income. There are no a priori grounds for predicting the relative impacts of these effects" *(aw)*.

There is a further consideration which supports the same conclusion. If savings are to be encouraged, it is axiomatic that an incentive to save must be provided. "An incentive" in this context is obviously a lower relative burden of taxation for those who save. That incentive can only be financed in two ways. One is by an overall reduction in revenue demands, and that, realistically, is unlikely. The other is by increasing the relative burden on those who save less. Several consequences follow, the most significant for

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(ao) Supra.

(ap) The author of the paper noted supra, fn *(aj)*.

(aq) For present purposes this term may be treated as being synonymous with a general retail sales tax.

(ar) Supra, fn *(aj)*, p 36.

(as) Supra, fn *(aj)*, p 36.

(at) See the discussion by Barker ibid, pp 35–37.

(au) See Morgan, David, Cohen and Brazer, *Income and Welfare in the United States* (New York 1967) pp 76–77. See too Barker, supra fn (aj), p 27.

present purposes being that the capacity of tax units in the latter group to save is reduced since more of their disposable income is taken than formerly. What effect will this have on aggregate savings? It is of course impossible to say. But the combined results of the two considerations in question must be that the Council's bald "savings will be encouraged" assertion is far from the self-evident truism which it is put forward as being.

There is too a further point. Given a continuing demand for revenue of roughly existing levels, then, even on the assumption that retail sales taxation would lead to an increase in aggregate savings, it is unlikely that the government could countenance any dramatic increase in savings from this source in any event. Suppose two-thirds of families were to respond to the incentive and increase the proportion of disposable income saved. As earlier noted, that incentive must be paid for, presumably by those families that did not – or, more probably, could not – respond to the incentive. It is highly unlikely that the units in the later category could bear the additional burden imposed: pressure for a rate reduction would undoubtedly arise and that would lead to a decrease in gross revenue. Of course: this example is crude in the extreme and in the absence of far more detailed proposals it is impossible to say to what extent relative tax burdens could be shifted before an "undue" burden was imposed on non-savers. But it does serve to illustrate that a retail sales tax can only be permitted to operate as a savings incentive within fixed and, one suspects, reasonably narrow limits. It may indeed be the case – there is certainly no evidence provided by the Council to prove it is not – that the government would be obliged to *limit* any incentives there might be provided by retail sales taxes to ensure the maintenance of existing revenue levels *(ax)*.

None of this is to say that retail sales taxation *may* not operate to increase aggregate savings, nor that it cannot do so without an undue or inequitable shifting of tax burdens to non-savers. It is simply to suggest that the savings incentive does not provide a case as compelling as it is presented as being by the Council.

(d) *Equity Considerations*

As we have seen *(ay)* the Council favoured a shift to expenditure based taxation in part for the reason that the latter basis would result in the taxation of some capital gains – namely, those gains which are used to finance consumption.

Undoubtedly, this would indeed be one consequence of the shift proposed. To those who believe that capital gains should be subject to taxation there is inevitably a degree of attraction in the argument.

But only a degree. It is quite true that a shift to retail sales taxation would exact a greater tax burden from aggregate capital gains than is presently levied. But it is equally clear that the burden exacted would be levied in a haphazard and purely coincidental way, principally dependent on the decision of individual taxpayers as to whether or not to commit those gains to expenditure. If it is legitimate to view capital gains as fit subjects for the imposition of the taxing power – and the council apparently agrees that it is – then let us do so by more scientific means. Let us do so first by adopting this form of taxation as government policy. And then let us devise the detailed and sophisticated code necessary to implement that policy. Both stages of this process raise questions of the greatest complexity, and, for that reason if for no other, we should be loathe to see them "resolved" by anything short of the most detailed and thorough-going investigation.

This is not to suggest we should not tax capital gains. It is far from suggesting that the Council should not nor could not argue cogently in favour of such taxation. But it is to suggest that the argument in question is a mere make-weight that should not possess any substantial significance.

(e) *Fiscal advantages*

Retail sales taxation has clear advantages over the income tax in the respects noted *(az)*.

Conclusions on Council's reasoning

Of the five arguments canvassed to this point only the last, the fiscal advantages of retail sales taxation, may be accepted without major qualification. The rest, for varying reasons, do not persuade. In substantial measure that is not because the considerations put forward by the Council are necessarily incorrect, but rather because they are not *proven* by it to be valid

(av) Report No 31, p 23.

(aw) Andrews, *A Consumption-Type Personal Income Tax* 87 Harv LR 1113 at p 1173.

(ax) The Canadian *Carter Commission* (supra, fn *(r)* also took the view that a shift towards greater emphasis on sales taxation would not "significantly" lead to an increase in aggregate savings. For its arguments, see Vol 2, pp 150–154.

