

## ISSUE

Was the taxpayer entitled to deduct the payment made to the defrauded clients?

## DECISION

**High Court: Latham CJ, Rich, Dixon and McTiernan JJ.**

1. The taxpayer was not entitled to deduct the payment made to the defrauded clients.
2. Per Latham CJ: The payment was made to discharge a capital liability and was of a capital nature.
3. Per Dixon J: The payment was made to discharge a personal liability and was "quite independent of his continuing to practice and quite unconnected with the earning of future income."

"In my opinion the loss inflicted upon the taxpayer by his fraudulent partner takes no place in the subsequent carrying on of his practice. It was simply a loss or depletion of his general resources as a result of his undertaking the risk of such a liability when by entering into partnership each partner armed the other with an authority which he might impose liabilities upon him." (CLR p 283)

## ¶25 ASHGROVE PTY LTD & ORS V DFC OF T

94 ATC 4549; (1994) 53 FCR 452

### FACTS & ARGUMENTS

The five taxpayers were each a party in the relevant income years to one or more agreements for the sale of timber on their land. Each taxpayer acquired their land before 20 September 1985 for purposes which did not involve profit making from the sale of timber.

The first taxpayer, Mrs Gooch, entered into two timber agreements with North Broken Hill Limited (NBH) under which she received \$21,800. Mrs Gooch had also entered into a similar agreement some years before and had entered into the further agreements because she needed the money. As part of the arrangement with NBH under the further agreements, Mrs Gooch entered into a timber harvesting plan under the *Forest Practices Act 1985* (Tas) for the regeneration of the timber to restore the land for the benefit of future generations.

The second taxpayer, Ashgrove Pty Ltd (Ashgrove), entered into two timber agreements in 1987 with Tasmanian Pulp and Forest Holdings Limited (TPFH) which also gave TPFH a series of options to purchase additional timber. As a result of the exercise of the option under the first agreement, Ashgrove received \$49,900. Ashgrove also entered into a timber harvesting plan that provided for natural regeneration of the logged land, which Ashgrove eventually planned to use for bush stock grazing.

The third taxpayer, Mr Swain, entered into a timber agreement with Forest Resources (FR) in 1987 to remove timber from a particular area in order to stop stock straying, discourage shooters and to clean up the area. The price under the agreement (\$18,550) was arrived at by reference to a per tonnage rate and was payable by monthly instalments which could vary with the volume of timber removed. Although the agreement contemplated that Mr Swain would receive only a total of \$18,550, he actually received over \$26,000 paid at variable per tonnage rates. The quantity of timber taken was also more than that provided for in the agreement.

The fourth taxpayer, Mr Wadley, entered into a timber agreement with FR because he wanted to reduce the level of his debt. The agreement provided for the sale of 10,000 tonnes of timber for a price of \$24,250 payable by monthly instalments which could vary with the volume of timber removed. However, Mr Wadley in fact received over \$60,000 paid on a tonnage basis at variable rates and the quantity of timber taken was more than 10,000 tonnes. Mr Wadley also entered a second agreement with FR which provided for the regeneration of forest on the logged land. Under the agreement FR was required to pay a "reafforestation incentive payment" for pulpwood and salvage wood removed from the area at set rates per tonne by Mr Wadley. Mr Wadley subsequently received a payment of \$60,381. Mr Wadley wanted to regenerate the logged land so that he could leave it for future generations as he found it.

The fifth taxpayer, Mr Davey, in partnership with his wife, entered into an agreement with NBH which gave it a series of options to purchase timber on their land. The agreement was entered into largely to cover Mr Davey's potential liability under guarantees. As a result of the exercise of several of the options, Mr and Mrs Davey received \$61,560 which the Commissioner claimed was net income of the partnership. After logging, the land was cleared and ploughed and woodchip trees planted for the purpose of resale. Mr Davey had decided to start the plantation when he entered into a concurrent replanting agreement. Mr and Mrs Davey had also entered into an earlier agreement with NBH for woodchip timber on their land and they had also sold mill logs to different millers.

The Commissioner contended that the relevant amounts received by the taxpayers were assessable under the capital gains tax provisions in Pt IIIA of the *Income Tax Assessment Act 1936* (Cth) and were income according to ordinary concepts assessable under s 25(1), 25A or 26(f). With respect to the application of Pt IIIA, the Commissioner argued that each timber agreement involved the creation in law or in equity of a *profit à prendre* or other interest in land on which the respective timber stood with the consequence that each agreement amounted to a disposition within the meaning of either former s 160M(6) or 160M(7). The Commissioner considered that the entire amounts received constituted the consideration on disposal and that no cost base applied. Hence, the Commissioner was of the view that the entire proceeds received by the taxpayers constituted capital gains. Alternatively, the Commissioner contended that if the timber contracts were contracts for the sale of goods (rather than the creation of an interest in land), the goods

system, skill and organisation can all play a part in reducing although not eliminating the element of chance, especially where the punter bets with a bookmaker rather than on the on-course totalizator or TAB. In favour of mere punting being inherently incapable of being a business, is, that at the end of the day no matter how informed a punter may be and no matter how systematic he may seek to make his endeavours, there are so many chance factors intervening over which he has no control, that chance probably remains the predominant factor in the outcome . . .

. . . I am inclined, particularly with the growth of modern technology such as computers, to think that there may be cases today . . . where the activity of betting has become so organised, systematic and businesslike and is carried on with such dedication to potential profit that the man in the street would recognise that activity to be a business. That being so, I propose to proceed on the assumption that mere punting may constitute a business although the intrusion of chance into the activity as a predominant ingredient at least in the outcome of the race itself does suggest to me that it will be a rare case where a court will conclude that the activity is a business. However, it is not necessary for me in the present case to reach a final conclusion on the matter . . . for in my opinion even if the activities of betting are inherently capable in some circumstances of constituting a business, the facts of the present case do not reveal the [taxpayer] to be carrying on any business at all." (ATC p 4969)

#### ¶44 BAKER V CAMPBELL

83 ATC 4606; (1983) 153 CLR 52

##### FACTS & ARGUMENTS

The plaintiff brought an action against the defendant, a policeman, who had obtained a search warrant issued under s 10 of the *Crimes Act 1914* (Cth) and had attempted to obtain documents held by the plaintiff's solicitors at their offices. The documents were being sought in respect of the alleged commission of offences by the plaintiff and other persons against the sales tax legislation.

The documents which were the subject of the search were all brought into existence for the purpose of obtaining or giving legal advice but only some of the documents related to civil or criminal proceedings then existing or in contemplation.

The plaintiff contended that legal professional privilege applied to protect the documents from being disclosed under the search warrant.

The defendant contended that s 10 of the *Crimes Act* was not subject to the privilege and that, even if it were subject to the privilege, the decision of the High Court in *O'Reilly & Ors v Commissioner of the State Bank of Victoria* 82 ATC 4671 was authority for the proposition that the privilege applied only to

documents brought into existence for use in existing or contemplated litigation and not to documents merely brought into existence for the purpose of obtaining legal advice.

##### ISSUES

To which documents does the doctrine of legal professional privilege apply and was the search warrant issued under s 10 of the *Crimes Act* subject to the doctrine?

##### DECISION

**Full High Court: Gibbs CJ, Mason, Murphy, Wilson, Brennan, Deane and Dawson JJ.**

1. Per Murphy, Wilson, Deane and Dawson JJ (Gibbs CJ, Mason and Brennan JJ dissenting): Legal professional privilege applies to all forms of documents, unless expressly or by necessary implication excluded by parliament. Section 10 of the *Crimes Act* did not exclude the doctrine of legal professional privilege and therefore the doctrine applied to override the search warrants. Per Deane J:

"It is a settled rule of construction that general provisions of a statute should only be read as abrogating common law principles or rights to the extent made necessary by express words or necessary intendment . . . It is to be presumed that if the Parliament intended to authorize the impairment or destruction of that confidentiality by administrative action it would frame the relevant statutory mandate in express and unambiguous terms.

