IN THE SUPREME COURT OF NEW ZEALAND

SC 10/2017
[2017] NZSC 152

BETWEEN	CRAIG DUTHIE AND KIRSTEN TAYLOR-RUITERMAN First Appellants
	DRK CHARTERED ACCOUNTANTS LIMITED Second Appellant
AND	DENISE MICHELLE ROOSE First Respondent
	DENISE DEVELOPMENTS LIMITED Second Respondent
	DMR DEVELOPMENT LIMITED Third Respondent

Hearing:	8 August 2017
Court:	Elias CJ, William Young, Glazebrook, O'Regan and Ellen France JJ
Counsel:	G D Pearson, J K Scragg and T A V McKeown for Appellants K J Crossland and J S Langston for Respondents H W Ebersohn and S J Osborne for Attorney-General as Intervener
Judgment:	6 October 2017

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants are to pay costs of $25,000 to the respondents and reasonable disbursements.

REASONS
(Given by William Young J)

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The appeal

[1] This case concerns the transfer of a property from the second respondent, Denise Developments Ltd (DDL) to the third respondent, DMR Development Ltd (DMR). Both companies are associated with the first respondent, Denise Roose, and we will refer to Ms Roose and the two companies collectively as the Roose parties. The sale by DDL to DMR attracted adverse tax consequences for which the Roose parties seek damages from their chartered accountants, Craig Duthie and Kirsten Taylor-Ruiterman, later incorporated as DRK Chartered Accountants Ltd. They are the appellants and we will refer to them collectively as DRK. The Roose parties' case is that, prior to the sale by DDL to DMR, Ms Roose sought Mr Duthie's advice about the proposed transfer and was negligently told that it would not generate tax liability. A number of causes of action are alleged, including negligence.

[2] The sale by DDL to DMR was pursuant to an agreement entered into on 14 April 2008, with the transaction being settled on 2 May 2008. The proceedings were commenced on 1 May 2014. On a preliminary issue, Toogood J concluded that the Roose parties first suffered relevant loss before 1 May 2008 and that, accordingly, the negligence claim was barred by the six year limitation period in s 4 of the Limitation Act 1950.[1] A subsequent appeal to the Court of Appeal by the Roose parties was allowed.[2]

The background facts

[3] The property in issue was acquired by DDL in 2006. DDL subsequently obtained a resource consent to subdivide the property into seven sections.

[4] In early 2008, Ms Roose, concerned to protect herself against the possibility of a relationship property claim, sought advice from Mr Duthie about the proposed transfer of the property from DDL to a trust. She claims that Mr Duthie advised her that such a transfer would not attract income tax and the sale would be zero rated for GST purposes. The detail of the interaction between Ms Roose and Mr Duthie is in dispute but we must deal with the appeal on the basis that Ms Roose's allegations are correct and that the advice that she attributes to Mr Duthie was negligently given.

[5] A new trust (the DMR Development Trust) was formed and DMR was incorporated to act as its trustee. On 14 April 2008 DDL and DMR entered into an agreement under which DDL was to sell, and DMR to purchase, the property for $1,950,000. This price was based on a valuation. The agreement provided that on settlement DMR would provide a deed of acknowledgment of debt for the purchase price under which demand for payment could not be made for five years. Ms Roose executed this agreement on behalf of both DDL and DMR. On the same date, Ms Roose, on behalf of DDL and DMR, signed an acknowledgement of debt by DMR in favour of DDL for the purchase price.

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1 *Roose v Duthie* [2015] NZHC 2035 [*Duthie* (HC)] at [86].

2 *Roose v Duthie* [2016] NZCA 600, (2016) 28 NZTC ¶23-011 (Wild, Mallon and Williams JJ) [*Duthie* (CA)].

[6] Under the 14 April 2008 agreement, settlement was to take place on 21 April 2008. In her affidavit, Ms Roose said that it was agreed that the settlement date be varied. As it turned out, settlement was effected electronically on 2 May 2008. Ms Roose's solicitors acted on both sides of the transaction.

[7] As a result of an audit, the Commissioner of Inland Revenue determined that DDL's taxable activity was property development, reassessed DDL's income tax for the 2009 year and imposed a shortfall penalty. The resulting tax dispute was subsequently settled. We were told the settlement was predicated on DDL being liable to tax on the transaction under s CB 14 of the Income Tax Act 2007.

Overview of the case

[8] The case for the Roose parties is based on the contention that, had Ms Roose been properly advised by Mr Duthie, DDL would not have transferred the land. Their claims for damages proceed on the basis that, as a result of the sale, DDL incurred an unnecessary liability to tax. The primary loss alleged is the incurring of the tax liability but the claims extend to losses associated with the steps taken to raise the money required to discharge the tax liability. If DDL's tax liability accrued on 14 April 2008 (that is, when the agreement for sale and purchase was signed), as DRK maintains, the claims are barred by limitation.

[9] DRK also contends that, even if the tax liability did not accrue until 2 May 2008, the respondents had already suffered appreciable loss in respect of: (a) the incurring of wasted costs associated with the transfer of the land (being the set-up costs of DMR and the DMR Trust, the obtaining of the valuation on which the purchase price was based and legal costs associated with the transfer); and (b) unwind costs which would have been incurred if the tax problem had been recognised before settlement on 2 May. We will refer to the wasted costs and unwind costs as "ancillary losses". We note that DRK did not rely on the wasted costs argument in the High Court or Court of Appeal.

