[¶1] ABB Australia Pty Ltd v FC of T

2007 ATC 475; (2007) 162 FCR 189

Facts and Arguments

ABB Australia was an Australian resident company wholly owned and controlled by ABB Zurich, a Swiss company. On 30 May 1996, ABB Australia declared a $49m dividend payable on 21 June 1996. On 3 June 1996, ABB Zurich entered into an oral agreement for consideration to assign its right to the dividend to BZW (an English company). On 4 June 1996, BZW entered into an oral agreement for consideration to assign that right to BAL (an Australian resident company). On 6 June 1996, BAL notified ABB Zurich of the assignment, requesting it to instruct ABB Australia to pay the dividend to BAL's Sydney bank account. On 21 June 1996, the dividend was duly credited to BAL's account.

ABB Australia and ABB Zurich (the applicants) sought declarations under s 39B of the *Judiciary Act 1903* (Cth) that:

- ABB Zurich was not liable for withholding tax on the dividend under s 128B(4) of the *Income Assessment Act 1936* (Cth), and
- ABB Australia was not required to deduct withholding tax from the dividend under s 221YL(1) of the Act.

'Withholding tax' was defined in s 6(1) as 'income tax payable in accordance with s 128B'. Section 128B(1) stated:

> this section applies to income that:
> (a) is derived … by a non-resident; and
> (b) consists of a dividend paid by a company that is a resident.

Section 128B(4) stated:

> A person who derives income to which this section applies that consists of a dividend is liable to pay income tax upon that income …

Section 221YL(1) imposed an obligation on a resident company to deduct withholding tax from dividends paid to a holder of a share in a resident company who is shown in the register of members as having an address outside Australia, or who authorised or directed the company to pay the dividends at a place outside Australia.

The applicants contended that a dividend could not be 'derived' before it was paid and could not be derived by a person to whom it was not paid. It was submitted that the only payment made by ABB Australia was to BAL, a resident company, and as a result there was no obligation to withhold any tax. The applicants argued that although ABB Zurich derived a gain from the sale of its right to receive the dividend, it did not derive 'income' that 'consists of a dividend'. They contended that the direction given to ABB Australia by ABB Zurich, and the subsequent payment to BAL, occurred when ABB Zurich was a bare trustee of the right to receive the dividend and that it could not derive income to which it was not beneficially entitled.

The Commissioner argued that:

- when the dividend was declared (on 30 May 1996), ABB Zurich, being a non-resident company, derived income consisting of the dividend with the consequence that s 128B(1)(a) was satisfied, and
- when the dividend was paid (on 21 June 1996), a dividend was 'paid by a company that is a resident', with the consequence that s 128B(1)(b) was satisfied.

According to the Commissioner, it was not necessary that payment be made to the non-resident who derived the income consisting of the dividend; the words 'derived' in s 128B(1)(a) and 'derives' in s 128B(4) should not be read down as being limited to 'payment'. The Commissioner contended that ABB Zurich was an accruals-basis taxpayer that derived the dividend when it was declared as a debt arose at that time.

Alternatively, the Commissioner submitted that the dividend was derived beneficially by ABB Zurich as the assignment was planned and executed to ensure that ABB Zurich still retained the benefit of the dividend. Failing that, even if the dividend was not derived beneficially, it was derived by ABB Zurich exclusively as a non-resident trustee, which brought it within the scope of s 128B(1).

The Commissioner also maintained that ABB Zurich could not, without assigning the underlying shares, avoid the consequences that it derived the dividend.

Issue

Was ABB Zurich liable for withholding tax on the dividend and was ABB Australia required to deduct withholding tax from the dividend?

Decision

Federal Court: Lindgren J.

1. ABB Zurich was liable for withholding tax on the dividend and ABB Australia was required to deduct withholding tax from the dividend.

2. Generally, dividend income is derived when it is received. However, this general rule applies to passive shareholders who do not control the declaration of dividends and do not carry on a business declaring dividends. ABB Australia was wholly owned and controlled by ABB Zurich, whose business involved managing investments in around 1,000 subsidiaries globally. The decision to declare the dividend and defer payment was entirely that of ABB Zurich, who was not a passive investor. The evidence indicated that ABB Zurich recognised dividends at the time of declaration, and this supported the conclusion that it derived income that consists of a dividend when ABB Australia declared the dividend on 30 May 1996. The dividend was a debt owed by the taxpayer to ABB Zurich on that date.

3. Alternatively, even if the dividend was derived when it was paid, ABB Zurich derived income consisting of a dividend on 21 June 1996—regardless of the fact that the payment was actually credited to BAL's account. The actual transfer of the dividend arose as a result of equitable assignments undertaken by ABB Zurich to BZW and by BZW to BAL. The taxpayer, in crediting BAL's account, was only discharging its debt to ABB Zurich, who had directed the taxpayer to pay BAL. Hence, the payment to BAL was also a payment to ABB Zurich.

