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The Concept of Assessable Income Has It Changed

Abstract

Recent case law has caused many commentators to suggest that there is now a predisposition to regard business receipts as being on income account. A close analysis, however, should lead to the unmistakable conclusion that all receipts are still regarded as income unless shown to fall within some other category (eg capital, exempt income, private or domestic receipts etc) and recent case law has not departed from previously existing principles.

Keywords

receipts, taxation, assessable income

THE CONCEPT OF ASSESSABLE INCOME HAS IT CHANGED?

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Recent case law has caused many commentators to suggest that there is now a predisposition to regard business receipts as being on income account. A closer analysis, however, should lead to the unmistakable conclusion that all receipts are still regarded as income unless shown to fall within some other category (eg capital, exempt income, private or domestic receipts etc) and recent case law has not departed from previously existing principles.

Introduction

Whilst the topic "the Concept of Assessable Income" is apt to include all provisions of the Income Tax Assessment Act 1936 ("the Act") which bring amounts into the calculation of taxable income, this paper addresses what appears to be a broadening of the concept following recent judicial decisions and deals with the further question whether the courts are now adopting a stance more favourable to the revenue than heretofore, or, alternatively, whether certain obiter statements have been misinterpreted. These issues restrict the discussion to the general concept of income within s 25(1) of the Act and this paper is limited to that issue.

The recent decisions to which the topic directs attention are all concerned with taxpayers who were indisputably carrying on a business and this paper therefore focuses on the taxation implications of receipts of business taxpayers.

Business taxpayers – past and present

The answer to the question whether or not the concept of assessable income has been broadened requires a comparison of the past and present states of the law in its application to legally relevant facts and the state of the law which existed in the past in its application to similar facts.

That formulation has been chosen deliberately because, with one exception, there has been no major change in the law applicable to the commercially relevant facts. Actual situations which would not in the past have attracted a tax liability will not now do so, with one exception, and

recent cases in which a tax liability has been found to exist are entirely consonant with earlier doctrine.

There has of course been no change to the wording of s 25(1) and no formally acknowledged change in the legal doctrine associated with the subsection. Indeed, the doctrinal position of the courts as enunciated in reasons for judgments is almost uniformly that nothing has changed. But the reality, it is often suggested, is very different. Thus it is argued that if the facts in *Scottish Australian Mining Co Ltd v FC of T*¹ were to recur today the taxpayer would be assessed under s 25(1) of the Act and the assessment would be confirmed. It is likewise argued that if the facts in issue in *FC of T v Cooling*² had occurred between 1939 and 1942 the taxpayer would not have been held liable to tax.

The conclusion reached as a result of the discussion which follows is that the extent of any change is far less than is often suggested, and that if an increasing range of transactions will be held to give rise to assessable income, that arises not from any change in the tests which are applied but from the vastly increased range of commercial transactions to which those tests are required to be applied.

It is submitted that it is not (and never was) the law that, in the words of Finlay J in *Lambe v IRC*³ income is "what in one form or another goes into a man's pocket". If the reasons for the judgment in *Cooling v FC of T*⁴ at first instance fairly summarise the submission of counsel for the Commissioner to this effect, it was indeed a bold one. The issues in *Lambe v IRC*⁵ were whether interest which had accrued to a taxpayer but had not been paid was nevertheless chargeable to tax in the year in which it accrued either according to ordinary principles, or by reason of the alteration made to the general law by s 39(2) of the Finance Act 1927 (UK). The point of the quoted observation of Finlay J was that before income could be assessed as income according to ordinary concepts, it must be received and his decision affirmed that in the absence of receipt, accrued interest was not in the circumstances of the taxpayer in that case assessable.

The Scottish Australian Mining Co Ltd case

A suitable starting point for the comparison is a case which, if there has been a change in the law, represents the high-water mark for non-assessable receipts:⁶ The material facts were stated by Williams J as being that the taxpayer was incorporated on 6 January 1859 for the purpose of acquiring coal assets in New South Wales from a related company. It did not appear that the taxpayer had carried on mining on any of those lands, although it may have done so for a short period. All of those lands were sold early in its history. It acquired further land in the Newcastle area between 1863 and

1 (1950) 81 CLR 188.
 2 (1990) 90 ATC 4472.
 3 [1934] 1 KB 178, 183.
 4 Above n 2.
 5 Above n 3.
 6 (1950) 81 CLR 188.