[10] The case raises two issues:

(a) The first is whether the tax liability of DDL arose on 14 April 2008. This aspect of the case turns on the application of the Income Tax Act to the facts of the case.

(b) The second, which arises only if the tax liability did not arise until 2 May 2008, is whether, by reason of the ancillary losses, the cause of action in negligence arose prior to 2 May 2008. This aspect of the case falls to be determined by reference to the leading authorities on limitation, including the judgment of this Court in *Thom v Davys Burton*[3] and the advice of the Privy Council in *Maharaj v Johnson*.[4]

[11] There is a slightly awkward procedural issue which we should explain at this point. It was the Roose parties who applied to the High Court under r 10.15 of the High Court Rules for the determination of a separate question in respect of limitation. The question proposed in the application was awkwardly expressed but it relevantly came down to whether the negligence claim was barred by limitation. We do not have a copy of the order made on the application, so it is not clear to us whether that was the form of the question approved by the Court. Assuming the question was formulated in that way, the parties should have led all relevant evidence bearing on the point.

[12] As it turned out, when the case came before Toogood J, there was virtually no evidence before him. It was perhaps for this reason that when he came to set out the question which required pre-trial determination, he expressed it in terms of whether it was "arguable" that the Roose parties' claim was not defeated by limitation.[5] In the result, the case was addressed by both Toogood J and the Court of Appeal as if it were a "back-to-front" strike out application (that is, one initiated by the plaintiffs).[6]

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3 *Thom v Davys Burton* [2008] NZSC 65, [2009] 1 NZLR 437.

4 *Maharaj v Johnson* [2015] UKPC 28, [2015] PNLR 27.

5 *Duthie* (HC), above n 1, at [29]. The way in which he expressed the question admits of ambiguity but in the context of the judgment as a whole, it is clear that he was dealing with case as if a strike out application was before him, that is whether it arguable that the limitation defence would not succeed.

6 See *Duthie* (HC), above n 1, at [11], [29], [35], [61], [86] and [91]; and see *Duthie* (CA), above n 2, at [4] and [60].

That being so, it is not possible for us to determine finally the limitation defence. Instead, our judgment must be treated as if it were the determination of an appeal from a strike out application.

High Court decision

[13] Toogood J held that the limitation period began to run when DDL entered into the agreement on 14 April 2008.[7]

[14] In his reasons, the Judge discussed the competing arguments of the parties as to when the critical tax liability arose.[8] Although his reasons do not spell this out precisely, he would appear to have concluded that the liability arose on settlement, that is, on 2 May 2008.[9] He nonetheless concluded that the claim was barred by limitation:

> [84] … In this case, DDL entered into an unconditional sale with [DMR] on 14 April 2008 and in return received an acknowledgement of debt. The limitation period in tort started to run when the vendor entered into a binding agreement with a view to receiving net sale proceeds which were significantly less, on account of the tax liability, than what it had expected to receive. The plaintiff's loss occurred with the transaction, although the loss may not have been quantifiable at once.
>
> [85] I acknowledge that, if the problem with Mr Duthie's advice had been discovered between 14 April 2008 and 2 May 2008, the deal might have been unwound by the contracting parties. But the plaintiffs would have incurred legal costs in undoing the agreement so that there would have been actionable loss to that extent at least.
>
> [86] Applying *Thom v Davys Burton,* I find that DMR's loss did not arise when the transfer settled on 2 May 2008 and the vendor became liable to pay tax on the proceeds of sale, but as soon as the vendor and the purchaser entered into binding legal obligations with one another. That was on 14 April 2008, meaning the limitation period for the claim in tort expired on 14 April 2014. The claim in tort based on incorrect tax advice regarding the transfer of the property is out of time and cannot be pursued on the current pleading.
>
> (footnotes omitted)

[15] Put shortly, the position adopted by the Judge was that when the Roose parties entered into the 14 April 2008 agreement, they were committed to a

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7 *Duthie* (HC), above n 1, at [86].
8 See his discussion at [64]–[78].
9 At [79]–[82].

loss, being either the tax liability which accrued on 2 May 2008 or the costs associated with the steps which would have been necessary to prevent that loss occurring, that is, the unwind costs.[10]

The Court of Appeal decision

[16] The Court reviewed the judgment of this Court in *Davys Burton* and the advice of the Privy Council in *Maharaj v Johnson* and in doing so adopted the terminology from the latter judgment of "flawed transaction" and "no transaction" cases.[11] It saw the present case as being a "no transaction" case; that is, on its analysis, the Roose parties would not have entered into the transaction (being the transfer from DDL to DMR) but for the negligent advice. On this basis it identified the issue for decision in this way:[12]

> For determining when loss was first suffered the relevant comparison is therefore between (a) what DDL's position would have been if the transfer had not taken place; and (b) DDL's position under the transfer of the property to DMR. The moment that comparison reveals an actual quantifiable loss, the cause of action in tort is complete and the limitation period begins to run.

[17] After referring to *Gasparin v Commissioner of Taxation*,[13] *Mills v Commissioner of Inland Revenue*,[14] *Ruddenklau v Charlesworth*[15] and a Tax Information Bulletin issued by the Commissioner,[16] the Court concluded that DDL's tax liability arose on 2 May 2008 when the transfer from DDL to DMR was registered.[17] It dismissed the argument that once the agreement was entered into on 14 April 2008 the tax implications became inevitable:[18]

> Parties to an agreement that has not been performed may agree to discharge the contract. We do not accept that deciding not to proceed with a sale of land likely, or even certain, to result in a tax liability if settled would amount to tax evasion, as the respondent submitted. The respondents did not support this submission with any relevant authority.