> Essential to the notion of payment is the agreement of a creditor to accept something as payment. If a creditor directs the debtor to pay a third party to whom the creditor has an obligation and the debtor does so, the payment to the third party is payment to the creditor because the creditor had consented to treat it as such …
>
> Even a payment to the creditor's bank account is a payment to a third party, namely, the bank. The payment is made on the basis that the amount will be credited to the creditor's bank account with the bank and we have no difficulty saying that the debtor has 'paid' the creditor. (ATC 4793–4)

4. Between the time BZW paid ABB Zurich for the assignment of the right and the dividend payment, ABB Zurich held its legal right to be paid 'on trust' for BZW. Although it subsequently held the debt on trust for BAL, it continued to have contractual obligations to BZW.

[¶2] AGC (Advances) Ltd v FC of T

75 ATC 4057; (1975) 132 CLR 175

Facts and Arguments

The taxpayer, under a former name, carried on a moneylending and hire-purchase financing business as a subsidiary of Master Butchers Ltd (MB). In December 1968, the taxpayer's operations were suspended after inspectors were appointed under companies legislation to investigate its affairs. In March 1969, the taxpayer, MB and another subsidiary of MB entered into a scheme of compromise and arrangement with their creditors. The scheme required a special manager to conduct the affairs of the three companies, to collect debts due to them, to pay the debts into a special account and pay 'dividends' to the creditors whenever sufficient funds were available.

In April 1970, Australian Guarantee Corporation Ltd (AGC) purchased MB's shares in the taxpayer, whereupon the taxpayer resumed its finance business under its new name, AGC (Advances) Ltd. At that time, the taxpayer had not collected all book debts due in respect of loans and hire-purchase transactions entered into before the suspension of its business. In each of the 1970/72 income years, the taxpayer wrote off some of these debts as bad debts and claimed deductions for those which related to (1) money lent and (2) 'interest' in respect of hire-purchase accounts which had been brought to account as assessable income in prior years.

The taxpayer argued that it was entitled to the deductions for bad debts relating to the money lent under s 63(1)(b) of the *Income Tax Assessment Act 1936* (Cth) on the basis that it carried on a moneylending business and the money was lent in the ordinary course of that business. The taxpayer also contended that it was entitled to the deductions for bad debts relating to the interest in respect of hire-purchase accounts under s 63(1)(a) on the basis that it had brought to account such interest as assessable income in prior income years. In addition, the taxpayer claimed deductions under s 51 in respect of so much of the bad debts as represented instalments of principal due on hire-purchase accounts. The taxpayer contended that these amounts represented losses 'incurred in gaining or producing the assessable income' or 'necessarily incurred carrying on a business for the purpose of gaining or producing such income'.

The claims under s 63 were disallowed by the Commissioner. According to the Commissioner, a deduction for bad debts could only be claimed under s 63 if the taxpayer had a beneficial interest in the bad debts. The Commissioner argued that the taxpayer had no such interest at the time it claimed the deduction, as the creditor's scheme extinguished the taxpayer's beneficial ownership in the debts. It was argued that the scheme operated as an immediate equitable assignment of those debts at the time it was entered into and that this conclusion was supported by the Full High Court decision in *GE Crane Sales Pty Ltd v FC of T* 71 ATC 4268.

The Commissioner also disallowed the taxpayer's claims under s 51(1) on the basis that no precise relationship existed between the writing-off of the debts and the gaining of assessable income in the income year in which the deduction was claimed. The Commissioner further contended that the taxpayer's claim for a deduction was precluded by the Full High Court decision in *Amalgamated Zinc (De Bavay's) Ltd v FC of T* (1935) 54 CLR 295. In that case it was held that the words 'the assessable income' in s 23(1)(a) of the *Income Tax Assessment Act 1922* (Cth) (s 51(1)'s predecessor) should be read as referring to the assessable income of the year in which the expenditure was incurred. However, Latham CJ qualified the narrow effect of that interpretation by stating that expenditure designed to produce income in a past or future year was deductible where it was 'of such a character that, in a continuing business, it must be met from time to time as a part of the process of gaining assessable income'. The Commissioner argued that the break in the conduct of the taxpayer's business during the period the scheme operated meant that it was not a 'continuing business' at the time the debts were written off as bad.

Issue

Was the taxpayer entitled to deductions in the relevant income years under s 63 (for the bad debts written off in respect of money lent and 'interest' on hire-purchase accounts) and s 51 (for bad debts written off in respect of instalments of 'principal' due on hire-purchase accounts)?

Decision

Full High Court: Barwick CJ, Gibbs and Mason JJ.