(1991) 2 Revenue L J

1865 totalling 1,771 acres which it did mine and continued to mine until the coal was exhausted in 1924. Williams J said:

... [T]he company then commenced to sell the land in sub-division in a large way. There had been some minor sales in previous years. Forty-five acres were set aside in 1864 for the township of Lambton to provide homes for the miners. There was a small isolated sale in 1904. In 1907 twenty-four acres was subdivided and a road known as Russell Road built in the sub-division. After 1924, the appellant commenced to push the sale of the land and incurred considerable expenditure in sub-dividing and making the land attractive to purchasers. It constructed roads. It built a railway station for £5,000. It granted land to public institutions such as schools and churches, and set aside land for parks. It sold a large area of land in the sub-division to the Newcastle Hospital.⁷

From 1932 the only revenue derived by the taxpayer, apart from the profits on the sale of land, comprised royalties, some interest and rent. The reasons for judgment do not state what level of profit arose, but it is described as "considerable". Interestingly the purchase money on most of the sales was payable by instalments, and the taxpayer held those in a suspense account and only brought the profit into the profit and loss account when the purchase money was paid in full. It was only those profits which the Commissioner sought to assess.

In holding the profits non-assessable pursuant to either s 25(1) or s 26(a), Williams J extracted a number of statements of principle from other decided cases, some of which would, at best, require qualification today:

- no weight should be attached to the circumstance that large sales were made every year: *Hudson's Bay Co Ltd v Stevens*;⁸
- a landowner may lay out part of his estate with roads and sewers and sell it in lots for building, but he does this as an owner and not as a land speculator;⁹
- in order to see clearly that the *Hudson's Bay* case does not apply there must be something in the nature of buying at any rate and not merely selling, which is mere turning of your property into money: *Alabama Coal, Iron, Land and Colonisation Co Ltd v Mylam*;¹⁰
- the suggestion that the mere extensiveness of the organisation set up to realise an asset or assets might cause the realisation to become a business is a proposition not to be entertained: *Commissioner of Taxes v British Australian Wool Realisation Association*.¹¹

His Honour's ultimate conclusion was that "whilst in this class of case the ultimate finding is often one of degree and fact, the present evidence is consistent and consistent only with the finding that the appellant was engaged only in realising a capital asset". The Commissioner appealed from this decision but the appeal was dismissed with costs by consent by the Full High Court.

⁷ Ibid at 193.

⁸ (1909) 5 TC 424, 436 per Cozens Hardy MR.

⁹ Ibid 437 per Farwell LJ.

¹⁰ (1926) 11 TC 254, 257 per Rowlatt J.

¹¹ [1931] AC 224, 252, per Lord Blanesburgh.

The Commonwealth Law Reports show that the case took two days to hear, that judgment was pronounced six days later, and that the appeal was determined seven weeks after judgment at first instance. These dates give us some information about the way the case must have been conducted, as well as evoking nostalgia for times when court delays and extended hearings did not form such a part of the litigation process. Clearly there cannot have been a prolonged factual enquiry into the activities of the taxpayer or extensive disputes about the accounting or other issues involved in the case. That may well explain the fact that what must have been a substantial commercial exercise was treated as a mere realisation of a capital asset.

The Whitfords Beach case

A fact situation which was in many respects similar was considered in the decision in *Whitfords Beach Pty Ltd v FC of T*.¹² The Judge who heard the matter at first instance,¹³ a dissenting member of the Federal Court¹⁴ and the Full High Court all took the view that the Commissioner was entitled to succeed. In the High Court Murphy J decided the matter on the basis that s 26(a) applied. All the other judges who decided the matter in favour of the Commissioner took the view that s 25(1) applied. The most detailed analysis of the actual transactions of the taxpayer, however, is in the reasons for judgment in proceedings remitted from the High Court to the Full Federal Court.¹⁵

It will be recalled that, in the *Whitfords Beach* case, the taxpayer was incorporated in 1954 to acquire a block of land to guarantee its shareholders, who were the proprietors of fishing shacks, access to the nearby beachfront. There was no intention of profit-making by sale. The total area was 1,584 acres, of which none was able to be developed as at 20 December 1967 when the original shareholders disposed of their shares for \$1.6 million. At that time the land was valued at \$3.1 million. By 30 June 1975 further outgoings of \$5,748,000 had been incurred by the company and total sales of \$7,880,000 had eventuated. The nature of the expenses is described in the report as compliance with planning and sub-divisional requirements, including the construction of a road and installation of sewerage and other essential services. On its face, therefore, the nature and scale of activity does not seem to be greatly different from that which occurred in the *Scottish Australian Mining Co Ltd* case.¹⁶ There was, it is true, a change of purpose in the controlling mind of the company which was effective on the date its ownership changed, and that changed purpose was reflected in a new set of articles of association. Gibbs CJ in the *Whitfords Beach* case¹⁷ expressed "grave doubt" whether the profits resulting from the development sub-division and sale of the land would have been taxable had it not been for the