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10 Discussed above at [9].
11 See *Maharaj*, above n 4, at [19].
12 *Duthie* (CA), above n 2, at [43].
13 *Gasparin v Commissioner of Taxation* (1994) 50 FCR 73.
14 *Mills v Commissioner of Inland Revenue* (1985) 7 NZTC 5,025 (HC).
15 *Ruddenklau v Charlesworth* [1925] NZLR 161 (SC); appeal on a different issue dismissed [1925] NZLR 169 (CA).
16 Inland Revenue Department *Tax Information Bulletin* Vol 16 No 5 (June 2004).
17 *Duthie* (CA), above n 2, at [49].
18 At [50] (footnotes omitted).

[18] The Court also dismissed DRK's argument as to unwind costs:

> [51] … [DRK] submit[s] there would be costs to [the Roose parties] in unwinding the transaction because [they] would need to seek legal advice as to how to achieve that without incurring tax liability. As we have explained, however, *Thom v Davys Burton* was a different kind of case. The loss arising from the flawed transaction (the invalid matrimonial property agreement) arose immediately, even if its full extent did not become apparent until much later. But the reduced value of the asset (the invalid agreement) was immediately at least the cost of obtaining a valid agreement (had the invalidity been discovered). At the point of entry into the agreement actual loss had therefore been suffered.
>
> [52] In contrast, in the present case no loss was suffered unless and until a tax liability arose. Up until that point damage could be anticipated if the transaction proceeded, but had not been incurred. …
>
> [53] In any event, we do not agree there would have been more than nominal costs to unwind the transaction here. If Ms Roose had become aware between 14 April 2008 and 2 May 2008 of the tax liability that would accrue upon settlement on 2 May 2008, all she had to do was abandon the transaction. No transfer would have been registered from DDL to DMR. If she wanted to keep a record of her change of mind, she could simply have written "cancelled" on the agreement and signed and dated that cancellation. As she controlled both parties to the agreement this was entirely within her power, unlike the situation in *Maharaj* and *Thom v Davys Burton*. Had she cancelled, no tax liability would have arisen as no income would have been derived.

The incurring of the tax liability

A preliminary comment

[19] We are not in a position to form a concluded view as to the basis of DDL's liability to tax. It may be that the property was acquired by DDL with the intention of disposal.[19] Indeed, from what we were told, the Commissioner initially proposed to assess DDL on this basis. If so, the transfer to DMR may just have accelerated the accrual of a tax liability which, in broad terms at least, was inevitable. As we have noted, however, the tax dispute was ultimately settled on the basis that the liability to tax arose under s CB 14. This section applies only: (a) to disposals of land within 10 years of acquisition; and (b) where the proceeds of such disposal are not income under ss CB 6A–CB 12.[20] DDL could have avoided the application of this section by retaining the land for 10 years. As the damages sought relate, in part, to

19 See the Income Tax Act 2007, s CB 6.
20 There are other requirements not material for present purposes, see the section below at [24].

settlement as if s CB 14 applied, we must approach the point at which a tax liability arose by reference to s CB 14.

[20] As we will see, DRK's argument as to when DDL derived income is based substantially on s GC 1 (which addresses income derived from the disposal of trading stock for less than market value). Given that the sale and purchase agreement and settlement occurred in the same tax year, s GC 1 had no role to play in the tax dispute between the Commissioner and DDL.

DRK's argument

[21] DRK's arguments proceeds on the basis that:

(a) the agreement of 14 April 2008 was a disposal of the land for the purposes of s CB 14; and

(b) pursuant to s GC 1, DDL derived income from the disposal on the same day.

There was also a suggested, although not fully developed, argument, that once disposal had occurred (that is, on DRK's argument, on 14 April 2008) it was not open to the parties to unwind the transaction and thus avoid the tax consequences which would follow on settlement.

[22] DRK's arguments are very particular to the present case. But they are difficult to follow and assess without a broader understanding of the general law as to the derivation of income associated with the disposal of land. So in succeeding sections of this part of the judgment, we will discuss:

(a) The primarily relevant provisions of the Income Tax Act.

(b) When is property disposed of?

(c) Derivation of income from disposals of land – general principles.

(d) Application of the general principles to the particular circumstances of this case.

(e) The s GC 1 argument.

(f) Could the Roose parties have unwound the transaction without adverse tax consequences?

The primarily relevant provisions of the Income Tax Act

[23] Derivation of income is addressed generally in s BD 3 which relevantly provides:

> **BD 3 Allocation of income to particular income years**
>
> *Application*
>
> (1) Every amount of income must be allocated to an income year under this section.
>
> *General rule*
>
> (2) An amount of income is allocated to the income year in which the amount is derived, unless a provision in any of Parts C or E to I provides for allocation on another basis.
>
> *Interpretation of derive*
>
> (3) When the time of derivation of an amount of income is being determined, regard must be had to case law, which—
>
> (a) requires some people to recognise income on an accrual basis; and
>
> (b) requires other people to recognise income on a cash basis; and
>
> (c) more generally, defines the concept of derivation.