. . . sec 10 contains no express reference to communications between a person and his legal advisers. It neither expressly includes them in, nor expressly excludes them from, the things to which it refers. There is nothing in either sec 10 or in any other provision of the Act which indicates either that the Parliament directed its attention to the particular matter of modifying or destroying the confidentiality of relevant communications between a person and his legal advisers or that there existed a legislative intention to modify the common law principle that the confidentiality of such communications should be preserved. In accordance with the ordinary principles of construction, the section should be construed as not including, in the things which it authorizes to be inspected or seized, documents whose confidentiality would be protected in the Courts of the land by the doctrine of legal professional privilege . . . The consequence of that construction of the section is that the search warrant in the present case should be read as not referring to documents to which legal professional privilege attaches." (ATC pp 4642-4643; CLR pp 116-118)

2. The decision of the High Court in *O'Reilly & Ors v Commissioner of the State Bank of Victoria*, which decided that legal professional privilege was only available to protect evidence from disclosure in the actual course of judicial or quasi-judicial proceedings, should be overruled. Per Murphy J:

of the business and the incurring of the interest liability. His Honour was applying the principles established in the *AGC, Placer Pacific* and *Riverside Road* cases and his approach was fully supported by the approach to deductibility of interest under s 51(1) (albeit the first limb) in *Steele*.

3. In *Steele* a number of observations were made in the majority judgment of Gleeson CJ, Gaudron and Gummow JJ (with whom Callinan J agreed, save on the issue of relief). Those issues may be summarised as follows:

"1. The reference in s 51(1) to 'the assessable income' is to be construed as an abstract phrase referring not only to assessable income derived in any particular year but also to assessable income the relevant outgoing 'would be expected to produce'. Thus, the test of deductibility under the first limb is that 'it is both sufficient and necessary that the occasion of the loss or outgoing should be found in whatever is productive of the assessable income or, if none be produced, would be expected to produce assessable income': see *Fletcher & Ors v FC of T* 91 ATC 4950 at 4957; (1991) 173 CLR 1 at 16-17 and *Steele* at par 22.

2. Interest paid on ordinary commercial terms for the use of money expended to acquire property held for an income producing purpose is a recurrent payment which secures, not an enduring advantage, but rather, the use of borrowed money during the term of the loan. Therefore, in the usual case, where interest is a recurrent payment to secure the use for a limited term of loan funds, it is proper to regard the interest as a revenue item and its character is not altered by reason of the fact that the borrowed funds are used to purchase a capital asset. Once it is determined that the interest paid during a relevant year is an outgoing incurred in gaining or producing a taxpayer's assessable income generally then, even though no assessable income is derived during that year and no such income may ever be derived, the circumstance that the capital asset has produced no income is not a reason to conclude that the interest is an outgoing of a capital nature: see *Steele* pars 25-29.

3. In deciding whether, in a case such as *Steele*, the interest was an outgoing 'incurred in gaining or producing the assessable income' it is unnecessary to distinguish between the purpose of the taxpayer in borrowing the money and the use to which the borrowed funds were put. The reason for that is that even though no assessable income may be produced in the year in which the outgoing is incurred, where the purpose of the taxpayer in borrowing the money is immediately satisfied by the use of the borrowed funds to acquire the capital asset for income producing purposes, the necessary connection exists.

4. The temporal relationship between the incurring of an outgoing and the actual or projected receipt of income may in other cases, but not *Steele*, be one of a number of factors relevant to a judgment as to whether the necessary connection might in a given case exist. However, contemporaneity is not legally essential and whether it is factually important may depend upon the circumstances of a particular case: see *Steele* par 44." (ATC p 4605)

4. The observations in *Steele* "are of considerable assistance in confining, but not determining, the issues arising in the present case". In the present case it is appropriate to approach the issue of the occasion of the interest outgoings "by reference to the purpose of the taxpayer and his wife in borrowing the money and the use to which those borrowed funds were put":

"Thus, the occasion for the recurring liability for interest on the Bank loan was the Bank loan agreement the purpose of which was for the taxpayer and his wife to acquire and carry on in partnership the delicatessen business. As stated in the majority judgment in *Steele* (at par 46), the taxpayer may still be entitled to a deduction after the business ceased in respect of a recurrent liability for interest:

'... provided the occasion of a business outgoing is to be found in the business operations directed towards the gaining or production of assessable income generally.'" (ATC p 4606)

5. The relevance of the cessation of business is of factual importance and relates to whether the occasion of the outgoings in question are no longer to be found in the business operations directed towards the gaining or production of assessable income generally of the partnership business. As Carr J pointed out, "there may come a period of time between cessation of business and the payment of interest which is such that, in all the circumstances of the case, the payment is no longer sufficiently proximate to the activities of the business to be deductible under s 51(1) with the consequence that those activities no longer provide the occasion for the outgoing. However, the evidence in the present case did not establish that that point had been arrived at during the 1993 or 1994 financial years. Answers to such questions depend upon a 'commonsense' or 'practical' weighing of all the factors: see [*Fletcher & Ors v FC of T* 91 ATC 4950 at 4958]."

6. The fact that the Bank, as a matter of practicability rather than legal obligation, allowed early repayment did not alter the analysis.

"... In our view his Honour was correct in characterising the occasion for the liability in such circumstances as depending upon the terms of the contract rather than upon whether or not the partners might or might not have availed themselves of an opportunity to repay the loan on a particular day because of an indulgence shown by the lender on that occasion. In that regard, it is significant that the partners did apply the net proceeds of sale in repayment of the loan and his Honour did not appear to be prepared to find that the taxpayer and his wife had any other partnership assets which were available, had the Bank agreed, to discharge the loan when, or even after, the partnership business ceased.

Had the loan agreement in question been a 'roll over' business loan facility which entitled the taxpayer conducting the business, on the date of each monthly payment, to elect to repay the principal and thereby avoid incurring liability for interest or to 'roll over' the loan and continue to be liable for interest, that may have been a different situation. In that circumstance there may be considerable force in a contention that the occasion of the liability was the election to 'roll over' the loan on each

made with the suppliers ... s 260 has been regarded [by the Commissioner] as a warrant for disregarding part of the price actually paid for goods pursuant to contracts, the validity of which remains unaffected. I do not think that section authorizes the Commissioner to substitute a different price for that actually paid in accordance with those contracts. Indeed, s 260 does not authorize the Commissioner to do anything; it avoids as against the Commissioner arrangements, etc as specified and so leaves him to assess taxable income and tax on the facts as they appear when the avoided arrangements, etc are disregarded. Here, it is not revealed that the taxpayer company's real outgoings for its supplies were £19,777 less than the price it paid or that the additional £19,777 was not paid or was a gift to Breckler Pty Ltd. To arrive at any such conclusion would, I think, be an unauthorized reconstruction of what occurred and, moreover, would not be in accordance with the true facts." (CLR pp 440-441)

## ¶117 FC OF T V CENTURY YUASA BATTERIES PTY LTD

98 ATC 4380

### FACTS & ARGUMENTS

In 1990, the taxpayer borrowed money, at interest, from "BNI" (a non-resident bank). Clause 11 of the loan facility agreement, required the taxpayer to pay BNI an "additional amount" in respect of any withholding tax deducted from payments it made. The "gross up" was designed to ensure that BNI would receive a net amount equal to the amount that it would otherwise receive if no withholding tax was payable. The precise terms of cl 11 were as follows:

"All sums payable by the Borrower under this Agreement shall be paid in full without set-off or counterclaim and free and clear of and without any deduction or withholding for or on account of any tax. If the Borrower or any other person is required by any law or regulation to make any deduction or withholding from any payment, the Borrower shall together with such payment pay an additional amount so that the Lender receives free and clear of any tax the full amount which it would have received if no such deduction or withholding had been required. The Borrower shall pay to the relevant taxing or other authority the full amount of the deduction or withholding made by it and promptly forward to the Lender copies of official receipts or other evidence showing that the full amount of any such deduction or withholding has been paid over to the relevant taxation or other authority before the date on which penalties attach thereto."

The Commissioner argued that additional amounts payable under cl 11 were either "interest" or "in the nature of interest" for the purposes of s 128A(1) of the *Income Tax Assessment Act 1936* (Cth) and that withholding tax was therefore payable on such amounts. It was submitted that cl 11 obliged the borrower to pay "an additional amount", so that BNI receives "the full

amount which it would have received if no such deduction or withholding had been required". According to the Commissioner, the full amount which BNI "would have received" is the full amount of interest and that consequently there is no reason why the additional payment does not itself have the character of interest.

The taxpayer contended that the additional amounts were not "interest" or "in the nature of interest" because, as Cooper J had decided at first instance, the gross up was not calculated by reference to the principal sum loaned and was not in the nature of an additional return or profit to BNI on the money advanced over and above the interest calculated and payable under the loan.