12 (1978) 78 ATC 4211; (1979) 79 ATC 4648; (1982) 150 CLR 355; (1982) 82 ATC 4031.

13 (1978) 78 ATC 4211, Wickham J.

14 (1979) 79 ATC 4648, 4661 per Deane J.

15 (1983) 83 ATC 4277.

16 Above n 6.

17 (1982) 150 CLR 355 at 369-370.

(1991) 2 Revenue L J

change of ownership. So did Wilson J.¹⁸ Mason J, however, was clearly of the view that the *Scottish Australian Mining Co Ltd* decision was wrong.¹⁹ The court failed to agree on the consequence of the application of s 25(1). Gibbs CJ's discussion on the subject was in the following terms:

Although the case is not without its difficulties, I have concluded that the *profits* were income within ordinary concepts and taxable accordingly.²⁰ [Emphasis added.]

Mason J concluded:

Because s 26(a) looks to net profit and s 25(1) deals with gross income, different consequences may follow, according to which provision is found to apply to a taxpayer. In ascertaining net profit for the purpose of s 26(a), general accounting principles, rather than the statutory provisions relating to allowable deductions may need to be applied. In the result in a given case there may not necessarily be a correspondence in the operation of s 25(1) and s 26(a).²¹

He also said:

Accordingly, the gross income is assessable under s 25(1). But for this conclusion I would have held that the activity of the respondent amounted to the carrying out of a profit making undertaking or scheme which exhibited the characteristics of a business deal so that net profit of the respondent would have been assessable under the second limb of s 26(a), if not under s 25(1).²²

Since Murphy J decided the case under the second limb of s 26(a), his reasons did not need to deal with this issue. Wilson J, whose view of the matter did make it necessary for him to resolve the issue, observed that the proceeds of the business were assessable income within the meaning of s 25²³ but in the light of the facts that Gibbs CJ regarded the expression "proceeds" as referring only to profits and that Wilson J went on to refer to the Commissioner's contention that the "profits" were assessable under either s 25 or the second limb of s 26(a), it seems likely that he was not intending by use of the expression "proceeds" to express a concluded view on this issue.

The approach of Deane J in the Federal Court was also to regard the profit component of the receipt as the only amount brought within assessable income. With the benefit of hindsight it is possible to say that his judgment has been one of seminal importance in the development of the law. Many of the concepts there discussed (and in particular, the focussing on the word "mere" in the context of the phrase "mere realisation of a capital asset") are repeated both in the High Court reasons in *Whitfords Beach*²⁴ itself and in the decision in *FC of T v Myer Emporium Ltd*.²⁵

The distinction between gross receipts and net profits is one which does not arise under the United Kingdom legislation (or under other profits-based

18 Above n 17 at 398-399.

19 Above n 17 at 385.

20 Above n 17 at 371.

21 Above n 17 at 382.

22 Above n 17 at 386.

23 Above n 17 at 401.

24 Above n 17.

25 (1987) 163 CLR 199.

tax systems); but it is one of fundamental importance in the Australian context because, as Mason J pointed out,²⁶ once gross income is brought to account, the taxpayer must point to a statutory provision relating to allowable deductions if assessable income is not to equal taxable income.

The final litigation in the *Whitfords Beach* case did not address this issue because it was common ground between the parties that the amount to be included in the taxpayer's assessable income was the amount of the taxpayer's profit from the material sales,²⁷ although, contrary to what is said in the judgment, that concession was not required by anything said by Gibbs CJ in the High Court. There was no relevant detachment of profit from the other receipts when the sales occurred. Indeed, as a matter of commercial reality, it would be almost impossible to establish exact apportionments of expenses to particular blocks sold: at best a process of averaging would be involved.

The notion that net profit only might be brought to account by s 25(1) avoided one of the problems which otherwise existed with the concept that the sale of land in such circumstances generated an income receipt. For the proper operation of the Act would otherwise necessarily produce the result that what was brought to tax did not reflect the true profit which arose.