[24] Section CB 14 is in these terms:

> **CB 14 Disposal: amount from land affected by change and not already in income**
>
> *Income*
>
> (1) An amount that a person <u>derives from disposing of land</u> is income of the person if—

(a) the amount is not income under any of sections CB 6 to CB 12; and

(b) the person disposed of the land within 10 years of acquiring it; and

(c) the total amount that they derive from its disposal is more than the cost of the land; and

(d) at least 20% of the excess arises from a factor, or more than 1 factor, that—

(i) relates to the land; and

(ii) is described in subsection (2); and

(iii) occurs after the person acquired the land, for the factors described in subsection (2) … (e) … .

Factors for purposes of subsection (1)(d)

(2) The factors referred to in subsection (1)(d) are—

…

(e) a consent granted under the Resource Management Act 1991:

(emphasis added by way of underlining)

[25] DDL was liable under s CB 14 if:

(a) it was not otherwise liable to tax on the proceeds of sale;

(b) the disposal of the land occurred within 10 years of acquisition; and

(c) at least 20 per cent of the difference between acquisition cost and sale price arose from the obtaining of a resource consent (being the subdivision consent mentioned above).

[26] As at 14 April 2008, s GC 1 was in these terms:

GC 1 Disposals of trading stock at below market value

When this section applies

(1) This section applies if a person (the ***transferor***) disposes of trading stock to another person (the ***transferee***) for—

(a) no consideration:

(b) an amount of consideration that is less than the market value of the trading stock at the time of disposal.

Disposal treated as being for market value

(2) For the purposes of this Act, the consideration received by the transferor and provided by the transferee is treated as being an amount equal to the market value at the time.

[27] There is a slightly awkward issue as to this section as it was replaced in 2010, with retrospective effect, by s 54(1) of the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010. We are inclined to think that the present case should be determined by reference to the earlier version of s GC 1 – that is the one we have set out above[21] – and will address the argument on this basis. As will become apparent, however, the outcome is the same if the more recent version were to be applied.

When is property disposed of?

[28] The current case was argued on the basis that the 14 April 2008 agreement represented a disposal of the land and we are content to approach the appeal on that basis.

[29] Support for the view that the agreement was a disposal of the land is to be found in the judgment of Hardie Boys J in *Mills v Commissioner of Inland Revenue*, a case concerned with a transitional provision in what was a precursor to s CB 14.[22] The provision applied only to proceeds of sale "derived from any sale or other disposition made on or after the 10th day of August 1973." Conditional contracts for the sale of the property in issue had been entered into before 10 August 1973, but these did not become unconditional until after that date. Hardie Boys J held that, as at 10 August 1973, the sales had not been "made". It is implicit in his judgment that

21 As between the Commissioner and the Roose parties, we consider that the new section is applicable. But for the purposes of determining, as between the Roose parties and DRK, when the cause of action in negligence arose, we are inclined to the view that the issue falls to be determined by reference to the law as it was at the time. If the position was that there was no loss to the Roose parties until 2 May 2008, it would be odd to construe the Taxation (Annual Rates, Trans-Tasman Savings Portability, KiwiSaver, and Remedial Matters) Act 2010 as affecting purely private rights.

22 *Mills,* above n 14.

his conclusion would have been the other way if the sales had been unconditional and arguably implicit that he would have regarded an unconditional agreement as a disposition of land. This would be consistent with the approach taken by Henry J in *Beetham v Commissioner of Inland Revenue*,[23] a case which Hardie Boys J cited with approval.[24]

Derivation of income from disposals of land – general principles

[30] As will have been noted, under s CB 14, tax is imposed on "the amount" the vendor "derives from disposing of land". This means that a liability to tax arises only at the point that the vendor derives income from the disposal of land.

[31] Under an unconditional contract for the sale of land, the vendor is entitled to seek specific performance. Although an order for specific performance, if obtained, will require the purchaser to pay the purchase price, the right to seek specific performance is not the same as the right to sue for the purchase price as a debt. This was explained in *Ruddenklau v Charlesworth* in this way:[25]

> As a general rule, on the failure or refusal of a purchaser to complete an executory contract for the purchase of land the vendor is not entitled to sue for the purchase-money as a debt. He is entitled merely to sue for specific performance or for damages for the loss of his bargain. It is only when the contract has been completed by the execution and acceptance of a conveyance that unpaid purchase-money may become a debt and can be recovered accordingly.

The distinction drawn in *Ruddenklau* is valid conceptually. If a purchaser is unable to come up with the money to settle, the ultimate judgment will be for damages and not the purchase price.

[32] The clearest authority as to whether a vendor who becomes entitled to seek specific performance of an agreement for the sale of land has thereby derived income is *Gasparin*.[26] That case involved the subdivision and sale of land. At the end of the tax year in question, the taxpayer had in place 64 unconditional agreements for the sale of sections. Deposits had been received but the sales were not to be settled until

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23 *Beetham v Commissioner of Inland Revenue* [1973] 1 NZLR 575 (SC).
24 Mills, above n 14, at 5,027.
25 *Ruddenklau* (SC), above n 15, at 164.
26 *Gasparin*, above n 13.

the following tax year. The taxpayer treated the 64 allotments as "closing stock on hand". The Commissioner disagreed, contending that the income associated with the sale of the allotments was derived once the agreements became unconditional. This approach was upheld by both the Administrative Appeals Tribunal and at first instance in the Federal Court. On appeal, the Full Court (Jenkinson, Spender and von Doussa JJ) held to the contrary.[27]

[33] Their approach, as explained by von Doussa J, was as follows:

(a) Applying, amongst other cases, *Ruddenklau*, the position at the end of the tax year in relation to each agreement was that "there was no accrued liability on the part of the purchaser to pay the balance of the purchase price".[28]

(b) Applying a series of Australian tax cases, most particularly *Farnsworth v Commissioner of Taxation*,[29] income associated with the disposal of stock-in-trade was not derived until it was represented by a debt. To treat the income as derived on the entering into of an unconditional agreement would not allow for the contingency that settlement might not occur.