In the conduct of the case, the parties accepted that, following the decision in *David Securities Pty Ltd v Commonwealth Bank of Australia* 92 ATC 4658, cl 11 was void under s 261 of the Act. The parties also accepted that "interest" in s 128A bore its ordinary meaning, namely the return, consideration or compensation for the use or retention by one person of a sum of money belonging to, or owed to another, and that interest must be referable to a principal sum.

### ISSUE

Were the additional amounts that were payable under cl 11 of the agreement "interest" or "in the nature of interest"?

### DECISION

**Full Federal Court: Spender, Kiefel and Finn JJ.**

1. The additional amounts that were payable under cl 11 of the agreement were not "interest" or "in the nature of interest", but were an indemnity against BNI's liability for income tax.
2. The additional amounts did not have the character of a return or profit to the lender for the use of money advanced to the borrower. They were not calculated by reference to the principal sum advanced and were not in the nature of an additional return or profit to BNI on the money advanced over and above the interest calculated and charged. The purpose for the "gross up" was to ensure the effective rate of interest earned by BNI was not reduced.
3. Per Spender Kiefel and Finn JJ:

"The submission on behalf of the Commissioner is that the extension intended by the phrase 'an amount in the nature of interest' was the inclusion of payments which, 'though not strictly interest', are properly to be regarded as part of the cost to the borrower, which the lender extracts as the price of the borrowing.

The conclusion of the learned primary judge on this aspect of the matter was as follows [97 ATC at 4315]:

'Clause 11 is not concerned with any additional liability to pay interest over and above the obligation contained in clause 5. Rather, clause 11 seeks to make the applicant as between it and BNI responsible for the payment in Australia of BNI's liability for

- (b) Per Fullagar J: The payments were of an income nature as they were a "substitute" for wages that the taxpayer would otherwise have received:

"It seems to me that the [taxpayer's] receipts from MacDonald, Hamilton & Co must be regarded as having the character of income. They were regular periodic payments — a matter which has been regarded in the cases as having some importance in determining whether particular receipts possess the character of income or capital in the hands of the recipient . . . What is, to my mind, decisive is that the expressed object and the actual effect of the payments made was to make an addition to the earnings, the undoubted income, of the respondent. What the employing firm decided to do, and what it really did, in relation to the [taxpayer] and others in the same position, was 'to make up the difference between their present rate of wages and the amount they will receive'. What is paid is not salary or remuneration, and it is not paid in respect of or in relation to any employment of the recipient. But it is intended to be, and is in fact, a substitute for — the equivalent *pro tanto* of — the salary or wages which would have been earned and paid if the enlistment had not taken place. As such, it must be income, even though it is paid voluntarily and there is not even a moral obligation to continue making the payments. It acquires the character of that for which it is substituted and that to which it is added." (CLR pp 567–568)

2. Per Dixon CJ, Williams, Fullagar, McTiernan and Webb JJ: The payments were not assessable under s 26(e) as they were not granted to the taxpayer in relation directly or indirectly to any employment or services rendered by him:

- (a) Per Dixon CJ and Williams J:

"There can, of course, be no doubt that the sum of £104 represented an allowance, gratuity or benefit allowed or given to the taxpayer by MacDonald, Hamilton & Co. Our difficulty is in agreeing with the view that it was allowed or given to him in respect of or in relation, directly or indirectly, to any employment of or, services rendered by him. It is hardly necessary to say that the words 'directly or indirectly' extend the operation of the words 'in relation . . . to'. In spite of their adverbial form they mean that a direct relation or an indirect relation to the employment or services shall suffice. A direct relation may be regarded as one where the employment is the proximate cause of the payment, an indirect relation as one where the employment is a cause less proximate, or, indeed, only one contributory cause. It may be conceded also that the proviso has an effect upon the construction of par (e) of sec 26, but the effect is only to show that the allowance may be in consequence of a retirement from or termination of the office, not to show that a mere historical connection, as it may be called, is sufficient. We are not prepared to give sec 26(e) a construction which makes it unnecessary that the allowance, gratuity, compensation, benefit, bonus or premium shall in any sense be a recompense or

consequence of the continued or contemporaneous existence of the relation of employer and employee or a reward for services rendered given either during the employment or at or in consequence of its termination." (CLR pp 553–554)

- (b) Per Fullagar J:

"the receipts in question are not so related to any employment of the [taxpayer] as to fall either within the terms of the definition of 'income from personal exertion' in sec 6 of the *Income Tax Assessment Act* 1936–1943 or within the terms of sec 26(e) of the Act. The moneys would not, of course, have been paid if the [taxpayer] had not been employed by MacDonald, Hamilton & Co up to the date of enlistment. But nothing that he had done in his employment by MacDonald, Hamilton & Co, or might thereafter do if he re-entered their employment, provided the occasion of the payments. The payments were made irrespective of any services given by an employee as employee. The same bounty was available to one who had served for one month or for ten years . . . The fact of the [taxpayer's] employment explains the selection of him as a recipient, but it in no degree characterizes the payment. The payment does not partake in any degree of the character of a reward for services rendered or to be rendered." (CLR pp 563–564)

## ¶170 DONOVAN V DFC OF T

92 ATC 4114

### FACTS & ARGUMENTS

The applicant had been charged in respect of various breaches of the *Cash Transaction Reports Act 1988* (Cth), including opening bank accounts and conducting dealings under false names. The trial for these charges was pending in the District Court of Western Australia and the applicant intended to plead not guilty to the charges and maintain her right to silence.

Concurrently to these matters, taxation officers were investigating the affairs of a company that had employed the applicant. The Deputy Commissioner issued a notice to the applicant under s 264 of the *Income Tax Assessment Act* 1936 (Cth) requiring her to attend an interview and give evidence on oath relating to the company.

During the interview, the applicant refused to answer 19 questions that were put to her, on the basis that they related to her pending criminal proceedings and that her answers might incriminate her. The taxation officers provided the applicant with a written undertaking that the Deputy Commissioner and his delegates would not, without seven days' notice in writing, directly or indirectly:

- "(a) disclose to any authorised law enforcement agency officer . . . any information, evidence, book, document or other paper furnished, given or produced by the applicant . . .

to the taxpayer for the hiring services it provided under the hiring contracts. These factors pointed so clearly to the revenue character of the payments that the mere fact that the payments were compensation in respect of capital items could not deprive the profits of their income character.

3. Per Beaumont J: It could not be said that the payments received were for the disposal of the scaffolding to the customer, since the scaffolding had been lost by the time the compensation clause was enforced. Rather, the amounts received under the compensation clause constituted "an additional hiring fee" and consequently "had the same revenue character as the hiring fees themselves".

## ¶228 GP INTERNATIONAL PIPECOATERS PTY LTD V FC OF T

Full Federal Court 88 ATC 4823; (1988) 19 FCR 516; Full High Court 90 ATC 4413; (1990) 170 CLR 124

### FACTS & ARGUMENTS

The taxpayer was a joint venture company which was established for the sole purpose of performing a "pipe contract" granted to it by the State Energy Commission of Western Australia. Under the pipe contract, the taxpayer was required to coat pipes which would be used to create a natural gas pipeline. The pipe contract also required the taxpayer to construct a pipe coating plant, which it would own.

Pursuant to the terms of the pipe contract, the taxpayer was paid \$4.675m by instalments in establishment costs for the construction of the pipe coating plant. The taxpayer constructed the plant for \$5.35m and claimed depreciation on the plant. On completion of the contract the plant was sold for its salvage value of \$500,000.

The Commissioner assessed the taxpayer on the \$4.675m that it received on the basis that the receipt was of an income nature and therefore assessable under s 25(1) of the *Income Tax Assessment Act 1936* (Cth). The Commissioner contended that the construction of the plant was an integral part of the pipe contract as a whole and that the progress payments which the taxpayer received under the contract were received in the ordinary course of its business.

The taxpayer contended that the amounts received for the construction of the plant were of a capital nature and therefore not assessable. According to the taxpayer the construction of the plant represented a severable part of the contract and was only "a means to an end", being the coating of pipes. The taxpayer argued that it did not intend to derive, nor in fact did it derive, profit from the construction of the plant and that, accordingly, the amounts which it received for the construction of the plant should not be regarded as being of an income nature.

### ISSUE

Were the amounts received by the taxpayer in respect of the construction of the pipe coating plant of an income or capital nature?