The requirements of s 51(1) of the Act need to be met in order to claim deductions in a case such as *Whitfords Beach*. A loss or outgoing must be incurred. None of the tests which had previously been applied in elucidating the meaning of that expression, comprehended what occurred in 1967: Arguably the company incurred a loss or outgoing when it initially acquired the property (for what was presumably a negligible amount) or when it parted with possession of it (because at that stage it gave up valuable rights in respective properties). But it suffered no loss or outgoing of any sort in 1967 when its shareholders changed.

The difficulty is that a calculation based on the acquisition price produces a profit which is too high if one looks at the enterprise as a whole, whose expenses included the new shareholders' costs of acquiring the shares, while a calculation based on the value of the land disposed of will either produce, depending upon the approach to the accounting involved, a nil result or a loss.

The Myer Emporium case

The concept of income being generated from a one-off sale of an asset was further developed in *Federal Commissioner of Taxation v Myer Emporium Ltd*.²⁸ The facts of the case were that the taxpayer lent \$80 million to an associated company, Myer Finance Ltd, for a period exceeding seven years at 12.5 percent per annum interest. Three days after making the loan, the taxpayer assigned to Citicorp (Canberra) Pty Ltd ("Citicorp"), an unassociated financier, in accordance with an arrangement entered into before the loan was made, "the moneys due or to become due as the interest

²⁶ Above n 17 at 371.

²⁷ (1983) 83 ATC 4277, 4278 per Bowen CJ.

²⁸ (1987) 87 ATC 4363; (1987) 163 CLR 199.

(1991) 2 Revenue L J

payments [pursuant to the loan agreement] and interest thereon". The consideration for the assignment was \$45.37 million, which was paid immediately. The consideration was calculated as the value at the date of assignment of the right to interest over the period of the loan.

The taxpayer was the holding company of the Myer Group ("the Group"). Myer Finance was a wholly-owned subsidiary which had been brought into the Group shortly before the transaction with the intention of its becoming the finance company within the Group. The sums lent by the taxpayer to Myer Finance represented for the most part, the proceeds of the sale of shares in other subsidiary companies which owned shops and shopping centres by the taxpayer to another subsidiary which had been newly formed for the purpose of holding all the real property assets of the Group.

The litigation was conducted on the basis that the price paid for the right to receive the interest was an arm's length price.²⁹ It was not suggested that the interest rate payable on the loan was other than a commercial rate.

Both at first instance and in the Federal Court the taxpayer succeeded in the argument that no profit or income was derived from the transactions. The making of the loan at interest did not commercially benefit the taxpayer and, it was said, that sale of the right to receive the future interest payments for its value could not generate either income or a profit. As to s 25(1), the fact that the transaction was a "one off" transaction precluded its being income according to ordinary concepts, even if there were a profit involved.

The logical flaw in this argument is at once both obvious and elusive. If it is right that a person who lends money at a commercial interest rate derives no commercial gain because the value of what is foregone (possession of the money lent for the period of the loan) is equal to what is obtained (interest and, ultimately, repayment of principal), then interest would, on principle be non-assessable. It has never been suggested that that is the position under either United Kingdom or Australian legislation. If the interest is assessable, then to receive it in one form (payment of its present value in advance) rather than another (payment of the whole amount over time) should not affect its assessability. Similarly, it has never been suggested (except in the context of the discussion about inflation accounting) that interest does not represent a profit arising from the investment of money. Once it is accepted that a profit was made, the question which arises is whether the receipt of the proceeds of sale was on revenue account, capital account, or of a mixed nature. The problem for the taxpayer is that the capital recovery of the moneys lent would take the form of repayment of principal which was due to occur in slightly over seven years time. The Commissioner therefore argued that the whole amount was received on income account.

The taxpayer replied that what it had sold was not future amounts of interest, but the right to receive future interest as and when it became due

29 (1985) 85 ATC 4111, 4117 per Murphy J at first instance.

which, it contended, was not the same thing. The response of the High Court to that proposition was:

If economic equivalence were the appropriate accounting basis, the debt would be brought to account at the beginning of the period in an amount less than the amount of the money lent and would increase day by day until it equalled the amount of the money lent when the period expired. On that basis the right to interest on the money lent would be brought to account at the beginning of the period at a maximum figure reducing to nil when the period expired. On that basis the right to interest on the money lent would be brought to account at the beginning of the period at a maximum figure reducing to nil when the period expired. The aggregate of the two amounts – the debt and the right to interest – would equal, throughout the period, the amount of the money lent, assuming that the rate of interest payable on the principal debt were the same. On that basis, both the debt and the right to interest might be treated as capital assets.