(ay) Supra.

(az) See generally Due, supra fn (k), p 31 et seq.

either internationally or, more significantly, in the New Zealand context. Given a degree of probability that greater reliance on indirect taxation would indeed lead to greater productivity or would increase the incentives to both work and save, there would then be a reasonably strong case for a restructuring of the tax system along the lines it advocates. In the absence of evidence that transforms the possibility of those phenomena into a probability, however, we should be loathe to move in the direction the Council seeks to push us.

That conclusion is justified, it is suggested, on a number of counts. First, the above analysis might be reason enough. Secondly, the sketchy and vague character of the Council's path would in itself dissuade. But there is an additional reason of even greater significance. This relates to the equity consequences of retail sales taxation. It is a consideration of sufficient importance to warrant separate treatment.

Retail sales taxation and taxpayer equity

(a) *General considerations*

Sales taxes are, as earlier noted *(ba)*, inherently regressive relative to income. By this is meant that they exact a larger proportion of the income of those on low incomes than of those on high incomes. Those on low incomes have little if any choice other than to spend the entirety of their income to provide food and shelter. Those on high incomes need spend a lower proportion of their income for those purposes. The rest may be saved or otherwise withdrawn from the ambit of the sales tax, Samuelson puts it with characteristic simplicity:

> "An important use of after-tax income is saving for the future rather than consuming now. It is a matter of common observation that rich men save more than poor men, not only in absolute amounts but also as percentages of their incomes. The very poor are unable to save at all. They may even "dissave", that is, spend more than they earn" *(bb)*.

The phenomenon has two related consequences. First, as suggested above, it subjects the entire income of those on low incomes to retail sales taxation while leaving untaxed a proportion of those on higher incomes. And secondly, and as a result, it operates to exactly the reverse effect of the existing progressive income tax. It is precisely on those grounds that Due labels sales taxes as "second best taxes" *(bc)* and concludes in relation to them that "In terms of usual standards of equity, a sales tax, no matter how carefully established, is inferior to the income tax" *(bd)*.

Due also advances a further equity objection to sales taxes. In addition to promoting inequities of a vertical character – the first objection – he suggests it is productive of unfairness between income units with the same gross incomes but with different taxpaying capacities. To quote him once more:

> "[S]ales taxation tends to penalise any groups whose circumstances compel them to spend higher percentages of their incomes to attain a given standard of living. Thus the tax tends to burden large families more heavily than smaller families ... since the former must spend a higher percentage of income to attain a given living standard [; it tends to penalise] newly married couples spending high percentages of income for consumer durables [; and persons] losing property by casualty and forced to replace it" (p 37).

The horizontal equity objection is not of great significance to themes of this paper. Beyond question, the assertion of a penalty or greater burden being imposed upon the classes noted is correct. It needs to be recognised however, that albeit to varying degrees, every form of taxation, direct or indirect, proportional or progressive, income or expenditure based, may be criticised from an analogous standpoint. In regard to the New Zealand proposal income tax, no attempt is made to accommodate the "inequities" arising in the third situation noted by Due. The second is recognised only obliquely and even then to a limited extent. While it is true that other countries often go somewhat further in attempting to recognise differences in taxpaying capacity attributable to considerations such as those referred to by Due it is far from certain that our own failure to do so points out a weakness in our structure *(be)*. While the accusation Due levels against retail sales taxation is accordingly valid, it does not constitute a particularly cogent basis

(ba) Supra.

(bb) Samuelson, *Economics* (Australian ed, 1970) p 228.

(bc) Supra, fn (k), p 41.

(bd) Ibid, p 40. For a similar observation, see the Report of the Carter Commission, supra fn (r), Vol 5, p 6, where the Commissioners declared: "We can see no economic justification for placing greater weight on sales taxes. We have no doubt that, from an equity point of view, income taxes are superior to sales taxes. ..."

(be) Under the guise of correcting "inequities" many out and out taxation preferences have developed in jurisdiction other than our own.

on which to justify progressive income taxation.

The first equity charge against retail sales tax is however of quite a different character. In essence it suggests that this form of taxation offends the principal of progressivity, the central and most fundamental prop of our personal taxation structure. To those committed to that principle – as are virtually all of us, including the authors of the Monetary and Economic Council reports which are the subject of this paper *(bf)* – that inherent tendency poses the principal, possibly overwhelming, objection to retail sales taxation.

(b) *The Council's antidotes*

Seemingly the Council accepts this argument at least in part, for as we have seen it saw it necessary to suggest three ways in which the new tax might be structured which would overcome equity objections, namely: to exempt food and other goods and services comprising a large proportion of the expenditure of lower income families; more progression in the personal income tax; and the provision of exemptions or cash grants to those with large families *(bg)*. Do these suggestions provide a basis upon which the regressive character of sales taxation might be overcome?