On this basis, von Doussa J concluded:[30]

> In my opinion it should be held that the [taxpayer] derived income from the sale of the allotments of land which comprise their trading sock not when the contracts became unconditional, but at settlement when a debt accrued due from each purchaser to the [taxpayer]. The critical consideration is the time when the debt arose.

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27 Von Doussa J delivered the only substantive judgment, with which Jenkinson and Spender JJ agreed.

28 At 77B.

29 *Farnsworth v Federal Commissioner of Taxation* (1949) 78 CLR 504.

30 *Gasparin,* above n 13, at 83F–83G.

[34] In New Zealand, the Commissioner has adopted the approach taken in *Gasparin*. Thus the Tax Information Bulletin to which we have referred notes:[31]

> Derivation generally occurs when there is a right to sue upon a debt. This will commonly, but not always, be when the vendor loses their dispositive power over the land. In relation to the timing of derivation it is important to consider what will give the correct reflex of the taxpayer's income. For some sales of land the timing of derivation and settlement will be the same, but for others settlement and derivation may occur at different times. …
>
> …
>
> Cases that have specifically dealt with land sales adopt the same approach as the one taken in general cases concerning derivation. The Commissioner considers that the judgments in both *Gasparin* ... and *Ruddenklau* ... support the concept of derivation generally occurring when there is an enforceable debt (which is different from there being an ability to sue for specific performance) and that this is generally the same time as the vendor loses their dispositive power over the property.

[35] The Tax Information Bulletin addresses circumstances in which time of settlement might not be the point at which income is derived. This might be the case if possession is parted with before settlement and particular payments are required to be made pending settlement. As we will explain later, we do not see this consideration as material in the present context.

[36] The parties and the Attorney-General as intervener agreed that, as a general principle, income from the sale of land is derived at settlement and, in particular, is not derived merely because there is an unconditional agreement for the sale of the land. For the purposes of this appeal, we are content to adopt the same position.

Application of the general principles to the particular circumstances of this case

[37] The agreement for sale and purchase stipulated 21 April 2008 as the date of possession and settlement. It also provided:

> 15.0 The vendor agrees to leave the sum of $1,950,000 owing as at the date for settlement on the basis that the purchaser is to forthwith execute and deliver to the vendor a Deed of Acknowledgement of Debt recording the terms on which this debt is payable.
>
> 16.0 The said debt shall thereafter be payable by the purchaser to the vendor upon demand. Pending demand the debt is to be interest free.

[31] Above n 16, at 35–36 (citations omitted).

> No demand for repayment of debt or any part thereof shall be made at any time before the 5th anniversary of the date for settlement and possession.

[38] The relevant provisions of the deed of acknowledgement of debt are:

> A. Pursuant to an Agreement for Sale & Purchase made between the parties dated 14 April 2008, the lender sold to the borrower the land at … Pukekohe for the sum of $1,950,000 inclusive of GST on the terms more particularly described therein.
>
> B. As at the date for settlement (ie 21 April 2008) the lender agreed to leave the entire purchase price of $1,950,000 outstanding and owing by the borrower on the terms set out herein.
>
> **NOW THEREFORE** the parties agree as follows:
>
> 1. The borrower acknowledges it is indebted to the lender in the sum of $1,950,000 being the unpaid the purchase price for the said property.
>
> 2. The said debt of $1,950,000 shall be repayable upon demand.
>
> 3. Pending demand the debt shall be interest free.
>
> 4. In consideration of the payment by the borrower to the lender of the additional sum of $100 (the receipt of which is hereby acknowledged by the lender) the lender agrees not to make demand for the repayment of the said sum of $1,950,000 or any part thereof at any time before the 5th anniversary of the date of settlement of the said agreement for sale and purchase.

[39] As we have noted, Ms Roose said that it was agreed to defer settlement. What she meant by this is not clear. It may have involved nothing more than discussions between her (representing both DDL and DMR) and her solicitor. It seems unlikely that any practical steps were taken by DMR to take possession of the property from DDL. As far as we can tell, there was no settlement statement. We were told that all documents required for settlement were lodged electronically with the Land Transfer Office by 30 April 2008. From that point Ms Roose's solicitor (acting for both DDL and DMR) would have able to complete settlement instantly.

[40] Contingencies as to settlement of the kind which affect agreements between unrelated parties were not present because of:

(a) Ms Roose's control of DDL and DMR;

(b) the 14 April 2008 execution of the deed of acknowledgment of debt;

(c) the terms of the deed of acknowledgment of debt (which could be construed as providing that time started to run on the five year deferral from 21 April 2008); and

(d) the electronic lodging of all documents with the Land Transfer Office.

Thus, in a practical sense, the case differs from *Gasparin*.

[41] The considerations just discussed are all associated with the artificiality of the transaction. Artificiality of this kind may well be material to whether income has been derived and, if so, how much. In this case, however, the debate is very limited; it is confined to when income was derived within a period of only some two and half weeks (that is between 14 April and 2 May 2008) occurring within the same tax year. In this context, artificiality is of no obvious relevance. Accordingly, we would be reluctant to treat the time of derivation of the income as being controlled by what are simply incidents of this artificiality.