But when a debt is brought to account in the same amount as the amount of the money lent, the right to interest on the money lent is not treated as an asset at all. It does not appear in either the balance sheet or the profit and loss account of the lender. The right to interest is not distinguished for accounting purposes from the interest to which it relates. So long as the amount of the principal debt is treated as equivalent to the amount of the money lent, the right to interest cannot be treated as an additional capital asset. The making of a loan does not immediately produce a capital gain equal to the present value of the interest to be paid. The right to interest is not a capital asset which is progressively transformed into income as and when the interest is received.³⁰

It might be added to this analysis that s 26(a) of the Act is apt to include loans which, having been acquired for less than their face value, thereafter increase in value.³¹ If, therefore, the correct analysis is that the right to receive the interest payable was a separate and detachable asset from the interest itself, with the result that the debt was not worth its face value, the cost price of the debt necessarily must have been less than its face value and in consequence the ultimate realisation of the debt would have generated assessable income on the *XCO Pty Ltd* principle, although, consistently with that principle the assessable profit would have been derived in the year of the repayment of the loan. The result in the *Myer Emporium* case therefore accords with legal principle, commercial reality and common sense. But what was said in that case has implications which go well beyond the issues specifically raised.

The kernel of the judgment is as follows.

Although it is well settled that a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow that a profit or gain made in a transaction entered into otherwise than in the ordinary course of carrying on the taxpayer's business, is not income. Because a business is carried on with a view to profit, a gain made in the ordinary course of carrying on the business is invested with the profit-making purpose, thereby stamping the profit with the character of income. But a gain made otherwise than in the ordinary course of carrying on the business which nevertheless arises from a transaction entered into by the taxpayer with the intention or purpose of making a profit or

³⁰ (1987) 163 CLR 199 at 217 per Mason ACJ for the Court.

³¹ *XCO Pty Ltd v FC of T* (1971) 71 ATC 4152.

(1991) 2 Revenue L J

gain may well constitute income. Whether it does depends very much on the circumstances of the case. Generally speaking, however, it may be said that if the circumstances are such as to give rise to the inference that the taxpayer's intention or purpose in entering into the transaction was to make a profit or gain, the profit or gain will be income, notwithstanding that the transaction was extraordinary judged by reference to the ordinary course of the taxpayer's business. Nor does the fact that a profit or gain is made as the result of an isolated venture of or a "one-off" transaction preclude it from being properly characterised as income: *FC of T v Whitfords Beach Pty Ltd*. The authorities establish that a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit . . .

The important proposition to be derived from *Californian Copper Syndicate v Harris*³² and *Ducker v Rees Roturbo Development Syndicate*³³ is that a receipt may constitute income if it arises from an isolated business operation or commercial transaction entered into otherwise than in the ordinary course of the carrying on of the taxpayer's business, so long as the taxpayer entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction.

Several different strands of thought have combined to deter courts so far from accepting the simple proposition that the existence of an intention or purpose of making a profit or gain is enough in itself to stamp the receipt with the character of income. The first was the notion that the realisation of an asset was a matter of capital, not income. The second was the apprehension that windfall gains and gains from games of chance would constitute income unless the concept of income, apart from income from personal exertion and investments, was confined to profits and gains arising from business transactions. And the third notion, itself associated with the idea that the carrying on of a business involves a systematic series of recurrent acts or activities, was that a gain generated by recurrent transactions is income, whereas a gain generated by an isolated transaction of capital . . .

The proposition that a mere realisation or change of investment is not income requires more elaboration. Firstly, the emphasis is on the adjective "mere": *Whitfords Beach*. Secondly, profits made on a realisation or change of investments may constitute income if the investments were initially acquired as part of a business with the intention or purpose that they be realized subsequently in order to capture the profit arising from their expected increase in value: see the discussion by Gibbs J in *London Australia Investment Co Ltd v Federal Commissioner of Taxation*.³⁴ It is one thing if the decision to sell an asset is taken after its acquisition, there having been no intention or purpose at the time of acquisition of acquiring for the purpose of profit-making by sale. Then if the asset be not a revenue asset on other grounds, the profit made is capital because it proceeds from a mere realisation. But it is quite another thing if the decision to sell is taken by way of implementation of an intention or purpose, existing at the time of acquisition, or profit-making by sale at least in the context of carrying on a business or carrying out a business operation or commercial transaction.³⁵

The characterisation in the instant case of the right to receive interest payments as a right which had been created so as to enable its disposal

32 (1904) 5 TC 159.