1. Per Barwick CJ, Gibbs and Mason JJ: The taxpayer was entitled to deductions in the relevant income years under s 63 for the bad debts written off in respect of money lent and 'interest' on hire-purchase accounts. The creditors scheme, upon its proper construction, did not extinguish the taxpayer's beneficial interest in the debts. Per Barwick CJ (Mason J concurring):

> the proper construction of the scheme is that for its period the special manager as agent of the [taxpayer] was to collect as much of the debts due to the [taxpayer] at the date of the commencement of the scheme as he could, and that upon the expiry of the scheme his authority would cease, meantime the terms of the scheme determined how the moneys collected were to be dealt with. The debts remained throughout in the legal and equitable ownership of the [taxpayer] and on the expiry of this scheme could be dealt with by the [taxpayer] as its own.

> In my opinion, there was no assignment whatever of the debts due to the [taxpayer] either to the special manager or to the group creditors or to Master Butchers Limited. That being so, nothing said by the Court in *GE Crane Sales Pty Ltd v FC of T* has any bearing on the resolution of the present question. (ATC 4063; CLR 184)

2. Per Barwick CJ and Mason J (Gibbs J dissenting): The taxpayer was also entitled to deductions under s 51(1) for the bad debts written off in respect of instalments of 'principal' due on hire-purchase accounts.

(a) Per Barwick CJ and Mason J: Section 51(1) does not require that to be deductible, expenditures and losses must relate precisely to the assessable income which is returned for a year in which the expenditures are made or the losses are suffered. The reference to assessable income in either of the limbs of s 51(1) should be read as a reference to the assessable income of the taxpayer generally without regard to division into accounting periods.

(i) Per Barwick CJ:

> In the application of [s 51(1)], it has not been possible to utilise the definite article so as to require the expenditure in question to have produced or to have assisted to produce the assessable income of the particular year of the expenditure. Nor can it be construed to require that the loss be similarly related to the assessable income of the particular year (ATC 4064; CLR 185)

(ii) Per Mason J:

> It is inconceivable that Parliament intended to confine deductions to losses and outgoings incurred in connection with the production of income in the year in question and to exclude losses and outgoings incurred in connection with the production of income in preceding or succeeding years. (ATC 4071; CLR 197)

(b) Per Barwick CJ: The unpaid instalments of principal were deductible under s 51 as trading losses made in the gaining of assessable income.

> the unpaid instalments of hire, clearly cannot be written off under sec 63 of the Act. But, in my opinion, they may be written off under sec 51. The [taxpayer] was in business of financing hire purchase transactions. Following a common commercial practice it took title to the chattel, paying out the seller of it and then hiring it under hire purchase to the 'purchaser'. In this way the cost of the chattel became part of what may properly be described as circulating capital. The purchase of the chattel for the purpose of enabling the legal formalities of hire purchase to be observed was not the acquisition of a capital asset. It was the acquisition of something much more akin to trading stock. In my opinion upon the failure to recover the amount paid for the chattel there was a trading loss made in the gaining of assessable income, that assessable income being the hiring charges made by the hire purchase agreement under which the chattel was made available to the hirer. (ATC 4063; CLR 184)

(c) Per Barwick CJ: *De Bavay's case* did not preclude the taxpayer's entitlement to deductions in respect of instalments of principal. The most that *De Bavay's case* stands for is that in relation to an expenditure, where there has been a break in the carrying on of the business yielding the assessable income of the particular year that business must in its nature be substantially the same as that which was carried on at the earlier period of time. On the facts, the taxpayer was carrying on in the years it claimed the losses the same business as it carried on before it entered into the creditors' scheme with the result that it was a continuing business within the meaning of *De Bavay's case*. Furthermore, *De Bavay's case* does not apply to the deduction of losses. In order to be deductible, a loss which flows from carrying on a business to gain assessable income need not necessarily occur in a year when the company is actively carrying on that business.

> I do not regard the expression 'continuing' in such a temporal sense that if there were any break in the carrying on of the business for some reason, the business could not be regarded relevantly as continuous. (ATC 4064; CLR 186)