### DECISION

**Full Federal Court: Woodward, Northrop and French JJ.**

1. The amounts received by the taxpayer in respect of the construction of the pipe coating plant were of an income nature and were therefore properly assessable under s 25(1).

2. Per Woodward, Northrop and French JJ:

"We believe that, if a company is brought into existence for the sole purpose of performing one contract for profit, and particularly if the life of the contract is comparatively short . . . then all payments made under the contract are likely to be income rather than capital receipts in the hands of the company. The business of such a company is the performance of the contract, and the receipts are in the ordinary course of the business.

Looking at the matter broadly . . . the construction of the pipe-coating plant was simply the first stage of a continuous but strictly finite operation, for which regular payments were made under the one contract." (ATC p 4833)

**Full High Court: Brennan, Dawson, Toohey, Gaudron and McHugh JJ.**

1. The decision of the Full Federal Court should be upheld. The amount received by the taxpayer was of an income nature as it was received in the ordinary course of carrying on its business and was therefore assessable under s 25(1).

2. Per Brennan, Dawson, Toohey, Gaudron and McHugh JJ:

"To determine whether a receipt is of an income or of a capital nature, various factors may be relevant. Sometimes, the character of receipts will be revealed most clearly by their periodicity, regularity or recurrence; sometimes, by the character of a right or thing disposed of in exchange for the receipt; sometimes, by the scope of the transaction, venture or business in or by reason of which money is received and by the recipient's purpose in engaging in the transaction, venture or business. The factors relevant to the ascertainment of the character of a receipt of money are not necessarily the same as the factors relevant to the ascertainment of the character of its payment." (ATC p 4420; CLR p 138)

3. The plant establishment costs were not received in respect of a severable part of the contract. It was impossible to treat the business of the taxpayer as limited to the coating of the pipe when the construction of the pipe coating plant was an integral part of the work which the taxpayer was bound to perform. The amounts received by the taxpayer for the establishment of the

The Inspector of Taxes assessed the taxpayer on the payment under Sch E of the Income Tax Act 1952 (UK), which levied income tax on "every person having or exercising an office or employment . . . in respect of all salaries, fees, wages, perquisites or profits whatsoever therefrom". The Inspector argued that payments received from employers are profits from employment, except where the employee advances substantial consideration aside from his services, in money or money's worth. According to the Inspector, the taxpayer did not advance any consideration for the compensation payment he received. Hence, the £350 was profit received as reward for his services and nothing else.

The taxpayer argued that onus is on the Crown to prove in each case that payments received were for services arising from employment. The taxpayer argued that such onus was not discharged as the source of the £350 payment was from the housing agreement, and not any services performed by him.

### ISSUE

Was the £350 payment a profit arising from employment and therefore assessable to income tax under Sch E?

### DECISION

**House of Lords: Viscount Simonds, Lord Radcliffe, Lord Cohen, Lord Keith, Lord Denning.**

1. The £350 payment did not arise from employment and therefore was not assessable under Sch E.
2. Per Viscount Simonds and Lord Radcliffe: The question is whether, in light of the facts of each case, a payment is or is not a profit arising from employment. The onus is on the Crown to establish that the payment is a reward for the employee's services. The payment may be in reference to services performed in the past, present or future. In the present case, the wages of employees were calculated independently to any payments they may receive under the housing scheme. In fact the wages of employees who were part of the housing scheme were better than those who were not. This suggests that the payment was made for reasons other than services rendered. Questions of whether consideration was advanced by the employee, whether that consideration was sufficient or substantial, colourable or not and whether the housing agreement was "collateral" were irrelevant.
3. Per Lord Cohen: Although the employment was the *causa sine qua non* (necessary precondition) for the benefit, it was not the *causa causans* (the actual cause). It was the housing agreement that was actual the source of profit.
4. Per Lord Denning: The £350 received was not a "profit" but merely compensation received for a loss that the taxpayer incurred as a consequence of his employment. Such compensation is analogous to indemnification received for workplace injuries.

## ¶272 FC OF T V HOLMES

95 ATC 4476; (1995) 58 FCR 151

### FACTS & ARGUMENTS

The taxpayer was an employee of a shipping line (P&O) on a tug and supply vessel (the *Lady Kathleen*). The vessel responded to a mayday call from a distressed leaking oil tanker (the *Kirki*), which was stranded off the West Australian coast. By the time the *Lady Kathleen* reached the *Kirki*, its crew had been evacuated and it was drifting towards shore posing a considerable risk to both its cargo and the environment. Fortunately, due to heroic efforts by some of the *Lady Kathleen's* crew, the *Lady Kathleen* was able to tow the *Kirki* out of danger with the result that the vessel was eventually saved and its cargo salvaged.

As a result of the taxpayer's participation in the operations, he received, inter alia, a payment of \$23,381 being his entitlement to a "salvage reward" for his participation in the salvage of the vessel. No reward would have been payable if the vessel had been lost.

The Commissioner assessed the taxpayer on this payment on the basis that it either constituted income according to ordinary concepts under s 25(1), or that it fell within s 26(e) which includes in assessable income "the value to the taxpayer of all allowances, gratuities, compensations, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any . . . services rendered by him . . ."

The Administrative Appeals Tribunal held that neither s 25(1) nor 26(e) applied. The tribunal found that the taxpayer had no right or expectation of receiving any payment over his ordinary wages unless the salvage was successful and that the payment was a "windfall gain" which was paid as a result of the success of the salvage operation rather than out of the taxpayer's employment or services rendered by him.

### ISSUE

Was the payment received by the taxpayer assessable under either s 25(1) or 26(e)?

### DECISION

**Full Federal Court: Hill, Cooper and Keifel JJ.**

1. The payment received by the taxpayer was assessable under s 26(e) and it was therefore not necessary to consider whether it also constituted income according to ordinary concepts under s 25(1).
2. The payment was unrelated in any relevant sense to the taxpayer's employment. This was the case even though the taxpayer would not have had the opportunity to participate in the salvage operation had he not been an

more than one place ... and in that case he is held to reside in both places and to be chargeable with tax in this country ... more difficult questions arise when the person sought to be charged has no home or establishment in any country but lives his life in hotels or at the houses of his friends. If such a man spends the whole of the year in hotels in the United Kingdom, then he is held to reside in this country ... But probably the most difficult case is that of a wanderer who, having no home in any country, spends a part only of his time in hotels in the United Kingdom and the remaining and greater part of his time in hotels abroad. In such cases the question is one of fact and of degree, and must be determined on all the circumstances of the case ...” (AC pp 222–223)

### ¶320 FC OF T V LEWIS BERGER & SONS (AUSTRALIA) LTD

(1927) 39 CLR 468

#### FACTS & ARGUMENTS

The taxpayer carried on a business of manufacturing and dealing in paints, varnishes and similar products. Part of the taxpayer's sales were made to customers in New Zealand. The *Income Tax Assessment Act 1922* (Cth) assessed a taxpayer on income derived by the taxpayer from sources in Australia but not from sources outside Australia. The Commissioner apportioned the annual income of the taxpayer between Australian and New Zealand sources by applying a formula in which the New Zealand income was calculated as follows:

- The portion of profit on New Zealand sales was calculated by dividing the New Zealand sales by the total sales and multiplying this amount by the total net profit for the year.
- The portion of profit on the New Zealand sales attributable to New Zealand sources was calculated as expenditure in New Zealand, divided by total expenditure, multiplied by the New Zealand sales profit.

The Board of Review rejected this formula and instead apportioned the profit derived by the taxpayer equally between Australian and New Zealand sources.

The Commissioner appealed, contending that the board had made an error in law in the way in which it apportioned the source of the taxpayer's income.

The taxpayer argued that the Commissioner was not able to appeal to the High Court in respect of the method of apportionment used by the Board of Review, on the basis that appeals to the High Court from the board were only available concerning questions of law and that no appeal was available in this case as the apportionment of the source of income was a question of fact.

#### ISSUE

Did the basis of apportionment adopted by the Board of Review concern a question of law?

#### DECISION

##### High Court: Starke J.

- The basis of apportionment adopted by the Board of Review did not concern a question of law and consequently no appeal was available.
- Apportionment depends on business judgment and experience, applied to the facts of the particular case, the nature of the business, and the mode in which it was actually carried on. No fixed or rigid formulae can or should be applied.