33 [1928] AC 132, HL.

34 (1977) 138 CLR 106 at 116-118.

35 Above n 30 at 209-210.

necessarily, in the view of the court, produced the result that the proceeds of sale were assessable income.

Once this conceptual approach is accepted, the case fits comfortably with older decisions such as that of Rowlatt J in *Alabama Coal Iron and Colonisation Co Ltd v Mylam*³⁶ in which it was recognised that once the person buys a property with the intention of selling it, sale will not be a mere realisation. The only authority out of line with this analysis is the decision in *Jones v Leeming*³⁷ in which it was held that the profit made on the sale of two rubber estates acquired for the purpose of profit making by sale, when the purchase and sale was an isolated transaction not being undertaken in the course of business or trade, was not in the nature of income, but an accretion to capital. That was not the law in Australia at the time: it had, for example, been said in *Blockey v FC of T* that:

... [A] mere realisation of property though producing profit, does not, as I have said, produce income. It is a mere enlargement of capital. But if a man, even in a single instance, risks capital in a commercial venture – say, in the purchase of a cargo of sugar or a flock of sheep – for the purpose of profit making by resale and make profit accordingly, I do not for a moment mean to say he has not received "income" which is taxable. I intimated during the argument that this was possible; and I leave it open.³⁸

The first limb of s 26(a) was plainly intended to overrule *Jones v Leeming*³⁹ and the actual decision was, as noted by Mason J in *Whitfords Beach*,⁴⁰ ultimately held to be wrong in *Edwards v Bairstow*.⁴¹

At this point, therefore, the line of authority is clear and represents little change over the period considered: purposeful dealings in property directed to obtaining a profit produce business income which will normally be taxable under s 25(1) unless the property is a capital asset. It will meet that criterion only if it was acquired in circumstances where its resale is not intended.

The position, therefore, is not far removed from the position in *FC of T v Reynolds*,⁴² where Neasey J said:

There is no definition of "income" in the Act. The question is whether the receipt is "income" according to ordinary concepts in *Scott v C of T (NSW)*;⁴³ and see *FC of T v Harris*.⁴⁴ Whether it is to be characterised as income for the purposes of the Act depends, as authorities show, upon the character of the receipt and the circumstances in which it came to the hands of the taxpayer. In the case of a taxpayer conducting a business, if the receipt is as a matter of reality, part of the proceeds of the business or a product of or incidental to the conduct of the business, it is usually income.⁴⁵

36 Above n 10.

37 [1930] AC 415, HL.

38 (1923) 31 CLR 503, 508-509 per Isaacs J.

39 Above n 37.

40 Above n 17.

41 [1956] AC 14, HL.

42 (1981) 81 ATC 4131.

43 (1935) 35 SR (NSW) 215, 220 per Jordan CJ.

44 (1979) 79 ATC 4383, 4387-4388; 37 FLR 325, 332 per Murphy J.

45 Above n 41 at 4141-4142.

(1991) 2 Revenue L J

The Cooling case

One of the most recent cases dealing with the subject is the decision of the Full Federal Court in *FC of T v Cooling*⁴⁶ overruling the decision of Spender J.⁴⁷ The position is further complicated because the majority of Federal Court held (Hill J dissenting) that s 160M(7) of the Act was apt to include the amount received by the taxpayer in his assessable income pursuant to Part IIIA of the Act. Only Hill J expressed detailed reasons for the conclusion that the amount would also be income within the meaning of s 25(1) and the other members of the court agreed with this.

The facts of the case were that the taxpayer was one of six partners in a Brisbane firm of solicitors. Over the fifty years of its existence the firm had practised from various leased premises. The firm had established a service company to provide for superannuation benefits to the partners. One of the services provided by the service company was the provision of office accommodation.