> I do not regard [*De Bavay's case*] as deciding that, even in the case of expenditure, the business in respect of which the expenditure is made must be or has already been carried on without any substantial break. It seems to me that the most that could be deduced from the construction of the section applied in [*De Bavay's case*] … in relation to an expenditure is that where there has been a break in the carrying on of the business yielding the assessable income of the particular year that business must in its nature be substantially the same as that which was carried on at the earlier period of time.
>
> But in any case … [*De Bavay's case*] has nothing to say as to the deduction of losses. It is quite clear that a loss may not show up for years after money has been ventured in a business … If a hire purchase company decided to wind up and to discontinue the granting of hire purchase agreements in a particular year, and in a subsequent year the company in liquidation found itself unable to recover instalments of hire on the goods in circumstances which caused it to write the amount off as a bad debt, it seems to me not merely unjust but unacceptable to hold that it could not deduct that loss as a loss which it had incurred in the course of gaining assessable income. The problem of deciding whether any and if so what relationship should exist between the assessable income of the particular year and the loss, in my opinion, does not arise as it has done in relation to any expenditure.
>
> It is clear enough … that in order to be a relevant loss it must be a loss of money which has been put out in order to gain assessable income. It may be … that if a long period of years separated the two events and meantime the company had started a different business or become an investment company as in [*De Bavay's case*], it may be necessary if that decision is followed in such a case to say that the relationship between the two had ceased to be sufficiently proximate. It would suffice for my present purpose that I am not satisfied that, in order to be deductible, the loss which flows from carrying on a business carried on to gain assessable income need necessarily occur in a year when the company is actively carrying on that business.
>
> … the scheme was entered into … in order to enable the companies to extricate themselves from their financial embarrassment so as to be able, if they so chose, to continue to carry on the business which had caused them the financial embarrassment. The break in years was relatively short. The fact that the [taxpayer] changed its name … can have no possible bearing … upon the nature or continuing nature of the business which the [taxpayer] was carrying on: nor does it matter … that the address from which it conducted its affairs was changed. The nature of the [taxpayer's] business, both before

> and at the conclusion of the scheme when the [taxpayer] resumed its activities, was that of a financier, lending directly to borrowers and also servicing hire purchase arrangements. There was no change in the nature of the business at all … it was the same business which was carried on after a break, a break which … was not for the purpose of abandoning the business but rather to enable its continuance. (ATC 4065–6; CLR 187–9)

(d) Per Mason J: The court is entitled to reach its own conclusion on the construction of s 51(1) unfettered by what was said in *De Bavay's case*. The unpaid instalments of principal were deductible under the second limb of s 51(1) as the occasion for the loss was found in a transaction entered into in the carrying on of the business for the purpose of producing assessable income:

> It may be argued that if the taxpayer has ceased to carry on a particular business, a loss subsequently sustained in relation to that business cannot be described accurately as a loss incurred in carrying on that business, or at any rate one incurred in carrying it on for the purpose of gaining or producing assessable income. But the soundness of the argument depends on what is meant by 'incurred'. A loss constituted by the writing off of a bad debt is no doubt incurred, in the sense that it is sustained, at the time when the debt is written off, and that may occur in a given case after the taxpayer has ceased to carry on as a going concern the business in which the debt was created. Yet even in such a case it may be correct to speak of the loss as having been incurred in the carrying on of the business. This is because the occasion for the loss is to be found in a transaction entered into in the carrying on of the business for the purpose of producing assessable income, that is, in the agreement by which the debt was created. Because the loss had its origin in such a transaction the loss may be said to be one which was incurred in the carrying on of the business for the purpose of producing assessable income, notwithstanding that its true character as a loss is not finally ascertained until the debt is written off. (ATC 4071–2; CLR 197–8)

[¶3] AGC (Investments) Ltd v FC of T

92 ATC 4239

Facts and Arguments

The taxpayer was a wholly owned subsidiary of AGC (Insurances) Ltd, which carried on an insurance business and which itself was a wholly owned subsidiary of Australian Guarantee Corporation Ltd (AGC). The affairs of the taxpayer, AGC (Insurances) and another subsidiary of AGC were administered as a single unit known as the 'AGC Insurance Division' of the AGC group of companies.

Over a considerable period spanning some 15 years, AGC (Insurances) advanced substantial sums to the taxpayer (interest free and repayable on demand) which the taxpayer invested in a portfolio of shares in listed public companies. The share portfolio was managed by Westpac Investment Management Pty Ltd. As at 30 September 1986, the portfolio included shares in some 51 companies and had a market value of $85,909,940. In mid-September 1987, shortly before the stock market slump the following October, the taxpayer decided to commence selling the portfolio and reinvest the proceeds in fixed interest securities. In the 12 months to 30 September 1987, the taxpayer accordingly sold its holdings in 33 companies (representing about one-half of the value of the portfolio) and realised a profit of $45,068,073.

The Commissioner assessed the taxpayer on this profit under s 25(1) of the *Income Tax Assessment Act 1936* (Cth) for the year of income ending 30 September 1987 on the basis that it was income according to ordinary concepts. According to the Commissioner, the taxpayer was carrying on a business which was integral to the insurance business of its parent company, and in the course of its business the portfolio of shares was acquired for the purpose of making a profit.