"A basis", possibly; a conclusive answer to the acknowledged equity disadvantages, not at all. That latter would require an infinitely more elaborate analysis than that provided by the Council, both in relation to the overall scheme it generally proposes and the remedial devices on the point immediately in question. Given the level of generality at which it presents its case it is impossible to calculate whether regression *would* be countered for one is given no basis whatsoever to calculate the *degree* of recession in question.

There are nevertheless several points that should be made at a very general level about the devices noted by the Council.

First, in regard to the third device – the granting of cash payments or exemptions – it seems proper to acknowledge that at the level of theory it is no doubt conceivable that a system of payments or exemptions could operate to the general end suggested by the Council. It is appropriate to note that both Due and the Carter Commission, although both proponents of the personal income tax and opponents of many features of retail sales taxation, accept this theoretical possibility *(bh)*. Little more than this can be said. Whether that theoretical possibility would become a practical reality is another question. Our past record at fixing the level of exemptions and rebates indicates a philosophy far from generous: few if any of those presently available come anywhere near representing the actual cost of the expenditure for which they are designed to compensate or the lower tax-paying capacity they are designed to reflect. The shadow may fall between theory and execution in the instant respect as well.

The Council's second remedy – more progression in the income tax – is also less than totally persuasive, though for different reasons. Undoubtedly the personal income tax *could* be rendered more progressive. Indeed, the case for doing so may be seen as reasonably strong altogether apart from the topic at hand given that inflation coupled with basically unchanged tax rates have taken much of the progressivity out of the scale. Yet in terms of the case made out by the Council, and in terms of the specific purpose to be fulfilled by more progressive income tax rates, the argument has a somewhat suspect ring to it. By implication the Council's earlier analysis proceeded in part upon the basis that the income tax was defective on productivity and incentive grounds. On first principles, a progressive income tax may operate as a disincentive on two grounds. One is by high *overall* rates of tax. The second is by high progressivity. The first of these is presumably the basis upon which the Council criticised the present income tax. But the second is what it would necessarily introduce as a counter to the regressive or at best proportional impact of the retail sales tax. Of course it may be both unfair and inaccurate to suggest that "high" progressivity would be introduced following the Council's recommendations: it does not tell us the proportion of tax revenue to be generated by the sales tax and it may, in the event, be sufficiently small to obviate the need for steep progressivity in the income tax. But at the level of general debate it is legitimate to observe that one of the consequences of a scheme which marches under the banner of promoting incentives may be to take them away in order to render the overall scheme politically and socially acceptable.

The third remedy proposed by the Council – the exemption of food and other necessities from the ambit of the sales tax – is the least persuasive of all. Apart altogether from the virtually inevitable distortion of resource allo-

(bf) At least by inference, given that the Council makes an attempt to counter the regressive tendency of retail sales taxation: see infra.

(bg) Report No 31, p 23.

(bh) See Due, supra fn (k), pp 379–380. See too Carter, supra fn (r), p 62 et seq.

cation such exemption would create – and the wider the exemption the greater the distortion *(bi)*, apart from the acute administrative difficulties in determining which goods and services to exempt, apart from the fact that the resulting tax may bear more resemblance to a series of selective excises, the exemption of food and necessities is highly unlikely to come anywhere near retaining the progressivity of the present income tax. The writer is aware of no New Zealand studies on this question, but data collected in North America indicates that the exemption of food from retail sales taxation, at best, makes that tax *proportional* across most income groups *(bj)*. "Proportional" of course indicates in this context that the same percentage of the income of those on low levels is taken by the tax as is taken from those on higher incomes. Further, the qualification "at best" is necessarily inserted in the above summary. For the surveys in question illustrate that at higher income levels the tax remains regressive in its operation, in that the wealthiest taxpayers continue to pay a lower proportion of their income than the lowest income groups.

(c) *"Equity" concluded:*

Retail sales taxation is a challenge to progressivity. That is common ground between all commentators on this subject. It is accordingly a challenge to one of our most fundamental notions of taxpayer equity. It may not be unanswerable, of course, but as the above analysis has shown even its partial success would involve substantial prejudice to thousands of taxpaying units.

The question consequently becomes one of whether the benefits to be derived from retail sales taxation are sufficiently great to justify the running of that risk. On that point many taxation commentators are doubtful. And so, collectively, should we be. On neither its productivity, savings, or equity grounds does the Council prove either that the present system is so defective that a shift is essential or that the benefits to be derived from that shift are so great as to justify the risks it involves. This is not to say that it is wrong. It is simply to suggest that it does not adduce sufficiently cogent evidence to persuade.

(bi) See generally Due, supra fn (k), pp 376–377.