In April 1985 the firm received a written proposal from the agents for the AMP Society suggesting that the firm relocate to a new office block (Comalco House) which had been built for the AMP. The proposal provided for an incentive payment to the firm at the commencement of the lease. As a matter of evidence accepted by the court, it was, at that time, common in Brisbane for landlords of new city buildings to offer incentives to prospective tenants. After protracted negotiations, the agents wrote to the firm offering it the sum of \$162,000 as an incentive to procure the service company to accept a ten year lease of a whole floor of the building and to guarantee the service company's obligations under the lease. The lease guarantees were duly executed and the incentive payment was duly made. The essential reasoning of Hill J can be summarised as follows:

- the decision in the *Myer Emporium* case⁴⁸ establishes that a gain made by a taxpayer in a business operation for the purpose of profit making is income on ordinary concepts, notwithstanding that the transaction may be extraordinary judged by reference to the ordinary course of the taxpayer's business;
- when a taxpayer carries on business from leased premises, the move from one set of premises to another, and the leasing of the premises occupied, are acts of the taxpayer in the course of its business activity;
- if, (as was the case), it was an ordinary incident of leasing premises in a new city building to receive incentive payments of the kind in question, such receipts fall ordinarily into income.

The position is, therefore, reached that where a taxpayer who is carrying on a business enters into a commercial transaction which forms part of that business activity and a not insignificant purpose of it is the obtaining of a

⁴⁶ (1990) 90 ATC 4472.

⁴⁷ (1989) 89 ATC 4731.

⁴⁸ Above n 28.

commercial profit, such profit, if obtained, will be assessable unless it can be shown to be excluded from assessable income.

In practice, in the context of a person carrying on a business, the only receipt likely to attract the exemption is a receipt of capital. In order that a receipt can be so characterised, it may either be a realisation of a capital asset (by which is meant an asset acquired with the intention that it should be held as part of the profit making structure of the business rather than for resale) or a windfall gain.

In the words of the Federal Court in *FC of T v Spedley Securities Ltd*:

The decision in *Myer Emporium Ltd* was given jointly by five judges, doubtless with some recognition that the court was reversing cumulative decisions of the Supreme Court of Victoria, and this Court on a question of whether a receipt was, on the application of the Income Tax Assessment Act 1936, s 25(1), one of the capital or income. The case is strong authority for what it decides, but it may only have taken a different view of the facts than had the lower courts. The use made of the decision is this case on behalf of the Commissioner is to say that the amount in question was received in the course of business operations, the operations, taken broadly, being intended to produce a profit. The phrase "in the course of" involves a temporal connection. If the proposition were correct, it would mean that any receipt by a business would necessarily be of an income nature, and this would be contrary to authority, to the Act itself and to basic concepts concerning the distinction between capital and income. In *Myer* what was received related solely to income by way of interest on a loan made by the taxpayer, the amount received being for a transfer of the right to receive the interest in the future. The High Court did not base its decision on *Myer* being, in the broader sense, a profit-making company. The purpose of profit making must exist in relation to the particular operation.⁴⁹

The Westfield case

Finally, the most recent decision dealing with the subject is that of the Full Federal Court in *Westfield v FC of T*.⁵⁰ The decision overruled the earlier decision of Sheppard J.⁵¹ The facts of the case showed that the taxpayer's main activity was the design, construction, letting and management of shopping centres. In the early 1970s an area in a Brisbane suburb with potential for development as a shopping centre was targeted. In May 1978 the taxpayer acquired an option to buy a block of land central to any such development. It also acquired options over various neighbouring blocks. The taxpayer's initial plans to develop the land itself were abandoned until it heard that a competitor was attempting to secure options over land in the area. The taxpayer then secured a further option over the central block of land. The latter option was exercised in April 1981 and the land purchased for \$450,000. At the time when the option was exercised the taxpayer had already entered into negotiations with the AMP Society with a view to some form of participation by AMP in the project. The land was sold to AMP for \$735,000 in December 1982. The taxpayer was subsequently engaged by

49 (1988) 88 ATC 4126, 4130 per Fox, Fisher and Sheppard JJ.

50 (1991) 91 ATC 4234.

51 (1990) 90 ATC 4801.

(1991) 2 Revenue L J

AMP to design and construct the shopping centre. The Commissioner included the profit from the sale in the taxpayer's assessable income for the 1983 income year. The taxpayer objected.

At first instance Sheppard J dismissed the taxpayer's appeal,⁵² holding that the profit on the sale of the land was incidental to a part of a whole transaction carried out in the ordinary course of the taxpayer's business and was part of an overall profit-making venture. As the taxpayer had acquired the land for use in a way which would ensure that the taxpayer would participate in the development of it, Shepherd J held that the profit was assessable income. The taxpayer then appealed to the Full Federal Court.⁵³

The Full Federal Court allowed the appeal and found as follows.