At first instance before the Federal Court, Hill J held that the profit was assessable under s 25(1) on the basis that it was income according to ordinary concepts. According to Hill J, the decisions in *London Australia Investment Co Ltd v FC of T* 77 ATC 4398 and *FC of T v Myer Emporium Ltd* 87 ATC 4363 stood for the proposition that profits made on the realisation of investments constituted income according to ordinary concepts if the investments were acquired as part of a business and at the time of acquisition there was an intention or purpose that they be realised at a profit. Hill J held that the taxpayer was carrying on a business which was integral to the insurance business of its parent, AGC (Insurances) Ltd, and in the course of that business the taxpayer acquired a portfolio of shares for the purpose of making a profit. Hill J also found that the fact that the shares were to be treated as long term investments was not inconsistent with the conclusion that the shares were acquired with a profit-making purpose and that they were acquired with the knowledge that their sale may be required to provide funds for the purposes of the insurance business of AGC (Insurances) Ltd, 'albeit not on a day-to-day basis, but only perhaps in the event of a catastrophe or a running down of particular insurance business'.

Before the Full Federal Court, the taxpayer disputed Hill J's finding that it was carrying on a business that was integral to its parent's insurance business and his Honour's conclusion that in the course of this business it acquired the portfolio of shares for the purpose of making a profit. The taxpayer argued that Hill J should have held that it was engaged in a business of investment, in which the realisation of surpluses on disposal was 'no more than a known possibility, rather than its object'. The taxpayer maintained that its purpose was to produce a steady and growing dividend income and that as a consequence, the profits were on capital, and not on revenue, account.

Issue

Were the profits made by the taxpayer assessable under s 25(1) as income according to ordinary concepts?

Decision

Full Federal Court: Beaumont, Gummow and French JJ.

1. The profits realised by the taxpayer were on capital account and therefore were not assessable under s 25(1).

2. At the time of acquisition, the shares in the taxpayer's portfolio were not acquired with an intention that they be realised subsequently at a profit. The facts of the present case were distinguishable from the usual circumstances of an insurance company or a bank, where the need to buy and sell securities on a regular basis, in order to maintain

liquidity, justifies the conclusion that such steps are normal steps in carrying on a banking or insurance business, with the consequence that the profits so earned are regarded as income. The evidence suggested that there was no need for the taxpayer to buy the shares in order to maintain the liquidity of AGC (Insurances).

> [It] was not part of the corporate scheme that the [taxpayer] buy equities in order to maintain liquidity for the insurance operations of the AGC Group. The memorandum and the other evidence, documentary and oral … demonstrate that it was at all times intended that the [taxpayer] invest long-term. Its subsequent conduct was consistent with this intention … 26 of the equities acquired were held for a period exceeding 15 years, 20 for between 10 and 15 years and a further 14 for between 5 and 10 years. This pattern of activity is inconsistent with an objective or purpose of acquiring the shares in order to provide liquid funds for the Insurance Division.
>
> It may be accepted, as Hill J found, that the [taxpayer] was the investment vehicle for the Insurances Division. But it does not necessarily follow that the investments made by the [taxpayer] were not made on a long-term basis. The evidence demonstrates that, in fact, the securities now in question were acquired with a view to their long-term capital growth.
>
> The evidence also indicates that, insofar as liquid funds were required for the purposes of the insurance operations, they were found in sources other than the [taxpayer's] share portfolio … the documentary and other evidence, taken as whole, indicates that the Westpac Management was instructed to achieve, and did achieve, the objective of long-term capital growth in the [taxpayer's] portfolio. (ATC 4252–3)

[¶4] ATS Pacific Pty Ltd v FC of T

2014 ATC ¶20-449

Facts and Arguments

The taxpayer was an Australian resident company that conducted an inbound tour operating business. It entered into contracts with non-resident travel agents (NRTAs) in relation to products (eg accommodation, car hire, transfers, meals etc) which were provided to non-resident tourists by Australian providers. The NRTAs would select the products from the taxpayer's website to build a tour package for non-resident tourists. Once the NRTAs made their selection, the taxpayer would then enter into contracts with relevant Australian providers, who would be required to provide the non-resident tourists with the various products when they came to Australia. The taxpayer charged the NRTAs a fee that included the cost of the products as well as a margin.

The Commissioner characterised the supplies made by the taxpayer to the NRTAs as taxable supplies under s 9-5 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). The Commissioner contended that the taxpayer had either supplied the products themselves or promised to the NRTAs that the products would be provided by the Australian providers.

The taxpayer, however, argued that it had only arranged travel services for the NRTAs, and that the supplies were GST-free under s 38-190(1) of the GST Act.

Section s 38-190(1) provided that the kinds of supplies listed in the third column of the table in the section (except to the extent that they are supplies of goods or real property) were GST-free. The taxpayer argued that the supplies fell within item 2 of the table, as they were 'made to a non-resident who is not in Australia when the thing supplied is done …'.