[42] More generally, we consider that the policy of the Income Tax Act is best advanced if a bright-line approach is taken to the timing of derivation of income. An approach which left derivation to be determined by reference to the degree of contingency as to the probability of settlement would be unsatisfactorily uncertain. This is illustrated by the facts of the present case. While the usual contingencies bearing on the likelihood of settlement of unconditional agreements between unrelated parties were not present, Ms Roose was on both sides of the transaction and could thus cancel it without infringing the rights of third parties. On one view of the case, this made settlement extremely contingent.

[43] Against that background, we see the *Gasparin* approach as applying to related party transactions even though there is little practical contingency affecting settlement. More particularly, we construe the references in the deed of acknowledgement of debt to the date of settlement being 21 April 2008 as properly read as encompassing later settlement and, more importantly, predicated upon

settlement occurring. And although it would have been practicable for Ms Roose's solicitor to complete the transaction earlier than 2 May, 2 May was the actual date of settlement. We are accordingly of the view that, subject to the s GC 1 argument, liability under s CB 14 did not accrue prior to 2 May 2008.

The s GC 1 argument

[44] Mr Pearson contended that, for the purposes of s GC 1:[32]

(a) "the amount of consideration" for the sale by DDL to DMR was "less than the market value" of the land at the time of disposal; and

(b) the effect of s GC 1(2) is that the vendor is deemed to have received at the time of disposal the market value of the land at that time.

[45] The face value of the consideration for the sale by DDL to DMR ($1,950,000) equated to the market value of the land at the time. But, given the interest free period of five years during which the payment could not be demanded, the present value of the consideration provided by DMR at settlement was distinctly less. On this basis, Mr Pearson argued that "the amount of consideration" received by DDL (on his argument, the deed of acknowledgment of debt) was, relevantly, less than the market value of the land. Whether that is so for the purposes of s GC 1 was the subject of some debate before us. A little context is necessary to explain the conflicting positions.

[46] In the case of some activities, cash receipts may provide the best reflex of the income of the taxpayer.[33] In other cases, income is derived when taxable activity results in the creation of a debt to the taxpayer. Thus in *Gasparin*, income was derived when the disposal of trading stock resulted in the establishment of a debt.[34] The same approach can be taken in relation to debts generated by other income producing activity.[35] This is the accrual basis of derivation referred to in s BD 3(a). In such instances, income derived is usually assessed by reference to the face value

[32] The section is set out above at [26].
[33] See s BD 3(3), set out above at [23].
[34] *Gasparin*, above n 13.
[35] See *Fincon (Construction) Ltd v Commissioner of Inland Revenue* [1970] NZLR 462 (CA).

of the debt. This was the view taken in two New Zealand cases, *Commissioner of Inland Revenue v Farmers Trading Co*[36] and *Commissioner of Inland Revenue v National Bank of New Zealand*.[37] Scope for abusive practice is limited by reason of the financial arrangements rules and general and specific anti-avoidance rules.[38]

[47] On the basis of the considerations just outlined, Mr Ebersohn for the Attorney-General argued that "the amount of consideration" was $1,950,000, which was the face value of the debt created by the deed of acknowledgment of debt. He thus contended that s GC 1 had no application as the disposal was for market value. Mr Pearson, on the other hand, maintained that, in circumstances such as the present, s GC 1 envisaged an approach to the "amount of consideration" that allowed for the time value of money.

[48] There is force in Mr Pearson's argument. It is open to question whether the face value approach taken in the *Farmers* and *National Bank* cases is applicable given that payment of the amount of the purchase price could not be demanded for five years. If it were necessary to decide this question, consideration would obviously also have to be given to the very specific language used in s GC 1. However, we are satisfied that this issue does not require determination; this because we do not accept Mr Pearson's interpretation of s GC 1(2).

[49] Mr Pearson contended that the subsection deems the transferor to have "received", at the time of disposal, the market value of the land. It is clear that "the time of disposal" identifies the time at which market value is to be calculated. On Mr Pearson's argument it also identifies the time at which that consideration is deemed to have been received. We do not regard this as natural reading of s GC 1(2) given that "at the time" immediately follows "market value". As well, Mr Pearson's argument would produce something of an oddity: different time of derivation rules depending on whether the consideration equated to, or was slightly less than, the market value of the land.

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36 *Commissioner of Inland Revenue v Farmers' Trading Co Ltd* (1986) 8 NZTC 5,062 (HC); and see *Commissioner of Inland Revenue v Farmers' Trading Co Ltd* (1982) 5 NZTC 61,321 (CA).
37 *Commissioner of Inland Revenue v National Bank of New Zealand* (1976) 2 NZTC 61,150 (CA).
38 See sub-pt EW and ss BG 1 and GB 21.

[50] We prefer to interpret s GC 1(2) as meaning that market value is to be assessed at the time of disposal, but the timing of the derivation of resulting income falls to be determined by reference to the general principles which we have identified.

[51] For the sake of completeness, in the current version of s GC 1, subsection (2) is in these terms:

> The person is treated as deriving an amount equal to the market value of the trading stock at the time of disposal.

We would construe this subsection in the same way as its predecessor as to the timing of derivation of income.

Could the Roose parties have unwound the transaction without adverse tax consequences?