### ¶321 LIEDIG V FC OF T

94 ATC 4269; (1994) 50 FCR 461

#### FACTS & ARGUMENTS

The taxpayer's parents-in-law had conducted a land broking business in South Australia. They sold the business to the taxpayer for \$130,000. However, \$65,000 of this amount was forgiven after the taxpayer orally agreed that he would acquire the business as trustee and thereafter hold the assets and income from it for the benefit of himself and his wife equally.

In his returns for the 1986 to 1990 income years, the taxpayer claimed deductions of between approximately \$19,000 and \$25,000 for wages paid to his wife. However, the Commissioner denied these deductions. The taxpayer objected, arguing that the amounts claimed were not income derived beneficially by him but represented income derived by him as a trustee and assessable to his wife.

The tribunal found that the taxpayer operated the land broking business as a sole trader, that the taxpayer's wife made no contribution to the running of the business, and that the income from the business was generated from the taxpayer's personal exertion. The tribunal held that, for tax purposes, the taxpayer's personal exertion income remained his income (being earnings derived by him as a land broker) and that a trust whether express, implied or constructive, could not be used to divert the income to his wife. According to the tribunal, it followed that such income could not constitute trust income not subject to tax in the hands of the trustee in reliance on s 96 of the Act, which provided that: "Except as provided in this Act, a trustee shall not be liable as trustee to pay income tax upon the income of the trust estate."

#### ISSUE

Was there a principle of tax law that a person acting in the capacity of trustee and carrying on a business involving the performance of personal services must derive the income beneficially?

#### DECISION

##### Federal Court: Hill J.

- There is no general law doctrine that in no case can income, which is personal service income, be derived by a person as trustee in such a way as to exonerate that person from a personal liability to tax arising under the Act outside Div 6:

2. The central management and control of the taxpayer resided in Australia with Mr Sleigh, since he exercised complete management and control over the business operations and internal administration of the taxpayer from Australia. This in turn meant that the taxpayer was also carrying on business in Australia, since a company carries on its real business where its central management and control abide. Accordingly, that part of the definition of resident in s 6(1) which deemed a company to be a resident if it carried on business in Australia and had its central management and control in Australia was satisfied and it was irrelevant whether the other business operations involving the charter party contracts were carried on inside or outside Australia. Once it was found that a company had its central management and control in Australia, that was sufficient in itself to constitute it a resident of Australia.

3. Mr Sleigh's activity in relation to the charter party operations amounted to the taxpayer carrying on business in Australia. The question of where a business is carried on by a company is in every case one of fact. The question is "where do the operations take place from which the profits in substance arise?" Here, the essence of the taxpayer's business operations was the decision in Melbourne of Mr Sleigh to charter and sub-charter the tanker. This decision in every substantial sense gave rise to the profits which the taxpayer made out of the subcharters. Forwarding of contracts to Singapore for execution was a mere formality. Further, Mr Sleigh's shareholding gave him control of the voting power of the taxpayer. Accordingly, that part of the definition in s 6(1) which deemed a company to be resident if it was carrying on business in Australia and had its voting power controlled by resident shareholders was also satisfied.

4. The relationship between the "central management control" test and the "voting power control" test can be explained as follows:

"if the business of the company carried on in Australia consists of or includes its central management and control, then the company is carrying on business in Australia and its central management and control is in Australia. If, on the other hand, a company incorporated elsewhere is merely trading in Australia and its central management and control is abroad, it does not become a resident of Australia unless its voting power is controlled by shareholders who are residents of Australia . . ." (CLR p 159)

## ¶352 MANSFIELD V FC OF T

96 ATC 4001

### FACTS & ARGUMENTS

The taxpayer was a flight attendant with Australian Airlines. In the year of income ending 30 June 1990, she claimed deductions under s 51(1) of the *Income Tax Assessment Act 1936* (Cth) totalling \$1,215 in respect of the following items:

¶352

*Moisturisers:* The taxpayer claimed a deduction of \$469 for expenditure on moisturisers which were said to be used by her to combat the dehydration effects caused by her continual work in pressurised aircraft. During the year she also incurred expenditure on other makeup products but did not claim a deduction for that expenditure.

*Hairdressing:* The taxpayer claimed a deduction of \$434 for hairdressing expenditure. She gave evidence that she attended a hairdresser approximately every fortnight to have a good quality conditioner applied to her hair; that she needed to wash her hair and apply moisturising substances to it every night preceding a flight; that she also was required to apply hair spray approximately four times a day because the hat she wore as part of her uniform flattened her hair; and that it was essential that she had clean hair and a hair style that conformed to airline regulations given her continual handling of food.

*Shoes:* The taxpayer claimed a deduction of \$180 in respect of the purchase of shoes (including two pairs of cabin shoes) which conformed with her airline's colour and style standards. The taxpayer only used the shoes when in uniform (the cabin shoes were worn only inside aeroplanes). Evidence also indicated that her continual walking and standing required good comfortable shoes; that due to the effects of cabin pressure her cabin shoes were required to be a half size larger than those acquired for ordinary use; and that her shoes suffered from regular scuffing arising out of her duties.

*Pantyhose:* Australian Airlines required flight attendants to wear unladdered grey or blue pantyhose while in uniform. The taxpayer claimed a deduction of \$132 for purchasing such hosiery during the year. She gave evidence that she only wore the pantyhose when working and that due to both the confined space of aircraft and passengers' negligence frequent laddering occurred.

For the relevant year of income, the taxpayer received an allowance of \$1,019 from her employer under the Flight Attendant's Award in relation to the above items.

The Commissioner assessed the taxpayer in respect of the full amount of the allowance but denied her a deduction for any of the above expenditure. In particular, the Commissioner referred to the Full Federal Court decision in *FC of T v Edwards* 94 ATC 4255 in which a deduction for the cost of "additional" clothing over and above that necessary for the relevant taxpayer's personal requirements of "modesty, decency and warmth" was allowed. According to the Commissioner, the taxpayer's expenditure on shoes and stockings should not be deductible as such items were necessary for her modesty, decency and warmth.

### ISSUE

Was the taxpayer entitled to deductions under s 51(1) in respect of the above items?

2. Per Dixon CJ, McTiernan, Windeyer, Menzies and Owen JJ: The assignment was also not effective to alienate the dividend income from the taxpayer because:

- (a) Per Windeyer, McTiernan, Menzies and Owen JJ: A future dividend is a mere expectancy and does not constitute an existing chose in action.
- (b) Per Dixon CJ: It is not possible for a shareholder to assign a future undeclared dividend without also transferring the shares.

## ¶397 NORTH AUSTRALIAN PASTORAL COMPANY LTD V FC OF T

(1946) 71 CLR 623

### FACTS & ARGUMENTS

The taxpayer was incorporated in the Northern Territory and conducted a cattle station business at Alexandria, where it had its registered office. The taxpayer established a branch office in Brisbane, since five of its seven directors resided there. It was in Brisbane, for two of the four years of income in question, that all meetings of the directors and shareholders were held, where the secretary resided and kept the common seal and share register and where the chief bank account of the company was operated. The books of account were kept at Alexandria, but duplicate accounts were maintained at the Brisbane office. The managing director of the company initially resided in Brisbane, while the management of the station was under the control of a manager who resided at Alexandria. Later, the station manager was made managing director of the taxpayer and a new secretary, who resided at Alexandria, was appointed.

The taxpayer's business transacted in Brisbane consisted of purchases of plant and stock, effecting insurance, meeting government authorities regarding lease renewals, affixing the seal to documents, approving share transfers, administering the bank overdraft, appointing a secretary and recommending dividends. The more important decisions concerning management of the station rested primarily with the manager, but the directors made some visits to Alexandria and decisions of policy were arrived at with the manager at the station.

The Commissioner assessed the taxpayer under the *Income Tax Assessment Act 1936* (Cth) on the income which it derived from its business.

The taxpayer contended that it was a resident of the Northern Territory and that its income was derived from primary production in the territory. On this basis, the taxpayer contended that s 23(m) of the Act, which provided an exemption to territory residents in respect of income derived from primary production in the territory, operated to exempt the taxpayer from tax on the income which it derived from its business.

The Commissioner argued that, by reason of the company having its branch office in Queensland at which board meetings were held and company seals and documents were kept, the company had become a resident of Queensland

and was not therefore a resident of the Northern Territory and consequently not entitled to the exemption under s 23(m).