Section 38-190(1), however, operated subject to s 38-190(2), which provided that a supply covered by any of the items in the table is not GST-free if it is the supply of a right or option to acquire something the supply of which would be connected with Australia and would not be GST-free.

Furthermore, s 38-190(3) provided that a supply covered by item 2 in the table is not GST-free if it is a supply under an agreement with a non-resident and that supply is provided to another entity in Australia.

The Federal Court found that the taxpayer had supplied the NRTAs with a promise that it would ensure that the Australian providers would provide the products to the non-resident tourists. Bennett J held that the taxpayer's promise relating to the accommodation component of the tours was a supply of real property, which did not fall within s 38-190(1). Her Honour also held that the taxpayer's promise relating to the non-accommodation components of the tours was a supply of goods, which did not fall within s 38-190(1). In addition, she held the taxpayer's promise relating to the tour or land transport were supplies of services which were not GST-free by virtue of s 38-190(3).

Bennett J rejected the Commissioner's argument that the margin formed part of a single supply, and concluded that the taxpayer had actually made two kinds of supply: one in respect of the products themselves (which was taxable), and the other in relation to the arranging services (which was GST-free).

Issue

What was the character of the supplies made by the taxpayer to the NRTAs and were they GST-free under s 38-190?

Decision

Full Federal Court: Edmonds, Pagone and Davies JJ.

1. The character of the supplies made by the taxpayer to the NRTAs was the promise that it would ensure that the Australian providers would provide the products to the non-resident tourists.

2. The issue of the characterisation of a supply is a question of fact. Per Edmonds J:

> While the issue of identification of whether or not a supply is made may be a question of law or, perhaps more correctly, a mixed question of fact and law, see the definition of "supply" in s 9-10 of the GST Act … the issue of characterisation of the supply in a particular case, in other words the process of deciding what was supplied, is undoubtedly a question of fact. In many cases the task of characterisation will be easy; in others, it will be hard. (ATC para 38)

3. From a practical and business point of view, there was only one supply (ie the supply of the promise). The supply of arranging services made by the taxpayer to the NRTAs was 'ancillary or incidental' to the supply of the products. It was 'part and parcel of the promised package for which there is a single indivisible consideration'.

4. The accommodation component of the supplies was not GST-free under s 38-190. The promise that the hotel proprietors would provide accommodation to the non-resident tourists when they arrived in Australia amounted to the promise of a supply of 'real property' within the definition in s 195-1 of the GST Act. It was therefore excluded from GST-free treatment under s 38-190(1) by virtue of the exception in that provision.

5. The non-accommodation component of the supplies was also not GST-free under s 38-190. Such a promise constituted a right to the acquisition of the goods and services by the non-resident tourists when they arrived in Australia and as such was excluded from GST-free treatment under s 38-190(1) by virtue of s 38-190(2).

[¶5] AVCO Financial Services Ltd v FC of T

82 ATC 4246; (1982) 150 CLR 510

Facts and Arguments

The taxpayer was a finance company which provided consumer credit in the form of personal loans, hire-purchase transactions and consumer mortgages. In order to carry on its business the taxpayer raised funds by borrowing relatively large sums of money in both Australia and the United States.

In relation to its overseas borrowings, as a result of exchange rate fluctuations between the Australian dollar and the US dollar, the taxpayer made various exchange gains and losses when it repaid the amounts borrowed. In the income years ending 30 June 1972, 1973 and 1974 it made exchange gains of $175,084, $1,579,020 and $298,501 respectively. In the income years ending 30 June 1975 and 1976 the taxpayer made exchange gains and losses that produced a net gain of $243,038 to 30 June 1975 and a net loss of $126,412 to 30 June 1976. In the year ending 30 June 1977 it made a net loss of $2,799,903.

The Commissioner assessed the taxpayer under s 25(1) of the *Income Tax Assessment Act 1936* (Cth) on its exchange gains but refused any deduction under s 51(1) for the exchange losses. The Commissioner, relying on the decision in *Commercial & General Acceptance Ltd v FC of T* 77 ATC 4375, contended that the exchange losses were of a non-deductible capital nature.

The taxpayer argued that the exchange gains did not constitute assessable income and that the exchange losses were deductible. The taxpayer sought to distinguish the decision in *Commercial & General Acceptance Ltd v FC of T* on the basis that in that case the purpose of the foreign borrowings was to improve the finance company's liquidity problems and accordingly strengthen its capital structure whereas in this case the purpose of the borrowings was to on-lend the borrowed funds in the ordinary course of the taxpayer's business.

Issues

Were the exchange gains assessable under s 25(1)?

Were the exchange losses deductible under s 51(1)?

Decision

Full High Court: Gibbs CJ, Mason, Aickin, Wilson and Murphy JJ.