[52] It will be recalled that the Court of Appeal dismissed an argument to the effect that an unwinding of the sale and purchase agreement between 14 April and 2 May 2008 would have amounted to "tax evasion".[39] A similar argument was advanced to us which was expressed in this way in DRK's written submissions:

> If there has been a disposition under s CB 14, writing "cancelled" on an agreement and not reporting the tax consequences would result in a false tax return, with the risk of severe penalties.

[53] To the extent to which this argument assumes the application of s GC 1, it falls away given our conclusion that that section does not have the meaning contended for by DRK. To the extent to which it is a stand-alone submission – that is, as not dependent on the s GC 1 argument – we dismiss it. If the Roose parties had decided not to proceed to settlement, no income would have been derived and thus there would have been no accrual of a liability to tax. A tax return prepared on that basis would have been correct rather than "false".[40]

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39 See above at [17].
40 The approach we favour is in accord with the submissions of the intervener.

Ancillary losses

An overview of the law

[54] A cause of action in negligence arises on the first occurrence of damage. Under the Limitation Act 1950, which governs this case, there was no general principle of reasonable discoverability.[41] On the other hand, it has always been accepted that limitation does not start to run in respect of the occurrence of damage which is merely negligible.[42]

[55] Many limitation cases have concerned circumstances in which the negligence of the defendant has created the potential for harm which, as events developed, matured into an actual loss. In issue has been the point at which the potential for harm constituted a loss. This has led to a not entirely satisfactory set of distinctions most particularly between contingencies which mean that a loss has not been suffered and those which bear merely on the quantification of loss which has already occurred. In applying that distinction, the courts have resorted to further categorising cases by reference to various labels, such as for instance "damaged asset" or "exposure to a contingent liability" (as in *Davys Burton*[43]) and "no transaction" or "flawed transaction" (as in *Maharaj*[44]). In the latter case, Lord Wilson discussed the distinction between "no transaction" and "flawed transaction" cases in this way:[45]

> … it is essential to bear in mind that the central concept behind the "no transaction" and the "flawed transaction" cases is different. For in the latter the claimant *does enter* into a "flawed transaction" in circumstances in which, in the absence of the defendant's breach of duty, he would have entered into an analogous, but flawless, transaction. In the former, however, the claimant also enters into a transaction but in circumstances in which, in the absence of the defendant's breach of duty, he *would have entered* into "no transaction" at all. The difference in concept dictates a difference in the

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41 *Murray v Morel & Co Ltd* [2007] NZSC 27, [2007] 3 NZLR 721. The exceptions were claims for: (a) economic loss associated with faulty buildings; (b) personal injury; and (c) sexual abuse.

42 See *Cartledge v E Jopling & Sons Ltd* [1963] AC 758 (HL) at 773–774 per Lord Evershed: "it cannot ... be in doubt ... that the cause of action from such a wrong accrues when the damage—that is, real damage as distinct from purely minimal damage—is suffered." Cited with approval in *Rothwell v Chemical & Insulating Co Ltd* [2007] UKHL 39, [2008] AC 281 at 65 per Lord Scott.

43 *Davys Burton*, above n 3.

44 *Maharaj,* above n 4.

45 At [19] (emphasis in original). Lady Hale, Lord Carnwath and Lord Hodge agreed with Lord Wilson.

> inquiry as to whether, and if so when, the claimant suffered actual or measurable damage. In the "flawed transaction" case the inquiry is whether the value to the claimant of the flawed transaction was measurably less than what would have been the value to him of the flawless transaction. In the "no transaction" case the inquiry is whether, and if so at what point, the transaction into which the claimant entered caused his financial position to be measurably worse than if he had not entered into it … .

A slightly awkward feature of this language is that "flawed transaction" refers to the transaction which was entered into, whereas "no transaction" is a reference to the counter-factual, that is what the plaintiff would have done if properly advised.

[56] Although attempts to apply the distinctions of the kind just discussed – that is the damaged asset or exposure to a contingent liability or the no transaction or flawed transaction distinctions – may be useful in terms of facilitating discussion of what are sometimes elusive issues, the descriptions are not terms of art. Unless used carefully and in a way which is closely focused on the occurrence of loss, they may result in distracting semantic debate, a point which the present case illustrates, as we will explain.

[57] It could be argued that in the present case the agreement of 14 April 2008 was a flawed transaction because the tax position of DDL under it was less favourable than anticipated. Such an approach, however, is of no moment for limitation purposes because, flawed or not, the 14 April 2008 agreement did not result in a tax liability. The Court of Appeal considered it was dealing with a no transaction case, on the basis that, properly advised, the Roose parties would not have settled the sale. It being the settlement which triggered the loss, the settlement is relevantly the (no) transaction. While we agree with the result arrived at by the Court of Appeal, we have some reservations as to whether the flawed transaction or no transaction distinction is of much assistance in this case in determining when loss occurred.

[58] Because of our conclusion that a tax liability did not accrue until 2 May 2008, the associated loss, which of course is what is primarily in issue in this case, did not arise until then. DRK maintains, however, that in two other ancillary respects, a loss had already arisen.