(bj) See Carter, supra fn (r), Vol 5 p 60; see too Due, ibid, pp 25–29 where all major studies then available are reviewed.

CORRESPONDENCE

Dear Sir,

Powers of entry of traffic officers

I write against an article published in your issue No 14 of this year, under the above heading and in the name as author, of "Bill Hodge, Senior Lecturer in Law, University of Auckland". In the article Mr Hodge opposes the idea of legislation giving traffic officers the right to enter the homes of possibly drunken motorists to test their alcoholic content.

The possibility of such legislation arises from the recent decision of the Court of Appeal in *Ministry of Transport v Payn* (CA 127/76), to the effect that a traffic officer may not without consent make such an entry and require the suspect to undergo a breath or blood test. Removal of this hindrance to traffic officers, by an amendment to the Transport Act, is opposed by Mr Hodge in the following passage: "For the following reasons it is submitted that the level of alcoholic chaos on the New Zealand highways need not be affected by this *(Payn)* decision and that the present level of effectiveness (or ineffectiveness) of the blood alcohol laws will be maintained".

Four reasons for the foregoing submission are given in the article, and may be summarised as follows, the words in brackets being comments by the writer of this letter:

1 If traffic officers (who alone, and not the police, are said by the article to be concerned by *Payn's* case) were authorised to enter suspects' homes, they would then have more right of entry than the police. (Mr Hodge seems to deem it unthinkable that the police should likewise be authorised, presumably because any increase whatever in police power he considers a bad thing).

2 The *Payn* decision does not bar entry to any old private property, but only to that of which the suspect is in law the occupier. (And what is wrong with that? the author seems to ask).

3 The officer can always innocently knock on the suspect's door, chat with him, and on smelling liquor, demand a breath test before being ordered off as a trespasser; and if the officer does all that, he wins. (Having thus told the officer how to outwit the suspect, the author then, perhaps dis-

closing his real feelings, advises the suspect how to outsmart the officer).

4 Traffic officers frustrated by *Payn's* case can always lay charges for driving offences not involving alcohol, because "It may well be that the Magistracy of New Zealand will co-operate with the Ministry of Transport by passing maximum sentences upon conviction of lesser crimes, for those who escape the blood alcohol provisions". (This cosy deal should be easy to arrange, so why bother to amend the Transport Act?).

These heavy reasons are put forward to support the submission that the denial by *Payn's* case, of the right of entry to a suspect's home, can be circumvented, leaving unimpaired the present "chaotic" and "ineffective" laws on alcohol for motorists. But why leave them? Why not improve these laws by the simple process of an amendment to the Transport Act, giving both traffic officers and police the right of entry? Obviously Mr Hodge does not want that, but rather that the suspect be not deprived of any present means of escape, nor the officer given any help in apprehending the suspect.

I suggest that the author and those like-minded ask themselves seriously whether the civil liberty of the suspect is really more important than the safety of the man in the street.

Yours truly,

W G Clavis
Auckland

MAGISTRATES APPOINTED

Mr P J McAloon

The Minister of Justice (Hon D Thomson) has announced the appointments of Mr P J McAloon of Christchurch and Mr P J Duncan of Rotorua as Stipendiary Magistrates.

Mr McAloon, aged 41, was educated in Christchurch and graduated in law from the Canterbury University. He has been in practice in Christchurch since 1959. He is a Riccarton Borough Councillor, a member of the Regional Planning Authority and the Town Hall Board of Management. For some time he has been Chairman of the Town Planning Committee of the Riccarton Borough Council and has lectured at the University of Canterbury in both the Commerce and Law Faculties in a part time capacity. He will sit in Christchurch.

Mr P J Duncan

Mr Duncan, aged 49, has been in practice in Rotorua since March 1957.

Mr Duncan's outside interests include rugby, and at one time he was Secretary of the Bay of Plenty Rubgy Union, and has served a term as President of his local football club. He has also served as a member of the Marriage Guidance Council. He will sit in Auckland initially, but will move to the Otahuhu Court early in the New Year. Mr Duncan took up his appointment on 1 November 1977.

Law firm structure

Senior partner
Leaps tall buildings with a single bound
Is more powerful than a locomotive
Is faster than a speeding bullet
Walks on water
Gives policy to God.

Junior partner
Leaps short buildings with a single bound
Is more powerful than a switch engine
Is just as fast as a speeding bullet
Walks on water if sea is calm
Talks to God.

Legal executive
Leaps short buildings with a running start and favourable wind
Is almost as powerful as a switch engine
Is faster than a speeding BB
Walks on water in indoor swimming pools
Talks with God if special request is approved.

Secretary
Lifts tall buildings and walks beneath
Kicks locomotives off the tracks
Catches speeding bullets between teeth
Freezes water with a single glance
Because . . . . she is God!