1. The exchange gains were assessable under s 25(1) and the exchange losses were deductible under s 51(1).

2. As the taxpayer was in the business of providing credit facilities, it was required to borrow and repay moneys as part of its day to day business activities. Such borrowings took the character of trading stock necessarily required by the taxpayer to enable it to make advances of credit to consumers. On this basis the borrowings were outgoings necessarily incurred in carrying on the day to day business of a credit provider and accordingly the exchange losses incurred on repayment of the foreign borrowings were on revenue account and therefore deductible and, likewise, the exchange gains made on the foreign borrowings were of an income nature and were therefore assessable. Per Gibbs CJ:

> Where a taxpayer carries on the business of borrowing and lending money, the moneys used for that purpose are analogous to trading stock—the taxpayer in effect deals in the money. Exchange gains and losses, regularly and frequently made and incurred, in the course of making repayments of borrowed money which is used by a taxpayer in making loans in the course of its finance business are outgoings made in the day to day conduct of the business and for the purpose of carrying on the business as a going concern … From that point of view, the additional moneys paid as a result of the unfavourable exchange variations—the exchange losses—were part of the price by which the [taxpayer] obtained the money which it used to make a profit—part of the process by which the [taxpayer] obtained regular returns … The exchange losses were in my opinion losses on revenue account, and of course the gains have the same character. (ATC 4251; CLR 518)

3. Where a finance company borrows moneys for the purpose of on-lending to consumers as part of its day to day business activities, any exchange loss incurred as a result of depreciation of the Australian dollar relative to the foreign currency is an additional cost of the borrowings and would therefore be an allowable deduction under s 51(1) of the Act. Similarly, an exchange gain on such foreign borrowings as a result of appreciation of the Australian dollar relative to the foreign currency must take the form of income derived in the ordinary course of the finance company's day to day business activities and therefore would be assessable income under s 25(1) of the Act. Per Mason, Aickin and Wilson JJ:

> With respect to those who think otherwise, the proposition that exchange variations affecting the repayment of loans in foreign currencies are always an affair of capital in the case of a finance company is supported neither by principle nor by authority. The true principle is that in the case of a finance company which borrows money overseas in the ordinary course of its business and not for some special purpose, the added cost of repayment in foreign currency caused by the devaluation or depreciation of the Australian dollar is an additional cost of the borrowing and, like other costs of the borrowing, is an allowable deduction under sec 51(1). Conversely, a saving in the amount of foreign currency needed to repay an overseas loan due to a revaluation or an appreciation in the value of the Australian dollar is to be considered as income arising directly out of the finance company's ordinary business. (ATC 4258; CLR 529–30)

4. The proposition stated in *Commercial & General Acceptance Ltd v FC of T* that exchange gains and losses made on variations in foreign exchange rates should always be considered in the nature of capital is rejected. Unlike the facts of the present case, the facts in *Commercial & General Acceptance Ltd v FC of T* indicated that the purpose of the foreign borrowings was a special purpose extraordinary to that finance company's day to day business activities. In that case the purpose of the foreign borrowings was to improve the finance company's liquidity problems and accordingly strengthened its capital structure. Per Mason, Aickin and Wilson JJ:

> The borrowing of money and the repayment of loans by a finance company in the ordinary course of its business stand in a different situation from borrowings by a company not undertaken in the ordinary course of its income-earning business. The essence of the business of a finance company as carried on by the taxpayer is the borrowing and lending of money, the rates of interest payable on money lent being significantly higher than the rates payable on the money borrowed, for it is from the difference in the rates that the company generates its profit … Borrowing otherwise than for on-lending or for the repayment of funds borrowed for on-lending, that is, borrowing undertaken for capital rather than revenue purposes, as in [*Commercial & General Acceptance Ltd v FC of T*], is an exception to the general rule. (ATC 4256; CLR 527)

[¶6] Abbott v Philbin (Inspector of Taxes)

[1961] AC 352

Facts and Arguments

The taxpayer was the secretary of a company. In October 1954, for a consideration of £20, the taxpayer was granted an option to purchase up to 2,000 shares in the company at 68s 6d per share. The option was non-transferable, although there was no restriction on the transfer of shares acquired as a result of an exercise of the option. The option was also of a limited term, expiring on the earlier of the taxpayer's death or retirement, or 10 years from the date of its issue.

In March 1956, the taxpayer exercised the option to purchase 250 shares, paying 68s 6d per share at a time when the market price had risen to 82s per share.

Schedule E to the Income Tax Act 1952 (UK) charged tax on 'all salaries, fees, wages, perquisites or profits whatsoever' from an office or employment of a person.

The Inspector of Taxes assessed the relevant profit as the difference between the option exercise price of 68s 6d per share and the market price of the shares at the time the option was exercised in March 1956, 82s per share (with a deduction for part of the £20 paid for the option). The Inspector of Taxes also treated the profit as being derived by the taxpayer at the time the option was exercised, namely in March 1956.