Wasted costs

[59] The general narrative of events which we have provided suggests that one or more of the Roose parties incurred set-up costs in relation to the transfer. These include the cost of the advice provided by Mr Duthie, costs in relation to the establishment of DMR and the DMR Trust, a valuation fee and legal costs associated with the conveyance. On the argument of DRK, there would have been no occasion to incur these costs but for the decision to proceed with transaction between DDL and DMR and this transaction would not have occurred but for the impugned advice of Mr Duthie. So if it were the case that the mistake attributed to Mr Duthie had been appreciated by Ms Roose, say, on 30 April 2008, those who had incurred the costs would have had a claim against DRK to recover them.

[60] As we have noted, the appellants did not rely on this wasted costs argument in either the High Court or Court of Appeal. Further, the material we have as to the costs is at an extremely general level and is not specifically addressed to the point now in issue. In particular, we do not know when bills for set-up costs were rendered and when they were paid. Nor do we know who paid them. There was no evidence as to what, if any, other utility the Roose parties might have derived from the products of the set-up costs. If this argument was to be relied on, it should have been advanced in the High Court and supported by evidence. Accordingly, it is too late to advance it now.

[61] Notwithstanding what we have just said, it will be open to DRK to run the wasted costs argument at trial; this because we are constrained by the way the case was dealt with in the High Court and Court of Appeal to deal with it as if what was in issue was a strike out application. In light of this, the following two comments may be of assistance.

[62] The first is that the postulated loss is very collateral to the primary complaint of the Roose parties. In limitation cases concerned with negligent professional advice, the focus has always been on the failure to achieve the purpose for which advice was sought. In such cases, the hypothetical cost of remedying the consequences of negligent advice which would have been incurred if the error had

been detected early can constitute loss. This is illustrated by *Davys Burton*.[46] But what the cases have not addressed is whether costs incurred in relation to the obtaining and implementation of the advice are relevantly regarded as a loss. DRK's argument extends to the costs paid to them by the Roose parties in respect of the transaction in issue. If this argument is right, a claim for negligent advice will always, or almost always, accrue at (or very close to) the time when the advice is given or at the latest when the negligent advice is paid for. This line of argument has not been referred to in any of the leading cases. Against this background, a possible response to the wasted costs argument is that the wasted costs represent damage which is separate and distinct from the damage associated with the tax liability and that there are thus separate and distinct causes of action. If so, the limitation period applying to the cause of action in respect of the tax liability would not have been triggered by the wasting of costs. There are decisions from the Court of Appeal which would provide some support for an argument along these lines.[47]

[63] The second and related point is that, in cases turning on a single transaction entered into on the basis of negligent advice, it may be unrealistic to focus closely on the various steps (and associated costs) which resulted in the completion of that transaction. Although continuing duty arguments are often artificial, we doubt if it would be artificial to conclude that, on the Roose parties' case, DRK's negligence persisted until settlement.

Unwind costs

[64] Where a transaction has been entered into as a result of negligent professional advice creating a potential for loss, early realisation of the error might provide an opportunity to take steps which will prevent that potential crystallising into an actual loss. But, if such steps would themselves result in the incurring of costs which are more than negligible, the need to incur them is itself a loss and the cause of action will thus be held to have arisen on entry into the transaction. This is illustrated by

46 *Davys Burton*, above n 3.

47 See *Bowen v Paramount Builders (Hamilton) Ltd* [1977] 1 NZLR 394 (CA) at 424 per Cooke J; *Mount Albert Borough Council v Johnson* [1979] 2 NZLR 234 (CA) at 239 per Cooke J and at 243 per Richardson J; and *S v G* [1995] 3 NZLR 681 (CA) at 687. The point was also referred to in the judgment of this Court in *Murray*, above n 41, at [46].

Davys Burton.[48] DRK says that this is the correct analysis of what happened here; the 14 April 2008 agreement created a situation in which the Roose parties would incur a tax liability unless they unwound the transaction and such unwinding would itself cost money. On this basis, there was a loss as at 14 April 2008.

[65] In cases involving negligent professional advice, there will normally have been steps taken by both the plaintiff and defendant which set the scene for the entry into the transaction which is impugned. By way of example, assume:

(a) a solicitor advises a client that it is appropriate to give a guarantee;[49] and, in doing so, erroneously assures the client that liability under the guarantee is subject to a particular limitation of liability; and

(b) the client responds by telephone accepting the advice and making an appointment to execute the guarantee.

In such circumstances the giving and acceptance of the advice and the making of the appointment to execute the guarantee create a potential for loss, but the cause of action would plainly not arise until the guarantee is executed.

[66] We see the example we have just provided as analogous to what, in the present case, occurred prior to 2 May 2008. Everything that occurred prior to then was no more than preliminary to the settlement which triggered the tax liability. On the case advanced by the Roose parties, a realisation of the true position before 2 May 2008 would have resulted in settlement not occurring and thus the liability not arising. No unwind costs needed to be incurred. All that was required was for DDL not to settle with DMR.

[67] As will be apparent, we agree with the approach of the Court of Appeal expressed at [51]–[53] of its judgment, cited above at [18].

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48 *Davys Burton*, above n 3.

49 For the avoidance of debate, we should also assume that the guarantee is to be secured by mortgage, see Limitation Act 1950, s 20: compare *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514; and *Foster v Outred & Co (a firm)* [1982] 1 WLR 86 (CA) and the discussion in *Davys Burton*, above n 3, at [18].

[68] This approach reflects the fact that the DDL/DMR transaction was not at arm's length. Had the similar advice resulted in a sale to a third party, we accept that the position may have been different.

Disposition

[69] The appeal is dismissed. The appellants are to pay the Roose parties costs of $25,000 and reasonable disbursements.

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