### ISSUE

Was the taxpayer a resident of the Northern Territory throughout the relevant period?

### DECISION

#### High Court: Dixon J.

1. The taxpayer was a resident of the Northern Territory throughout the relevant period even though, for part of the period, it was also a resident of Queensland. The taxpayer's income from primary production in the Northern Territory was therefore exempt from tax under s 23(m).

2. The basic principle is that a company resides where its real business is carried on and it is for the purpose of determining where that is that the subsidiary principle is invoked that the place where the superior direction and control is exercised determines where the real business is carried on. This is a question of fact and degree and the place of incorporation and the registered office are not decisive or conclusive.

3. A company can be a resident of more than one country or territory:

"... I am quite prepared to concede that during the earlier two years of the period in question the use made of the branch office in Brisbane as a place of meeting for directors and shareholders and for the administration of the company and for the exertions of higher directing authority would suffice to give the company a residence in Queensland. But I think that this does not exclude the possibility of the company being a resident of the Northern Territory during those two years as well as in the later two years." (CLR p 633)

4. The facts of the case lead to the conclusion that the taxpayer was a resident of the Northern Territory during the whole period notwithstanding that it may also have been a resident of Queensland for part of the period. Factors supporting this conclusion that it was a resident of the territory included the fact that its whole undertaking, incorporation, registered office, public office and full books of account were located there; the fact that the directors met in Brisbane only as a matter of convenience rather than to further company affairs; and the fact that the manager at Alexandria took responsibility for the success or failure of the venture. Also of importance was that the directors made visits to the station and the visits of directors to the station were acknowledged to be of importance in reaching policy decisions after consultation with the manager and viewing the place of business.

"These visits meant the occasional exercise of the superior controlling authority where the business was carried on... There has not been a case so far in which, although the place where the substantial business of the company is carried on is the same as that of its incorporation and its formal life, the company has been held not to reside there." (CLR pp 633-634)

## (a) Per Finn J:

"It is well accepted that if a person prepares and then makes a documentary communication to a legal adviser for the dominant purpose of obtaining legal advice, that documentary communication attracts legal professional privilege: *Esso Australia Resources Ltd v FC of T* 2000 ATC 4042; (1999) 201 CLR 49. It is equally well accepted that if a person directs or authorises a third party ('an agent') to prepare and then make a documentary communication on that person's behalf to a legal adviser for the dominant purpose of obtaining legal advice, that documentary communication by the agent attracts legal professional privilege: *Australian Rugby Union Ltd v Hospitality Group Pty Ltd* (1999) 165 ALR 253. But it is not accepted that, if a person ('a principal') directs or authorises a third party who is not an employee of that person to prepare a documentary communication for the dominant purpose of its being communicated by the principal and not directly by the third party to a legal adviser for the purpose of obtaining legal advice, that documentary communication from the third party to the principal attracts legal professional privilege.

This last conclusion, which was acted upon by the primary judge ... is said to reflect the inexorable logic of decided case law. Her Honour, nonetheless, had some concern about the consequence of it, noting that ...

'... too much may turn on whether a written communication is prepared by a corporation internally, or externally by a third party, notwithstanding that the communication in either case is for the dominant purpose of obtaining legal advice and may contain the same information.'

To hold to such an apparently arbitrary distinction becomes the more arresting now that legal professional privilege has been recognised in this country as not merely a rule of substantive law. 'It is ... an important common law immunity': *The Daniels Corporation International Pty Ltd v Australian Competition and Consumer Commission* ... The principal question in these appeals is whether we are, nonetheless, obliged to accept the distinction so drawn with its inevitable and obvious triumph of form over substance. I consider we are not. I would add that this country's legal development in this area of law has been such, in my view, as to induce caution in embracing authorities from other common law jurisdictions and, most notably, from England and New Zealand." (ATC p 4527)

"The primary principle, stated by *Barwick* CJ in *Grant v Downs* (1976) 135 CLR 674 at 677 (in what was then a dissenting view on the issue of sole vs dominant purpose), is that:

'... a document which was produced or brought into existence either with the dominant purpose of its author, or of the person or authority under whose direction, whether particular or general,

it was produced or brought into existence, of using it or its contents in order to obtain legal advice or to conduct or aid in the conduct of litigation, at the time of its production in reasonable prospect, should be privileged and excluded from inspection.' (emphasis added)

I have quoted this statement rather than one of the many others in High Court decisions which emphasise that the question for the court is whether the dominant purpose of supplying a document to a legal adviser accounts for the existence of that document, for the following reason. As the matter emphasised in the quotation indicates, the person who brings the relevant document into existence need not necessarily be the person who 'communicates' the document to the legal adviser ...

Because of the interpretation given to *Barwick* CJ's statement of principle by recent English authority ... it is necessary that I express the following views on it. The setting for *Grant v Downs* involved a claim for litigation privilege. This notwithstanding, neither *Barwick* CJ's statement, nor for that matter that of the majority judgment (at 682), differentiated in any operative way between advice privilege and litigation privilege for the purpose of resolving the actual issue before the Court which related to the purpose ('sole' or 'dominant') necessary to attract privilege. Rather the principle formulated by *Barwick* CJ was intended to be declaratory of the law for the future; was stated compendiously; and had equal application to both manifestations of the privilege. Such formulations are now the commonplace in this country irrespective of whether the actual issue in a given case has involved advice privilege or litigation privilege ... Further, I consider that the Chief Justice's related comments on what for convenience I will call the 'lack of identity principle' in relation to the authorship of a documentary communication were likewise intended to have common application to both manifestations of the privilege. There is, with respect, nothing to suggest that they were intended to be confined to cases of litigation privilege. Nor, as I will indicate below, is there any reason in principle or authority why they should be so confined in this country." (ATC pp 4528-4529)

## (b) Per Stone J:

"The coherent rationale for legal professional privilege developed by the High Court does not lend itself to artificial distinction between situations where that expert assistance is provided by an agent or alter ego of the client and where it is provided by a third party. Nor, in my view, should the availability of privilege depend on whether the expert opinion is delivered to the lawyer directly by the expert or by the client. Provided that the dominant purpose requirement is met I see no reason why privilege should not extend to the communication by the expert to the client. This approach is consistent with the High

consideration. See, eg, *McDermott v Black* (1940) 63 CLR 161. It is the releasor's entry into the deed or agreement that extinguishes the claim or demand. See *Bowes v Foster* (1858) 2 H & N 779 at 782: 157 ER 322 at 323. Again, such a release could not be entered into without voluntary action upon the part of the releasor.

The obligation of the judgment debtor to pay the judgment sum is extinguished by the act of payment. The extinguishment or release does not depend upon any action on the part of the judgment creditor. As White J said in *Interchase* at par 54 [at 4554]:

'A taxable supply is made if the supply is made for consideration (s 9-5(a)). Consideration includes matters done pursuant to orders of a court (s 9-15(2A)(a)) but that does not of itself constitute a supply. The receipt of payment by a judgment creditor does not obviously involve the creation, grant, transfer, assignment or surrender of any right or the entry or release from an obligation (s 9-10(2)(e)(f)). When the judgment is satisfied the debt created by the judgment is thereby extinguished and does not depend on the surrender of any rights or the release of the judgment debtor.'

It is true that in some circumstances, a release occurs by operation of law. For example, the discharge of a bankrupt operates as a release from all his debts subject to certain exceptions. However, the Act, s 9-5 opens with the words, 'You make a taxable supply if...' The verb 'make' indicates a legislative intention to impose the tax only on voluntary supplies, not upon those supplies that occur without an act of the releasor. The editors of *GST in Practice — Transactions & Precedents* at pars 10-680 and 57-610, question whether a compulsory acquisition of land is a supply within the meaning of the Act, s 9-10. Reference is made to *FC of T v St Hubert's Island Pty Ltd (in liq)* 78 ATC 4104, (1978) 138 CLR 210 in which case it was held that a sale of land by the liquidator was a voluntary disposition and fell within the scope of the *Income Tax Assessment Act 1936* (Cth), s 36, notwithstanding an obligation imposed on the liquidator by the relevant Companies Act to make the sale. Accordingly, the editors question whether the same reasoning might be applied to compulsory acquisitions and the Act. It seems to me that different considerations arise when considering the meaning of 'supply' in the Act. Notwithstanding the statutory compulsion, the liquidator's disposition in *St Hubert's Island Pty Ltd (in liq)* was something that was 'made' by him and for that reason would be likely to be considered a supply within the meaning of the Act. This is quite a different situation from the matter at hand, for the release of the obligation to pay a judgment sum by the payment of that sum will occur regardless of whether the judgment creditor makes or does any act at all. It was held in *Databank Systems Ltd v Commissioner of Inland Revenue (NZ)* (1987) 9 NZTC 6213 that 'supply' means 'to furnish or provide'. Application of that proposition to the word 'supply' as enacted in the Act, s 9-10

reinforces the concept that there is a legislative intention not to include in the word 'supply' the release of an obligation that occurs independently of the act of the releasor.