- Although a profit or gain made in the ordinary course of carrying on a business constitutes income, it does not follow from the decision in *FC of T v Myer Emporium Ltd*⁵⁴ that every profit made by a taxpayer in the course of the taxpayer's business activity will be of an income nature. To express the proposition in such a way would eliminate the distinction between an income profit and a capital profit. It is necessary that the purpose of profit-making must exist in relation to the particular operation.
- In a case where the transaction, which gives rise to the profit, is itself a part of the ordinary business of the taxpayer, the identification of the business activity will stamp the transaction as one having a profit-making purpose. The same can be said of a transaction which is an ordinary incident of the business activity of the taxpayer, albeit not directly its main business activity or a necessary incident thereof. Since the taxpayer's business activity was the construction, leasing, or management of shopping centres, whether on its own land or on the land of others, or on joint venture land, the resale of land was not part of the taxpayer's ordinary business activity or a necessary incident thereof.
- Where a transaction occurs outside the scope of ordinary business activities it will be necessary to find, not merely that the transaction was "commercial", but also that there was, at the time the transaction was entered into, the intention or purpose of making a profit. The profit-making purpose must exist in relation to the particular operation by which the profit was in fact made and not simply in a temporal sense. Although at the time when the land was acquired, a possibility open to the taxpayer was its subsequent sale to AMP, the taxpayer's preference was to develop the land itself. The taxpayer therefore lacked the necessary profit-making purpose at the time of acquisition.
- The sale of the land to achieve participation in the development of a shopping centre was not part of a profit-making scheme and did not therefore reflect the necessary profit-making purpose. Obtaining the

⁵² Ibid.

⁵³ Above n 50.

⁵⁴ (1987) 87 ATC 4363.

contract to construct and manage the centre was not, of itself, a scheme of profit-making. It was a scheme for deriving income from the performance of work under the building and management contracts.

Summary and conclusion

The conclusions stated above as to the present state of the law are perhaps less likely to be questioned than the propositions advanced as to the course of the law's development. Contrary to the proposition implicit in the topic, it is suggested that the decisions under review do not warrant the adoption of the view that there has been a movement by the courts, as presently constituted, towards a newly-developed predisposition to regard receipts as being on revenue account. Such a predisposition has always attended taxpayers conducting a business who receive profits or gains associated therewith unless such amounts are shown to be capital.

There does remain a problem in the area of disposal of assets which were plainly acquired as part of the capital structure of a taxpayer conducting a business. Part of that confusion arises from the decision in *Scottish Australian Mining Co Ltd*,⁵⁵ which almost certainly would not be followed today. This issue will remain a live one because it will almost always be to the advantage of the Commissioner to assess pursuant to s 25(1) or s 25A(1), if such an assessment can be maintained rather than Part IIIA of the Act. It is submitted that in both the *Scottish Australian Mining* case⁵⁶ and the *Whitfords Beach*⁵⁷ case the assessment should have been made pursuant to s 26(a) (now s 25A(1)), and that in neither case should the assessment have been made pursuant to s 25(1). If those cases had been decided in that way, it is suggested that there would have been a reasonably consistent line of authority reaching from the earliest decisions on the subject to the present position.

In the light of the reliance on the fact that the company changed from a company holding land for domestic purposes to one engaged in a commercial venture with a view to profit, placed by Gibbs CJ⁵⁸ and Wilson J⁵⁹ in *Whitfords Beach*, that case is perhaps more appropriately regarded as an example of the increasing readiness of the courts to look through the corporate veil than as establishing any new principle. If the company had been formed on the date of change of ownership and had then acquired the subject property, the decision would have been squarely within the broad stream of authority.

What is seen as a predisposition to regard business receipts as being on income account is, it is suggested, in reality, little more than the reflection in the context of s 25(1) of the proposition explicit in s 51(1), ie that all receipts are income unless shown to fall within some other category, amounts of

⁵⁵ Above n 1.

⁵⁶ Ibid.

⁵⁷ Above n 17.

⁵⁸ Ibid 370.

⁵⁹ Ibid 398.

(1991) 2 Revenue L J

capital, amounts of exempt income, or private or domestic receipts (eg maintenance payments). The recent cases represent not a departure from previously existing principles, but a reaffirmation of them.