The taxpayer conceded that he was taxable under Sch E in respect of the option. He contended, however, that he should have been assessed on receipt of the option in October 1954 (rather than at the time of its exercise in March 1956) and that the value of the option at the time of receipt should be brought to account as the taxable profit (rather than the value of the option at the time of its exercise).

The Inspector of Taxes, however, relying on the authority of *Tennant v Smith* [1892] AC 150, argued that income, for tax purposes, includes only money or things capable of conversion into money. The option was not taxable at the time it was granted because, being non-transferable, it could not be turned to pecuniary account by the taxpayer. Only upon exercise of the option did the taxpayer acquire something which could be converted to money.

Issue

Should the taxpayer be assessed in respect of the option at the time it was granted (October 1954) or at the time it was exercised (March 1956)?

Decision

House of Lords: Viscount Simonds, Lord Reid, Lord Radcliffe, Lord Keith of Avonholm and Lord Denning.

1. Per Viscount Simonds, Lord Reid and Lord Radcliffe (Lord Keith of Avonholm and Lord Denning dissenting): The taxpayer should be assessed in respect of the option at the time when it was granted (October 1954) since the taxable receipt was the acquisition of the option and it was its monetary value (if any) at that date which was the profit or perquisite of office.

2. The conditions and restrictions on the option did not prevent it from being a profit or perquisite of office at the time it was granted. In accordance with the authority of *Tennant v Smith*, the option was something which constituted income because it could have been converted into money by the taxpayer. The restrictions on transfer did not in law or practice effectively prevent the taxpayer from doing something with the option when he got it which would turn it to pecuniary account. Even though the option was not transferable and could not itself be sold, there were other ways of turning it to pecuniary account. For example, the taxpayer could have exercised the option and then sold the shares for cash.

[¶7] Ahern v DFC of T

86 ATC 4023; (1985) 7 FCR 582

Facts and Arguments

The Deputy Commissioner assessed the applicant, an accountant, to income tax and additional tax in the sum of $3,847,358.89 for the income years ending 30 June 1974 to 30 June 1982.

During the period October to December 1984, the applicant lodged objections to the Deputy Commissioner's assessments, which were disallowed. The applicant then appealed to the Supreme Court of Queensland. The outcome of the appeal was pending at the time of the hearing of this case.

Between July and December 1984, the applicant had, under s 206 of the *Income Tax Assessment Act 1936* (Cth), also made a number of written requests to the Deputy Commissioner for an extension of time to pay the tax owing under the assessments.

In October 1985, the applicant was notified by the Deputy Commissioner that no extension would be granted and that recovery proceedings would be commenced unless the applicant paid within seven days.

The applicant made a request under s 13(1) of the *Administrative Decisions (Judicial Review) Act 1977* (Cth) (ADJR Act) for the Commissioner to provide a statement in writing setting out his reasons for denying the applicant an extension of time to pay the tax owing under the assessments.

In his statement of reasons, furnished pursuant to s 13(2) of the ADJR Act, the Deputy Commissioner stated:

- The evidence put forward by the applicant, at the time of one of his applications requesting an extension of time to pay the tax, did not reflect all the assets to which the applicant had recourse or all funds which were legally available to him to pay the tax.
- The evidence put forward by the applicant did not show that the applicant would be able to pay his outstanding tax if an extension of time was provided.
- The applicant's applications for extension of time were not warranted as the applicant showed no reason why the Deputy Commissioner should depart from the guidelines detailed in IT 2091, IT 2101 and IT 2156.

The applicant sought a review under the ADJR Act of:

- the Deputy Commissioner's decision in October 1985 refusing an extension of time to pay the tax purportedly owing under the relevant assessments
- the Deputy Commissioner's decision to institute proceedings for the recovery of the tax purportedly owing under the assessments.

The applicant argued that the Deputy Commissioner, in making the relevant decisions, had improperly exercised the power which was conferred upon him under the Assessment Act and that this constituted a ground for a review under s 5(1)(e) of the ADJR Act. The applicant argued that the grounds for review under s 5(1)(e) were made out as the Deputy Commissioner had:

- failed to take relevant considerations into account in the exercise of his powers (s 5(2)(b))
- exercised his powers in a manner so unreasonable that no reasonable person could have so exercised the powers (s 5(2)(g))
- taken irrelevant considerations into account in the exercise of his powers (s 5(2)(a))
- exercised his discretionary powers without regard to the merits of the particular case and in accordance with inflexible rules or policies (s 5(2)(f))
- otherwise improperly exercised his power (s 5(2)(j)).

Issue

Had the Deputy Commissioner improperly exercised his powers under the Assessment Act?