For those reasons I am not persuaded that upon the defendants making payment of the judgment sum the plaintiff will make a supply within the meaning of the Act, s 9-10 and consequently be liable to pay GST. Further, I am unpersuaded that there is a substantial risk that that will be the case." (ATC pp 4057-4058)

## ¶488 DFC OF T V SHEEHAN

86 ATC 4718

### FACTS & ARGUMENTS

The Deputy Commissioner of Taxation had instituted proceedings against the taxpayer seeking to recover various amounts of income tax (including provisional tax) as well as additional tax for late payment under s 207 and penalty tax under s 226 of the *Income Tax Assessment Act 1936* (Cth) relating to the 1977 to 1980 income years. He produced what purported to be certified extracts from notices of assessments for the relevant years and relied on s 177 of the *Income Tax Assessment Act* to argue that this constituted conclusive evidence of the due making of the assessments and (except in appeal proceedings) that the particulars of the assessments were correct.

The taxpayer challenged the recovery proceedings on a number of grounds. First he argued that the original 1978 notice of assessment did not, in truth, constitute an actual assessment and was therefore not protected by s 177 and open to challenge in the recovery proceedings.

The circumstances surrounding the 1978 assessment were as follows. The taxpayer had, in responding to a 14-day notice to furnish a return for the 1978 year, lodged a return in November 1978 disclosing a loss of \$245,046. The return contained a note stating that it had been prepared on an estimated basis to comply with the notice and that an amended return would be lodged when all necessary information regarding partnerships in which the taxpayer was a partner had been received. Subsequently, in January 1979, the taxpayer lodged a second return disclosing a loss of \$219,854.

In May 1989, the Commissioner issued what purported to be a notice of assessment for the 1978 year. It was accompanied by an adjustment sheet which referred to the loss detailed in the first return of \$245,046 but then added a series of figures by way of adjustment of losses claimed for three specified partnerships and, in addition, disallowed a claimed loss from the partnership of Norman Sheehan & Associates. The figures added back amounted to \$350,892 producing a taxable income of \$105,846. The adjustment sheet also contained the following handwritten note: "N.B. You are advised that the assessment will be reviewed upon confirmation of partnership losses". Dispatched together with the notice of assessment were three questionnaires seeking information from the taxpayer in relation to the three partnerships in respect of which the losses had been adjusted.

## ¶526 STERLING GUARDIAN PTY LTD V FC OF T

2006 ATC 4227

### FACTS & ARGUMENTS

The taxpayer was the representative member of a "GST group". One of the members of the group was a trust (Forest Lodge No. 4 Unit Trust) which carried on a property development enterprise. In March 2000 (prior to the introduction of GST in Australia), the trust settled the purchase of land in Camperdown for \$4m. It subsequently constructed a residential stratum unit development on the property for nearly \$30m. The trust received tax invoices for its construction costs totalling \$26.4m (inclusive of GST) and the taxpayer as representative member of the GST group claimed input tax credits of not less than \$2.4m.

Under the *A New Tax System (Goods and Services Tax) Act 1999* (Cth), the amount of GST payable on a taxable supply is generally 1/11th of the (GST inclusive) consideration for the supply (s 9-70 and s 9-75). However, Div 75 of the Act permits a taxpayer to use the "margin scheme" as an alternative method for calculating GST. Under the margin scheme, the GST is calculated as 1/11th of the "margin" for the supply. The relevant sections in Div 75, as enacted at the time, provided as follows:

#### "75-5 Choosing to apply the margin scheme

- (1) If you make a \*taxable supply of \*real property by:
  - (a) selling a freehold interest in land; or
  - (b) selling a \*stratum unit; or
  - (c) granting or selling a \*long-term lease;
 

you may choose to apply the \*margin scheme in working out the amount of GST on the supply.
- (2) However, you cannot choose to apply the \*margin scheme if you acquired the freehold interest, \*stratum unit or \*long-term lease through a \*taxable supply on which the GST was worked out without applying the margin scheme.

#### 75-10 The amount of GST on taxable supplies

- (1) If a \*taxable supply of \*real property is under the \*margin scheme, the amount of GST on the supply is 1/11 of the \*margin for the supply.
- (2) The *margin* for the supply is the amount by which the \*consideration for the supply exceeds the consideration for your acquisition of the interest, unit or lease in question.

...

#### 75-15 Subdivided land

For the purposes of section 75-10, if the freehold interest, \*stratum unit or \*long-term lease you supply relates only to part of land or premises that you acquired, the \*consideration for your acquisition of that part is the corresponding proportion of the consideration for the land or premises that you acquired."

Between 1 April and 30 September 2002 taxable supplies totalling \$32.7m were made of the residential stratum units and the "margin scheme" was used to calculate the GST payable on these supplies by the taxpayer. The taxpayer claimed that in calculating the margin for the supplies, it was entitled to include the costs of bringing the units into existence. The Commissioner, however, assessed the taxpayer on the basis that only the land costs should be included in the "margin". In other words, the Commissioner contended that the consideration for the acquisition of the units should not include non-land costs such as construction costs.

The Federal Court ruled in favour of the Commissioner. Stone J held that the taxpayer was liable to GST on the difference between the cost of the land and the amount received on sale of the units. Her Honour said the explanation given in the explanatory memorandum, in combination with s 75-15, made it abundantly clear not only that GST was only payable on value added after the GST commenced on 1 July 2000, but also that the cost of improvements to the property made since that date could not be taken into account when calculating the original purchase price.

### ISSUE

Did the "consideration for (the taxpayer's) acquisition" of the units under s 75-10(2) only include the land costs of \$4m or did it also include the construction costs?

### DECISION

#### *Full Federal Court: Heerey, Dowsett and Conti JJ.*

1. The "consideration for (the taxpayer's) acquisition" of the units under s 75-10(2) only included the land costs.
2. Per Heerey, Dowsett and Conti JJ:

"The burden of GST is progressively passed down the chain of persons who make taxable supplies as for example, in the case of goods, from manufacturer to wholesaler to retailer. At each transaction the price includes GST, which the supplier pays to the Commissioner. The acquirer gets an input tax credit for the amount of GST included in the price which he has paid and includes GST in the price he charges the next person in the chain. Finally, the ultimate consumer pays a price which includes the GST paid by the previous person in the chain (in this example, the retailer). The ultimate consumer does not get any input tax credit because he is not registered or required to be registered.

In economic terms it may be correct to call the GST a consumption tax, because the effective burden falls on the ultimate consumer. But as a matter of legal analysis what is taxed, that is to say what generates the tax liability (and the obligations of recording and reporting), is not consumption but a particular form of transaction, namely supply; see generally *H P Mercantile Pty Ltd v Commissioner of Taxation* (2005) 143 FCR 553 at [10]–[15].

2. The interest paid in respect of the loan was not deductible under s 51(1) as it was an outgoing of either a capital or private or domestic nature. Although one of the three rooms of the extension was to be used by the taxpayer as his study, the loan should not be regarded as having been applied to provide the taxpayer with business premises.

3. The taxpayer was entitled to claim deductions in respect of his primary production activities and to the benefit of the income averaging provisions in Div 16 as the taxpayer was not merely involved in a recreation or hobby but, rather, was involved in the business of primary production.

"[The taxpayer] in planting the avocado pear trees and the macadamia nut trees set out to grow them on a scale that was much greater than was required to satisfy his own domestic needs and he expected upon reasonable grounds that their produce would have a ready market and would yield, if the trees became established, a financial return which would be of a significant amount, with a relatively small outlay of time and money, and that this return would continue for a very long time. In these circumstances, I think it is proper to find ... that he set out to engage in producing the pears and the nuts as a business ..." (ATC pp 4099-4100)

4. The decisions in *Ronpibon Tin NL v FC of T* (1949) 78 CLR 47, *John Fairfax and Sons Pty Ltd v FC of T* (1959) 101 CLR 30 and *FC of T v Finn* (1961) 106 CLR 60 are authority for justifying that losses and outgoings may be allowable deductions under s 51(1) although they are incurred in a year in which no assessable income is actually gained or produced by the activities in relation to which the losses or outgoings are incurred.

## ¶547 THORPE NOMINEES PTY LTD V FC OF T

88 ATC 4886

### FACTS & ARGUMENTS

The taxpayer was incorporated in Australia to act as trustee of a trust established as part of a tax minimisation plan. The plan concerned the sale of Australian land owned by Collaroy Holdings Pty Ltd (Collaroy) and also involved two other companies (Vaucraft and Nawor). All the parties were controlled by Mr and Mrs Thorpe. Pursuant to the plan, Collaroy granted the taxpayer or its nominee options to purchase its land for \$189,000. Some time later, Vaucraft replaced the taxpayer as trustee. An offer to purchase for \$410,000 "the right to be nominated as the person to exercise the options" was made in Switzerland by Nawor and accepted through Vaucraft's Swiss attorney. Later in Australia, the options were exercised by Nawor and agreements for the sale of the land were executed by Collaroy. Vaucraft subsequently received the \$410,000.

The Commissioner assessed the taxpayer (which had since been reinstated as trustee of the trust) under former s 99 of the *Income Tax Assessment Act 1936* (Cth) on the \$410,000 it received from Nawor on the basis that this amount represented net income of the trust estate to which no beneficiary was presently entitled. Based on the decision in *Union Fidelity Trustee Co of*

*Australia Ltd & Anor v FC of T* 69 ATC 4084, former s 95 only included Australian source income in the net income of a trust estate. According to the Commissioner the source of income was a matter of fact, the question being what a practical person would regard as its real source. On this basis the Commissioner argued the income received by the taxpayer had an Australian source as Switzerland was "merely the stage where the actors played out their parts following the script written in Sydney". It was contended that the plan of action, pursuant to which the transactions were carried out, was designed in Australia, that the real subject of the nomination rights was the ability to purchase land in Australia and that no real decisions were made in Switzerland. Alternatively, the Commissioner contended that s 260 applied to avoid the arrangements to the extent that they avoided income tax.

The taxpayer argued that it was the "proximate", not the "ultimate" source of income which was determinative. According to the taxpayer, the \$410,000 was sourced in Switzerland as the contract of sale of the nomination rights was executed and completed there. The taxpayer contended that although the value of these rights was referable to land in Australia, that was too remote to deduce that the profit came from an Australian source and that the element of planning which had led to the apparent derivation of income from Switzerland was irrelevant.

The Board of Review held that the amounts received by the taxpayer had an Australian source. The taxpayer appealed to the New South Wales Supreme Court which held that it had jurisdiction to hear the appeal on the basis that it involved a question of law. On subsequent appeal before the Full Federal Court, the Commissioner also argued that the board's decision involved only questions of fact and not law and that accordingly the Supreme Court had no jurisdiction to hear the appeal.

### ISSUES

What was the source of the amounts received by the taxpayer and did the decision of the Board of Review involve a question of law?

### DECISION

#### **Full Federal Court: Lockhart, Sheppard and Burchett JJ.**

1. Per Lockhart, Sheppard and Burchett JJ: The source of the amounts received by the taxpayer in respect of the nomination rights was within Australia. The taxpayer was therefore properly assessed under s 99.

2. Per Lockhart, Sheppard and Burchett JJ: The meaning of the source of income is best described by the Full High Court in *Nathan v FC of T* (1918) 25 CLR 183 where it was stated at pp 189-190 that: "The Legislature in using the word 'source' meant, not a legal concept, but something which a practical hard man would regard as a real source of income. Legal concepts must, of course, enter into the question when we have to consider to whom a given source belongs. But the ascertainment of the actual source of a given income is a practical, hard matter of fact."

paid up for the share". The Commissioner contended that the sum assessed was a dividend as it was received "over and above" the paid-up amount of the shares and should be treated as a distribution of the profits of the company.

The taxpayer contended that the total sum received on the reduction of capital was a capital sum and was not capable of dissection.

### ISSUE

Did the sum of £30,044, being the excess returned on the cancellation of the shares above the paid-up value of the shares, constitute an assessable dividend under s 44(1)?

### DECISION

#### **Full High Court: Kitto, Taylor and Menzies JJ.**

1. Per Taylor and Menzies JJ (Kitto J dissenting): The sum of £30,044, being the excess returned on the cancellation of the shares above the paid-up value of the shares, did not constitute an assessable dividend under s 44(1).

2. Even if only £2,244 of the £32,288 received by the taxpayer upon the cancellation of his shares represented a "return of paid-up capital" and the balance £30,044 constituted a "dividend", in order for the balance to be assessable under s 44(1) that "dividend" must be a dividend paid out of the profits derived by the company and in this case the distribution was not a distribution paid out of the profits derived by the company. Per Taylor J:

"it is impossible to say that this amount was paid out of profits derived by the company. It was ... received in partial distribution of a mass of assets which, although in a colloquial sense they contained profits, was a distribution of capital. The point which [*FC of T v Blakely* (1951) 82 CLR 388] made was that, although, in the case of a distribution by a liquidator, sec 47 carried the matter as far as deeming such distributions to a limited extent to be dividends *paid out of profits derived by the company*, in the case of distributions of the character now under consideration, no provision of the Act takes this final and essential step." (CLR p 642)

3. The whole of the sum received by the taxpayer constituted a "return of paid-up capital" and as a consequence neither the whole nor any part of that sum constituted a "dividend" within the s 6(1) meaning of that word. Per Menzies J:

"When in the course of a confirmed reduction of capital a taxpayer receives from a company in which he is a shareholder money or assets *in specie* for the payment off of capital paid up upon his shares, no part of what he so receives is a dividend for the purposes of the [Act]. Such a distribution is not a dividend or other distribution of income according to the principles of company law and I regard the express exclusion of 'a return of paid-up capital' from the definition of 'dividend' in sec 6 of the Act as an adoption of the company law principle for the purpose of income tax." (CLR p 643)

## ¶568 VABU PTY LTD V FC OF T

96 ATC 4898

### FACTS & ARGUMENTS

The appellant company engaged couriers to collect and deliver parcels and items for the purpose of carrying on its courier business. The couriers used a variety of vehicles including bicycles, motorcycles and motor cars which they supplied themselves and in respect of which they bore the running costs. The company provided telephones and required the couriers to be neat and tidy, to wear uniforms provided by the company, to replace their vehicles when the company considered them unsatisfactory, to observe a starting time, to work a set number of hours and not to use foul language. In addition, the company required couriers to accept work allocated to them, deliver goods in the manner which it directed, accept re-routing if told to by the company and take no more leave than the company permitted.

Couriers who used bicycles received a flag fall payment for each contract of carriage undertaken while couriers who used other vehicles received a flag fall payment plus a running rate per kilometre. When paying the couriers, the company treated the couriers as independent contractors rather than employees to which the PAYE system applied by deducting 20% from the gross payments to the couriers pursuant to the prescribed payments system. This treatment of the payments made to the couriers was never disputed by the Commissioner. The company also permitted the couriers to be paid under a business or corporate name if they so wished.

The company sought a declaration that it was not an employer for the purposes of the superannuation guarantee scheme provided for under the *Superannuation Guarantee Charge Act 1992* (Cth) and the *Superannuation Guarantee (Administration) Act 1992* (Cth) (SGAA). The superannuation guarantee scheme prescribes a minimum level of superannuation support required to be provided by employers to employees. Where the minimum level of support has not been provided in respect of an employee, the employer must lodge a superannuation guarantee statement with the Commissioner together with payment of a charge relating to the shortfall. According to s 12(1) of the SGAA, the terms "employee" and "employer" have their ordinary meaning. However, their meaning is expanded by 12(3) which provides that if "a person works under a contract that is wholly or principally for the labour of the person, the person is an employee of the other party to the contract".

The company contended that it was not an employer for the purposes of the superannuation guarantee scheme on the basis that the couriers it engaged were not employees within the common law meaning of that term or within the extended definition contained in s 12(3).

The Commissioner argued that the superannuation guarantee scheme applied to the company. According to the Commissioner, the couriers engaged by the company were employees within the common law meaning of the term on the